THE FREEMAN

IDEAS ON LIBERTY

CONTENTS
APRIL
1989
VOL. 39
NO. 4

THE FREEMAN
IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533

The Freeman is the monthly publication of The Foundation for Economic Education, Inc., Irvington-on-Hudson, NY 10533 (914) 591-7230. FEE, founded in 1946 by Leonard E. Read, is a nonpolitical educational champion of private property, the free market, and limited government. FEE is classified as a 26 USC 501 (c) (3) tax-exempt organization. Other officers of FEE's Board of Trustees are: Thomas C. Stevens, chairman; Ridgway K. Foley, Jr., vice-chairman; Paul L. Poirot, secretary; H.F. Langenberg, treasurer.

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Bound volumes of *The Freeman* are available from The Foundation for calendar years 1969 to date. Earlier volumes as well as current issues are available on microfilm from University Microfilms, 300 North Zeeb Road, Ann Arbor, MI 48106.

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PERSPECTIVE

Look Around

Look around the world today and ask: where are the victories against poverty most dramatic? Where is the race to the future being won? Where is peace most secure?

Again and again, the answer can be found in that small group of nations where men and women have freedom: freedom to pray and to speak, freedom to vote, assemble and dissent, and freedom to seek their fortune without fear or without favor, and where freedom is coupled with moral responsibility: responsibility to one's community, responsibility to one's countrymen, and ultimately and inescapably responsibility to the God who rules us all. For the abiding hope and the unlimited possibilities of freedom rest in the strength of freedom's moral foundations as well as in that crucial link between our economic and our personal and political freedom.

—William E. Simon
Speaking at Templeton College, Oxford

Protecting the Irresponsible

Most people agree that government should punish irresponsible conduct which infringes, in a direct way, on the rights of others. Thus, there is common agreement on the legitimacy of laws against such conduct as murder, assault, rape, and theft.

However, there is also a wide range of conduct which many people consider irresponsible but which does not directly impact against others. Examples include the denying of God, refusing to care for others, viewing pornography, listening to rock and roll, believing in communism, ingesting drugs, and attempting suicide.

Should government punish individuals for pursuing actions which are harmful only to themselves? The answer is unequivocally *no*! Individuals have the absolute right to engage in this type of conduct and it is the sovereign duty of government to protect the exercise of this right.

The essence of freedom is the right to choose between alternative courses of action. If an individual is not permitted to choose an irresponsible course of action that harms only himself, then he cannot truly be considered free. Does this mean that advocates of liberty necessarily approve of the choices which others make with respect to their own lives? Of course not. But we view liberty as so crucially important to human life that we are willing not only to tolerate these choices but also to affirm the right of others to make them.

Why is freedom of choice so vitally important? There are three reasons. First, freedom of choice is a God-given right and, therefore, cannot legitimately be taken away by man. God wants us to choose good over bad, and virtue over vice, but under no circumstances does He force us to do so. He leaves us free to choose our own way, recognizing that each individual must ultimately bear the consequences of his own choices. Since God permits man to sin against himself, government has no legitimate authority to prevent him from doing so.

Second, freedom of choice is necessary for individual growth. In order to improve and perfect himself, an individual must be provided the widest possible latitude to choose between good and evil. The ultimate conquest over self can take place only through a continuous process of choosing between good and bad, moral and immoral. It is this process of choosing that enables an individual to move forward in his aim of constantly refining himself.

Third, freedom of choice makes the pursuit of correct conduct meaningful. If a person is coerced into doing good, or prevented from doing bad, then his actions mean nothing. It is only when the individual voluntarily and deliberately pursues good for its own sake, rather than as a result of coercion or manipulation, that his conduct has positive meaning for both himself and his God.

The true test of a free society, then, is the extent to which laws protect, rather than punish, the pursuit of irresponsible conduct which does not directly harm others. Not only is freedom of choice a divine right, it is the only method for individuals to reform themselves in meaningful ways.

—JACOB G. HORNBERGER

Where Your Mail Went

The Postal Service may soon have to file environmental impact statements for all the mail it is dumping in America's trash boxes and dumpsters. For example, a Rhode Island carrier was arrested after 94,000 letters were found buried in his backyard. A 1987 survey by Doubleday and Company found that up to 14 percent of bulk business mail was either thrown away or lost. One Arlington, Virginia, postal clerk told a customer, "We don't have room for the junk mail—so we've been throwing it out." In 1987, 1,315 postal workers were fired for theft and/or mistreatment of mail. A Postal Inspection Service audit found properly addressed mail dumped in the trash at 76 percent of the post offices it visited. A survey by Doubleday found that up to 14 percent of properly addressed third-class mail vanished in the postal labyrinth. The throwing away of mail has become so pervasive that postal inspectors have notified employees that it is bad for the Postal Service's business.

—JAMES BOVARD
"The Slow Death of the U.S. Postal Service," published by the Cato Institute

Regulatory Chaos

At first blush, the regulatory system seems reasonably orderly. Administrative agencies provide oversight before products go on the market, while the courts supervise matters farther down the line. But the structure beneath is much more chaotic. The hierarchy of regulatory powers is so fragmented that the system can never say "yes," only "maybe." One agency's approval may be trumped by a second's disapproval. Approvals by two agencies may be refuted shortly afterward by a federal court. And approvals of all three may be rejected by a liability court following an accident decades later. . . .

Any endeavor can tolerate only so much uncertainty. Compounding scientific doubt with unnecessary layers of regulatory unknowns will sink many undertakings regardless of their scientific and economic merits.

—PETER HUBER, writing in
Technology Review

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The Real Meaning of Tax Loopholes

by James L. Payne

Tax loopholes are one of the great mysteries of modern politics. They are wrong, everyone seems to say, and crusades are mounted against them time and again. Yet the evil never gets stamped out, for loopholes keep creeping back into the tax code. What causes this curious inconsistency?

The root of the problem is a misunderstanding about taxpayers. At first glance, taxpayers seem to be selfish individuals who spend their income on their own pleasures. Being preoccupied with their private needs, they ignore the needs of the community. Therefore, government is brought in to reflect those needs. It takes away some of the citizen's money in taxes and spends it on worthy public purposes.

This all seems logical until you notice one thing: it is based on a distinction between personal and public spending that is largely fictitious, especially today. In the past, when most public spending funded truly public goods like police protection and the judicial system, there was some validity in saying that taxes supported community functions not funded privately. But today, most government spending goes for private goods—things citizens can and do buy for themselves. In other words, government wants for us what we already want for ourselves.

James L. Payne is a political scientist specializing in Congress and economic policy. His latest book, The Culture of Spending, *sponsored by the Cato Institute, examines congressional confusions about the budget.*

Take housing. The need for a nice home is a personal desire. Yet nice homes for people are also a social good. Hence politicians have set up numerous subsidy programs to help people get decent housing, from government-backed loans to public housing projects.

It's the same with most other spending programs. Citizen desires for education, opera tickets, quality medical care, or comfortable retirement are private needs. But from the public (governmental) point of view, it is also good for citizens to have these things. Hence the government has programs to purchase them: loan programs to pay for college, subsidies for the arts, payments for medical care, and government retirement programs.

In the business world, we see the same overlap between public and private spending. Take research and development. Companies want to discover new products for a self-oriented reason—to improve sales and profits. But the development of new products is also a public good, since these mean more jobs, more exports, and benefits to consumers. Hence, government has programs to subsidize private corporate research.

Normally, legislators miss the connection between private and public spending. They take money from people who would have purchased housing, and (after losses in the taxing and spending process) give it back to people who want housing. They take funds from college-

Every so often, politicians notice that people are privately spending money on exactly the same thing that the politicians want them to have. Then they create a tax loophole.

bound students and their parents, and (again, with waste) funnel it back to them in loan programs and other subsidies. They take money from firms that would have used it for research, and (again, minus overhead costs) channel it back to research through government grants and subsidies.

Every so often, however, politicians notice that people are privately spending money on exactly the same thing that the politicians want them to have. Then they create a tax loophole, now called by its prettier name, a "tax deduction." They declare that the income spent on the worthy purpose is exempt from taxation. The money you put aside for your retirement—a worthy purpose—is exempt from taxation. The money you donate to charity—a worthy purpose—is exempt from taxation. The money you spend on home ownership (interest) is exempt from taxation. The money a business spends on research is exempt from taxation.

This is not to say that the deductions are always taken in the spirit intended. This is where the negative connotation of "loophole" comes in. As happens with any government regulation, some people extend the interpretation of the law. They get the lower taxes without really doing the socially desired thing. For example, a company might send its scientists for a vacation in Hawaii, calling it a "research conference" in order to take the research tax deduction. As Congress finds out about such abuses, it moves to abolish the deduction. But then it hears about the useful, non-abusive spending of the same kind, and moves to re-establish the deduction. And so we go round and round.

How can we promote socially useful private spending without adding a lot of red tape? The solution is so simple most politicians rush right past it: cut government spending. Stop trying to give people things through government programs that they can buy for themselves. With less spending you can have lower taxes, and people will have the money to buy them! ☐

The Invisible Hand at Work

by Jane S. Shaw

A friend of mine recently received an inheritance that appeared large enough to let her quit work. She was then employed as a part-time English teacher and wanted to spend more time with her 11-year-old daughter and pursue intellectual interests such as history and German literature.

My friend, whom I'll call Ellen, is a gentle person who lives simply, loves humanity, and has a great interest in culture. The last thing she would ever think of is hurting people or depriving them of something valued. Yet she was about to deprive students of an excellent teacher.

In considering whether to continue teaching or not, Ellen looked at her job—as most of us do—in terms of what it did for her. Did it pay well? Did it provide meaning in her life? Was it emotionally rewarding or mostly tedious? Much lower on the list, or completely forgotten in the calculation, was whether or not her students might lose a good teacher.

Most jobs exist because they provide a product or service that someone wants. Yet, like Ellen, we rarely think about them this way.

We read "how to" books that tell us how to improve job satisfaction through higher pay and better relationships with the boss. We never read about how our job benefits our customers.

In the press, it's the jobholder, not the customer, who gets our attention. High unemployment dismays us because it means people are left without jobs and income—rather than because people lose the opportunity to buy goods or services, even though their losses, too, may be substantial.

Jane S. Shaw is a Senior Associate of the Political Economy Research Center in Bozeman, Montana.

Our focus on the jobholder is so intense that we tend to suppose that those who work with little or no pay, such as Peace Corps volunteers, are doing more for society than, say, Sears Roebuck & Co. employees in the same country. Yet however admirable it may be, personal sacrifice doesn't make a person more effective.

Our emphasis on job satisfaction is really an example of Adam Smith's "invisible hand" at work. By pursuing our own desires we inadvertently satisfy those of others. That is because the only way we can earn income is by providing what other people want. Their wishes create our jobs.

So, paradoxically, a hardhearted and selfish entrepreneur who builds a great business selling clothes or canning soup may improve the lives of millions of people while a Peace Corps volunteer may help only a few. This entrepreneur may care nothing personally about his customers, and his character may not deserve our praise, but in order to succeed he has to consider what other people want—convenience, economy, good taste, for example,—and provide it at a reasonable cost.

It is sad but indisputable that without this desire for material gain, most people would be unlikely to give as careful consideration to the desires of others. Even tender-hearted Ellen weighed income and job satisfaction against the trial and tribulation of teaching high school students. What made her different was that her desire for material gain was so very modest. Yet by wanting little, she gave little as well.

If income meant more to Ellen—if she were more greedy—she would have tailored her talents to provide services that people want. Ironically, without such greed and with a little income, she could pretty much do what she pleased.

