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IDEAS ON LIBERTY

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PERSPECTIVE

Justice and Charity

What is justice? The first thing to remember is that justice is blind. We have been trying to tell people that for a great many centuries. There leaps to mind the famous statue of Justice with scales held high and sword in hand, and blindfold over the eyes. Justice does not discriminate. It does not see whether one is of high or low class, rich or poor, black or white, working or not working. It does not see one's national origin. It does not detect one's religion. It treats all men alike and all men equally. That is the essence of justice. The statue would also remind us by the sword that it is enforced by the coercive power of the state. The principal business of the state, of law and of government, is the enforcement of justice, the protecting of the rights of all people equally.

On the other hand, charity is not based on coercion, nor is it blind. Charity is discriminating and voluntary. If you remove the voluntary aspect of charity, it ceases to be charity. What would you think if, after Robin Hood had placed his sword at the throat of some rich man and deprived him of his purse and scattered his coins to the poor, that rich man told his friends how charitable he had been to the poor? There was no charity in what happened on the rich man's part—not a penny's worth! If you take away the voluntary aspect of charity, it becomes despoliation. It is legal plunder. It is robbery, not charity. Confusing justice and charity has produced something called "social justice," the basis for the welfare state. Social justice is having a tremendous negative impact upon the economic well-being of this country.

You cannot have charity or justice when you forcibly take money from A and give it to B. You have not charity because it was not freely willed. You have not justice because you are not treating A and B alike but are taking from one and giving to the other. The rights of each have not been protected, but stripped.

—excerpted from "The Bible and Economics," a sermon by Dr. D. James Kennedy, Coral Ridge Ministries

The Decline of Moral Consciousness

The great tragedy of the welfare state has been the decline of moral consciousness among the American people in the twentieth century. The use of the political process to provide special, privileged benefits to certain classes of people is now considered to be as American as apple pie. The common belief is that since the welfare system is now an ingrained part of American life, people should simply accept its legitimacy and direct their efforts to making the system function more efficiently.

This degeneration in moral consciousness can be found even in some of the most free-market oriented people in the country. I recently attended a conference whose purpose was to promote an improved understanding of the free enterprise system. One keynote speaker at the conference proudly attributed his business success to a Small Business Administration loan. Another keynote speaker called for a closer partnership in business development between businessmen and politicians.

Neither speaker even remotely suggested that the use of the political process to feather a person's nest is morally wrong. Equally tragic, the talks appeared to be well-received by the audiences, almost as if the listeners were comforted by this "practical approach" to free enterprise.

We should never be ashamed or embarrassed to speak out against the immoral actions of our own government. How else can we hope to eradicate the evil which pervades the entire political system? To remain silent in the face of wrongdoing not only constitutes cowardice, it also is an implied acceptance of enshrined political immorality.

The only legitimate functions of law are the protection of life, liberty, and property and the preservation of peace. We have permitted the politicians to pervert law by using it to direct lives, limit liberty, and plunder property. The result is not peace but rather perpetual conflict over the distribution of the loot. It is time to eliminate, not reduce or make more efficient, government welfare, social security, food stamps, loan guaranties, subsidies, licenses, import restrictions, educational grants, and all other means by which some people use the political process to gain at the expense of others.

Only by standing firm against the immoral nature of the welfare state can we hope to raise the moral consciousness of our fellow citizens.

—JACOB G. HORNBERGER

The Insanity of Inflation

Sanity consists in limitation; the inordinate is always insane and always ends in destruction. Because inflation is indeed inordinate, it too has a certain insanity about it and naturally it tends to end in an explosion of destruction, a nihilist act with money. The insanity of inflation leaves a mark of insanity on society; it changes a good society into one which, so long as inflation lasts, is wholly and fraudulently unjust. All evil is a breach of order, but only some evil is a breach of order with unlimited effect; inflation is an unlimited monetary and *economic evil.*

—WILLIAM REES-MOGG
The Reigning Error

Reader's Digest Reprints Free Trade Article

"The Political Economy of Protectionism," by Thomas J. DiLorenzo, has been reprinted in the February 1989 *Reader's Digest.* This article originally appeared in the July 1988 issue of *The Freeman.*

We have extra copies of the *Digest* version of Professor DiLorenzo's article. Please write to FEE, stating the quantity you'd like.

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Lessons in a Supermarket

by John A. Baden and Ramona Marotz-Baden

Bozeman, Montana, a town with 30,000 people, contains a modest supermarket that offers valuable lessons. This store has tens of thousands of items of various sizes and brands, generic labels, and bulk products. Competition for the consumer's dollar occurs among this and other stores, among brands within the store, and among different products within individual brands.

Information regarding consumer preferences toward items in this huge mix of products is continuously generated by a simple procedure. People make decisions, a process with which we are all familiar. Consumers take their selection of products to the check-out line. There, check-out clerks tally the price and automatically enter information about the sale on the store's computer by passing the product's bar code across a scanner.

Among the stores in Bozeman, as elsewhere, the shopkeepers compete in offering differing mixes of service and economy. Even the check-out lines vary in lengths and the degree of service. Each self-interested grocer seeks to attract and satisfy consumers holding varying degrees of wealth, economic sophistication, nutritional knowledge, and body-type preference associated with differing food groups.

Competition responds to differing consumer preferences for health, economy, convenience, and vanity. In these stores we see people as diverse as ranchers who survived the dust bowls of the 1930s, refugees of the counterculture of the 1960s who look like they are in a time warp, Park City blondes from Dallas summering at Big Sky, and neo-Spartan hedonists of all ages who bounce among Montana's ski slopes, white-water rivers, and mountain trails. We find them all in Albertson's at the University Mall.

Individuals representing all of these diverse types shop cheek to jowl, sample ice cream and fajita strips in the aisles, and peacefully shuffle through the check-out lines at the supermarket located between the Bonanza Steak House and Yogi's Vegetarian Bakery. The stores and suppliers who fail to satisfy are passed by in favor of those who offer more attractive products.

This selection of winners is determined by voluntary transactions. The losers gradually lose shelf space. Ultimately they either improve their products or lose out and pass from the scene. The consumer really is sovereign. The market registers his preferences and automatically makes the adjustments which harmoniously reconcile demand with supply.

This process is quite remarkable. It demonstrates that the market is best understood as a system which organizes information with truly amazing efficiency and effectiveness. At root, the market is a social arrangement which efficiently generates information about peoples' wants and reservations while providing incentives to heed the preferences of others. It is a system which economizes on the information required to make rational decisions.

Dr. John Baden is Chairman of the Foundation for Research on Economics and the Environment (FREE), with offices in Dallas, Texas, and Bozeman, Montana. Dr. Ramona Marotz-Baden is a Senior Associate of FREE and a Professor at Montana State University.

The recent well-intended but thoroughly pathetic Soviet efforts at economic reform offer a valuable lesson. The Soviet Union's failing attempts to mimic the market's ability to respond to consumers' wants demonstrate the importance of allowing buyers and sellers to communicate freely. They also teach us how difficult it is to coordinate economic activities when people are not allowed to communicate.

Price controls prohibit buyers and sellers from communicating their true preferences with one another. Thus, price controls are best understood as a form of censorship. Fortunately, they are rarely found in their worst form in American supermarkets. That is why these stores work so well.

Despite their success in meeting citizens' demands, however, supermarkets are often criticized. Some people object to products with a lack of fiber, some to products with an excess of sugar. Some oppose plastic packaging or advertisements that appeal to children.

In this setting offered by a free and open market system, each can satisfy his wants without imposing his preferences on others. In this manner, diversity, freedom of choice, and innovations are all encouraged. In this imperfect world, we can hardly ask for anything more. Yet, there is another huge advantage we normally take entirely for granted.

Surely the store in the mall provides a model for efficiently responding to diverse and rapidly changing preferences. But this efficiency, marvelous though it is, is only the minor miracle. The benefits of harmonious interaction fostered by market exchange in accordance with the rule of willing consent are even greater.

Market exchange, subject to willing participation by full-facultied individuals, permits people with radically differing views to peacefully coexist. In Bozeman we find a substantial number of hard-core vegetarians. They can shop peacefully and amicably with rancher and logger meat eaters who consume vegetables only as a concession to their health.

Bozeman is also a national center for teetotaling Seventh-Day Adventists. The supermarket accommodates their preference for nonalcoholic wine, and they shop harmoniously with those whose nightly ritual includes a bottle of French wine. This peaceful interaction occurs only because all transactions are voluntary. Imagine the uproar if the decisions to permit the selling of wine were determined in the political arena.

Nearly all analysts who have seriously studied the free market agree that the market promotes efficiency, diversity, and innovations which respond to consumers' changing preferences. Few, however, appreciate the degree to which private property rights and free exchange foster harmony and peace. This set of social arrangements renounces coercion as a means for making choices. These arrangements enable people who feel strongly about such issues as vegetarianism or prohibition to coexist constructively with people holding antithetical views.

This great benefit of market exchange is often neglected or underrated. Essentially, markets economize on that most scarce resource, love in the Christian sense of the term.

What if the stocking of a grocery store were determined politically? Think of the fights between vegetarians and meat eaters; the teetotalers and those who enjoy wine with dinner; the granola organics who argue against pesticides and the farmers who find chemicals useful; the populists who are strongly opposed to corporate agriculture and those with an interest in these firms; employed mothers who want the stores open 24 hours a day, seven days a week, and the fundamentalists who believe they should be closed on Sunday.

Fortunately, we have pretty much kept these decisions out of the political arena. People make decisions and exercise their consciences instead of imposing their preferences by using the force of the state. Peace, progress, and efficiency are the result we have learned to expect. □

Growth Controls and Individual Liberties

by Jonathan Sandy and Dirk Yandell

A fundamental freedom in the United States is the ability to travel, and to move and live wherever an individual finds the greatest opportunities. However, this freedom is increasingly coming under attack. Although no policies exist that directly regulate movement, more subtle restrictions are emerging. Potential entrants to many regions face limits in the form of housing shortages brought about by residential growth controls.

The argument in support of growth controls is that rapid population growth reduces the "quality of life" of existing residents. Members of existing communities often fear change, and want to protect themselves from the risks of new development. New residents require new homes that lead to changes in the character of an existing community. Growth control proponents argue that unregulated growth is the cause of crowding at beaches, parks, and public facilities. Unregulated growth is also blamed for traffic congestion, reduced air and water quality, the loss of open space, and the destruction of the natural environment.

The proposed solution is to place a moratorium on residential building permits as though houses were the fundamental cause of all growth-related problems. In extreme cases a municipality may even set a legal population limit, forbidding entry by law. The shortcomings and inefficiencies of such growth controls are numerous.

Professors Sandy and Yandell teach economics at the School of Business Administration, University of San Diego.

The fundamental flaw in the argument for growth control is the perception that housing growth causes a regional expansion. In fact, the reverse is true. A strong regional economy attracts new residents. New homes are built by developers in response to this increase in demand. Restrictions on building during an expansion will result in a deliberate shortage of housing and will do nothing to solve regional problems.

Policies that reduce the housing supply simply do not address the quality of life concerns that are purported to be the major issues. Growth controls are offered as a blanket solution for such diverse issues as traffic, inadequate sewage facilities, overcrowding of all types, the deterioration of air quality, and the loss of open spaces. In fact, growth controls can increase all of these problems if development shifts out from the controlled area.

Traffic provides a good illustration. Can anyone deny that traffic congestion results from the improper management of our highways? If roads were operated in private competitive markets, drivers would pay some price for the service. This price would reflect the demand for road use so that it would be highest during prime driving times. The prices would give drivers and firms the incentive to spread driving out across the day, reducing traffic congestion.

Rather than focusing directly on the traffic problem with incentives, however, many metropolitan areas are proposing growth controls as the solution. When a city restricts housing development it causes developers to build on unregulated land on the urban fringe. New home buyers have no choice but to move farther from the central business district. The result is longer daily commutes and a loss of open space. The intent is to reduce traffic. The result is just the opposite—more traffic and the attendant increase in air pollution.

Controls Lead to Higher Prices

Of course, growth controls have a more obvious consequence: higher housing costs and rents. The more severe and broad the controls, the higher the prices. Building restrictions limit the supply of homes without reducing demand, increasing competition for available houses. Higher prices reduce the ability of low- and middle-income families to afford a home. Renters find that rents rise as housing prices climb, and that a larger percent of income must be paid for housing. It becomes more difficult for renters to acquire a down payment, and upward mobility suffers.

Those who own more than one house, on the other hand, will gain. They will receive both capital gains and higher rental income from their investment property. Those with only one house may gain depending on the details of the growth control policy. For example, many such policies define environmentally sensitive areas as off-limits to future construction. Owning a house adjacent to such an area will result in above-normal appreciation.

For other families who own only one house the net result of a growth control policy is not clear. There will be an increase in capital gains, but this may not translate to an increase in a family's standard of living. All houses in the region will increase in value, so capital gains will always be tied up in housing, even if the family moves within the city. The only way to cash out the capital gains is to move out of the region.

Renters, who as a group contain a large proportion of poor, young, and minority families, clearly are made worse off, so growth control policies are regressive. Further, these policies are at least somewhat discriminatory given the demographic characteristics of renters.

It is ironic that growth controls are increasing in popularity when one considers that a major goal of all prosperous countries is to provide adequate and affordable housing for its citizens. A variety of policies have been enacted in the United States to support this goal. Housing subsidies for the poor and elderly, FHA and VA mortgage subsidy programs, and the tax deductibility of mortgage interest are all designed to promote home ownership. Growth control policies are in direct conflict with these goals, since they increase prices and preclude many from home ownership and upward mobility.

The state of housing in many socialist countries is dismal. It is not unusual to wait five years for the chance to rent a single room in a government housing project. Parents in many Eastern bloc nations will place the name of a newborn child on the official state housing waiting list so that the child will have a chance of obtaining a small apartment when he or she grows up and marries. Housing is regulated by the state, and families often must share small units in crowded housing complexes.