In the end, it didn't turn out that way. Ellen soon found that the property she had inherited doesn't provide enough income for her to live comfortably. So, she is back at work again, this time teaching German to college students, and she is earning extra income working at a retail store. I don't think she realizes it, but her need for income has had a positive result—it has led her to help others. □

The Tide in the Affairs of Men

by Milton Friedman and Rose D. Friedman

There is a tide in the affairs of men,
Which, taken at the flood, leads on to fortune;
Omitted, all the voyage of their life
Is bound in shallows and in miseries.
SHAKESPEARE, *Julius Caesar*

Shakespeare's image is an apt text for our essay. There are powerful tides in the affairs of men, interpreted as the collective entity we call society, just as in the affairs of individuals. The tides in the affairs of society are slow to become apparent, as one tide begins to overrun its predecessor. Each tide lasts a long time—decades, not hours—once it begins to flood and leaves its mark on its successor even after it recedes.

How tides begin in the minds of men, spread to the conduct of public policy, often generate their own reversal, and are succeeded by another tide—all this is a vast topic insufficiently explored by historians, economists, and other social scientists.[1]

The aim of this brief essay is modest: to present a hypothesis that has become increasingly plausible to us over the years, to illustrate it with experience over the past three centuries, and to discuss some of its implications. The hypothesis is that a major change in social and economic policy is preceded by a shift in the climate of intellectual *opinion,* itself generated, at least in part, by contemporaneous social, political, and economic circumstances. This shift may begin in one country but, if it proves lasting, ultimately spreads worldwide. At first it will have little effect on social and economic policy. After a lag, sometimes of decades, an intellectual tide "taken at its flood" will spread at first gradually, then more rapidly, to the public at large and through the public's pressure on government will affect the course of economic, social, and political policy. As the tide in *events* reaches its flood, the intellectual tide starts to ebb, offset by what A. V. Dicey calls counter-currents of opinion. The counter-currents typically represent a reaction to the practical consequences attributed to the earlier intellectual tide. Promise tends to be utopian. Performance never is and therefore disappoints. The initial protagonists of the intellectual tide die out and the intellectual quality of their followers and

Milton Friedman and Rose D. Friedman, both economists, are the authors of Capitalism and Freedom *and* Free to Choose. *Milton Friedman, recipient of the Nobel prize for economics in 1976, is senior research fellow at the Hoover Institution and Paul Snowden Russell Distinguished Service Professor of Economics, Emeritus, at the University of Chicago.*

This essay originally appeared as a chapter in Thinking About America: The United States in the 1990s, *edited by Annelise Anderson and Dennis L. Bark. It is reprinted here with permission of the publishers, Hoover Institution Press, Stanford, California.*

supporters inevitably declines. It takes intellectual independence and courage to start a counter-current to dominant opinion. It takes far less of either to climb on a bandwagon. The venturesome, independent, and courageous young seek new fields to conquer and that calls for exploring the new and untried. The counter-currents that gather force set in motion the next tidal wave, and the process is repeated.

Needless to say, this sketch is oversimplified and excessively formalized. In particular it omits any discussion of the subtle mutual interaction between intellectual opinion, public opinion, and the course of events. Gradual changes in policy and institutional arrangements are always going on. Major changes seldom occur, however, except at times of crisis, when, to use Richard Weaver's evocative phrase, "ideas have consequences." The intellectual tide is spread to the public by all manner of intellectual retailers—teachers and preachers, journalists in print and on television, pundits and politicians. The public begins to react to the crisis according to the options that intellectuals have explored, options that effectively limit the alternatives open to the powers that be. In almost every tide a crisis can be identified as the catalyst for a major change in the direction of policy.

We shall illustrate the relevance of our hypothesis with the two latest completed tides as well as the tide that, as we put it in the title of the final chapter of *Free to Choose,* is turning.[2]

The Rise of Laissez-Faire: The Adam Smith Tide

The first tide we discuss begins in the eighteenth century in Scotland with a reaction against mercantilism expressed in the writings of David Hume, Adam Smith's *Theory of Moral Sentiments* (1759), and above all Smith's *The Wealth of Nations* (1776).

The Wealth of Nations is widely and correctly regarded as the foundation stone of modern scientific economics. Its normative thrust and its influence on the wider intellectual world are of greater interest for our present purpose. Its rapid success in influencing the intellectual community doubtless reflected the seeds planted by Hume and others—the intellectual counter-currents to the mercantilist tide—as well as the early stages of the Industrial Revolution.

On the other side of the Atlantic 1776 also saw the proclamation of the Declaration of Independence—in many ways the political twin of Smith's economics. Smith's work quickly became common currency to the Founding Fathers. Alexander Hamilton documented that phenomenon in a backhanded way in his 1791 *Report on Manufactures.* He quoted Smith extensively and praised him profusely while at the same time devoting the substance of his report to arguing that Smith's doctrines did not apply to the United States, which needed not free international trade but the protection of infant industries by tariffs—an example of the homage that vice, even intellectual vice, pays to virtue.

Smith had no illusions about the impact of his intellectual ideas on public policy: "To expect that the freedom of trade should ever be entirely restored in Great Britain, is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals, irresistibly oppose it."[3]

His prediction proved false. By the early nineteenth century the ideas of laissez-faire, of the operation of the invisible hand, of the undesirability of government intervention into economic matters, had swept first the intellectual world and then public policy. Bentham, Ricardo, James Mill, and John Stuart Mill were actively engaged in spreading these ideas and promoting them politically. Maria Edgeworth was writing novels based on Ricardian economics. Cobden and Bright were campaigning for the repeal of the corn laws. Reinforced by pressures arising out of the Industrial Revolution, these ideas were beginning to affect public policy, though the process was delayed by the Napoleonic Wars with the accompanying high government spending and restrictions on international trade. Yet the wars also furnished the needed catalytic crisis.

The repeal of the corn laws in 1846 is generally regarded as the final triumph of Smith after a 70-year delay. In fact some reductions in trade barriers had started much earlier, and many nonagricultural items continued to be pro-

HOOVER INSTITUTION

Rose and Milton Friedman

tected by tariffs until 1874. Thereafter only revenue tariffs remained on such items as spirits, wine, beer, and tobacco, countervailed by excise duties on competing domestic products. So it took nearly a century for the completing of one response to Adam Smith.

U.S. Experience

The other countries of Europe and the United States did not follow the British lead by establishing complete free trade in goods. During most of the nineteenth century, however, U.S. duties on imports were primarily for revenue, though protection did play a significant role, as rancorous political debates, particularly between the North and the South, testify. Except for a few years after the War of 1812, customs provided between 90 and 100 percent of total Federal revenues up to the Civil War. And except for a few years during and after that war, customs provided half or more of Federal revenues until the Spanish-American War at the end of the century.

Nontariff barriers such as quotas were nonexistent. Movement of people and capital was hardly impeded at all. The United States in particular had completely free immigration. In Europe before World War I "the inhabitant of London," in John Maynard Keynes's eloquent words, "could secure . . . cheap and comfortable means of transit to any country or climate without passport or other formality . . . and could . . . proceed abroad to foreign quarters, without knowledge of the religion, language, or customs . . . and would consider himself greatly aggrieved and much surprised at the least interference."[4]

Hamilton's success in achieving protectionist legislation in the United States reflects the absence of effective ideological commitment by policy makers to avoiding intervention by government into economic activity, despite the intellectual tide set in motion by Adam Smith, the French physiocrats, and their later followers. However, strong belief in states' rights meant that states, not the federal government, played the major role. Many states established state banks, built canals, and engaged in other commercial enterprises. The catalytic crisis that produced a drastic change was the panic of 1837, in the course of which many, perhaps most, government enterprises went bankrupt. That panic served the same role in discrediting government enterprise as the Great Depression did nearly a century later in discrediting private enterprise.

In the aftermath the ideas of Adam Smith offered both an explanation and an obvious alternative option; tariffs aside, near complete laissez-faire and nonintervention reigned into the next century.

Measuring the role of government in the economy is not easy. One readily available, though admittedly imperfect, measure is the ratio of government spending to national income. At the height of laissez-faire, peacetime government spending was less than 10 percent of national income in both the United States and Great Britain. Two-thirds of U.S. spending was by state and local governments, with about half for education; Federal spending was generally less than 3 percent of national income, with half of that for the military.

A striking example of the worldwide impact of the Adam Smith tide—this time in practice, not in ideas—is provided by post-Meiji Japan. For centuries prior to the Meiji Restoration in 1867, Japan had been almost completely isolated from the Western world. The new rulers had no ideological understanding, let alone commitment, to laissez-faire. On the contrary, they attached little value to individual freedom, either political or economic. Their overriding objective was simply to strengthen the power and glory of their country. Nevertheless, when the Meiji rulers burst into a Western world in which laissez-faire Britain was the dominant economy, they simply took for granted that Britain's policy was the one to emulate. They did not by any means extend complete economic and political freedom to their citizens, but they did go a long way, with dramatic and highly favorable results.[5]

The absence of a widespread ideological underpinning for these policies helps explain their lack of robustness. After World War I Japan succumbed to centralized control by a military dictatorship—a policy that led to economic stagnation, military adventurism, and finally Japan's entry into World War II on the side of the Nazis.

On the broader scale the tide that swept the nineteenth century brought greater political as well as economic freedom: widening rights and a higher standard of living for individuals accompanied increased international trade and human contact. It was heralded as a century of peace—but that is somewhat overstated. The tide did not prevent the U.S. Civil War, the Crimean War, the Franco-Prussian War, or other local conflicts. But there was no major widespread conflict between 1815 and 1914 comparable either to the Napoleonic Wars of the preceding years or to the world wars of the later years.

Despite occasional financial panics and crises, Britain and the United States experienced remarkable economic growth during the nineteenth century. The United States in particular became a mecca for the poor of all lands. All this was associated with—and many, including us, would say it was a result of—the increasing adoption of laissez-faire as the guiding principle of government policy.

The Rise of the Welfare State: The Fabian Tide

This remarkable progress did not prevent the intellectual tide from turning away from individualism and toward collectivism. Indeed, it doubtless contributed to that result. According to Dicey, "from 1848 onwards an alteration becomes perceptible in the intellectual and moral atmosphere of England."[6] The flood stage, when collectivism began to dominate intellectual opinion, came some decades later. The founding of the Fabian Society, dedicated to the gradual establishment of socialism, by George Bernard Shaw, Sidney Webb, and others in 1883 is perhaps as good a dividing date as any for Britain. A comparable date for the United States is 1885, when the American Economic Association was founded by a group of young economists who had returned from study in Germany imbued with socialist ideas, which they hoped to spread through the association—a hope that was largely frustrated when the association shortly adopted a policy of "nonpartisanship and avoidance of official commitments on practical economic questions and political issues."[7] Confirming evidence is provided by the publication in 1888 of Edward Bellamy's socialist utopian romance, *Looking Backwards,* which sold over a million copies.

How can we explain this shift in the intellectual tide when the growing pains of laissez-faire policies had long been overcome and impressive positive gains had been achieved? Dicey gives one indirect answer:

> The beneficial effect of State intervention, especially in the form of legislation, is direct, immediate, and so to speak, visible, whilst its evil effects are gradual and indirect, and lie out of sight . . . few are those who realize the undeniable truth that State help kills self-help. Hence the majority of mankind must almost of necessity look with undue favor upon governmental intervention. This natural bias can be counteracted only by the existence . . . , as in England between 1830 and 1860, of a presumption or prejudice in favor of individual liberty—that is, of *laissez-faire*. The mere decline, therefore, of faith in self-help . . . is of itself sufficient to account for the growth of legislation tending toward socialism.[8]

A more direct answer is that two effects of the success of laissez-faire fostered a reaction. First, success made residual evils stand out all the more sharply, both encouraging reformers to press for governmental solutions and making the public more sympathetic to their appeals.

Second, it became more reasonable to anticipate that government would be effective in attacking the residual evils. A severely limited government has few favors to give; hence there is little incentive to corrupt government officials, and government service has few attractions for persons concerned primarily with personal enrichment. Government was engaged primarily in enforcing laws against murder, theft, and the like and in providing municipal services such as local police and fire protection—activities that engendered almost unanimous citizen support. For these and other reasons, Britain, which went furthest toward complete laissez-faire, became legendary in the late nineteenth and early twentieth centuries for its incorruptible civil service and law-abiding citizenry—precisely the reverse of its reputation a century earlier. In the United States neither the quality of the civil service nor respect for the law ever reached the heights they did in Britain, but both improved over the course of the century.

Fabian Socialism Triumphs

Whatever the reasons, Fabian socialism became the dominant intellectual current in Britian, driving out, at the one extreme, radical Marxism, and at the other, laissez-faire. Gradually that intellectual current came to dominate first public opinion and then government policy. World War I hastened the process, but it was already well under way before the war, as is demonstrated by Dicey's prescient remarks in his 1914 preface to the second edition of *Law and Public Opinion:*

> By 1900, the doctrine of *laissez-faire,* in spite of the large element of truth which it contains, had more or less lost its hold upon the English people . . . It also was in 1900 apparent to any impartial observer that the feelings or the opinions which had given strength to collectivism would continue to tell as strongly upon the legislation of the twentieth century as they already told upon the later legislation of the nineteenth century . . . and this conclusion would naturally have been confirmed by the fact that in the sphere of finance there had occurred a revival of belief in protective tariffs, then known by the name of a demand for "fair trade" [echoes of 1987!].

Dicey lists "the laws which most directly illustrate the progress of collectivism," from the beginning of the twentieth century, starting with the Old Age Pension Act of 1908. In respect of a later act (the Mental Deficiency Act, 1913), he remarks that it "is the first step along a path on which no sane man can decline to enter, but which, if too far pursued, will bring statesmen across difficulties hard to meet without considerable interference with individual liberty."[9]

Clearly the seeds had been sown from which Britain's full-fledged welfare state grew, at first slowly in the interwar period and then with a final burst after World War II, marked perhaps by the adoption of the National Health Service and the panoply of measures recommended in the Beveridge report.

In the United States the development was similar, though somewhat delayed. After the popular success of Bellamy's utopian fantasy came the era of the muckrakers, led by Lincoln Steffens, Ray Stannard Baker, and Ida M. Tarbell, with their exposures of alleged corruption and malfeasance in municipal government, labor, and trusts. Upton Sinclair used the novel to promote socialist ideas, his most successful being *The Jungle* (1906), which resulted from an assignment by a socialist newspaper to investigate conditions in the Chicago stockyards. Sinclair wrote the novel to create sympathy for the workers, but it did far more to arouse indignation at the unsanitary conditions under which meat was processed. On a different level Louis Dembitz Brandeis criticized the financial community. His volume of essays, *Other People's Money and How the Bankers Use It* (1914), has been described as "a frontal assault on monopoly and interlocking directorates."[10]

"The Populist party, through which William Jennings Bryan rose to" the nomination for the presidency on the Democratic ticket in 1896, "called not merely for regulation of the railroads but for outright government ownership and operation."[11] The Interstate Commerce Commission, created in 1887, was shortly followed by the 1890 Sherman Antitrust Act and later by the 1906 Food and Drug Act, for which Sinclair's novel served as the catalyst. The modern welfare state was well on its way. World War I greatly expanded the role of government, notably by the takeover of the railroads. The postwar period brought something of a reaction, with the major exception of Prohibition.

As late as 1929 Federal spending amounted to only 3.2 percent of the national income; one-third of this was spent on the military, including veterans' benefits, and one-half on the military plus interest on the public debt. State and local spending was nearly three times as large—9 percent of national income—with more than half on education and highways. Spending by federal, state, and local governments on what today is described as income support, Social Security, and welfare totaled less than 1 percent of national income.

The world of ideas was different. By 1929 socialism was the dominant ideology on the nation's campuses. The *New Republic* and *The Nation* were the intellectuals' favorite journals of opinion and Norman Thomas their political hero. The impact of opinion on the world of practice, however, had so far been modest. The critical catalyst for a major change was, of course, the Great Depression, which rightly or wrongly shattered the public's confidence in private enterprise, leading it to regard government involvement as the only effective recourse in time of trouble and to treat government as a potential benefactor rather than simply a policeman and umpire.

The effect was dramatic. Federal government spending grew to roughly 30 percent of national income by the 1980s, or to nearly tenfold its 1929 level. State and local spending also grew, though far less dramatically, so that by the 1980s total government spending was over 40 percent of national income. And spending understates the role government came to play. Many intrusions into people's lives involve little or no spending: tariffs and quotas, price and wage controls, ceilings on interest rates, local ceilings on rents, zoning requirements, building codes, and so on.

The delayed impact of the intellectual climate of the 1920s illustrates one aspect of the influence of intellectual opinion—producing options for adoption when the time is ripe. Despite Norman Thomas's popularity on the campus, he received less than 1 percent of the popular vote for president in 1928 and only 2 percent in 1932. Nonetheless, we concluded that "the Socialist party was the most influential political party in the United States in the first decades of the twentieth century . . . [A]lmost every economic plank in its 1928 presidential platform has by now [1980] been enacted into law"[12]

Like the earlier tide, the Fabian tide was worldwide. It contributed no less to the success of the Russian and Chinese communist revolutions than to the welfare state in Britain and the New Deal in the United States. And it largely explains the adoption of centralized planning in India and other British and European former colonies when they achieved independence. A major exception was Hong Kong, one of the few British colonial possessions that remained under the control of the Colonial Office. It never departed from the Adam Smith tide and as a result was a precursor to the next tide.

The Resurgence of Free Markets: The Hayek Tide

As in the preceding wave, the world of ideas started to change direction just as the tide in the world of practice was cresting.[13] Throughout the ascendancy of socialist ideas there had, of course, been counter-currents—kept alive in Britain by G. K. Chesterton, Lionel Robbins, Friedrich Hayek, and some of their colleagues at the London School of Economics; in Austria by Ludwig von Mises and his disciples; and in the United States by Albert Jay Nock, H. L. Mencken, and other popular writers; Henry Simons, Frank Knight, and Jacob Viner at the University of Chicago; and Gottfried Haberler and Joseph Schumpeter at Harvard—to mention only a few.

Hayek's *Road to Serfdom,* a surprise best-seller in Britain and in the United States in 1944, was probably the first real inroad in the dominant intellectual view. Yet the impact of the free-market counter-current on the dominant tide of intellectual opinion, though perceptible to those directly involved, was at first minute. Even for those of us who were actively promoting free markets in the 1950s and 1960s it is difficult to recall how strong and pervasive was the intellectual climate of the times.

The tale of two books by the present authors, both directed at the general public and both promoting the same policies, provides striking evidence of the change in the climate of opinion. The first, *Capitalism and Freedom,* published in 1962 and destined to sell more than 400,000 copies in the next eighteen years, was not reviewed at the time in a single popular American periodical—not in the *New York Times,* the *Chicago Tribune, Newsweek, Time,* you name it. The second, *Free to Choose,* published in 1980, was reviewed by every major publication (by some more than once), became the year's best-selling nonfiction book in the United States, and received worldwide attention.

Further evidence of the change in the intellectual climate is the proliferation of think tanks promoting the ideas of limited government and reliance on free markets. In a recent talk Ed Feulner, president of the Heritage Foundation, could mention only four that existed three decades ago: the Hoover Institution, still here today; the Intercollegiate Society of Individualists, which has changed its name but kept the initials; an embryonic American Enterprise Institute; and the Center for Strategic and International Studies. He should also have included Leonard Read's Foundation for Economic Education (FEE).

Translating Ideas into Action

By contrast, Feulner noted a long list of additional institutions currently devoted to developing and spreading the idea of limited government and free markets, plus a host of others trying to translate ideas into action. The same contrast is true of publications. FEE's *Freeman* was the only one he or we can think of that was promoting the ideas of freedom 30 to 40 years ago. Today numerous publications promote these ideas, though with great differences in specific areas: *The Freeman, National Review, Human Events, The American Spectator, Policy Review,* and *Reason.* Even the *New Republic* and *The Nation* are no longer the undeviating proponents of socialist orthodoxy that they were three decades ago.

Why this great shift in public attitudes? The persuasive power of such books as Friedrich Hayek's *Road to Serfdom,* Ayn Rand's *Fountainhead* and *Atlas Shrugged,* our own *Capitalism and Freedom,* and numerous others led people to think about the problem in a different way and to become aware that government failure was as real as market failure. Nevertheless, we conjecture that the extraordinary force of experience was the major reason for the change.

Experience turned the great hopes that the collectivists and socialists had placed in Russia and China to ashes. Indeed, the only hope in those countries comes from recent moves toward the free market. Similarly experience dampened, to put it mildly, the extravagant hopes placed in Fabian socialism and the welfare state in Britain and in the New Deal in the United States. One major government program after another, each started with the best of intentions, resulted in more problems than solutions.

Few today still regard nationalization of enterprises as a way to promote more efficient production. Few still believe that every social problem can be solved by throwing government (that is, taxpayer) money at it. In these areas liberal ideas—in the original nineteenth-century meaning of liberal—have won the battle. The neoconservatives are correct in defining themselves as (modern) liberals mugged by reality. They still retain many of their earlier values but have been driven to recognize that they cannot achieve them through government.

In this country the Vietnam War helped to undermine belief in the beneficence of government. And most of all, as Dicey predicted nearly 75 years ago, the rising burden of taxation caused the general public to react against the growth of government and its spreading influence.[14]

In both the United States and Britain respect for the law declined in the twentieth century under the impact of the widening scope of government, strongly reinforced in the United States by Prohibition. The growing range of favors governments could give led to a steady increase in what economists have come to call rent-seeking and what the public refers to as special-interest lobbying.

Worldwide the contrast between the stagnation of those poorer countries that engaged in central planning (India, the former African colonies, Central American countries) and the rapid progress of the few that followed a largely free-market policy (notably the Four Tigers of the Far East: Hong Kong, Singapore, Taiwan, and South Korea) strongly reinforced the experience of the advanced countries of the West.

Ideas played a significant part, as in earlier episodes, less by persuading the public than by keeping options open, providing alternative policies to adopt when changes had to be made.

As in the two earlier waves, practice has lagged far behind ideas, so that both Britain and the United States are further from the ideal of a free society than they were 30 to 40 years ago in almost every dimension. In 1950 spending by U.S. federal, state, and local governments was 25 percent of national income; in 1985 it was 44 percent. In the past 30 years a host of new government agencies has been created: a Department of Education, a National Endowment for the Arts and another for the humanities, EPA, OSHA, and so on. Civil servants in these and many additional agencies decide for us what is in our best interest.

Nonetheless, practice has started to change. The catalytic crisis sparking the change was, we believe, the worldwide wave of inflation during the 1970s, originating in excessively expansive monetary growth in the United States in the 1960s. The episode was catalytic in two respects: first, stagflation destroyed the credibility of Keynesian monetary and fiscal policy and hence of the government's capacity to fine-tune the economy; second, it brought into play Dicey's "weight of taxation" through bracket creep and the implicit repudiation of government debt.

Already in the 1970s military conscription was terminated, airlines deregulated, and regulation Q, which limited the interest rates that banks could pay on deposits, eliminated. In 1982 the Civil Aeronautics Board that regulated the airlines was eliminated. Though government spending as a fraction of national income has continued to rise, the rate of increase has slowed. No major new spending programs have been passed since 1981. The increase in non-military government spending has been predominantly the effect of earlier programs.

The Tides Sweep Worldwide

As in earlier waves, the tides of both opinion and practice have swept worldwide. Britain went further in the direction of collectivism than the United States and still remains more collectivist—with both a higher ratio of government spending to national income and far more extensive nationalization of industry. Yet Britain has made more progress under Margaret Thatcher than the United States has under Ronald Reagan.