Rent control serves as an analogy in the United States. Trying to rent in controlled areas is a difficult task. It inevitably includes long waiting lists (and occasionally kickbacks or other non-price allocation methods). The controlled rent makes investment in apartments unattractive, so the quality and availability of rental units decline. The lesson is obvious: controlling housing markets yields serious and detrimental consequences.

Despite this, housing markets in the U.S. are already highly regulated. Zoning regulations and building codes restrict the quantity and quality of housing. Environmental impact reports and planning studies require years of review before some developments are authorized, and substantially increase the cost of building. Even so, the market has had some flexibility to respond to the demands of consumers about the types and locations of housing that are preferred. Willing buyers and sellers have been allowed to make mutually beneficial exchanges. The result is an increase in freedom and well-being.

Growth controls change all that. Developers are simply not allowed to respond to the desires of consumers. Instead, local bureaucrats determine every aspect of new developments, including who can build, what can be built, when it can be built, and what facilities must be included in the development.

Housing markets play a major role in the U.S. economy, and the past success of the U.S. housing market is striking. New residential construction expenditure represents nearly five percent of Gross National Product, and over four percent of the labor force is employed in residential construction. In 1985, about 64 percent of American households owned their own home. Growth controls threaten this success.

Controls also reduce the freedom of people to move and live where they hope to find the greatest opportunities. A simple example shows this clearly. Consider the declining cities in the Northeast or Midwest from which people are exiting in large numbers. This outward migration has significant negative economic consequences. Local economies are stagnating and the tax base is eroding. These cities would be better off if businesses and residents were not leaving. Should they mandate that no one may leave so that the remaining residents can maintain their quality of life? This is obviously absurd, and would be seen as a blatant attack on personal freedom and civil liberties. Yet growth control is really the same thing.

Another example can be used to show that growth controls are not in the best interests of society collectively. Suppose all people are initially suspended in time with no location. All families will be randomly assigned a residence location. If we initially had no location, would we ever agree to growth controls? The answer is clearly no. We could get assigned to an undesirable area and be unable to move to our preferred location.

Simply put, the political process that institutes growth controls excludes the desires of all potential entrants. The final policy is an "us against them" state where the "us" are current homeowners and the "them" consists of everyone else.

When people in a region are asked to vote on growth control policies they must consider obvious trade-offs. Foremost is the question of how much freedom they are willing to give up to obtain capital gains on their residences.

Existing homeowners may feel that they can shift all costs resulting from a building freeze to renters and potential entrants to the housing market. To the extent that current owners will not encounter the higher housing prices, they are correct. Other costs do exist, however. The house to which they aspire, for example, may never be built. Residents may become less mobile and find moving within the city difficult. In addition, the local economy may suffer. Higher housing costs can reduce the willingness of firms to locate in the area. Future employment opportunities fall as a result.

Developers and landowners have their property rights denied when control of building is passed to government. Landowners will no longer be able to determine the most efficient use of their land, and the market-determined timing of development is altered.

When property rights are given up they may never be recaptured. A government bureaucracy must be put into place to administer the controls, and will exercise all rights concerning development. Politically, a return to the prior state of a freer housing market is unlikely for several reasons. Everyone who owned a home prior to the controls has the incentive to maintain the controls to protect his capital gains. Everyone who purchases after the controls has a vested interest in continuing them. Local politicians will not give up their expanded role in housing. In short, once adopted, growth controls are very unlikely to be repealed.

It is clear that appointed or elected officials will have neither the necessary information nor the incentives to effectively and efficiently control development. The results are economic inefficiency, the creation of deliberate shortages of housing, more control over individual rights, and no guarantees that the negative aspects of growth will ever be addressed. The personal costs and economic costs of growth controls may prove to be exceedingly high. □

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Why Is There a Drug Problem?

by George C. Leef

Many people in the United States regularly use "recreational" drugs. But drug use is not recreation at all. It is a foolish type of escapism.

Now, there is nothing necessarily wrong with escapism. We all do it when we read novels or listen to music or go to the movies. Drug use, however, is virtually always harmful to the one who engages in it, and is frequently harmful to others who are victimized by drug users. There is as much agreement as one ever finds in this country with the proposition that we confront a serious drug problem and that we need to do something about it.

Most of the discussion about the drug problem has been about proposed solutions. But, as is so often the case, most of the "solutions" fail to analyze and deal with the causes of the problem. Attempting a solution before you know the causes is usually a waste of time and money, and often makes things worse. So, what I intend to do in this essay is to venture some thoughts on this subject: Why are so many people choosing to use drugs?

Let us first keep in mind that drug use is an individual matter. It is a misuse of language to say that the United States has a drug problem. "The United States" does not and cannot take drugs. What we should say is that a large number of people in the United States use drugs, and that their use leads to serious harm to themselves and often harm to others. We should focus on the problem at an individual level and ask: Why do so many people make the stupid and self-destructive decision to take drugs?

George C. Leef is Associate Professor of Law and Economics at Northwood Institute, Midland, Michigan, and adjunct scholar with the Mackinac Center.

Almost everyone knows that drug use is expensive and debilitating—a threat to one's health, job prospects, and family relationships. Perhaps there are a few who begin using drugs in the mistaken belief that it is just a harmless pleasure which they can quit at will, but they must be a very small minority. The typical drug user begins and continues his habit knowing that the long-range consequences of his actions will be decidedly negative.

Now, why would anyone risk losing the chance to live a long, healthy, and happy life in exchange for some immediate pleasure? I can think of two possible answers. First, someone who thinks he has no chance to live such a life, and who faces immediate problems which seem very severe, might think that taking drugs is desirable. Second, someone who is very present-oriented in his decision-making, ignoring or heavily discounting future considerations, might be taken in by the blandishments of the drug pusher. What I conclude is that drug use will rise as the number of people who fall into the above two categories (which are not mutually exclusive) rises.

Throughout most of our history, drugs have been legal, but use has been minimal. So, why has drug use risen so much in the last two decades? I submit that the answer, or a major part of it at least, must be that we have more people in the country who are prone to make the decision to use drugs. That is, there are more people who are very short-sighted or who view life with despair or indifference.

Why are there more people who fall into these categories? Historically, the United States has been the premier land of hope and opportunity. Millions of people have immigrated here for that reason. The work ethic has been exceptionally strong here. The vast majority of Americans for the last two centuries have accepted the idea that the proper way to live your life is to work hard, save, and improve yourself so that you and your family may have a more prosperous future. That ethic is missing in any drug user. If we can figure out why the work ethic is in decline, we will have made a big step toward understanding why there is a drug problem in this country.

Seeking an Answer

I doubt that I know the entire answer, but I believe that I know some parts of it.

First, we should look at our system of education. As a professional educator, I see proof every day that our primary and secondary schools are failing to prepare young people for the challenges of a competitive world. The horror stories about our educational collapse are true. Many students graduate from high school today with the most feeble reading, writing, and reasoning skills. (The large numbers who drop out are even worse off.) In many schools, standards are so low, and the dogma that a student's self-esteem is sacred is so pervasive, that passing is virtually automatic. In this pathetic environment, little is taught, little is expected, and little is learned.

One lesson, however, is learned all too well: You don't have to try to get by. Young people who see that there is no penalty for failing to work, to plan, and to exercise personal discipline will want and expect the rest of life to be that way. That is the mind-set of the drug user—short-sighted, indifferent, illogical.

A good education does more than just teach specific skills and facts. It also inculcates certain habits of mind which make the use of drugs (and many other forms of destructive, antisocial behavior) unthinkable. A good education teaches one not only how to use his mind, but also to appreciate it as his primary tool for success in the competition of life. It should come as no surprise that many young people who have an education in name only are attracted to mindless diversions, of which drug use is the most harmful manifestation.

Let us also keep in mind that people with little education are ill-equipped to cope with the problems which life inevitably presents. When a well-educated person confronts a problem, he is usually able to use his mind to analyze it, figure out what information he needs, obtain it, and then use it. But the poorly educated person doesn't have those abilities, and is apt to try to escape from his problems rather than to deal rationally with them. That escape, of course, includes turning to drug use.

Furthermore, for the ill-educated, job opportunities are very scarce. The high school dropout or the graduate who can hardly read a set of instructions isn't likely to be able to find and hold a job. The absence of discipline, cooperation, and courtesy, which are also learned as part of a sound education, makes it harder still for the ill-educated to keep a job. Idleness and boredom lure many into drug use.

Second, I think that the growing welfare state is also part of the explanation of our drug problem. The concept of welfare (now often referred to as the "safety net") says that you'll be taken care of without regard to your actions or lack of actions. Welfare encourages, especially in the poorly educated, a feeling of indifference and irresponsibility. A child who sees one or both of his parents doing little or no work and just barely making ends meet at the government's expense is apt to conclude that life will be the same no matter what you do. And it is people like that who are most prone to the short-lived escape which drugs offer. The huge expansion of the welfare state during the "Great Society" of the mid-1960s corresponds closely with the onset of the drug problem. Temporal correlations don't necessarily demonstrate causality, but I am convinced that there is a connection here.

Third, I believe that some aspects of our nation's economic policy are to blame for the rise in drug use. Because of a plethora of laws and regulations, it is very difficult today for a poorly educated person to obtain employment. Sixty years ago, even an illiterate immigrant could get a job rather easily. Of course, his wages would be low at first, and he wouldn't have guaranteed job security or any fringe benefits, but that is exactly why an employer could afford to give him a chance.

Today, the poorly educated run up against minimum wage laws. If their labor isn't worth the minimum wage (plus employer Social Security contributions and other government-mandated costs), they won't be hired. Moreover, "anti-discrimination" statutes raise the possibility that an employer will face a lawsuit if he dismisses a worker. The unhappy worker may charge discrimination even if the employer's decision was made strictly on merit, and may win if the employer can't persuade the court that he had a good business reason for his action.

These laws make it more costly and risky for a business to hire people with few skills, and thus opportunities for gainful employment are restricted. The number of people prone to drug use is further increased.

In *Losing Ground,* Charles Murray argues that the "welfare problem" is rooted in sociological changes which made welfare dependency easier and more acceptable from the mid-1960s on. The same is true, I maintain, about our current drug problem. The decline of quality education, the rising availability of welfare benefits, and rules which militate against the hiring of unskilled people have changed the social environment for millions. Where previously young people almost universally had reason to hope for a better future and possessed the mental acumen to bring it about, today a tragically large number are unable to read, write, and think well enough to take advantage of the limited opportunities open to them. Quite a few of our problems have their roots in this change in the social environment. The drug problem is one of the most serious.

Market Interferences

The common thread in these three factors which lead to increased drug use is that they are interferences with the natural order of the free market. Public schools are a non-market phenomenon, as are the welfare system and restrictions on freedom in the labor market. Nobody wanted these institutions to foster a drug problem, but I believe that they have contributed significantly to it. At work here is the law of unintended consequences. Laws which interfere with the free market have negative unintended consequences. The laws I have mentioned, rather than making life better for people, have harmed the lives of many.

Even if there were no drugs at all, a nation with large numbers of ill-educated, indifferent, and unemployable people would experience serious problems. If these people didn't turn to drugs, they would surely turn to some other vice. A completely successful war on drugs—which is probably impossible no matter what level of effort—would simply lead to other problems we'd have to wage war on.

The drug problem is not the disease itself, but one of the symptoms of a disease. The drug problem will go away when we again have a nation in which no one has any desire to take drugs. The problem lies in the demand for drugs, so that is where we must look for the solution.

If my analysis is correct, curing the disease will necessarily include the restoration of a sound educational system. People who are well educated—or at least not badly educated—will see the utter irrationality of drug use and abstain from it. Precisely how we can best go about restoring a sound educational system is the topic for many other essays, but I doubt that any significant progress will be made so long as education is publicly financed and run.

Solving the drug problem will also necessitate changing our welfare system so that it doesn't breed indolence and hopelessness. That is much easier said than done. And we will need to open up our labor market so that even those with few skills will have a chance at finding jobs.

I don't know if these changes by themselves are sufficient to eliminate the drug problem, but I am confident that they would reduce it greatly. Without making these changes, it is doubtful that significant progress can be made.

People in the free market movement have been advocating privatization of schools, welfare reform, and repeal of labor market interferences for years, and despite impeccable arguments have made little headway against determined opposition from powerful special-interest groups. We may be more successful in overcoming that opposition if we can show how much is at stake—a United States without a serious drug problem. □

"What Do You Want to Be?"

by Margaret Bidinotto

"What do you want to be when you grow up?" is a question my daughter, Katrina, has heard countless times from adults unsure of how to start a conversation with a six-year-old. Like most children her age, she has a different answer for each questioner—artist, dancer, teacher, bus driver, actress, mother, store owner—you name it, she's going to be it.

We adults smile to ourselves at the infinite variety and scope of our children's ambitions. But we sometimes fail to realize that an idea vital to the existence of liberty is taking root in their young minds—an idea that we instill almost accidentally, and then spend years inadvertently destroying.

"What do you want to be?" is not a universal question. Many if not most societies have been structured for sons to follow in their fathers' footsteps, while daughters repeat the lives of their mothers. Individuals have few choices to make and rarely expect any. Even in the early years of this country, choices, if not ambitions, were often severely limited by the primitive conditions of the society. But with ever-increasing wealth and well-being, men's options grew, and "What do you want to be?" became a valid and meaningful question.

By asking them what they want to be, we create in children the *expectation* that they will choose their own roles in life. Lacking maturity, children seldom fix upon one goal; but then, rarely do they question the belief that they someday will. Their observations of what appear to be fascinating adult occupations bring out a natural eagerness to be involved, and they look forward to that magical day when they will get to "pick for real."

Margaret Bidinotto is a free-lance writer in New Castle, Pennsylvania.

Making Choices

Human beings *need* to make choices, to function and thrive as their nature designed them to do. Liberty is the only condition under which legitimate decisions can be made. But for liberty to survive, people must *expect*—and, more importantly, *want*—to make choices. The individual who does not expect to make choices, or who does not want to do so, is in no position to defend liberty, or his own individual humanity.