Equally impressive are changes in the communist world. Even there it was impossible to repress all counter-currents, as Solzhenitsyn, Sakharov, and many other brave men and women so eloquently testify. But beyond the counter-currents, the economic reforms in Hungary, Solidarity in Poland, the widened resort to markets in China, the current reformist talk in the Soviet Union—these owe as much to the force of events and the options kept open by intellectual ideas as do the election of Margaret Thatcher and Ronald Reagan in the West. True, it is doubtful that such reforms will be permitted to go far enough to threaten the power of the current political elite. But that does not lessen their value as testimony to the power of ideas.

One interesting and instructive phenomenon is that freeing the market has been equally or more vigorously pursued under ostensibly left-wing governments as under ostensibly right-wing governments. Communist countries aside, one striking example is the U-turn in French policy effected by Mitterrand, a lifelong socialist. In Australia a Labour government replaced a conservative government and then moved sharply to widen the role of the market. New Zealand, under a Labour government headed by David Lange, first elected in 1984 and re-elected in 1987, has gone further than any other country in dismantling government controls and economic intervention.

By contrast, Germany, though it owed its dramatic post-World War II recovery to the free-market policies of Ludwig Erhard, has steadily moved away from those policies first under a Social Democratic government and, more recently, under conservative governments. Can the explanation for this aberration be that the dramatic move to free-market policies was primarily the result of one man's (Erhard's) actions and not of a change in public opinion?

All in all the force of ideas, propelled by the pressure of events, is clearly no respecter of geography or ideology or party label.

Conclusion

We have surveyed briefly two completed pairs of tides in the climate of opinion and the "affairs of men" and one pair still in progress. Each tide lasted between 50 and 100 years. First came the tide in the climate of public opinion: toward free markets and laissez-faire from, say, 1776 to 1883 in Britain, 1776 to 1885 in the United States; toward collectivism from 1883 to 1950 in Britain, from 1885 to 1970 in the United States. Some decades later came the tide in the "affairs of men": toward laissez-faire from, say, 1820 to 1900 in Britain, 1840 to 1930 in the United States; toward collectivism from, say, 1900 to 1978 in Britain, 1930 to 1980 in the United States. Needless to say, these are only the roughest of dates. They could easily be set a decade or so earlier or later.

Two new pairs of tides are now in their rising phases: in public opinion, toward renewed reliance on markets and more limited government, beginning in about 1950 in Britain and 1970 in the United States; in public policy, beginning in 1978 in Britain and 1980 in the United States, and even more recently in other countries.

If the completed tides are any guide, the current wave in opinion is approaching middle age and in public policy is still in its infancy. Both are therefore still rising and the flood stage, certainly in affairs, is yet to come.

For those who believe in a free society and a narrowly limited role for government, that is reason for optimism, but it is not a reason for complacency. Nothing is inevitable about the course of history—however it may appear in retrospect. "Because we live in a largely free society, we tend to forget how limited is the span of time and the part of the globe for which there has ever been anything like political freedom: the typical state of mankind is tyranny, servitude, and misery."[15]

The encouraging tide in affairs that is in its infancy can still be aborted, can be overwhelmed by a renewed tide of collectivism. The expanded role of government even in Western societies that pride themselves in being part of the free world has created many vested interests that will strongly resist the loss of privileges that they have come to regard as their right. Everyone is capable of believing that what is good for oneself is good for the country and therefore of justifying a special exception to a general rule that we all profess to favor.

Yet the lesson of the two earlier waves is clear: once a tide in opinion or in affairs is strongly set, it tends to overwhelm countercurrents and to keep going for a long time in the same direction. The tides are capable of ignoring geography, political labels, and other hindrances to their continuance. Yet it is also worth recalling that their very success tends to create conditions that may ultimately reverse them. □

1. A British constitutional-law scholar has written the most insightful book on the subject: A. V. Dicey, *Lectures on the Relation Between Law and Public Opinion in England During the Nineteenth Century,* 2d ed. (London: Macmillan, 1914).
2. Milton Friedman and Rose D. Friedman, *Free to Choose* (New York and London: Harcourt Brace Jovanovich, 1980), p. 283.
3. Adam Smith, *The Wealth of Nations,* Cannan 5th ed. (London: Methuen, 1930), bk. 4, chap. 2, p. 435.
4. J. M. Keynes, *Economic Consequences of the Peace* (London: Macmillan, 1919), pp. 6, 7, 9.
5. See Friedman and Friedman, *Free to Choose,* pp. 59, 61–62.
6. Dicey, *Law and Public Opinion,* p. 245.
7. A. W. Coats, "The American Economics Association and the Economics Profession," *Journal of Economic Literature* 23 (December 1985): 1702.
8. Dicey, *Law and Public Opinion,* pp. 257–58.
9. Ibid., pp. xxxi, xxxii, xxxiii, li.
10. *Encyclopaedia Britannica,* 1970 ed., s.v. "Brandeis, Louis Dembitz."
11. Friedman and Friedman, *Free to Choose,* p. 196.
12. Ibid., pp. 286, 287.
13. This section is based partly on Milton Friedman, "Where Are We on the Road to Liberty?" *Reason* 19, no. 2 (June 1987): pp. 31–33.
14. "[I]f the progress of socialistic legislation be arrested, the check will be due, not so much to the influence of any thinker as to some patent fact which shall command public attention; such, for instance, as that increase in the weight of taxation which is apparently the usual, if not the invariable, concomitant of a socialistic policy" (Dicey, *Law and Public Opinion,* p. 302n).
15. Milton Friedman, with the assistance of Rose D. Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), p. 9.

Everyone Can Win in a Truly Competitive Market

by Alan W. Bock

Advocates of a free and open economy in a free and open society often find themselves hampered—and sometimes hamper themselves—because of a widespread misunderstanding of the word "competition." Where friends of freedom simply mean an absence of arbitrary restriction, opponents and neutral observers often think they are endorsing and promoting a vicious, dog-eat-dog-cut-throat-you-have-to-be-No.-1 process that many find distasteful and unhealthy.

The word "competition" means something drastically different in the context of economics than it does in the context of sports, war, or national hegemony. In economics the meaning is limited. It simply means that access to markets is open—or at least available to all comers on a nondiscriminatory basis. If anybody who wants to can offer goods or services without being subject to a veto by government or those already in that business (assuming they can raise the capital to do so and attract customers), then the market is said to be competitive. Nobody can keep competitors out by force of law.

This meaning of competition is often subsumed by or identified with another meaning derived roughly from sports and more pervasive in our culture. This meaning was described in a recent article in *The New Age Journal* by Alfie Kohn as "mutually exclusive goal attainment—my success requires your failure; our fates are negatively linked." Only one person can win the race, or one team win the game; everybody else is defined as a "loser." You have to be No. 1 or nothing.

Mr. Bock is Senior Columnist of The Orange County Register, *where this article first appeared on April 28, 1988.*

There is little question that this understanding of competition can be personally and psychologically destructive and socially disruptive. If only one person in a race can be the winner, a lot of others may have their self-esteem damaged—or decide not to participate in advance. If winning is the only thing, then cheating and humiliation are likely to be common. A society that assumes that this is what competition is all about is likely to be characterized by a high level of stress, anxiety, or burnout.

That said, it should be noted that many critics of competition erect a straw man to knock down. Even in sports, which furnishes the paradigm, few believe, or act as if they believe, that winning is really everything. Even coaches who say things like "winning isn't everything; it's the only thing," providing easy targets for critics of destructive competition, often turn out in practice to be advocates of sportsmanship, cooperation, teamwork, and losing well when you lose rather than one-dimensional, win-at-all-costs fanatics.

But even if the straw man of the destructively competitive mindset were entirely accurate, it would have nothing to do with competition as it is understood by an economist.

In a competitive—i.e., open—marketplace, it is decidedly not the case that you're nothing if you're not No. 1. Although some businessmen get caught up in the rhetoric of being No. 1, or of beating the competition as in a footrace or football game, in most markets you can make a respectable—even lavish—living as No. 2, No. 6, or No. 17.

In the market that came closest to resembling a monopolistic model for a while—the computer industry, dominated for decades by IBM—several other companies survived, prospered, and even became large by most standards. The latest revolution—personal computers—was pioneered and dominated for a while by upstarts—because access to the market was open. For all its market power, IBM couldn't keep competitors out by law or force.

Values Important to Economic Competition

For all the gamelike rhetoric, economic competition places a premium on the values of cooperation, loyalty, openness to new ideas, and flexibility that critics say are subverted by the destructive kind of competition. In economic competition in an open marketplace, you win by pleasing customers, not by destroying rivals.

In economic competition, success comes to those who are constructive rather than destructive in their approach. An open marketplace based on truly voluntary exchanges produces untold opportunities for mutually beneficial "win-win" relationships. It is theoretically possible (though perhaps unlikely in practice, given human frailty) for economic competition to produce a situation where there are no losers, where nobody needs to feel inadequate.

Note also that economic competition does not require people to enter the rat-race. If markets are truly open, people are quite free to be laid-back or unconventional, even to drop out of the system or twist the system to fit their particular preferences. Back in the '60s a number of people who claimed to hate capitalism made a pretty good living running head shops or making tie-dyed earth shoes and the like.

The rule for the entrepreneur in a competitive marketplace is: "Find a need and fill it." Since people are so diverse, their perceived needs are diverse. An open market provides more interstices where people can break away from a stifling corporate lifestyle and do well than does a more controlled economy.

Ironically, an open or competitive economy provides more scope for expression of the values of those who are concerned about the destructive aspects of gotta-be-No.-1 competitiveness than does a controlled economy. It's a shame that a semantic hangup seems to prevent many from understanding this. □

Coping with Smoking

by Tibor R. Machan

Various legislative bodies are enacting laws forbidding business proprietors from permitting smoking on their private property—in offices, cinemas, aircraft, stores, and other places. Such policies are touted as a means to combat a harmful habit and to foster public health. But there are serious problems with this approach to the problems of smoking.

Owners of private establishments are being prevented—mostly by city ordinances—from deciding who will be permitted to smoke on their premises. But such government-mandated prohibitions ignore the rights of those who don't mind smoking as well as those who wish to live in a tolerant society. Since smokers now are in the minority, some believe this is the time to descend on them in full force. Their critics are willing to ignore individual rights to freedom of association and private property.

Of course, the issue often is presented in a way that makes it appear that smokers are the ones who violate individual rights. They are said to be assaulting the rest of us with their smoking. But is this really the case? And are the laws really designed to protect the rights of individuals against the intrusions of smokers?

No doubt, smokers can be annoying. Their smoke even may be harmful to those around them. One need not dispute these contentions still to be concerned with their rights.

In most cases, anti-smoking ordinances aren't limited to public places such as municipal courts. If the government confined itself to protecting the rights of nonsmokers in bona fide public areas, there would be nothing wrong with the current trend in legislation.

Instead of such a limited approach, however, government has embarked upon the full regimentation of people's choices concerning smoking. The government, under the leadership of public health officials, has decided to bully smokers, regardless of whether they violate anyone's rights or merely indulge with the consent of others. This is where government-mandated smoking bans have reached a dangerous phase.

There are many risks that people suffer willingly. And in a society that respects individual rights this has to be accepted. Boxers, football players, nurses, doctors, and many other people expose themselves to risks of harm that come from others' behavior. What is central, however, is that when this exposure is voluntary, in a free society it may not be interfered with. The sovereignty of persons may not be sacrificed even for the sake of their physical health.

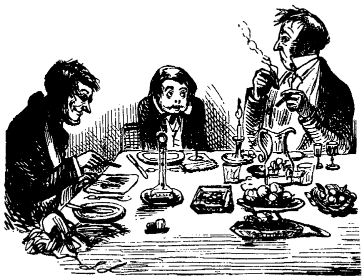
Respecting Individual Rights

Individuals' property rights are supposed to be protected by the Fifth Amendment. Not unless property is taken for public use—for the sake of a legitimate state activity—is it properly subject to government seizure. By treating the offices, work spaces, and lobbies of private firms as if they were public property, a grave injustice is done to the owners.