It is ironic, then, that this country, full of opportunity, has so many well-intentioned naysayers. Doting aunts tell a young person, "you can't do that," while concerned uncles grumble, "nobody's done that before." Exasperated teachers tell him to "get serious and grow up," as his parents lecture him to "come down to earth and be realistic."

By the time he is in his late teens, a person has heard enough adult exhortations to convince him that his goals and ambitions were foolish and nonsensical. By the time he is in his early twenties, he's been exposed to enough adults complaining about their "lot" in life, shirking their work, playing the lottery, and griping about their "lousy luck," to be convinced that life is just a crapshoot with overwhelming odds. It is the rare individual who makes it to adulthood with his youthful ambitions intact.

Most would agree that it would be the height of cruelty to tell a starving child, "just step into this room and you'll have all you can eat"—only to have him walk into an empty room. No one would be surprised if the child became cyn-

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ical or bitter. Nor should it come as surprise when young people, once promised a rich diet of unfettered choice, become cynics when force-fed the thin gruel of pragmatism and determinism.

These young cynics can only look back on their childhood ambitions with nostalgic longing and, eventually, pain. They will feel somewhat guilty as a small reproachful voice inside tells them they should have stuck to their goals; but as time progresses, they will convince themselves that they "couldn't help it," that circumstances rule their lives, and that they don't *want* to make their own decisions. Then, they will eagerly embrace any collective that will absolve their guilt and offer to relieve them of the personal responsibility of deciding their own fate. Finally, in time, they will work to relieve others of that same burden.

The next time a breathless six-year-old bubbles enthusiastically about his plans to be "a doctor, then a veterinarian, and then a singer," check your amusement and offer him warm approval instead. Share you own dreams and ambitions with the next teenager you encounter and encourage him to strengthen, not repress, his own interests. Tell him to close his ears to the voices preaching pragmatism and determinism, and ask him instead: "What do *you* want to be?" □

Responding to the Oil Shock: The U.S. Economy Since 1973

by Rodolfo Alejo Gonzalez and Roger Nils Folsom

In 1981 the price of crude oil peaked at $36 per barrel; today it is less than half as high. Meanwhile, prices in general have risen almost 30 percent.[1] The price-setting power of the Organization of Petroleum Exporting Countries (OPEC) cartel clearly has waned as oil consumers reduced their oil use, as the end of oil price controls encouraged oil production in the U.S. (the second largest producer in 1987, producing less than the Soviet Union but more than Saudi Arabia), as non-OPEC countries such as Britain, Norway, and Mexico greatly expanded their oil output, and as OPEC's members surreptitiously produced above their OPEC quotas and discounted below OPEC prices. Occasional intermittent truces in this economic warfare still twitch the oil markets from time to time, as will the end of the Iran-Iraq war, but OPEC's power is much diminished if not totally gone.

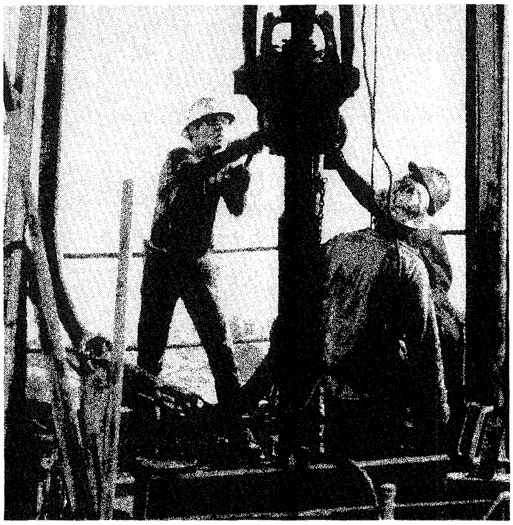
In the face of these developments, neither Keynesians nor monetarists have been able to supply a consistent explanation for the macroeconomic behavior of the U.S. economy since the first oil shock in 1973. Nevertheless, the main economic events of this period can be explained by assuming that private decision makers responded rationally to the energy "crisis" while policy makers, particularly the monetary authorities, did not.

In terms of aggregate economic output, energy is a complementary resource to both labor and real capital (including other natural resources). The shocks that decreased the availability of oil to the U.S. in the 1970s must have greatly decreased the (marginal) productivity of labor and also capital at that time. In contrast, if labor and the owners of real capital both believed that the energy crisis was temporary, and that energy would once again be plentiful, the oil shocks may not have significantly depressed the expected future opportunities for labor and capital in the 1980s.

Workers and capitalists may have been unimpressed by the argument—advanced by many energy "experts" in the 1970s—that the rise in oil prices was a sign of dwindling worldwide energy sources. Instead, they may have realized that high oil prices almost certainly would induce energy conservation and the discovery and development of new oil supplies not controlled by the cartel, and might stimulate the development of alternatives such as solar power. If they correctly perceived the energy situation as a temporary disruption caused by the OPEC cartel, they should have assigned a high probability to a recovery of energy supplies in a not-too-distant future.

Cartels rarely prevail for long against competitive market forces that move investment to

Professor Gonzalez teaches in the Department of Administrative Sciences at the Naval Postgraduate School. Professor Folsom teaches in the Department of Economics at San Jose State University. *Although solely responsible for the views expressed here, as well as for any errors, the authors greatly appreciate comments by J. Paul Leigh, Tim Sass, and David Saurman.*



the activities expected to be most profitable. Moreover, even if a profit-maximizing oil cartel had a perfect and unassailable monopoly, it would not reduce oil production permanently, but would merely shift production to the future.

If we suppose that the suppliers of labor and capital anticipated the return of more plentiful energy supplies, and responded rationally to the difference between existing and expected future opportunities created by the oil crisis — and by government policies that were at least partly reactions to the oil crisis[2] — by reallocating labor effort, leisure, and capital use over time, then the economic history of the U.S. in the 1970s and first half of the 1980s could read as follows:[3]

The demand for labor decreased with the fall in its productivity, but real wages did not fall significantly because workers did not expect the oil crisis to last, and therefore they were reluctant to accept real wages lower than those they expected in the future. Instead they accepted unemployment and greater leisure, expecting to increase their labor supply to above-normal levels in the future, when energy supplies and labor productivity had returned to normal.

Decreased productivity also reduced the demand for capital, and owners of capital responded in the same general way that workers did. Capital depreciation increases with use, so rather than accept lower returns, capital owners opted for a lower rate of depreciation and greater excess capacity, expecting to use the saved capacity in the future, when capital again would earn high returns.

Thus the oil supply contractions of the 1970s and the resulting decline in productivity had a negative effect on real national output and income, which was magnified by rational decisions to shift the sale of labor and the use of plant capacity to an expected more productive future.

Given the expectation that after the temporary oil shortage was over, supplies of labor and capital would be higher than during the shortage, households must have believed that their current income was substantially below what it would be in later years. Therefore, consumption spending was relatively buoyant, leading to a steep decline in the savings rate measured against current national output and income.

Inflation and Recession

The supply of money—which government policy has largely insulated from market forces—did not adjust quickly enough to the slowdown in real economic activity. In fact, the Federal Reserve encouraged the banking system to provide more money than the public was willing to hold, in an apparent attempt to induce more economic growth than was compatible with the reduced supplies of oil, labor, and capital. The result was a rise in the inflation rate, as the public tried to exchange excess money for goods and services. With stagnant output and high spending levels, the worsening inflation decreased the public's willingness to hold money even more.

By the end of the 1970s, accelerating inflation had so impaired public confidence in the government's willingness to exercise monetary discipline that there was talk of a flight from money and possible hyperinflation. This process continued until the Federal Reserve abruptly decreased the money supply growth rate and induced the 1981-82 recession, which lasted until sharply lower inflation rates finally changed the expectation that inflation would get worse and worse. Unfortunately, the Federal Reserve reduced the money supply growth rate so erratically that it took unnecessarily long for people to realize that monetary policy had in fact changed.

Meanwhile, Ronald Reagan's 1980 Presidential campaign suggested tax cuts that promised long-run benefits but that inevitably generated short-run uncertainty: whether a tax cut would be adopted at all, what its detailed provisions would be if adopted, and how long it would last before the next major tax change. As occurs with any tax cut proposal, the uncertain promise of lower tax rates encouraged people to shift economic activity to the future, when marginal tax rates might be lower (and almost certainly not higher), and when the best way to structure business decisions from a tax standpoint would be less obscure.

Unfortunately, these unavoidable incentives to postpone productive economic activity were compounded by the fact that the Economic Recovery Tax Act adopted in August 1981 phased its tax rate reductions so that they did not become fully effective until January 1984. Also, there were continual serious Congressional proposals to repeal or modify much or all of the 1981 tax cut, particularly its investment incentives, as occurred in the Tax Equity and Fiscal Responsibility Act adopted in late 1982. People were encouraged to postpone economic activity not only until 1981, but also until the lower marginal tax rates became fully effective and the details of the 1982 tax act (and the associated Internal Revenue Service regulations) became clear. Thus, fiscal policy contributed to the economy's below-capacity output between the 1979 and 1981-82 recessions, and worsened the length and severity of the 1981-82 recession.

During this period of low productivity and relatively high desired spending, many households were credit-constrained and unable to borrow as much as they wished. These households pressed for the Federal tax cuts discussed above, for state and local tax cuts (for example, Proposition 13 in California and Proposition "2.5" in Massachusetts), and for continued expansion of transfer payments and other government spending, and were unwilling to let government pay for increased defense spending by significant reductions in nondefense spending. In short, these households—unable because of their credit constraints to dissave as much as they wished for themselves—pressed for government dissaving. The U.S. government deficit exploded.[4]

After 1982 the demand for real investment increased substantially, to prepare for the expected higher productivity of capital after the return of normal oil supplies and prices.[5] But because of the decreased saving by households and dissaving by government, this increase in real investment had to be financed by a large change in the international flow of financial capital, so that the U.S. would have a large net inflow instead of its usual net outflow. Real interest rates in the U.S. rose very high in order to attract this net inflow of financial capital, which showed up statistically as a very large U.S. international trade deficit. The capital inflow increased the foreign demand for investment assets in the U.S., raising the international demand for dollars and consequently lifting the dollar's international exchange rate value to unprecedented heights.

An Inflow of Capital

The net flow of capital was from the rest of the world into the U.S., rather than the reverse, because the rise in the demand for investment relative to domestic savings was more pronounced in the U.S. than elsewhere. Although the oil shocks affected the whole Western world, oil was a more important productive input in the U.S. (Oil input per dollar of Gross Domestic Product was, and is, much higher in the U.S. than in Europe and Japan.) Consequently, the oil shocks decreased productivity—and contracted national income and saving—more in the U.S. than in other important centers of economic activity, while the need and willingness to invest in preparation for a greater abundance of oil was also higher in the more oil-reliant U.S.

Other things equal, high real interest rates raise the time value of money and encourage oil production out of existing fields, but simultaneously discourage oil exploration investments (along with other real investments). Thus the high real interest rates of the early and middle 1980s hit the major oil producing states such as Texas, Louisiana, and Oklahoma particularly hard, by driving oil prices even lower than they would have dropped otherwise and by decreasing oil exploration below even the levels that would be expected as a result of very low oil prices.

Once the expectation of lower oil prices had dramatically—albeit unsteadily—come true, the results were quite straightforward: confirmed expectations of much lower oil prices expanded economic output and greatly reduced unemployment, excess capacity, real interest rates, the government budget deficit, and the size of the trade deficit relative to Gross Domestic Product, and dropped the international value of the dollar. The most recent data suggest that our trade deficit has begun to decline not only relative to Gross National Product, but also absolutely.

Here ends our history. Note that our initial assumption, that actors in the U.S. economy expected the oil shortages and resulting declines in productivity to be temporary, plays a key role in explaining most of the significant features (also known as "problems") of the U.S. economy in the 1970s and early 1980s: slow real economic growth, severe inflation, high unemployment, excess capacity, low savings rates, huge government budget deficits, extraordinarily high real interest rates, large trade deficits, and a very high exchange-rate value of the dollar.

Given the steady improvement in the U.S. economy since 1982, there is no need to raise taxes in order to deal with the government budget deficit, which after peaking in fiscal 1986 then dropped by 30 percent. Nor is there any need to impose inefficient protectionist measures in order to reduce the trade deficit. Higher taxes (whether on personal or corporate income, oil, or energy), or higher trade barriers, would in fact be counterproductive.

The impatient may argue that because the improvement in the U.S. economy since 1985 has been not only steady but also slow, our optimism is too reminiscent of Pollyanna's. But the sluggishness of the economy since 1985, as in 1980-82, can be explained easily within the framework of this paper. In May 1985, after digesting angry criticisms of U.S. Treasury tax reform proposals[6] issued in late November 1984, the Reagan administration seriously proposed massive tax law revision and lower rates. The promise of lower future marginal tax rates, together with the enormous uncertainties generated by very different alternative proposals for massive revision of the tax code, encouraged people to postpone productive economic activity. Tax uncertainty lasted at least until the new tax law was enacted in late 1986 (numerous important regulations still remain to be written), and lower tax rates did not become fully effective until January 1988. And now we face new uncertainties about the tax and other economic policies to be adopted by President Bush and the Congress elected in 1988. In addition, adjusting to lower oil prices involves some costs: as resources are reallocated, some activities contract before others expand.

The economy is in transition. We need only to enjoy the supply-side benefits that will continue to come as the economy adjusts to lower oil prices and lower effective marginal tax rates. This prediction, of course, assumes that our legislators and monetary authorities will refrain from actions that would derail the current economic expansion. □

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1. As measured by the Gross National Product Implicit Price Deflator, which rose from 94.0 in 1981 to 121.8 at the end of the second quarter of 1988. In contrast, the "crude petroleum" component of the Producer Price Index fell 58 percent, from 109.6 in 1981 to 46.0 at the end of the second quarter of 1988.