When private property comes under government control, practices may be prohibited simply because those who engage in them are in the minority or waver from preferred government policy. Members of minority groups can easily lose their sphere of autonomy.

There is no need, however, to resort to government intervention to manage the public problems engendered by smoking. There are many cases of annoying and even harmful practices that can be isolated and kept from intruding on others. And they do not involve violating anyone's right to freedom of association and private property.

Tibor Machan teaches philosophy at Auburn University, Alabama. He is a Senior Editor of Reason *magazine. He recently edited* Commerce and Morality *for Rowman and Littlefield, and is now working on a book titled* Public Realms and Private Rights *for the Independent Institute of San Francisco.*



The smoking issue can be handled quite simply. In my house, shop, or factory, I should be the one who decides whether there will be smoking. This is what it means to respect my individual rights. Just as I may print anything I want on my printing press, or allow anyone to say whatever he or she wants in my lecture hall, so I should be free to decide whether people may smoke in my facilities.

Those displeased by my decision need not come to my facilities to work, play, or whatever. If the concern is great and the opportunity to work in a given place is highly valued, negotiations or contract talks can ensue in behalf of separating smokers from nonsmokers. In many cases all that's needed is to bring the problem to light. Maybe the firm's insurance costs will be high where there is smoking, or maybe a change in policy will come about because customers and workers are gradually leaving.

In some cases it may go so far as to involve tort litigation. Exposing employees to serious dangers that are not part of the job description and of which they were not warned may be actionable. But what the company does initially at least must be its decision. And the onus of proof in these cases must be on those who claim to have suffered unjustified harm. Government legislation and regulation often subvert this carefully conceived process, just because some people are impatient with how others run their own lives and properties.

Consider the somewhat analogous case of freedom of religion. If I own and run a private school, I decide whether students may pray. In state schools, of course, the state decides. And a sound system of government won't get on the side of either the prayers or the non-prayers. Similarly, the state should say nothing about the ultimate benefits or harms of smoking. This is no different from the well-respected view that the state shouldn't get on the side of a particular religion or even a scientific theory.

It is important to note that for many people, smoking is not categorically, universally bad. For some people it may be O.K. to smoke, just as it could be O.K. to have a couple of drinks or to run five miles a day. For others, smoking is clearly harmful to their health. In either case, health may not be the highest good for many people. All things considered, even those whose health suffers may wish to smoke. In a free society, people are free to do what is wrong, so long as they don't violate the rights of others.

But, some will cry out, here's the rub: smoking can adversely affect others, and there is reason for those who could be harmed to stay away from smokers.

But this doesn't mean that we should force someone who doesn't mind smoking to stay way from smokers. If I own a restaurant and choose to permit smoking, you have no right to come in and force someone not to smoke. You must deal with me first and I might accommodate you or I might not, depending on my values and choices. In a free society this should be the general policy. If you believe that I subject you to harm that you were not warned of, you can sue me. But this is a private dispute, not a matter for public policy.

Some want no smoking near them and ought to be free to associate with others who do not smoke. They should eat in restaurants, work in businesses, and play in clubs where smoking isn't allowed. Others like to smoke and should be free to join the like-minded to carry on their various activities. And some who don't smoke may not mind others smoking nearby. They, too, should be free to seek the appropriate company in the appropriate settings.

A free, pluralistic society can accommodate all these people. It isn't necessary to appoint the government as the caretaker of our health and the overseer of our interpersonal negotiations concerning how we best get along with each other. Only when there are decisive grounds for deeming an action as violating someone's rights should government enter the picture and prohibit it. □

Economics Has the Answer: What's the Question?

by Edmund A. Opitz

Adam Smith's monumental achievement was to enlarge the individual person's freedom of action in economic affairs, and thus in other sectors of his life as well. Smith's argument had several minor loopholes, but these were plugged by the Austrian School—Carl Menger, Eugen von Böhm-Bawerk—about a century after *The Wealth of Nations*. Today, it is fair to say that Ludwig von Mises and his students have created a genuine science of economics—a systematic exposition of the free market economy—which, as an intellectual structure, is virtually impregnable. Misesian economic science is, so to speak, The Answer. It's the recipe for anyone who wants to know how a society must organize its workplace activities so as to maximize economic well-being for all.

The Question is: How may we achieve the free and prosperous commonwealth? To which The Answer is: Install the free market economy, as taught by Austrian—and some other—economists.

Trouble is, almost no one is asking The Question!

Economic science does not tell John Doe how to make a million dollars on Wall Street, or a killing in real estate, or how to protect his assets. Entrepreneurship is an art, not a science; profitable investing likewise. Economic science, like every other science, deals with abstract principles and general rules. Economic science sets forth the general rules which members of a particular society must apply in practice if the society is to enjoy maximum productivity and raise the general level of economic well-being. Economic science is a scholarly endeavor which shows what must be done to maximize the wealth of nations.

Economic science has The Answer for anyone who asks how a society may advance from poverty toward affluence. But economic science has no answer for those who ask: How can *I* make a fast and easy buck?

This is the wrong question, so far as economic science is concerned. How can people be persuaded to ask the right question? The question people should ask might be phrased as follows: How can we create the social institutions which provide maximum opportunity for all of us to be more prosperous? Only a sense of moral obligation will generate such a question.

The ordinary, decent, law-abiding citizen in his private dealings with his fellows would not use force or fraud to gain advantage over another. But when force and/or fraud are legalized millions *do* seek some advantage for themselves at the expense of their fellows. When the State allocates resources and redistributes the wealth, it is using its power to deprive producers of what belongs to them, in order to dispense it to

The Reverend Mr. Opitz is a member of the staff of The Foundation for Economic Education and is the author of the book Religion and Capitalism: Allies, Not Enemies.

those who have not earned it. Everyone is forced to pay tribute for the benefit of the wielders of power and their friends. Concerned with their own immediate well-being and looking to the State for handouts, tens of millions of Americans have no interest in working toward an economic order which would assure a rising level of prosperity for everyone—the free market economy.

Austrian economics is The Answer, all right, but it is the answer to a question which only a few are asking. The reason: only a few have an ethical incentive to ask it. Millions are searching for ways to increase their salaries, double their incomes, and enjoy the good life. Only a handful, by comparison, are working with any intensity to advance the free society-market economy way of life.

Economic Fallacies

We have it on the authority of Henry Hazlitt that "Economics is haunted by more fallacies than any other study known to man." Who can deny it? Any reasonably bright high school student can read *Economics in One Lesson*. Having read the book, he can spot the fallacies in many textbooks of economics, in the speeches of public figures, in the commentaries of television and radio pundits, in sermons and academic lectures, in almost any place he cares to look.

The discipline of economics is not mired in simple ignorance; it is stalled by willful ignorance. Economic fallacies abound because every economic fallacy in practice gives someone an economic or other advantage over someone else. Pocketbook motivations keep economic fallacies alive; slay them in one generation and they return from the dead in the next.

Virtually every economic fallacy that plagues us today has been demolished time and again over the past couple of centuries; but has this work of demolition diminished the number and power of economic fallacies? Hardly; they appear about as numerous and virulent as ever. There are few new economic truths, but new errors proliferate wildly. Demolishing fallacies and exposing errors may be exhilarating for a time, but it is negative work; it is to toil on a treadmill. The positive truths of a market economy—together with its supporting institutions and ideas—are reached only by taking a different route.

The celebrated classicist, Gilbert Murray, offers some wise words on truth and error: "The great thing to remember is that the mind of man cannot be enlightened permanently by merely teaching him to reject some particular set of superstitions. There is an infinite supply of other superstitions always at hand; and the mind that desires such things—that is, the mind that has not trained itself to the hard discipline of reasonableness and honesty, will, as soon as its devils are cast out, proceed to fill itself with their relations."

There will always be a need to expose economic error and demolish fallacies, but something more is needed if we wish to advance in the direction of a truly free society; and that something more is the sense of moral obligation which motivates persons to pursue the goals they perceive to be ethically right and good. Economics needs ethics.

Mises points out that economics "is a science of means, not of ends," and that science, furthermore, is value-free. A science *de*scribes; but does not *pre*scribe. "Science," Mises goes on to say, "never tells a man how he should act; it merely shows how a man must act if he wants to attain definite ends. . . . Praxeology and economics do not say that men *should* peacefully cooperate within the frame of societal bonds; they merely say that men must act this way *if* they want to make their actions more successful than otherwise." Moral obligation, a sense of "oughtness," is not within the purview of science; the sciences, basically, operate in a sector of the universe that is ethically neutral. By the same token, there are no grounds in economic science *per se* for telling anyone that he ought to do this when he prefers to do that.

Although every science is value-free, the universe is not value-free! We live in a rationally and ethically structured universe where some things are morally right and other things are morally wrong; there is genuine good, as well as real evil. Moral obligation, besides being a reality that presses on the sensitive conscience, is a potent incentive to strive to translate the reasoned truths of economic science into a going concern economy.

Economics is the science of human action, and the actions of human beings are intimately implicated with ethical standards and moral obligation. In other words, economic science does not stand alone; it is a "means," and as a means economics needs to be hooked up with disciplines that deal with ends.

What we have here is an IF—THEN situation. The economist cannot tell us that we ought to prefer a free and prosperous commonwealth; but IF that is what we want, THEN economic science can demonstrate that the market economy is the only means to achieve that end. Economic science can only explain; the economic argument must therefore be joined to an ethical imperative which commands.

Strengthening the Case

Economic reasoning can demonstrate that the free market system is the most efficient way to produce goods and services, rewarding every participant according to his contribution to the productive process—as that contribution is judged by his peers. But the economic case for freedom is strengthened immeasurably when it is bolstered by moral reasoning which demonstrates that the market economy is the only economic order which embodies the ideas of liberty and justice for all. Capitalism is the only economic system that does not reward some at the expense of others.

The interventionist state provides cushy jobs for many a predator and parasite, people whose services would not be needed in a truly free economy. Many of these people, once they become dependent on consumer choice, might, to begin with, be worse off economically than before. The pocketbook argument will not persuade them, but the moral argument might.

The value-free science of economics is incomplete; it is only a means, and it is the nature of a means to complete itself by combining with an appropriate end. Value-free economics needs the value-rich discipline of ethics. And it needs something more as well, the related idea of "equal rights" which so inspired our Whig and Classical Liberal forebears. This is the conviction that a portion of the divine is incorporated into the makeup of every man and woman, generating a sacred precinct within, which to invade is to violate. This is the domain of those Creator-endowed rights specified in our Declaration as rights to Life, Liberty, and the Pursuit of Happiness, which governments are instituted to secure. Equal freedom and equal justice under the law follow logically, and provide the legal, cultural, and moral framework which demands the free economy as its natural corollary. □

1988-89 Essay Contest
"Why Choose Freedom?"

sponsored by The Foundation for Economic Education

First Prize ($1500): David Beers, George Mason University, "Social Consciousness and Individual Freedom"

Second Prize ($1000): Matthew B. Kibbe, George Mason University, "The Unspoken Dialogue of the Market"

Third Prize ($500): Roderick T. Long, Cornell University, "The Path of Liberty"

Honorable Mention: Matthew E. Schramm, Augustana College (Illinois); Bobby Taylor, University of Tennessee, Knoxville; Ellen Spertus, Massachusetts Institute of Technology; David M. Brown, Mercer County Community College (New Jersey); Darren R. Rice, University of Houston-Clear Lake; Richard Bostan, Simon Fraser University (Burnaby, British Columbia).

Dumping: An Evil or an Opportunity?

by Alex Huemer

In the latter half of the nineteenth century, America's rail barons were engaged in a titanic struggle for control of the nation's commercial rail traffic. Notable in this conflict was the attempt by Cornelius Vanderbilt to drive the Baltimore & Ohio Railroad out of business. Confident of success, Vanderbilt slashed the rates on his New York Central line's cargo fares, knowing Baltimore & Ohio couldn't hope to compete. Soon, however, the flush of victory turned to crimson rage: the head of the B & O railroad, Jim Fisk, had bought most of the cattle in Buffalo and shipped them to New York City for resale, on Central trains, at the ridiculously low fare of $1.00 per head. The rate war had failed, and Vanderbilt was humiliated.

Over 100 years later, titanic struggles are again taking place. This time, the principal actors are huge multinational corporations, and instead of "rate wars" we observe the heralded consequences of their competition: international dumping.

The act of dumping is defined as "foreign sales below the home price." The term has been used in recent years to describe myriad competitive activities undertaken by international firms, until it has become difficult to identify dumping as an activity apart from fair competition. The European Community Commission recently accused five Japanese companies of dumping because they were importing low-priced parts from Japan for their typewriter assembly plants in Europe. Meanwhile, Chrysler Corporation has been accusing the Japanese of dumping automobiles in the U.S. market, while deflecting accusations of import dumping themselves by arguing "the core of the [dumping] issue goes to the manufacturer of the cars, not distributors, such as ourselves."

In the press, in political speeches, and in the statements of interested parties, the term "dumping" has become a vague catchword with which to abuse every kind of foreign competition.

This statement was made by Gottfried Haberler in 1933. Abuse of the term "dumping" is not a modern phenomenon, but has resurfaced recently because of the awful images the term evokes: images of protected international monopolies overwhelming domestic markets, forcing Americans out of work and destroying strategic industries. But the images are exaggerated, the truth far less daunting.

Firms finding themselves exceeding their predicted inventories are often obliged to get rid of their excess stock of goods by temporarily selling below the usual retail price. When sold abroad in this fashion, we refer to it as intermittent or sporadic dumping, since sustained dumping of excess inventories cannot be maintained. This type of dumping is usually harmless; most firms can survive a temporary drop in the market price of their good. Moreover, for-

Mr. Huemer is a Ph.D. student in economics at Columbia University. This essay won first place in the 1988 Milton Friedman Essay Contest conducted by the Americanism Educational League, Buena Park, California. The contest drew over 4,000 entries, with Milton and Rose Friedman judging the finalists.

eign firms faced with excess inventory problems will not simply cut prices abroad, but domestically as well.

Another type of dumping is that performed by foreign monopolies. When faced with increasing returns to scale of production, and unable to increase its profits by raising domestic sales, a firm may still reap greater profits by expanding production for foreign markets. So long as the costs of producing the good are met by foreign demand, the fall in per unit production cost will increase profits in the domestic market.

Therefore, a firm may competitively charge less for its product abroad than at home. However, any fall in cost of production will lead a profit-seeking firm to expand domestic sales as well. To spur demand for its good, the firm will cut the domestic price, and the best dumping price will fall again, but somewhat less. Ultimately, the prices in the two countries must converge, following a process of successive domestic and foreign price cuts. Such dumping cannot be sustained indefinitely.

It is not necessary, therefore, to introduce tariffs or duties to equalize the price of dumped goods at home and abroad—remedies likely to be suggested by those firms operating too inefficiently to compete fairly with the foreign firms. Rather than enjoy the inexpensive product of efficient foreign industry, while we concentrate on developing our own, we are being asked to accept higher prices from aging, uncompetitive industries.

Arguing against dumping as a product of unfair foreign trade practices, many people have pointed out that domestic industries might effectively compete with dumping firms if they could sell goods in unprotected foreign markets, expanding domestic output and reducing costs of production. Unfortunately, in the midst of making this perfectly reasonable argument, many people are inexplicably stricken with an attack of hypocrisy. They reason that if foreign nations are successfully dumping because they are protectionist, our best response is to be protectionist in turn. In a sense, they attack the symptom by aggravating the disease. The results are higher prices, crippled trade, and the persistence of industrial inefficiency.

There is one other type of dumping: that arising from predatory pricing. It has been suggested that foreign firms dump their goods in an effort to drive their competition out of business, with the object of cartelizing the market in those goods. This is potentially the most damaging, yet least likely form of dumping to occur. In addition to being very costly to maintain, the resultant domination of the market would be exceedingly difficult to exploit. Any attempts to raise the price of the good above the competitive price would encourage other firms to come into the market and force the price down again.

How Should We Respond?

In the meantime, how should we respond to the dumping? For an answer, we need look no further than the example set by Jim Fisk: If foreign firms are prepared to sell us their goods below costs, we should let them. We can improve our standard of living and economic power by consuming their finished goods, and use their intermediate goods to cut our own production costs. Acts of predation can become opportunities for subsidy, if we are wise enough to take advantage of them.

Many people feel that we risk losing a great deal more than markets to foreign competition. It has been argued that we may lose our culture, our national security or even our power over our own government! Any careful consideration of these issues will lead us to reject these fears as groundless. As for companies influencing government policy, *The Economist* remarked recently, "This should more reasonably concern a tiny Pacific island . . . than a nation as large and diverse as the United States." On national security grounds, we must have access to strategic resources; but we needn't own them, and anti-dumping legislation has done much more to deny than to improve that access. Lest we fear for our culture, we should remind ourselves that as a free people, we needn't patronize those industries which do not cater to our tastes, or which offend our ideals. In the end, we need to realize that "ownership is no longer the main source of economic well-being."

What have we gained by criticizing international dumping? The only recent prosecution of a dumping case in our country has resulted in a trade agreement with Japan on the quantity and price of semiconductors the Japanese may sell us. While U.S. semiconductor producers continue to rail against the Japanese for questionable violations of the agreement, U.S. computer manufacturers are complaining of severe shortages of memory chips and semiconductors, resulting in serious production delays and mark-ups of as much as 400 percent. In Europe, the Japanese are finding it difficult to continue establishing factories, while the Europeans are, as *The Wall Street Journal* observed recently, "on the one hand inviting companies to create employment and improve the trade balance with Japan, and on the other hand restricting use of vital components that are often difficult to procure. . . ."

What Would Happen Today?

If we were to rewrite our story of the rail barons in modern terms, it might go something like this: Cornelius Vanderbilt slashes the rates on his New York Central cargo fares. This time, Jim Fisk complains to Senator "Boss" Tweed in Albany. Securing an injunction against Vanderbilt, Fisk appeals to the people against "the shameful predatory pricing" of the New York Central Railroad, and justifies the sudden legal barrier to lower rates as "'necessary" for the preservation of jobs, national security, and the sanctity of government institutions. Jim Fisk, no longer the wily entrepreneur, has become a coward and a scoundrel.

We, too, have an image to maintain. Where once Americans might have taken advantage of dumping to reap a tidy profit on finished goods and inexpensive consumption from cheap foreign exports, we now seek protection from them with barriers to fair trade and shrill condemnation of our allies and trading partners. In the name of dumping, we have humiliated ourselves internationally. Worse, in facing our problems we have denied our heritage of freedom and equality for the "opiate" of protectionism. It is time for us to reclaim that heritage, and with it the opportunity of a better future for America. It is time to overcome the "evil" of dumping, that evil which is in ourselves, and reclaim those opportunities which made America great. □

Protecting Whom from What?

by Bjorn Ahlstrom

I have a problem with the word "foreign." Every few years, someone urges us to protect American commerce by erecting trade barriers against "foreign" products. But what does foreign really mean?

Sony televisions are made in San Diego. Harley-Davidson motorcycles are 50 percent made in Japan. Which one is foreign?

For that matter, what is domestic? Some 335,000 of the "American" cars sold here each year are made in Japan or Korea—more than the number of cars imported by Mazda, Mitsubishi, and Isuzu combined. Chrysler Corp. annually sells in the United States more than 120,000 Chryslers imported from the Far East, representing more than 11 percent of its total sales, while Honda builds more than 320,000 cars here. Which of these are domestic and which foreign?

Bjorn Ahlstrom is president and chief executive officer of Volvo North America Corporation. This article first appeared in the July 14, 1988, issue of The Detroit News.

The Volvo 780 that we sell in the United States has a French engine, a Japanese transmission, an American air conditioner, a German electronic system, Singaporean control valves, a Canadian exhaust system, a Taiwanese power antenna, South Korean electrical components, Swedish axles, and Irish tires. It is designed and assembled in Italy. Is this a Swedish car?

Volvo North America sells the 780. We directly or indirectly (through our dealers) employ 25,000 American citizens—including me. The other cars and trucks we sell are made in Nova Scotia, Virginia, Ohio, Utah, Belgium, and Sweden. Our parent company, AB Volvo, is owned by 162,000 shareholders in 50 countries, quite a few of them in the United States. Is this a foreign company?

I think "international" is a better word. International, just like Ford. Or Coca-Cola. Or IBM.

Companies like these—and there are thousands of us—buy raw materials and components all over the world, wherever the price and the quality are right. We make our products all over the world, wherever it makes the most business sense.

But when we operate across a lot of borders, we all adopt what I call a "home-country" approach. We have to. What this means is that we operate in the United States or France or Australia as if it were our home country.

We cannot just take the Swedish Volvo and sell it, unchanged, in the United States. Americans have different tastes in handling, styling, and other areas. And transportation and component availability change the economics. So the American Volvo is unquestionably a Volvo—but it's a different car from the Swedish Volvo.

The same thing is true with a Coca-Cola: it tastes one way when it's bottled in Atlanta, and another way bottled in Stockholm. It's adapted to the characteristics of the markets in which it is sold.

That's what international companies do: in the many places they do business, they act as if they were local businesses, not carpetbaggers from abroad.

Now let's make this more complicated. AB Volvo is a Swedish company. Our Volvo Penta division makes marine engines in Virginia. Most are sold here, but some are exported, even to Sweden. What's foreign in this case? Are we dealing with imports or exports?

This is not a minor curiosity. Why is Taiwan's trade surplus with the United States so large? One-third of the surplus results from American corporations making or buying things in Taiwan and shipping them back to the United States—at a profit. The same thing is true of Singapore, South Korea, and Mexico: their trade surpluses are heavily dependent on American/international corporations that have based themselves there.

What's the point? After the Great Crash of 1929, our country erected huge trade barriers—and helped to launch the Great Depression. Back then, it was easy to tell the difference between "us" and "them" and to pass a law that penalized "them" (even if the law turned out to be a disaster).

Today, "us" is "them." Except for quite small businesses, there's no such thing as a domestic or foreign company. We're all international. And that means we're all American.

So, when you talk about trade barriers, remember this: You cannot write a trade-restriction law that will not cost American jobs. Or one that will not raise what we pay for American-made products. Or one that will not reduce the value of American savings invested in American and international securities.

The way the world works now, if anyone imposes trade barriers, everyone loses. □

The Key to Progress

In the highly complex, interwoven world marketplace of today, it is pointless to think of national economies as independent entities. Like it or not, modern industrial nations have become intertwined and interdependent economically, and the result is rising prosperity. Vigorous international commerce is the key to progress.

—RICHARD LESHER

The International Monetary Fund

by Ken S. Ewert

It was on July 1, 1944, just three weeks after the Allies had landed in Normandy, that the most significant intergovernmental conference of the century began. The conference took place at Bretton Woods, New Hampshire, and it represented, in the main, the thinking of two individuals, Harry Dexter White and John Maynard Keynes. Both of these men had grave doubts about the beneficence of market processes and preferred to put their faith in the ability of national and international "managers" to coordinate the world's economic affairs. And in 1944 White and Keynes were not alone in their views. As some 45 countries met to plan out the "new economic order," there was consensus on the necessity for increased economic coordination and a general view that the international gold standard was undesirable because of the restraints it placed on a nation's ability to pursue the "full employment" policies prescribed by the *nouveau* Keynesian wisdom.[1]

Two of the organizations formed at Bretton Woods have become increasingly more important in the world's economic affairs. These are the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank). Of these two institutions, the World Bank has evoked considerable criticism over the years for its policy of lending primarily to governments instead of to private, profit-seeking organizations. A strong case can be made that the policies of the World Bank have supported world-wide statist economic policies, and discouraged the expansion of the free market. The IMF, however, has generally been more acceptable to defenders of the market, since its operations do not so clearly subsidize anti-free market policies. However, as a closer look shows, the IMF has also been a major influence for statist economic policies.