2. The U.S. government could have taken steps, such as price decontrol of natural gas, to moderate the decrease in energy availability. Instead, the government decreased the supply of U.S. oil by continuing existing price controls (introduced by the Nixon administration as a general anti-inflationary measure in 1971) on oil and petroleum products, and in 1980, by imposing windfall profit taxes on domestic oil producers.

3. Our history reads as if there were a single oil shock to the U.S. economy in the early 1970s when in fact there was an initial shock with the Arab-Israeli war of 1973, followed by a partial recovery of oil supplies, and a second shock following the Iranian revolution in 1979. But to treat each shock separately would add substantially to our history's length without altering its substance.

4. Our analysis of household behavior builds on two ideas: first, that consumption depends primarily not on transitory income fluctuations but on expected permanent or "life-cycle" income; second, that credit constraints can significantly alter households' abilities to spend as much as would be appropriate given their expected permanent or "life-cycle" income. The first of these ideas was introduced by Milton Friedman (*A Theory of the Consumption Function*, Princeton, 1957), and then in a series of papers by Franco Modigliani, Richard Brumberg, and Albert Ando (see, for example, Modigliani's "The Life Cycle Hypothesis of Saving, the Demand for Wealth, and the Supply of Capital," *Social Research* 33, 1966). The modifications necessary to incorporate credit constraints into these expected permanent "life cycle" income models are being developed by Thayer Watkins, in papers that have not yet been published.

5. Some real capital investments undoubtedly were delayed as investors waited to see whether Congress would respond to the government budget deficit by repealing the lower tax rates enacted in 1981 and raising taxes even more than they were raised in 1982.

6. See Charles E. McClure, Jr. and George R. Zodrow, "Treasury I and the Tax Reform Act of 1986: The Economics and Politics of Tax Reform," *Journal of Economic Perspectives*, 1 (Summer 1987), pp. 37-58. The same issue contains a number of related papers.

The Entrenchment of the State

by Matthew Hoffman

Mikhail Gorbachev's new themes for the Soviet Union, *glasnost* (openness) and *perestroika* (reform), and their scant but widely publicized concrete manifestations, have caused a great stir in the West. Speculation about what has caused the Soviet leaders to attempt such changes varies widely, but one of the most popular theories is that they are desperate: their empire is crumbling from within, and if they do not change their system and relax controls, they will lose their power completely.

To classical liberals, this line of reasoning is appealing, for it is consistent with the principles of the free market. The lack of productivity incentives, supplied in a private property order by the availability of profit, as well as the inefficiency of a vast, corrupt, bureaucratic system of economic management devoid of the benefits of monetary calculation, will cripple the economy of any socialist nation. As Ludwig von Mises wrote, "In the face of the ordinary, everyday problems which the management of an economy presents, a socialist society would stand helpless, for it would have no possible way of keeping its accounts."[1]

The theoretical unworkability of socialism is, without a doubt, consistent with socialist experience. To dispute this would be to contradict the implications of almost all available data gathered from numerous failures of socialism around the world.

Mr. Hoffman is a senior in the media department of the High School for the Performing and Visual Arts in Houston, Texas.

It is wrong, however, to conclude that the failures of the stated goals of socialism, and the resulting public dissatisfaction with the system, are the causes of the reformation movement currently under way in the Soviet Union. In reality, the popularity of an entrenched Communist government is not a factor in its behavior. To such governments, public opinion is irrelevant, because it is for all practical purposes impossible for the populace to rebel successfully against their rulers. In fact, no major Communist government has ever been overthrown from within. To discover why this is so, we must analyze the system.

The Use of Terror

One of the principal ways a Communist totalitarian regime maintains its grip on the populace is the unconstrained use of terror.

The Bolshevik Party, for instance, had only an estimated 200,000 members when it overthrew Russia's Kerensky regime in 1917.[2] Aleksandr Kerensky was a member of the Socialist Revolutionary Party, which had the support of vast numbers of peasants, and received 58 percent of the vote in the elections of the Constituent Assembly, a congress elected by universal suffrage.[3] The Bolsheviks quickly abolished the Assembly, but the fact remained that the majority was clearly against them. How, then, did they maintain their power?

A short lull followed the Bolshevik coup, but preparations to consolidate their power began almost immediately. On December 20, 1917, Lenin established the Cheka, a secret police organization designed to "combat counterrevolution, speculation, and sabotage."[4]

Several months later, after a failed assassination attempt directed at Lenin, the Central Committee resolved that, "To the white terror of the enemies of the Workers' and Peasants' Government the workers and peasants will reply by a mass red terror against the bourgeoisie and its agents."[5]

With this decree, the Cheka was unleashed upon the population, indiscriminately arresting and torturing thousands of people, especially intellectuals. They paralyzed the country with fear, eliminating trust by creating false resistance organizations, and extracting "confessions" from victims at any cost.[6]

The Cheka, today called the KGB, has grown over time, and now penetrates every sphere of Soviet society. It contains hundreds of thousands, if not millions, of people and maintains a vast network of informants.[7] Dissidents are regularly arrested by the KGB and tortured in mental institutions.[8] The country is held in an iron grip of fear.

The use of terror to consolidate power has been adopted by many, if not all, Communist regimes. The Chinese Communists, after promising to maintain private property and free enterprise in 1949, began in 1950 a program of mass terror against property owners and "counter-revolutionaries," in which millions died.[9] The Khmer Rouge annihilated approximately one-third of the Cambodian people during their four-year reign.[10]

George Orwell, who ironically was a socialist, had a keen understanding of the ability of totalitarians to maintain their power, despite a lack of popular support. He modeled the workings of his futuristic police state in *1984* after the Bolsheviks, who practiced most of the repressive measures that Orwell's imaginary Oceania used. Orwell has the novel's antagonist state: "Obedience is not enough. Unless [a man] is suffering, how can you be sure that he is obeying your will and not his own? Power is in inflicting pain and humiliation. Power is in tearing human minds to pieces and putting them together again in new shapes of your own choosing."[11]

After a Communist government secures control over a people, it usually sets out to construct the utopia it has promised them. This often satisfies the socialistic intellectuals who may have been spared in the initial purges, as well as the masses, who often believe the party line. Many are convinced that their economic and political hardships are merely temporary, and will fade away as the Communist paradise evolves. In the new atmosphere of fear and lofty promises, dissent tends to abate. The government then will attempt to implement its policies, which usually include the complete abolition of private industry and free trade, the collectivization of farmlands, and bureaucratization of the economy.

In China, after the initial purge and the end of the Korean War, the government set out to do all these things, as did the Soviet Union after its Civil War. The Soviets enacted programs such as "War Communism" and the "New Economic Policy" (which allowed limited private enterprise), and finally settled on their system of five-year plans. Mao Tse-tung attempted "the Great Leap Forward," the failure of which ultimately led him to unleash the "Cultural Revolution."

None of these policies stimulated the economies of the two countries or improved the citizens' standards of living. However, they did put the economies under strict central control, exercised through immense bureaucracies. Today, for example, the People's Republic of China has approximately ten million government officials.[12]

Governments of such size and economic power are not overthrown. The only coups that take place do not result from mass uprisings, but from struggles within the bureaucracy. Viktor Suvorov, a defector from the Soviet Army, describes gigantic hierarchical factions within the government, supported by a system of interdependency.[13] These struggles may lead to government manipulation of the general populace, often using mob psychology.

When Stalin wished to collectivize Soviet farms in the late 1920s and early 1930s, he met with great resistance from the upper class of peasants (the kulaks) as well as the vast middle class (the seredniaks). Both groups had nothing to gain from the collectivization of their lands. However, the lower class, called bedniaks, were quite poor and favored the plan.

Stalin turned the bedniaks against the other groups, allowing them to attack the other peasants and take what they would. A great civil war erupted in the rural areas of the Soviet Union, and Stalin used the opportunity to force the collectivization. In doing so, he caused a famine that killed between 5 and 10 million people. Yet, they did not rebel against the government itself. Stalin had transformed a statist imposition into a conflict between groups.[14]

When the paranoid Stalin perceived the growing power of his rivals, he began to eliminate them one by one, in numerous assassinations and bogus trials. In order to consolidate his personal control of the state, he engineered the Great Terror, which resulted in millions of deaths. Under these horrible political conditions, the people did not rebel.

Similarly, with the failure of Mao Tse-tung's "Great Leap Forward" in China, various factions within the government suggested revising policies in order to cope with the economic problems of the country. Mao perceived this as a direct threat to his power, and struck at his enemies within the party by unleashing the "Great Proletarian Cultural Revolution" in which children and teenagers were organized in "Red Guard" groups, and told to annihilate anything "traditional," "luxurious," or "revisionist." They swept over the country in what may have been the most phenomenal orgy of destruction in history, and successfully purged the party ranks of anti-Maoists. The economy was left in ruins. The people, however, did not rise up against the government.[15]

As the antagonist in *1984* said: "It is time for you to gather some idea of what power means. The first thing you must realize is that power is collective."[16]

Entrenchment in the United States

Because of the growth of government power in the United States during the last century, America has acquired some of the characteristics of the totalitarian nations that facilitate the entrenchment of power.

Our government continues to send its tentacles deeper and deeper into the nation's economic life. The federal, state, and local governments employ almost 16.7 million people, about 7 percent of the entire population![17]

The collectivization and factionalization of our society continue, as special interest groups vie for coercive privileges, power, and government largess. Today, 90 million Americans depend on the government for support.[18]

In addition, the state controls our children's intellectual development through compulsory education laws, public schools, and school licensing. The regulation of thought is essential to the entrenchment of the state.

If we do not wish to meet the Orwellian fate of the citizens of the Communist nations, we must halt the growth of our government, and reverse the coercive, collectivist trends that threaten to deliver us to a potentially eternal tyranny. Walter Cronkite wrote in his preface to *1984:* "It has been said that *1984* fails as a prophecy because it succeeded as a warning. Well, that kind of self-congratulation is, to say the least, premature. 1984 may not arrive on time, but there's always 1985."[19] □

1. Ludwig von Mises, *Liberalism* (Irvington-on-Hudson: The Foundation for Economic Education, 1985), p. 72.
2. Robert E. Elson, *Prelude to War* (New York: Time-Life Books, 1976), p. 45.
3. *Ibid.*, p. 53.
4. William R. Corson and Robert T. Crowley, *The New KGB* (New York: William Morrow and Company, 1985), p. 31.
5. Edward H. Carr, *The Bolshevik Revolution 1917-1923,* vol. 1 (New York: W. W. Norton and Company, 1952), pp. 151-183.
6. Corson, pp. 41-42.
7. John Barron, *KGB Today: The Hidden Hand* (New York: Berkley Books, 1985), p. 385.
8. *Ibid.*, pp. viii-ix.
9. H. E. Chen, *The Chinese Communist Regime* (New York: Frederick A. Praeger, 1967), pp. 3-4.
10. "A Mass Murderer's Exit," *Maclean's* (September 16, 1985), p. 22.
11. George Orwell, *1984* (New York: New American Library, 1949), p. 220.
12. *Encyclopaedia Brittanica,* 1986, vol. 16, pp. 57-58.
13. Viktor Suvorov, *Inside the Aquarium* (New York: Berkley Books, 1986), pp. 81-82.
14. Basil Dmytryshyn, *USSR: A Concise History* (New York: Charles Scribner's Sons, 1984), pp. 170-171.
15. Anne F. Thurston, *Enemies of the People* (New York: Alfred A. Knopf, 1987).
16. Orwell, p. 218.
17. U.S. Department of Commerce, *Statistical Abstract of the United States* (Washington D.C., 1987).
18. Hans F. Sennholz, *Debts and Deficits* (Spring Mills: Libertarian Press, 1987), p. 11.
19. Orwell, p. 3.

Blockading Ourselves

by Cecil E. Bohanon and T. Norman Van Cott

Blockading enemies is a standard wartime tactic. The objective, of course, is to prevent an adversary from trading with other countries. At the same time, warring nations try to keep their own seaports open. In light of this centuries-old wartime tactic, it is curious that nations at peace regularly blockade themselves by pursuing policies which restrict imports. The irony of nations turning a wartime weapon on their own citizens during peacetime has escaped attention in the flood of recent commentary on international trade.

One might object to this wartime/peacetime contradiction on the grounds that it is an imperfect analogy. Note, however, that the goals of wartime blockades and peacetime import restrictions are similar in that both seek to prevent foreign goods from entering a particular market. Logical consistency implies that if wartime blockades hurt enemies, peacetime restrictions hurt our own economies. Alternatively, if peacetime restrictions improve a nation's economic strength, wartime blockades are treasonous.

A Lesson from U.S. History

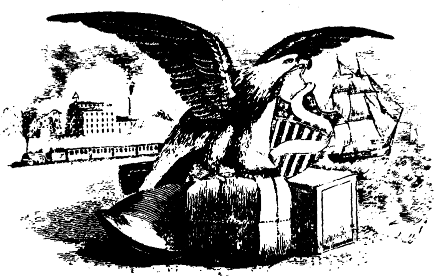
During the U.S. Civil War, the North blockaded the major seaports of the South. Historians generally agree that the South's economic strength was sapped by the blockade. Entering and leaving Confederate seaports became more costly, usually requiring the skills of blockade runners.

Professors Bohanon and Van Cott teach in the Department of Economics at Ball State University, Muncie, Indiana.

The adverse economic effects of the blockade on the South were twofold. First, the blockade made imported goods less available, so that the Confederacy had to eliminate certain uses to which imports heretofore had been put. The resources the Confederacy previously had been using to pay for these imports had to be redirected to less-preferred goods. Second, the imports that did slip through the blockade came at a greater cost. More costly imports meant the Confederacy had to send more of its production to foreigners as exports to obtain these imports.