The IMF was established "to promote international monetary cooperation" by maintaining fixed exchange rates among the currencies of different nations.[2] To accomplish this, the Fund was to make short-term loans to nations which had temporary balance of payments deficits (i.e., the net imports of the country exceeded its net exports). The short-term loans (usually three to five years) would presumably allow a nation to recover from its imbalance without having to resort to devaluing its currency.

IMF loans were, and are today, made according to the "quota" of each member nation. The quotas consist of the capital each country has paid in, usually 25 percent in gold and the rest in the member nation's currency. A member nation can exchange a portion of its quota to buy another nation's currency (usually dollars, German marks, or Japanese yen). These funds in turn can be used to support the borrowing country's currency on exchange markets or to pay off creditors while it (supposedly) gets its economic house in order.

While the capital for these loans is officially provided by all member nations, in reality it is

Mr. Ewert, a graduate of Grove City College, is working on a master's degree in public policy at CBN University.

the industrialized "hard currency" countries who provide the lion's share. At Bretton Woods, nearly every weak currency nation sought to increase its "quota" so that it could "buy" more currencies of real value. The same is true today as many debtor governments favor large increases in quotas while industrialized nations seek more moderate increases. The quota system amounts to an agreement of hard-currency countries to lend funds to the soft-currency countries, and it ultimately represents a net transfer of funds from citizens of industrialized countries to the debtor-nation governments (since the loaned funds are continuously rolled over or re-loaned, and not repaid to the donor country).[3]

Subject to special Fund approval, a member nation can also borrow amounts well beyond its quota. The size and number of these loans (called "standby agreements") have increased over the years, and they usually include specific economic conditions which the debtor nation must observe. The standby agreements usually are repaid over a period of three to five years. In addition to this regular financing, the IMF has greatly expanded its role by establishing several "special facilities" which give the Fund more discretion in lending and allow longer-term loans and larger subsidies for less developed countries (LDCs) which are the principal users of Fund resources.[4]

The Fund's credit-dispensing ability was further expanded in 1970 with the creation of "Special Drawing Rights" (SDRs). While dubbed "paper gold," the SDRs are actually fiat money, i.e., only bookkeeping entries in the Fund's books. They are allocated to countries according to their quotas, and they are used by member nations in their transactions with each other and as reserve assets. The SDR is the fulfillment of what John Maynard Keynes had envisioned in the early 1940s. Keynes proposed a world reserve currency called the "bancor" which supposedly would free all governments from the disciplines of gold. Like the proposed bancor, the SDRs are designed to replace gold in world monetary transactions and to further free member governments to inflate their currencies.

Initially the IMF's primary role was to foster the fixed exchange system.[5] But the Fund had little success at this, since the inflation* in many countries made devaluation of their currencies inevitable.[6] Even the widespread use of IMF credits couldn't sustain the value of debased currencies for long. By the time the fixed exchange system collapsed on August 15, 1971, the IMF had sanctioned more than 200 devaluations.[7]

Not only was the IMF powerless to stop the devaluations, its funding may well have been a net negative force since it restrained and slowed what would have been the normal market corrections of international exchange rates.[8]

When the fixed rate system finally collapsed (as the U.S. abandoned the gold-exchange standard) there were many people who speculated that the IMF would slowly fade into oblivion, since its primary role—maintenance of fixed rates—was eliminated. Such was not to be the case however, and the IMF has survived and even substantially expanded its role in the subsequent years.

When the IMF no longer had fixed exchange rates to justify its existence, it turned to lending for "temporary" balance of payments deficits as its primary function in the 1970s.[9] Between 1970 and 1975 the volume of the Fund's lending more than doubled in real terms, and from 1975 to 1982 it increased by a further 58 percent.[10]

Balance of Payments Deficits

For the most part, the balance-of-payment lending by the IMF seems to assume that a country's imbalance of payments is caused by factors other than its own economic policies. Examples of externally caused temporary trade imbalances (supposedly proving the necessity of the Fund's role) might be a poor year for a country's major export crop, or a sharp rise in the price of a principal import (such as oil). While national trade imbalances are sometimes caused by such factors, most often the culprit is not some twist of fate but rather the economic policies of the debtor nation's government.

Governments the world over find it expedient to spend more than their citizens are willing to

* The word "inflation" is used here to denote the expansion of the money and credit supply of a nation, not the most noticeable result of that monetary expansion, which is rising prices.

provide in tax revenues. The additional spending is often financed by increasing the quantity of money and credit, which results in rising domestic prices. Faced with rising prices at home, the country's citizens will tend to buy more goods and services from abroad, since they have become relatively cheaper. At the same time, exports from the inflating country will tend to become less attractive to foreign buyers because of their increased cost. The end result is a balance of payments deficit.

This deficit would tend to correct itself if exchange rates were left unmanipulated by the inflating country's central bank. The value of the inflated currency would tend to drop in relation to foreign currencies, and this in turn would discourage imports and encourage exports. But what often happens is that the inflating country's central bank intervenes in foreign exchange markets to prevent the value of its currency from falling to (or closer to) its market level. It can do so, however, only as long as it has access to foreign currency reserves with which it can intervene to purchase its own currency.

The Results of IMF Rescues

Often when a country has depleted its reserves, the IMF enters and offers loans which enable the inflating government to continue its folly by providing it with the funds to negate (temporarily) some of the consequences of the inflation. According to Henry Hazlitt: "If nations with 'balance-of-payments' problems did not have a quasi-charitable world government institution to fall back on and were obliged to resort to prudently managed private banks, domestic or foreign, to bail them out, they would be forced to make drastic reforms in their policies to obtain such loans. As it is, the IMF, in effect, encourages them to continue their socialist and inflationist course."[11] The IMF thus facilitates inflationary policies (euphemistically called "full-employment policies") in member nations by being a "safety net"—it is always there to bail out its profligate members with fresh funds.

There is no doubt that by rescuing LDC governments, the IMF has helped make possible the massive monetary inflation which has occurred and is still occurring in many of these countries. Even more important, it has allowed governments the world over to expropriate the wealth of their citizens more efficiently (through the hidden tax of inflation) while at the same time aggrandizing their own power. There is little doubt that the IMF is an influence for world-wide socialism.

Although IMF loans have been primarily short term and for the stated purpose of rectifying temporary balance of payments deficits, the Fund has been a *de facto* supplier of long-term financing to many LDCs.[12] A long-term loan is no different from a number of short-term loans strung together, and many of the IMF's member nations have a long record of back-to-back loans.[13] Between 1954 and 1984, 24 member nations used Fund credit for 11 continuous years or longer; it seems that the majority of countries which begin using IMF funds continue to do so.[14]

Without question, IMF lending has had a sizable impact on the long-term economic policies of some LDC governments, and it thus deserves some of the blame for the triple-digit inflation, price controls, oppressive taxation, stifling regulations, and general disregard for private property rights which are common to many of these countries. There is, of course, no way to know what political and economic changes for the better would have occurred in the absence of IMF bailouts, but as *The Economist* notes, the Fund often "stands as the last defense between a mismanaged economy and outright financial collapse."[15] Such a collapse, if it brings an end to statist policies, might well usher in increased economic freedom for millions of people.

Subsidizing LDC Governments

It might be objected that Fund lending merely takes the place of what otherwise would be private lending to LDC governments. And if this were the case, the IMF could not be held responsible for the policies that these loans made possible. However, the IMF often lends to financial "basket-case" countries which have little hope of obtaining private loans without IMF help. More important, almost all IMF loans are not market-rate loans, but are subsidized, sometimes heavily.[16] Given the basic economic axiom that more of an economic good will be consumed if its cost is lowered, the subsidized loans made by the IMF have encouraged LDC indebtedness and, since such loans are made to governments and not private individuals, increased the politicization of these societies.

Member nations can borrow from ordinary (non-facility) Fund resources at well below market rates. For example, from May 1982 through April 1984, the annual charge for use of these Fund resources was 6.6 percent. During this same period, interest rates paid by LDCs to commercial lenders were between 11 and 13 percent (often plus additional charges).[17]

The bulk of member borrowing, however, is done through Fund "facilities." As of 1984, more than one-third of these loans were financed by Fund borrowings from industrialized governments (rather than from quota contributions). Since the Fund can borrow at substantially lower interest rates than those available to the poor-risk LDC, it implicitly subsidized the borrowing country by passing on this lower rate. Moreover, some of the facilities are even more explicitly subsidized. The oil facility, for example, includes a "grant" factor of some thirty percent.[18]

With the increasing debt burden of many LDCs and the ensuing "international debt crisis," the IMF has garnered even more power and resources. In 1983 the Fund's resources were increased from 61 billion SDRs to 90 billion SDRs, and a number of new lending programs subsequently have been initiated.[19]

In addition to expanding its role as a lender, since the early 1980s the Fund has become the central player in "managing" the debt restructuring packages among debtor nations and their creditors. The IMF coordinates rescheduling packages in which commercial banks, governments of industrialized nations, and international agencies agree to supply new loans and reschedule old loans on the basis that the debtor nation promises to abide by IMF conditions.

The fact that the IMF loans are "conditionality agreements," which require the debtor nations to adhere to (or at least work toward) specific IMF-mandated policies, is pointed to by some Fund supporters as a crucial function served by the Fund, and one which justifies its existence. The Fund is supposedly needed to impose some sort of economic discipline on nations which seem unable to impose it on themselves.

However, the conditions imposed by the Fund are seldom free-market oriented. The Fund concentrates on "macro-policies," such as fiscal and monetary policies or exchange rates, and pays little attention to fundamental issues like private property rights and freedom of enterprise.[20] Implicit in the Fund's stated policy of "neutrality" with regard to national political decisions is a belief that with proper "macro-management" any economic system is viable, whether it be socialist or capitalist. Because the Fund does not advocate the true prerequisite for economic prosperity—a lawfully constrained government which respects private property—its record as an economic manager is rather poor. There is every reason to believe that in the absence of the IMF, private lenders would require conditions (in return for further loans) which would be at least as effective in promoting economic health for the LDC.[21]

Until recently the IMF conditions routinely required "austerity measures" in the debtor nation. These measures often included reduced budget deficits, slower money creation, and more realistic exchange rates. These conditions have invoked widespread protests both from within the "Third World" and from the universities, think tanks, and charities of the industrialized countries. Austerity measures are attacked by liberal critics as being overly harsh, politically unfeasible, and particularly harmful for the poor who depend upon government programs in the affected LDCs.

In response to this criticism, the IMF's newest director, Michael Camdessus, has indicated that the IMF in the future will be less stringent with the debtor nations and place more emphasis on "growth." According to Camdessus, the IMF must take care to "respect a member government's judgment of priorities and of domestic political constraints." Reflecting the same tone, at the annual meeting in September 1987, the IMF interim committee proposed that the "conditionality" of Fund loans should be reviewed in light of the "increased emphasis being placed on growth-oriented adjustment."

In addition to more lenient conditions, Camdessus, with the support of U.S. Treasury Secretary James Baker, advocated more funding (from industrialized countries) for the IMF over the next few years to enable the debtors to "grow" their way out of debt.[22]

The IMF role in the current crisis has not necessarily been beneficial and might well prove, in hindsight, to have worsened the debt situation. As IMF historian Margaret Garritsen de Vries notes, IMF involvement has prompted "net new lending from commercial banks on a much larger scale than had been thought possible in mid-1982."[23] Presumably the commercial lenders have been willing to extend new funds for one of two reasons: either they believe the IMF will "straighten out" the debtor nation's economy, or they believe that the IMF's involvement in the rescheduling process is an implicit guarantee of these loans. Congressman Henry B. Gonzalez, among others, believes the latter is true, and has called the IMF an "international FDIC for banks."[24]

Whatever reason for increased lending, if, as seems likely, the LDC debtor nations fail to "grow" out of their present predicament, the IMF deserves much of the blame for the future losses and financial havoc which will result.