Today's media pundits sing the praises of exports and consistently denigrate imports. Fortunately for the North, Abraham Lincoln and his Secretary of the Navy, Gideon Welles, knew better. The purpose of the blockade from the North's point of view was to reduce the Confederacy's access to *imports*. Admittedly, the North also tried to prevent Confederate exports when, for example, it intercepted cotton-laden ships bound for England. But these export interruptions served the North's interest only because they reduced the Confederacy's ability to pay for imports. The North surely would have been willing to permit Confederate exports, *provided* it could have completely eliminated Confederate imports. Popular wisdom aside, exporting without importing is counter to a nation's well-being; it reduces the availability of goods and services to the inhabitants.

From the time of Adam Smith and David Ricardo, economists have carried the torch for free trade. It is common to hear people say that economists have won all the formal debates on the subject, but have been steady losers in the



political arena. Curiously, economists have not trumpeted the fact that governments' wartime actions are consistent with the free-trade doctrines of Smith and Ricardo. Perhaps the economists' reticence reflects what Milton Friedman, in *The Optimum Quantity of Money and Other Essays,* describes as a tendency among economists "to discard war years as abnormal."

We submit, however, that government officials' wartime actions should not be overlooked. Indeed, the contradiction between their wartime and peacetime actions can be explained in terms of the first principles of economics. These same principles suggest, moreover, an important consideration if the dream of free trade is to become a reality.

Why do government officials behave as they do? The *personal* benefits and costs to politicians obviously play a key role. Peacetime import restrictions benefit politicians because they can confer privileges on domestic industries that are facing foreign competition. Politicians bear little personal cost because consumers harmed by the restrictions are spread throughout the economy and are too unorganized to be politically important. Politicians cover their tracks with rhetoric to the effect that imports "weaken the economy," "deter economic growth," and "destroy jobs."

However, if one believed this political rhetoric, one would never suggest a wartime blockade. Quite the opposite—a better wartime strategy would be to encourage neutral nations to trade with your enemies. Indeed, why not subsidize your own citizens' trade with enemy nations, since it supposedly saps your enemies' economic strength?

Any schoolchild, of course, can see the folly of this logic. Such policies risk national disaster, which in this case translates into personal disaster for the policy-makers. For this reason, the lessons of Smith and Ricardo necessarily loom large in the calculations of wartime politicians. When viewed in this perspective, the contradiction becomes more understandable.

At the risk of belaboring the wartime/peacetime imagery, the contradiction is similar to the foxhole religious conversions that occur during every war. Soldiers under heavy fire promise God they will "walk the straight and narrow" if God will get them out of their predicament. Once safe, however, they return to their "backsliding" ways. So it is with government officials and international economic policy. Peace reduces their personal costs of acting contrary to national economic efficiency.

Raising the Costs

Aside from pointing out the logical inconsistency of protectionist rhetoric, what does the foregoing tell us? Perhaps the salient point of the contradiction relates to how personal costs influence government policy-makers. This in turn suggests that the path to reform of international economic policy must go beyond merely explaining the economics of trade, as desirable as this may be. That is, essential to international economic reform is the idea that peacetime protectionism must be personally more costly to government policy-makers. It is quite likely that reform along these lines encompasses changes that are of a quasi-constitutional or constitutional nature. □

Popper, Hayek, and Classical Liberalism

by Jeremy Shearmur

Karl Popper, who turned 86 years old this past July, is justly famous for his work in the philosophy of science. As a young man, Popper was inspired by the way in which Einstein called into question the ideas of Isaac Newton. Einstein put forward a theory that, if true, explained why Newton's work had been so successful. From Einstein's theory, however, there could also be deduced consequences that differed from those of Newton's theory; predictions that could be put to the test.

Now Newton's *Principia* was possibly the best-confirmed scientific theory of all time. Alexander Pope, when composing an epitaph for Newton, wrote:

> Nature and Nature's laws lay hid in night,
> God said: Let Newton Be! and all was light.

It would scarcely be an exaggeration to say that, as more and more impressive confirmations of Newton's work were discovered, a major problem for philosophers became: How can we explain that, on the basis of experience, we have knowledge of truths such as Newton's theory.

Popper reflected on the character of Einstein's achievement, and was led to a new account of the development of scientific knowledge. In Popper's account, science is the product not of induction, but of a process of conjecture and of refutation. Science, which for Popper is probably mankind's greatest cultural achievement, always remains conjectural in its character, and human beings are seen as inescapably fallible.

All this also led Popper to a more general view of our condition. Popper sees human beings, like other animals, as involved in problem-solving. We have various inbuilt expectations and mechanisms by which we interpret the world around us. But our expectations and our interpretative mechanisms are fallible. We need to learn by trial and error. Unlike animals, however, it is possible for man, using the descriptive and argumentative functions of his language, to construct a world of culture, outside of himself, in which he is able to externalize, and thus to criticize, his knowledge. By this means, as Popper has often said, men differ from the animals, because it is possible for man to let his theories die in his stead.

Popper is also well-known for his writings on political philosophy, notably his *The Open Society and Its Enemies*. In this work, written during the Second World War, Popper drew upon themes from his philosophy of science. He criticized those who, like Plato, wished to claim power on the grounds that they had access to secure knowledge. And he criticized those like Marx who had allowed their essential humanitarianism to be channeled into directions that were hostile to the Open Society, because they held false theories of knowledge and of history. Popper's *Open Society* contains much detailed

Jeremy Shearmur was educated at the London School of Economics, University of London, where he worked for eight years as Assistant to Professor Sir Karl Popper in the Department of Philosophy. His Ph.D. dissertation was on the political thought of F. A. von Hayek. He is currently a Senior Research Fellow at the Institute for Humane Studies, George Mason University, Fairfax, Virginia 22030.

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critical discussion of both Plato and Marx. In addition, it contains Popper's own picture of an Open Society. Popper is here concerned with the freedom and well-being of all citizens. He pictures a democracy as functioning very much in the spirit of the scientific community. Politics, for Popper, is a matter of our discovering problems and putting forward tentative solutions to them. Just as in science, we should then hold our conjectures open to criticism—to feedback and critical responses from all citizens—so that we can most effectively discover where things are going wrong.

Learning from Our Mistakes

When Popper was writing, he considered that the big issue after the war would be the defense of the ideals of a free society against those who called them into question, from the left and from the right. Today, however, we may look to Popper's work with a different question in mind. What form of social organization would best enable us to learn from his insights about human fallibility and the need for us to learn from our mistakes?

Considered from this perspective, Popper's work does not fit too easily within the usual approaches to politics. Popper, when writing *The Open Society,* showed great sympathy for working people. He had no time at all for conservatives who felt that working people were unfit for citizenship, and he was also critical of the policy of "laissez faire." At the same time, Popper strongly emphasized the importance of markets and of the government's acting only through a legal framework.

Bryan Magee, at one time a member of the British Labour Party, has argued that "the young Popper worked out what the Philosophical foundations of democratic socialism should be."[1] And Popper has been hailed as a kind of secular patron saint of social democracy by a number of leading political figures, especially in West Germany.[2] Magee himself notes that Popper's own views have changed and that he would now describe himself as a liberal in the "old-fashioned" sense. And Popper, in his autobiography, has said that "if there could be such a thing as socialism combined with individual liberty, I would be a socialist still."[3]

But is it the case that the logic of Popper's argument points toward one rather than another form of social organization? I believe that, perhaps *despite* the views of the younger Popper, the logic of his argument points toward a form of social organization in which the market plays a major role, and politics a rather restricted one. I would thus suggest that the best way of making use of Popper's ideas about politics would be through those ideas that have been advocated by his old friend, Friedrich Hayek.

Popper and Hayek have influenced one another in many ways. Hayek has told us that his views on science were importantly changed as a result of his contacts with Popper. And Popper's political writings seem to bear the mark of Hayek's work (notably in his appreciation of the importance of markets and of a legal framework for government action).[4] There are certain common themes to their writings. Both see human freedom and well-being as of the greatest importance. They both see all human beings as fallible, and give great weight to the idea that, in designing social institutions, we should put a premium upon our ability to learn. They both believe that, in an affluent society, we have an obligation to help those who need it. And they both recognize the importance of our being able to change governments through elections, rather than only by force.

There are differences between them, however. Hayek views the market and a liberal constitutional order as a mechanism, by which individuals can learn by trial and error. For Popper, learning by trial and error in social affairs is made more the responsibility of government. Politicians and civil servants would diagnose our problems and offer solutions to them. Democratic politics is regarded as a mechanism by which they may learn that they have got things wrong.

But which is the most effective means through which we can learn in the realm of social affairs? Let us contrast the behavior of the entrepreneur and of the politician.

The entrepreneur wishes to discover if he is wrong. If he has backed a bad idea, he will want to discover this as quickly as possible and abandon it, because a bad idea will lose him money. He cannot peddle his bad ideas to people, because they will buy his ideas—his goods—only if they consider them worthwhile. And while no one likes to discover that they have made a big mistake, the entrepreneur has every incentive to abandon old failures and to move on to new and better ideas. He also has every incentive to try out bold and daring ideas. There is nothing wrong with his doing so, for only those citizens who choose to adopt his idea will share the risk. And there are excellent mechanisms to tell the entrepreneur when he has made a mistake.

Contrast with this the politician. When did you ever hear a politician who still had an election to fight admit that he had made a serious mistake? And if he did admit it, would he ever be allowed to forget it? Unless he was very lucky, it would dog him to his grave. Indeed, politicians typically die with their mistakes. And so—they seldom admit they are wrong. If they are wrong, they will attempt to cover it up. And if they are in power, they will be able to use the mechanisms of government to force their errors onto the rest of us, while telling us that they are successes. Above all, politicians are interested in power: and thus, in democratic countries, in their popularity, and in not saying anything out of turn. After spending over a year as Director of Studies of a public policy institute, I was still amazed by the unwillingness of politicians to say what they *really* felt about anything, even in private conversation.

In a country in which government plays a major role, much of the power is in the hands of civil servants. Civil servants, while usually dedicated to their work, are creatures of routine. And there simply do not exist mechanisms for assessing whether most of what government actually does should be undertaken at all, let alone whether it is being undertaken effectively.[5]

Above all, it is difficult for us to tell our masters—whether politicians or civil servants—in what respect they have got things wrong, or what in our view the trade-offs should be between, say, expenditure on one thing or another, and letting us keep our money in our own pockets.

The lesson in all this, it seems to me, is that we should put into the hands of government *nothing* that we can organize by other means. And we should also be reluctant to take from individuals the power of deciding what they want and to give it to anyone else. Once that power is shifted, we move decisions away from our most effective mechanism of accountability: accountability to individuals in the marketplace.

Many years ago, Friedrich Hayek came to the conclusion that it was not socialism (in which he had believed as a young man), but institutions in the tradition of classical liberalism that would do most for the well-being of his fellow citizens, especially the poor. It seems to me that it is the tradition of classical liberalism, as exemplified by Hayek's work, that also offers us the best institutional model for putting into practice Karl Popper's insights about our need to learn by trial and error in political and social affairs. □

1. Bryan Magee, *Popper* (London: Fontana Books, 1973), p. 84.
2. Cf. G. Luehrs *et al.* (eds.) *Kritischer Rationalismus und Sozialdemokratie,* I and II (Berlin and Bonn-Bad Godesburg, 1975, 1976).
3. Karl Popper, *Unended Quest* (London: Fontana Books, 1976), p. 115.
4. It is largely in this context that Popper refers to Hayek in his notes to *The Open Society and Its Enemies.*
5. If this seems an exaggeration, I would suggest the perusal of the discussion of rationality and decision-making in any standard text on policy making in the public sector, such as Christopher Ham and Michael Hill, *The Policy Process in the Modern Capitalist State* (Brighton: Wheatsheaf Books, 1984) or Brian Hogwood and Lewis Gunn, *Policy Analysis for the Real World* (Oxford: Oxford University Press, 1984).

Islamic Capitalism: The Turkish Boom

by Nick Elliott

Once dismissed as the "sick man of Europe," Turkey is now building a prosperous future. The Turkish economy has been growing at a faster rate than that of any other country in the OECD (Organization for Economic Cooperation and Development)—including Japan, Great Britain, and the United States. The Turks seem to have evolved a successful union of Islam and capitalism, not always a comfortable mix.

My own impressions were formed on a recent trip to Istanbul, during which I witnessed the frenetic commercial activity that is fueling the Turkish economy. Istanbul is a city with a fast pace, a whirlwind of people hurrying about their business, working hard.

For a country that is still relatively poor, it is a surprise to find no beggars. Instead, everyone works, in whatever niche he can find. To the Western eye, some of these jobs appear very menial: outside the railroad station a row of men crouch over jars of polish, offering to shine shoes. Everywhere men and boys squat beside flagons, with a drink of cold water for sale. To the Turk, these simple jobs are a way to make a living; and all of these people in their small ways are contributing to the economic expansion.

Turkey needs a booming economy to support a booming population. The current population of 52 million may reach 75 million by the end of the century.

Mr. Elliott works for the Adam Smith Institute, a free-market think tank in London. He is a regular contributor to the journal Economic Affairs, *published by the Institute of Economic Affairs.*

In Istanbul, children are everywhere. Turkey is still emerging from a Third World culture, in which children are a valued part of the family economy. They go to work in the family business, and they provide for their parents in old age. In Istanbul, young children work in shops, sell packets of postcards to tourists, sell birdseed to visitors who want to feed the pigeons, or learn the trade of shoe-blacking.

To the visiting Briton, the sight of a small child cleaning shoes clashes with the taboos we have constructed around "child labor." In Britain we have legislated to make children attend school until the age of 16. We force children to be taught about kings and queens and glacial striations, and to go on cross-country runs. Many of the children who pass through the system pick up little in the way of useful knowledge or values.

In Istanbul, children start learning early how the world works. They learn the rewards of hard work and application. They learn something about the pressures and pleasures of independence and responsibility. The sight reminded me of the bootblack hero in Horatio Alger's *Ragged Dick*.

Younger Turks have realized that a large part of their future will depend on working with foreigners from the West. Many of the young children have learned the benefits of being able to sell in more than one language. Stopping at a postcard shop in Istanbul, I was surrounded by a group of small boys who asked me where I was from, and proceeded to tell me in fluent English what I could buy. When a German stopped to look, they spoke to him in German.

These boys had learned their skills from finding a use for them in everyday life.

Istanbul is a city that bridges two continents, in more than the geographical sense. On Turkey's eastern border is Iran, the focus of a world fundamentalist revival, a movement for vigorous and uncompromising imposition of Holy Law. In Istanbul women cover their faces, and the wailing from the mosques resonates around the city, part of a culture that stretches across Islamic Asia. Yet modern Turkey is founded upon the ideas of Kemal Atatürk (1881-1938), who sought to make Turkey a secular republic. The Turks are serious about their religion, but recognize that it has its place.

One reason why Moslems are sometimes suspicious of capitalism is that it can disrupt the Islamic pattern of society. Capitalism entails an extension of choice, as its foundation and as its result. By making available new arrays of material goods, it tempts the Moslem with Western values. Capitalism pays no respect to hierarchies of power. It allows individual people to live independently of government, and disperses power to the many. It opens up new networks of communication, beyond the critical supervision of the guardians of Holy Law. Where Islam is imposed as a rigid code of uniformity, capitalism is a threat.

In Istanbul, alongside the mosques are shops selling Japanese cameras. In amongst the symbols of a traditional and ancient culture you find the trappings of Western materialism. A contrast it may be, but it is also a compliment to the tolerance of Turkish society. Turkey remains an Islamic country—a member of the Islamic Conference Organization—but Turkish society retains a flexibility that can admit deviation. It is marked by an openness that has never been more valuable than today.

From the East, Turkey must incorporate the pull of the fundamentalist revival, popular in universities. From the West come the attractions of liberalism and permissiveness. Potentially a conflict of values that could fracture their society, this meeting of East and West is more likely to be the making of modern Turkey. Turkey can find prosperity and status as the go-between in trade and international relations.

Some Turks frown upon the changes that have accompanied new riches. In Britain some observers already have started to lament the loss of the "simple life" in Turkey. Their fears are groundless: Turkish culture is too deep to be subsumed by Western life. To most Turks the future must be an exciting prospect, in a country gaining respect and influence.

Many Third World governments have foundered in their attempts to modernize their countries by pursuing false ideas to unworkable conclusions. Turkey is one of the better examples, a country where progress is succeeding by being left to evolve through the efforts of individuals. □

Markets and Morality

by Peter J. Hill

In terms of sheer ability to provide goods and services, most people would agree that capitalism wins hands down when compared with alternative economic systems such as socialism. Even so, many critics of private property and markets prefer a more socialistic system or at least one that places more power in the hands of the government. They argue that although capitalism delivers the goods in a material sense, it doesn't deliver them morally. That is, capitalism doesn't satisfy certain basic standards of justice.

This article challenges that position by examining several areas where moral issues weigh in on the side of the marketplace. This is not an argument that a society based on free markets is the same as a moral society; people can behave morally or immorally in a free market system just as they can in other systems. However, capitalism does have a number of moral strengths that are lacking in other economic systems.

Although the "market" is often considered an alternative to central planning or state ownership of the means of production, it is not a rigid institutional order like socialism or communism. What we call capitalism or a free-market society is a society based upon private property rights. Individuals may own, buy, and sell property (including their own labor) if they do not do so fraudulently, and they are free to do what they want with their property as long as they do not harm others. Individuals may decide to exchange their property with others, thereby creating a market. This market process is not mandated by anybody and requires only a well-defined and enforced system of private property rights in order to exist.

Inherent in capitalism is the ability to: provide freedom of choice, encourage cooperation, provide accountability, create wealth for large numbers of people, and limit the exercise of excessive power.

Peter J. Hill is George F. Bennett Professor of Economics at Wheaton College (Illinois) and a Senior Associate of the Political Economy Research Center (PERC) in Bozeman, Montana. This article was originally published as part of the PERC Viewpoints *series.*

Freedom of Choice

A market system assumes very little about the ideal way to organize economic life. Other societies may mandate cooperatives, or communes, or cottage industries, or they may prohibit them. But a system of private property offers a wide range of possible forms of organization. If cooperatives are desirable, they can be used; but other forms for organizing production are also permissible. And, in fact, the individual who wishes to ignore the market or construct alternative institutional arrangements is perfectly free to do so.

Throughout history certain groups have chosen to operate largely outside the market. One such group, the Hutterites, lives in the northern Great Plains of the United States and Canada. The more than 200 Hutterite agricultural colonies have been remarkably successful in maintaining their identity and expanding their population. Yet they are far from capitalistic. All property within the Hutterite colony, except the most basic personal items, is owned in common. All income is shared equally within the colony, and no wages are paid for labor.

The Hutterites were able to establish their colonies without prior approval from anyone in society. No committee, government agency, or group of well-meaning citizens had to meet and decide if the Hutterite lifestyle should be allowed. The freedom to choose such alternatives is unique to a free-market society.

In contrast, a centrally planned society does not grant freedom to those who want to engage in market transactions. It limits voluntary trade in the interest of some other goal, and undoubtedly would constrain groups like the Hutterites if the people in power disliked the Hutterites' form of organization.

Cooperation vs. Conflict

A free-market, private-property system usually is labeled competitive. Yet one of the major advantages of the market system is that it encourages cooperation rather then mere competition. Competition does exist in a market-based system, but competition is prevalent in any society in which scarcity exists.

In the marketplace successful competitors cooperate with, or satisfy, others in the society. In order to succeed in a private property system, individuals must offer a "better deal" than their competitors. They cannot coerce people to buy their products or services. They must focus their creative impulses and energy on figuring out ways to satisfy others. The person who does this best is the one who succeeds in the market. Thus, participants in a market economy—buyers and sellers—continually look for areas of agreement where they can get along, rather than concentrating unproductively on the areas of disagreement.

In contrast, under a collective order, rewards frequently come from being as truculent and uncompromising as possible. With collective decision-making those in stronger political positions have little reason to look for areas of agreement; generally, they have a better chance to succeed by discrediting the opposition to justify their own position, compromising only when others are strong.

A good example of the dissension caused by collective decision-making is the controversy over teaching the origins of mankind. School boards—which must make collective decisions—generally have to decide to teach either that human beings were created or that they evolved. Such decisions are fraught with conflict. People who disagree with the board's decision march, write letters to the newspaper, lobby, hire lawyers, and, in general, become quite exercised. This is almost inevitable when highly emotional issues are involved since any collective decision, including one made by majority vote, is likely to be contrary to the wishes of a minority. Thus, the decision-makers are in a no-win situation. If the board allows creationism to be taught, evolutionists will be irate. If they decide to teach evolution, creationists will be outraged.

In contrast, consider the decision to be vegetarian or carnivorous. There are individuals who feel every bit as strongly about this issue as those involved in the origins-of-mankind debate. Nevertheless, there is little chance that a decision about diet will generate public controversy. Diet is not determined by a collective decision-making process, so people can interact rather peacefully about it. The person who believes that avoiding meat is healthier or morally correct can pursue such a diet without arguing with the meat eater. Advocates of a meat diet can find producers and grocery stores eager to satisfy their desires. In fact, vegetarians and the meat eaters can shop at the same stores, pushing their carts past each other with no conflict. It is the absence of collective decision-making that permits this peaceful proximity.

The social harmony that results from a market order should be of great interest to those concerned with moral issues. People of very different cultures, values, and world views can live together without rancor under a system of private rights and markets. A market order requires only minimal agreement on personal goals or social end-states.

In contrast, alternative institutional orders are more oriented toward centrally determined goals. The very existence of such orders requires a more general agreement on what is "good" for society. A centrally planned system not relying on willing exchange of work for pay must direct individuals to labor to achieve certain ends, and those ends are not necessarily the same as workers or consumers would choose freely. For instance, in the Soviet Union very little freedom is allowed in occupational choice, and once one has been assigned a job it is very difficult to move to a different one.

Another reason that a system based on private property rights encourages social harmony is that it holds people accountable for what they do to others. Under a private property regime, a person who injures another or damages another's property is responsible for the damages, and courts enforce this responsibility. The mere knowledge that damage must be paid for leads people to act carefully and responsibly. When people are accountable for their actions, individual freedom can be allowed.

In contrast, a centrally planned system holds individuals far less accountable. Although in theory the government is charged with enforcing people's rights, rights in such a system are ill-defined and the government can and does respond to the wishes of powerful people with little regard for the rights or wishes of the powerless. Even in democracies, if government has the power to grant favors, powerful groups try to use the government to take what they want. What they take may have been worth far more to those from whom it was taken.

Zero-Sum vs. Positive-Sum Views of the World

Many objections to private property hinge on income distribution. Well-intentioned people often think that it is unfair for some to live in luxury while others have very little. I am sympathetic to the view that the affluent are morally obligated to share their wealth with those who have less. But that doesn't mean that the state is the appropriate agency for such redistribution.

A significant number of people who object to the relative position of the wealthy do so because of a basic misapprehension about where wealth comes from. They believe that those who live in luxury do so at the expense of others who live in poverty. In general this is not true.

The world is not zero-sum. That is, the wealth of the world is not limited so that it has to be divided up among everybody, with some people getting more and others getting less. While wealth can be obtained by taking it from others, wealth also can be created by properly motivated human action. When that happens, wealth represents a net addition to the well-being of a society. The significant increases in per capita wealth since the Industrial Revolution have come about primarily through the creation of wealth, not by taking from others.

Under a set of well-defined and enforced property rights, the *only* transactions people engage in are "positive-sum" or wealth-creating transactions, those that occur because all parties to the transaction believe they will be better off as a result. In a society where people have secure rights to their property, they will exchange property only voluntarily, and they will do so only when they see the potential for improving their situation. The people they are dealing with will do the same—engage in transactions only when they expect to be better off as a result.

A zero-sum world, where one accumulates more wealth solely by decreasing the wealth of others, occurs only in the *absence* of property rights. In such a world people—either by themselves as brigands and thieves or through the use of governmental power—can obtain command over resources without obtaining the consent of the owners of the resources.

Some critics argue that many market transactions are not voluntary, that some people are forced by circumstances to enter into transactions they don't want. For instance, they argue that an employer is exploiting workers by hiring them at the lowest possible wage. Yet in a society in which people act voluntarily, without coercion, the acceptance of such an offer means that no better wages are available. Indeed, the employer is expanding the opportunities for the unfortunate. A law mandating a $4.00 minimum wage, for example, actually decreases the opportunities for those whose work is worth only $2.00.

The only way a government—as opposed to the private sector, which acts through voluntary giving—can help these people is to give them wealth that it takes from someone else. Yet the fact that wealth usually has been created by its owners, not taken from others, weakens the moral case for such redistribution. A person whose creative effort adds to the stock of wealth without decreasing the well-being of others would seem to have a moral claim to that new wealth.

Moreover, under a private property system that relies on the market process, net additions to wealth roughly reflect how much one has added to the wealth of *other* people. In a market system, the only way to become wealthy is to please others, and the way to become *very* wealthy is to please the masses. Henry Ford catered to the masses with his automobile, satisfying their need for relatively cheap transportation, and he became immensely wealthy. In contrast, Henry Royce chose to serve only those with high incomes by producing an expensive automobile, and he did not become nearly as rich. To penalize people who carry out actions like Henry Ford's by forcibly taking large amounts of their income seems perverse.

Unfortunately, the mistaken zero-sum view of the world is quite prevalent. Many participants in discussions about Third World poverty believe that if only the wealthy nations weren't so well off, the poor nations would be richer. Although it certainly is possible that some of the wealth of some people has been taken from others, this is not usually the case. And if such takings occur, the solution is to move to a regime that protects people's rights to their property.

Ironically, the view that the world is zero-sum often makes conditions worse. Proponents of the zero-sum view usually favor large-scale political reallocation of rights. Such reallocation encourages, indeed requires, that everybody enter the fray. War is expensive whether it occurs on the battlefield or in the halls of Congress. When government has the ability to hand out numerous favors, many citizens compete for these favors, while others lobby vigorously to retain their assets. Typically, the net result is less wealth remaining after reallocation than before reallocation.

Power

The gravest injustices in the history of mankind have occurred when some people have had excessive power over others. This power sometimes has been economic and at other times political, but in either case the ability to control others' choices has caused enormous suffering. What sorts of institutions best fragment power and prevent some people from holding too much sway over the lives of others?

This question must be answered in the context of a realistic understanding of how the world operates. Whatever institutional arrangements exist, some people will be more powerful than others. The relevant issue is not what set of rules keeps people from having *any* control over others, but rather what institutions best limit the accumulation of power.

History is replete with examples of the misuse of coercive power in the hands of the state. One should therefore be suspicious of institutional arrangements that rely upon massive concentrations of power in the hands of the state, even though the explicit goal is to correct for injustices in the private economy. Societies without private property rights concentrate large amounts of power in the hands of a few, and that power traditionally has been badly abused.

A strong case can be made for an institutional order under which the state enforces clearly defined rules that keep people from imposing costs on others without their consent, but one in which the state is also limited in terms of the costs it can impose on individuals. A society where the government is responsible for defining and enforcing property rights, but where its role is also constitutionally limited, represents a viable combination. Such a system fragments power and restrains people from imposing costs on others without their consent.

Conclusion

A private-property, market system has much to recommend it. A system is more moral if it holds individuals accountable for their actions and encourages them to help others than if it allows them to impose costs on others without their consent.

This is not to argue that a market system can serve as a replacement for a society in which people act on the basis of moral conscience. Individual morality certainly will enhance capitalism, as it would any system. Honesty, compassion, and empathy make our world more livable whatever the institutional arrangement. Capitalism is not inimical to these qualities. When alternative economic systems are evaluated within a moral framework, sound reasons emerge for favoring private property rights and markets. Markets and morality can serve as useful complements in maintaining a just society. □

Taxation Versus Efficiency

by Richard Jones

Adam Smith appreciated specialization. In *The Wealth of Nations* he cited the example of pinmakers. By Smith's estimate an eighteenth-century pinmaker could produce, working by himself, fewer than 20 pins a day. However, by dividing the tasks involved in pinmaking, and with the aid of some specialized tools, 10 pinmakers could turn out 48,000 pins a day—or about 4,800 per worker.

In our day a skilled plumber can assemble pipes more efficiently than a carpenter. Not only does he have more experience at his job, he has specialized tools. By the same token a carpenter can frame a house more efficiently than a surgeon. And that surgeon can perform a heart bypass operation better than a mechanic. And the mechanic can . . . well, you get the idea. Specialization increases efficiency. Efficiency increases productivity. Productivity increases abundance.

All this should be obvious to anyone.

Well, almost anyone. It doesn't seem so obvious to those who tax us.

Consider an example. Bob the Baker wants to build a new house. His plans call for a relatively modest structure costing $60,000. Going by a rule of thumb, Bob knows that half of the $60,000 will go for materials, the other half for labor. The $30,000 for labor represents twelve months' work, say that of three framers for two months each, a cabinet maker for two months, a plumber for a month, an electrician for a month, a painter for a month, and a roofer/floor mechanic for a month. Twelve months of labor for $30,000.

Richard Jones is a winemaker/writer who built his own house in Sapello, New Mexico.

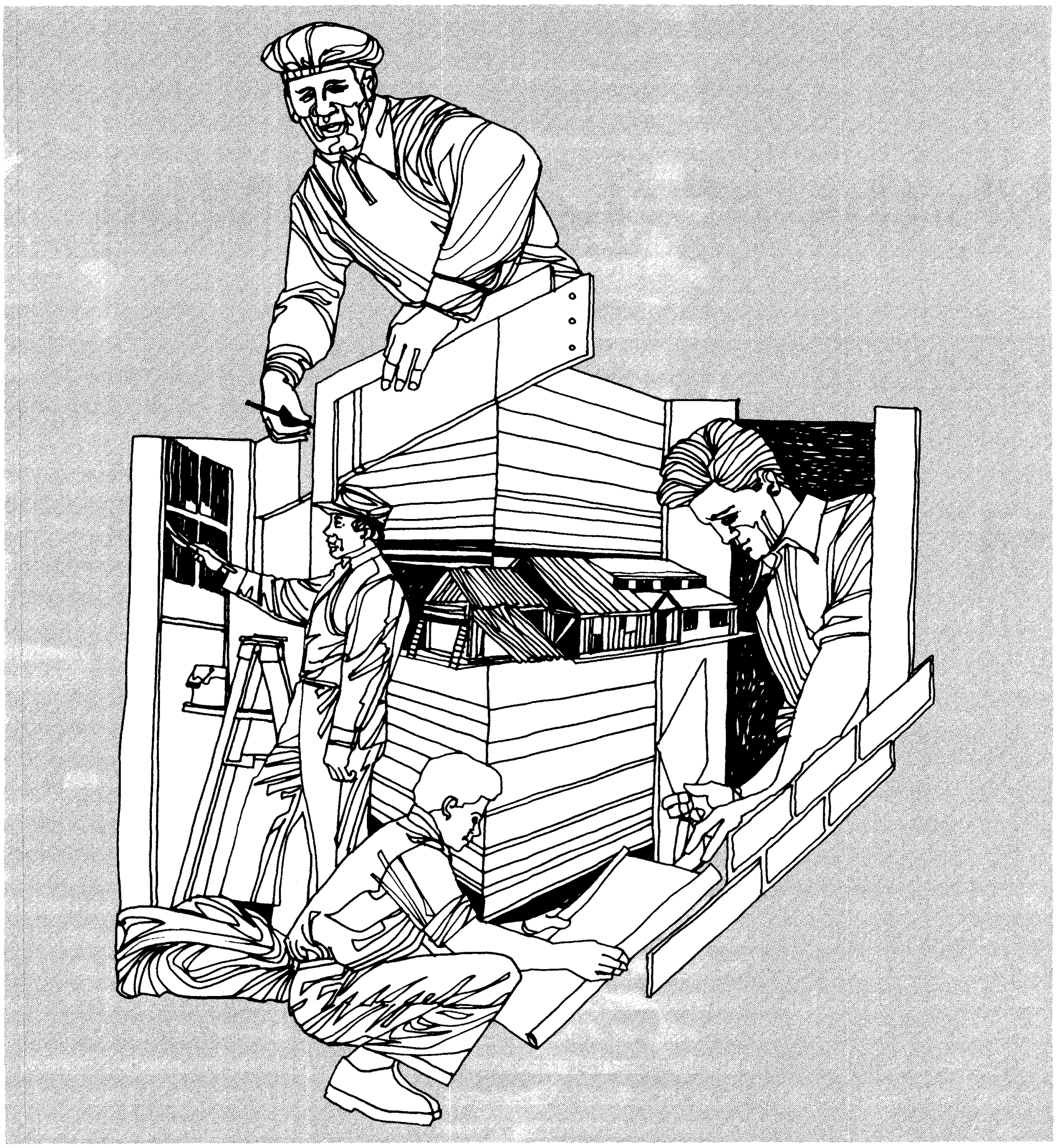
As a hard-working baker, Bob earns $30,000 a year. Over the past five years he has saved the $30,000 to pay for the materials. Now you would suppose that since he earns $30,000 a year, he can work a year, give the builders that $30,000 and have his new house paid for.

Right?

Wrong.

Of his $30,000, Bob must turn over approximately half to Federal, state, and local governments in direct and hidden taxes. He faces sales taxes, property taxes, excise taxes, Social Security taxes, amusement taxes, state and Federal (and perhaps even city) income taxes—indeed taxes on virtually anything you can think of. By the time Bob finishes paying his direct and indirect taxes he has about $15,000 of his $30,000 left. Consequently, after taxes it will take him *two* years, not one, working as a baker to pay the workmen to build his house.

But suppose Bob is pretty handy with tools. He has learned a little bit about carpentry, plumbing, and wiring. The roofing and flooring he can figure out when he gets there. By his estimate Bob can build the house by himself in 18 months. That's six months more than the combined labor of his specialists. Bob figures



that he can quit his job as a baker, spend 18 months building his house, then go back to work baking the last six months of the second year and come out $7,500 ahead (after paying $7,500 in taxes on his $15,000 income).

Bob stashes his bread pans and shuts down his ovens. He saws and nails and plumbs and wires for 18 months. His house is finished.

Compared to hiring specialists to do the work, Bob not only has his new house, but an extra $7,500, too. Everything's okay, right?

Well, it may be as far as Bob is concerned, but what about the economy as a whole? Eighteen months of work went into building a house which should have consumed only twelve months of labor. Six months of lost production means that fewer goods are produced. The economy suffers a net loss.

Whether taxation discourages the employment of carpenters or mechanics, of electricians or plumbers, the results will be the same. The more taxation discourages the advantages of specialization, the fewer goods will be produced. High taxes might appeal to some people, but they would seem plain foolish to the keen mind of Adam Smith. □

Myths of the Rich Man

by Joseph S. Fulda

When privatization is contemplated for such necessaries as potable water or the streets, the discussion is often clouded by fear of what "the rich man" who provides the resources might or might not do. The rich man might acquire all the drinking water and let no one else drink, or all the streets and let no one emerge from his house. Or the rich man might charge a small fortune for a glass of water or an afternoon walk on the streets, with none to stop him, since he is the owner. The rich man, it is further feared, might provide no water and build no streets. If the state does not provide for us by marketing these resources, perhaps no one will, and society will perish.

These fears are little more than myths. After all, there are plenty of other things we need—food, clothing, shelter—and yet none of the fears people have of the rich have materialized in any free market system. Economics teaches us why these fears are fallacious, and since they are nevertheless so prominent in discussions of privatization among the general public, it is well to review those teachings here.

Society is not at the mercy of the malevolent rich man controlling its necessities. A man who holds vast reservoirs of water or large parcels of land and makes no economic use of it out of spite (and it is fear of spitefulness that is behind this myth) will soon find the management costs of his properties causing him to lose all. The water will lose its potability, the pipes will become rusty, and the whole system will become worthless; the streets will fall into disrepair and require endless reconstruction. Certainly that is not how the rich man acquired his wealth!

But, still, what if? All that will happen is that large holdings of real estate will be converted to streets and reservoirs by others, rich or poor. As long as free entry—competition—is allowed, the rich man who has but will not market spites only himself and will lose his fortune. Someone else will see the need, convert his property to the now-more-marketable use and take the rich man's erstwhile profits away.

Nor can the rich man buy up all the streets or reservoirs and charge arbitrarily large sums for these necessaries. As he raises the price, conversion of other resources to these purposes becomes more attractive. Furthermore, substitutes, once far too expensive even to be contemplated let alone developed, begin to become attractive as well. All it takes is one person with a vision—be he rich or poor—and the consumer demand for a water-substitute or a street-substitute will be satisfied. As Julian Simon demonstrated in *The Ultimate Resource,* the human mind, throughout history, has been uniformly able to find alternatives which satisfy the very same need as some resource previously thought to be indispensable.

Finally, we must remark that the situation itself—a malevolent rich man monopolizing all but providing none, or providing only at impossibly steep prices—is most artificial. People are not like that. Besides, empirical studies have

Joseph S. Fulda is an assistant professor of biomathematical sciences at the Mt. Sinai School of Medicine and resides in Manhattan.

shown that as capitalist society progresses, the distribution of resources and funds for capital tends to become more diffuse and mobile. It is therefore doubtful on both psychological and economic grounds whether (without state grants of monopoly power or the equivalent) the scenarios that underlie the myths of the malevolent rich man could ever come to pass. But the freedom-lover may rest assured that even if such concentrations of wealth and malice somehow did befall society, all that would occur is adjustment—the redistribution and reallocation of natural resources, capital, labor, and entrepreneurial talent—nothing worse than a temporary inconvenience for the masses, coupled with special opportunities for those who would turn the situation to their advantage.

Nor does society, to consider the opposite fear, depend on the beneficence of the rich man to provide its necessities. Were none of the rich interested in providing water or streets, the poor aspiring to become rich would provide, although perhaps not in large quantities mediated through big corporations.

Perhaps water would be sold by local vendors. Perhaps streets would be owned by the homeowners and shopkeepers on the block, in small lots. Or perhaps workers would acquire streets in their neighborhood with their union pension funds, an investment linked to the general economic performance of the area, much like stocks or bonds. I repeatedly say "perhaps," for no one can know just how the market arrangements for, say, water and streets would work out.

But work out they would—the price system guarantees it. As water and streets become scarcer their prices will rise. As prices rise, the opportunities available for entrepreneurs will become increasingly irresistible. In a society with an economy in which everyone is free to take advantage of the available opportunities, one need not worry about the do-nothing rich any more than the spiteful rich.

Again, of course, the situation is artificial. Those with the most capital acquired their riches by taking advantage of opportunities, not by ignoring them. But even if somehow the rich will not provide, things will work out as new entrepreneurs replace the old rich and exercise their resolve to provide and thus be provided for. □

IDEAS ON LIBERTY

Promoting Competition

By competition, I refer to a situation that exists when the basic rules of the free society are observed — when everyone possesses the basic rights of private property and freedom of contract. Competition is not a mode of conduct that anyone has to promote institutionally. It develops naturally and necessarily among persons who are free to pursue their own interests. Whatever one's personal interest or objective may be — businessman, sculptor, or preacher — the consequence of pursuing it puts him in competition with all who share that objective. That being the case, preoccupation with promoting competition is at best a diversion of effort which could have been used to protect private property and freedom of contract.

—SYLVESTER PETRO

A REVIEWER'S NOTEBOOK

The Life of Herbert Hoover

by John Chamberlain

"Food will win the war." So we were told in 1917 by Herbert Hoover, who was just home after a three-year period of feeding Belgian and French civilians who were trapped in back of the contending Allied and German armies. Accordingly I signed up to work on a school farm in Windsor, Connecticut, where I did my bit by shingling a hen house roof and chopping stumps out of a field destined for corn. At the age of fourteen I was sure that Hoover was a man for the ages.

I was not so certain at a later age, when Hoover, as President, couldn't contend with what he called "the Mississippi Bubble of 1927-29." We forget that Hoover, in the White House, pioneered many of Franklin Roosevelt's New Deal devices. His Reconstruction Finance Corporation tried to save weak banks, his Federal Reserve Board bought millions of government notes in the open market, his Farm Board tried to prop up wheat prices. His excuse was that he had to compete with Europe in a world that had lost touch with Adam Smith. Roosevelt beat him at the polls in 1932, partly by a promise to balance the budget. Then Roosevelt proceeded to double Hoover's New Dealism in spades.

George H. Nash, the able historian of American conservatism, is doing a multi-volumed life of Hoover. He will be wrestling with the contradictory White House career of Hoover, the "chief," at some later date. We have already had a remarkable account from his pen of Hoover's pre-1914 days as a mining engineer all over the world, from the Australian "out back" to Burma, Siberia, and northern China at the time of the Boxer Rebellion. Hoover was a great competitor then. He made his million, dominating his ventures in silver and other metals from a London office, and was ready for public service when the outbreak of war came in August of 1914.

Nash's current installment of the Hoover saga is called *The Life of Herbert Hoover: The Humanitarian, 1914-1917* (New York: Norton, 497 pp., $25.00). It is a wonderfully researched story of a venture in practical benevolence that belies Hoover's outward demeanor of cold-hearted efficiency.

In the beginning, when he was setting up his CRB, or Commission for Relief in Belgium, Hoover was threatened with competition from the Rockefeller Foundation. The Swiss also had ideas of getting into the act. But Hoover insisted on a monopoly. He couldn't quite have it all his own way. The Spanish diplomat Villalobar and the Belgian banker Emile Francqui dogged him for three years. There had to be an agency inside Belgium to help distribute food in German-occupied territory. But by February of 1915 the British Admiralty and the Germans, with French concurrence, agreed that only a Hoover could properly coordinate tens of thousands of people on several continents in saving 9,000,000 Belgians and a much smaller number of Frenchmen from starvation.

The tens of thousands in the Hoover organization included volunteer fund-raisers in America, Australia, Canada, Great Britain, Italy, and Spain; farmers, bankers, accountants, shippers, and grain merchants in the U.S.; the crews and owners of dozens of cargo ships crossing the oceans to British ports and Rotterdam in Holland; diplomats in Madrid and Berlin and Le Havre; stevedores operating 600 tugs and barges along canals from Rotterdam into Belgium, where 40,000 volunteers stored the food in regional warehouses for distribution to hungry people in more than 2,500 communes.

Hoover, says Nash, appeared to sense the epic actualities of his endeavor as early as

March of 1915. To a Belgian priest he wrote: "To beg, borrow and buy nearly $1,800,000 worth of food every week; to ship it overseas from America, Australia, the Argentine and India; to traverse three belligerent lines; to transport it through a country with a wholly demoralized transportation service; to distribute it equitably to over 7,000,000 people; to see that it reaches the civilians only and that it is adapted to every condition from babyhood to old age . . . is a labour only rendered possible by the most steadfast teamwork on the part of all. . . . We are under daily zealous surveillance of all the governments involved; . . . we maintain an investigation department of our own . . . and we have the right to demand the absolute confidence and support of our fellow countrymen."

Hoover, if he had written to the Belgian priest again in 1917, would hardly have changed a word in his estimation of what he had done. But the difficulties of traversing belligerent lines were multiplied by the shifting attitude of the Germans in regard to submarine warfare. The sinking of the *Lusitania,* and the turn to unrestricted attacks on all shipping into British, Dutch, and French ports, forced Hoover to fight the Germans to obtain respect for the symbol CRB on the sides of his ships. The matter was never really settled.

Hoover's blunt ways of operating did not sit well with Brand Whitlock, the American ambassador to Belgium. Whitlock understood Hoover's virtues, but couldn't regard the eternal squabbling with Francqui over jurisdiction inside of Belgium with equanimity. He came almost literally to dislike Hoover. For his part, Hoover thought Whitlock was something of a weakling. He would have called him a wimp if he had known the word.

Hoover had to get along with the French and British governments to get regular subsidies for his "practical institution." But, although he aspired to play a big part in the Wilson administration once we were in the war, he regarded most governments as obstacles to be shunted aside. His way of dealing with governments involved him in undercover operations to plant stories in the press of two continents. He was a master of what we would now call media subversion. He ghostwrote articles for Ambassador to Britain Walter Hines Page and for others in embassy headquarters; he "edited" materials for the Associated Press. With him, freedom of the press was freedom to manipulate the press.

He did not butter up the young men who worked selflessly for him. The most he would say was a cool "well done." But his youthful supporters loved him for his assumption that good men should make correct decisions as a matter of course.

The British had always to be reassured that the Germans weren't stealing neutral-intended food from the regional warehouses. There were "angry egos" involved in the disputes about possible thefts. The relief of Belgium depended on German forbearance. This forbearance was never total, but what there was of it sufficed.

Hoover's one great disappointment was the behavior of his good friend Lindon Bates, head of the New York office. Bates feared Hoover was guilty of infringing the Logan Act and making foreign policy. No doubt he was. But 9,000,000 people remained alive. □

EQUITY AND GENDER
by Ellen Frankel Paul

Transaction Books, Rutgers University, New Brunswick, NJ 08903 • 1988 • 192 pages • $24.95 cloth, $12.95 paper

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Reviewed by Clint Bolick

Ellen Frankel Paul's new book may be greeted with skepticism: Why do we need another book on "comparable worth," when that theory is deader than a doornail?

The answer is simple: rumors of comparable worth's well-deserved demise are greatly exaggerated. Though presently discredited as a viable discrimination theory in Federal litigation, comparable worth is very much alive in state legislatures and in the hearts and minds of radical feminist groups and their allies.

As Paul notes, ten states have implemented the results of comparable worth studies, and 20 have commissioned studies. Some states are considering proposals to extend comparable worth to the private sector. And Congress is considering imposing comparable worth at the

Federal level, at a potential cost of billions of dollars. In a new administration, comparable worth advocates may gain even greater momentum.

Of course, it's not called "comparable worth" anymore, but rather the more benign-sounding "pay equity." But scratch the veneer of pay equity and the same old beast emerges: a concept that, as Paul describes it, would destroy "the very foundation of our market-based economic system."

Paul, who is affiliated with the Social Philosophy and Policy Center at Bowling Green State University, has a superb ability both to take complex issues and translate them into English, and to take simplistic rhetoric and explain its serious ramifications. Since comparable worth is at once both deceptively simple and enormously complex, *Equity and Gender* provides a vital tool with which to effectively defend the market.

Paul begins with a dispassionate and comprehensive review of the arguments in favor of comparable worth. She observes at the outset that " '[e]qual pay for equal work' is not the objective of the comparable worth advocates, for that standard has been the law of the land since 1963." Rather, they believe the market "is corrupted by discrimination, for nothing else can sufficiently explain discrepancies between women's wages and men's."

This discriminating "wage gap" can be redressed, the theory holds, by a scientific assessment of the objective worth of jobs to employers, to which salaries would be calibrated. Thus, Paul explains, "comparable worth provides the hope of a quick and easy fix for the injustices foisted upon women by the marketplace."

Paul then presents the arguments of comparable worth opponents, which she observes are primarily economic. The wage gap, they argue, is created by the combined impact of women's job choices, expanding work-force options for women, and entry by women into the labor market in growing numbers. And, they add, the wage gap is diminishing as women gain more experience and enter traditionally male jobs. Moreover, they argue that comparable worth would be enormously expensive to implement, thereby reducing America's ability to compete.

Paul then turns to the progress of comparable worth in the courts and legislatures, and finds that while comparable worth has been dealt serious setbacks in the courts, it is winning the day in the legislative arena. The bulk of the book thus comprises a useful summary of the arguments pro and con and the future prospects for comparable worth.

Paul concludes with her own views on the issue, and comes down solidly in favor of the market as the arbiter of salaries. Jobs do not have inherent value apart from the market, she argues. She concludes that comparable worth "depend[s] upon some rather dubious assumptions" and "embrace[s] a view that is at odds with our American tradition, [is] unpersuasive as an ideal, and incapable of being put into practice without chaotic results."

But the bottom line for Paul is that comparable worth destroys the freedom of choice that the market provides. She observes that the "women's movement in the late 1960s and 70s emphasized women's capacity, women's ability to perform jobs traditionally monopolized by men. Comparable worth sets a different agenda, portraying women in an unflattering light that enshrines their incapacity. Instead of encouraging women to engage in new ventures, it concedes that they will be secretaries, nurses, and teachers for a long time to come and only asks that they be paid more."

Nonetheless, Paul does not claim the moral high ground for adversaries of comparable worth. At the outset, Paul agrees with comparable worth proponents that ultimately "justice and equity must triumph over efficiency." But she fails to make the point strongly enough that in bargaining over wages, these values go hand in hand. While Paul seems to acknowledge that purely utilitarian arguments are inadequate to resist comparable worth, she does not present a compelling moral argument in favor of the market.

What defenders of the market must do is to expose comparable worth as a paternalistic theory that assumes women are incapable of succeeding on the level playing field guaranteed by the present anti-discrimination laws. They must also show it to be an elitist concept, denigrating the value of blue-collar jobs. And they must raise the Orwellian specter of a commission of "experts" determining wages in some mystical fashion and supplanting the will of individuals. Paul makes these points, but not graphically enough to recapture the terms of the debate.

These were the points I attempted to illustrate when I represented several female prison guards in opposing the American Nurses Association's unsuccessful comparable worth lawsuit against the State of Illinois in 1984-85. My clients were women who defied societal stereotypes and took on dangerous and unpleasant jobs in order to earn higher wages—only to have a board of experts conclude that entry-level secretaries were "worth" more than prison guards. Such a notion falls under the weight of its own absurdity.

Tactics like these betray comparable worth as not a "women's" issue at all, but as an issue of government control versus individual autonomy. The dignity and freedom of women requires the demise of comparable worth. Paul's book, thankfully, provides a wealth of ammunition to hasten that demise. □

(Clint Bolick is director of the Landmark Legal Foundation Center for Civil Rights in Washington, and author of Changing Course: Civil Rights at the Crossroads *[New Brunswick, NJ: Transaction Books, 1988].)*

THE THEORY OF FREE BANKING: MONEY SUPPLY UNDER COMPETITIVE NOTE ISSUE

by George A. Selgin

Rowman & Littlefield, 81 Adams Drive, Totowa, New Jersey 07512 • 1988 • 218 pages • $33.50 cloth

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Reviewed by Matthew B. Kibbe

Banks are in trouble. But an even greater crisis lurks beneath the political surface, on the university blackboards, and in the principles texts and academic journals. Consider the following argument, made recently by David Warsh in the May-June 1988 issue of the *Harvard Business Review:* "Money is funny stuff. Like language, it has meaning only insofar as people agree to share it. Unlike language, however, it requires supervision."

Here we have the "conventional wisdom," accepted by virtually every politician and the vast majority of professional economists. Money is different. Money cannot manage itself. End of story.

Enter, or should I say "re-enter," the Austrians. Standing firmly on the intellectual shoulders of Carl Menger, Ludwig von Mises, and F. A. Hayek, George Selgin has boldly challenged the status quo in monetary theory. In his recently published book, *The Theory of Free Banking,* Professor Selgin argues that money will, and *must,* manage itself.

Ever since Menger, the founder of the Austrian school, wrote his *Principles* in 1871, Austrian economists have been highly critical of government involvement in the business of money and banking. In Menger's view, money cannot be arbitrarily created by legislative fiat precisely because it came into being as the unintended consequence of individuals seeking to better satisfy their wants. Money, to be accepted widely, must be the product of voluntary exchange.

Ludwig von Mises refined and extended Menger's monetary theory in *The Theory of Money and Credit,* published in 1912. Employing his famous "regression theorem," Mises demonstrated that the value of money also evolves through a historical process of human interaction. According to Mises, the value of money today is linked to the "price" of money yesterday, and the expected value of money tomorrow will be based on the "price" of money today. When left alone by government, the value of money is both dynamic (responsive to ever-changing economic conditions) and stable (linked with the remembered past and an imagined future).

Because of its historical continuity, money provides a reliable "unit" for economic calculation, the means by which the millions of individuals within a society are able to coordinate their activities. This theoretical understanding of the nature of money provided the Austrians with a devastating critique of planning in general and of central banking in particular.

Unfortunately, this rich tradition in monetary theory was all but forgotten in the turmoil of the Keynesian revolution. Divorced from the plans and purposes of individuals, monetary theory was pushed deeper and deeper into the mystical world of Keynesian "macro-economics." The intentions of individuals were replaced with functional relationships between imaginary aggregates—equations to be manipulated by government officials to serve government ends.

The appearance of *The Theory of Free Banking* signals a well-written, well-organized shift in intellectual currents. Professor Selgin's book will shock some. I am delighted.

Soon after opening the book, the reader will notice the quick precision of Selgin's prose. After a brief overview of a number of historical episodes of free banking, Selgin moves directly into a theoretical discussion of the evolution of money and banking. Here, Menger's influence is strong and obvious.

The second part of the book develops the notion of "monetary equilibrium," borrowed from economists such as J. G. Koopmans, Gottfried Haberler, Fritz Machlup, and Dennis Robertson. This is the idea that there is both a demand for and a supply of bank notes which must continually adjust toward a coordinated equilibrium.

Selgin fuses the theory of monetary equilibrium with the Austrian critique of central banking as developed by Mises and Hayek. Central banking, they argued, is neither responsive nor stable. Besides the obvious political incentives which discourage sound money management within a central banking system, central bankers simply cannot obtain the *relevant knowledge* required to match the supply of money with money demand.

Only market competition and competitive note issue, Selgin concludes, provide both the incentives and information necessary to maintain monetary equilibrium. Free banking is the only monetary system that can properly adjust to changes in the market demand for bank notes without flooding the market with unneeded, unbacked paper currency. Selgin reminds us that fractional banking, when disciplined by free competition, provides an altogether superior alternative to centralized control and supervision.

While Mises might have objected to the use of such a mechanical metaphor, the insight of "monetary equilibrium" is clearly consistent with the Austrian understanding of money—even more so than Selgin is willing to admit. In *The Theory of Money and Credit,* Mises defined inflation as "an increase in the quantity of money . . . that is not offset by a corresponding increase in the need for money. . . ." Furthermore, "deflation . . . signifies a diminution of the quantity of money . . . which is not offset by a corresponding diminution of the demand for money. . . ."

The difference between Selgin and Mises appears to be one of emphasis. We can quibble over the proper interpretation of Mises on this point, but the fact remains that the real-world problem confronting Mises during the years he wrote was the rampant inflation generated by the central banks of both Europe and the United States. Naturally, Mises emphasized the distortive effects of an over-supply of money. But he also saw the solution, arguing in 1949 in *Human Action* that "free banking is the only method available for the prevention of the dangers inherent in credit expansion." According to Mises, there was "no reason whatever to abandon the principle of free enterprise in the field of banking."

Either way, the importance of Selgin's contribution should not be underrated. Mises did, in fact, tend to neglect the importance of "the demand side" of money. With the publication of *The Theory of Free Banking,* Selgin joins a small but growing number of economists who seek to revive and extend the forgotten Austrian tradition of free banking. I am thinking also of F. A. Hayek (*Denationalization of Money*), Hans Sennholz (*Money and Freedom*), and Lawrence White (*Free Banking in Britain*). With books such as Selgin's, there is hope for the future of ideas and our banking system. □

(Matthew Kibbe is a doctoral student in economics at George Mason University and a fellow at the Center for the Study of Market Processes.)