There are indications that the Fund may be currently evolving beyond its debt management role. It is clear from recent statements by Fund Director Camdessus that the IMF desires a more central role in international economic policy coordination and management of exchange rates. In fact, in recent years the IMF's annual meeting has increasingly come to serve as a focal point for the major industrialized countries' finance ministers and heads of central banks to meet and discuss economic coordination.

However, until now the U.S. has sat "in the driver's seat" so to speak, because of the premier position enjoyed by the dollar among world currencies. The IMF, supported by several industrialized countries, advocates replacing the current American pre-eminence in the global economic management process with the international oversight provided by the Fund. In order to achieve this, Director Camdessus advocates that the dollar be replaced as the world's reserve currency by the IMF-issued SDRs.

Conclusion

The IMF is seen by many within government (as well as banking and academic) circles as "the world's master economic trouble-shooter," and there is a growing call for an increased role for the Fund in world monetary and economic affairs.[25] More than 40 years after the Bretton Woods Conference, the same call continues to be echoed: "We need more international economic coordination."

Yet the faith that governments around the world are ever willing to place in a supranational organization like the IMF seems ill-founded. After all, the IMF has failed to achieve its original goal of maintaining fixed exchange rates, it has failed to attain its subsequent goal of improving the balance of payments problems of LDCs, and it is currently failing to solve the world debt crisis. Moreover, its "successes" also are open to serious question. It has financed statist policies in LDCs, it has transferred billions of dollars from citizens of industrialized nations to Third World regimes—some of them despotic—and it has facilitated worldwide inflation.

Why, then, the widespread support for the IMF?[26] The reason is more straightforward than many of us would like to believe. When governments speak of the need for "increased economic coordination," what they mean is that governments around the world want to better synchronize their inflationary monetary policies. Inflation is politically expedient for every government in our age. It temporarily stimulates economic activity and in so doing buys considerable political favor. Only later when the unpleasant effects appear—rising prices, economic dis-coordination, consumed capital, and unemployment—does the inflation become a political liability. The illusive goal pursued by governments around the world is to reap the political benefits of inflation without paying its subsequent costs.

The IMF is seen as a means to achieve this goal of simultaneous world monetary expansion. As Hans F. Sennholz observes, the IMF represents the "spurious notion that the policy of inflation can be made to last indefinitely through cooperation of all member governments. It acts like a governmental cooperative with 146 members that tries to coordinate the inflationary policies of its members."[27] It is this vain pursuit that has sustained and nurtured the IMF throughout its history. □

1. The Treasury Secretary at the time, Henry Morgenthau, declared: "It has been proved . . . that people in the international banking business cannot run successfully foreign exchange markets. It is up to the Governments to do it. We propose to do this if and when the legislative bodies approve Bretton Woods." Cited in Henry Hazlitt, *From Bretton Woods to World Inflation: A Study of Causes and Consequences* (Chicago: Regnery Gateway, 1984), p. 88.

2. Article I of the original "Articles of Agreement," cited in Margaret Garritsen de Vries, *The IMF in a Changing World: 1945-1985* (Washington: The International Monetary Fund, 1986), p. 14.

3. According to Henry Hazlitt: "The guiding idea of the conference, even at its opening, was that the value of the weak currencies should be maintained by the countries with strong currencies agreeing to buy them at a fixed rate, regardless of their market value." See Hazlitt, p. 46.

4. These "special facilities" include: 1) The General Arrangements to Borrow which coordinates the lending of ten major industrial countries to wayward debtor countries in order "to forestall or cope with an impairment of the international monetary system." 2) The Compensatory Financing Facility which allows short-term, non-conditional loans to countries suffering from a temporary major decline in primary exports. 3) The Oil Facility and Subsidy which was established in response to the sharp increase in oil prices and allows minimal-condition loans beyond normal drawing rights. 4) The Extended Fund Facility which was established in 1974 to allow longer-term financing (over 8 to 10 years instead of the previous 3 to 5 year terms for repayment). With this special facility, the Fund has officially moved into the medium to long-term financing traditionally done by the World Bank. 5) The Supplementary Financing Facility, which was financed by Fund borrowing from industrialized country governments, further aided countries which had large payments deficits and did not qualify for regular IMF financing. See Richard Goode, *Economic Assistance to Developing Countries Through the IMF* (Washington: The Brookings Institution, 1985), pp. 5-10.

5. More accurately, a system of "adjustable peg" rates. It was recognized that occasionally "fundamental disequilibriums" would occur in a nation's balance of payments which would necessitate adjustments in the value of the currency.

6. "Currency depreciation can always be avoided through a sufficiently restrictive, usually disinflationary, monetary policy. Exchange crises are—from a technical point of view—always the fault of the country's own monetary authorities." Roland Vaubel, "The Moral Hazard of IMF Lending," in Allan H. Meltzer, ed., *International Lending and the IMF: A Conference in Memory of Wilson E. Schmidt* (Washington: The Heritage Foundation, 1983) pp. 69-70.

7. Hans F. Sennholz, *Age of Inflation* (Belmont, Mass.: Western Islands, 1979), p. 138.

8. Without IMF assistance, "the countries with the most inflation would have suffered the consequences of their currency debasements much earlier and would have had to retrench much sooner." Sennholz, p. 138.

9. As *The Economist* wrote on January 17, 1976, "the IMF did its best to resist the change to floating. Now that it has had to be accepted, why is the IMF still bent on credit creation?" (cited in Vaubel, p. 70).

10. Vaubel, p. 66.

11. Hazlitt, p. 14. Even if the balance of payments problem were due to a "temporary" shock such as a sharp increase in the cost of oil imports, there is no reason to believe that postponing the necessary adjustment by borrowing will be beneficial to the country. Even if such "adjustment smoothing" was advantageous, the country hit by the disturbance could borrow in the international capital markets. This would lead to a better utilization of resources because the borrower would pay the full cost, instead of using subsidized IMF funds. The borrower "would have to borrow at the opportunity cost of lending in the rest of the world." (Vaubel, p. 71).

12. In recent years, the IMF has been increasingly lending for longer periods, often ten years.

13. "The IMF appears to have created a class of permanent bad-credit nations that have grown accustomed to its emergency assistance." Fred L. Smith, Jr., "The Politics of IMF Lending," *Cato Journal*, Vol. 4, No. 1 (Spring/Summer 1984), p. 222.

14. Goode, pp. 19-20.

15. "Poor Man's Fund," *The Economist*, February 13, 1988, p. 14.

16. Vaubel, p. 66.

17. Goode, pp. 15-16.

18. Goode, p. 18.

19. The Structural Adjustment Facility (SAF) was established in 1986 in order to aid the poorest African, Asian, and Pacific countries. It allows the borrower a five-year grace period after which repayments begin and continue for another five-year period. IMF Director Camdessus is seeking an expansion of SAF from its current three billion SDR to 11 billion SDR. In the fall of 1987, Treasury Secretary James Baker proposed yet another IMF facility called the External Contingency Facility which would provide further aid to help sovereign debtor and creditor countries. (Anthony Rowley, "All Friends Again: IMF-World Bank Meeting Produces Harmony, If No Answers," *Far Eastern Economic Review*, October 15, 1987, pp. 67-70).

20. "Does it make any difference whether budgets are balanced by cutting spending or raising taxes?" I [Tom Bethell] asked the IMF information officer.

"That's a national political decision," he said. "How the government does it is its own affair."

I raised the problem of very high tax rates in many Third World countries.

"What is too high?" he asked.

"What about property rights?" I further inquired. "Do you insist that they be respected?"

"No," he said. (Tom Bethell, "Loony Lending," *National Review*, October 14, 1983, p. 1260).

21. The lenders could, in the absence of the IMF, form a type of consortium arrangement for dealing with their problem debtors. Moreover, IMF programs have not been very successful in curing these sick debtors. A former executive director of the Fund, Jahangir Amuzegar, admits ". . . it is disturbing that, despite its valiant rescue efforts across the Third World, the IMF is hard pressed to show more than a few clearly viable programs out of the roughly three dozen under its wing." (Jahangir Amuzegar, "The IMF Under Fire," *Foreign Policy*, Fall 1986, p. 114) Another author notes that "According to an analysis performed by T. R. Reichman, an economist in the Fund's powerful Trade and Exchange Relations Department, 21 stabilization programs initiated after Oil Shock I had only about a 33 percent success rate." Michael Moffit, *The World's Money: International Banking from Bretton Woods to the Brink of Insolvency* (New York: Simon and Schuster, 1983), p. 130.

22. Rowley, p. 70. IMF Director Camdessus is presently calling for a further doubling of the Fund's capital.

23. de Vries, p. 189.

24. Smith, p. 218.

25. Amuzegar, p. 98.

26. There is also, happily, growing opposition to the IMF. The debate over increased funding in 1983 prompted a powerful coalition of Left/Right IMF opponents including Ralph Nader and Howard Phillips. It was only the about-face switch of the Reagan administration, which had been very critical of the IMF until the fall of 1982, that assured passage of the funding increase. Treasury Secretary Donald Regan was quoted in the *Financial Times* as saying, "I lobbied 400 out of 435 congressmen before that vote." (Smith, p. 238).

27. Hans F. Sennholz, "The World Debt Crisis," *The Freeman*, February 1983, p. 79.

State Funding Threatens Community Groups

by Robert J. Schimenz

Your local Little League may be on the dole. And it is not alone. Other youth baseball, football, and soccer leagues, police athletic clubs, senior citizen groups, and similar community-based volunteer organizations are on the receiving end of "member items"—state budget items in which elected officials are allotted funds to dole out to community organizations in their districts.

Community groups tend to have tight budgets, and their leaders are usually very frugal with their organizations' funds. The appeal of the state offering thousands of dollars, for the completion of a few simple forms, has been too much for most groups to resist.

If you question the legitimacy of state funding, you will likely hear one of two answers. The first response, typically from an organization member who senses something is askew, is that the money has already been allotted, and some group is going to get it anyway.

This response ignores the long-term consequences of state funding. The ease of collecting funds by using the state as a governmental United Way will lead to an increased demand for state support. This increased demand will put upward pressure on state budgets, translating into higher taxes. In the long run, we all pay.

Mr. Schimenz, a graduate student at Long Island University, is vice president of Island Trees Little League in New York.

The second response, generally heard from legislators, is that the state is always spending tax dollars on "bad" or "poor" people and it is only fair that we give some money to "good" middle class people and their activities. But because the bulk of the tax burden rests on the shoulders of the middle class, where is the gain? And because there is the cost of an added bureaucracy to collect and distribute the funds, the community suffers a net loss.

Forcing the general public to collectively support community organizations, no matter how worthy they may be, does long-term economic harm. Taxpayers are hurt by having less money to spend, and community organizations are hurt because they ultimately become dependent upon the state, where decisions are based on politics, not on merit.

The worth of community organizations is not at issue here. Worth is based on value and need. If people believe an organization is worthwhile, they will voluntarily donate their time or money. Businessmen will donate voluntarily, with an eye on their company's reputation. This is especially true for youth sports groups, where local businessmen often act as sponsors.

But with state funding, the worth of an organization is decided by political processes, not by individual choices. More than our money, state funding takes away our freedom of choice. □

The Dam Builders

by Cecil Kuhne

The federal government has built, and operates, hundreds of dams across the United States. Entire river systems have been dammed. The Tennessee River has more miles of reservoir shore line than surrounds all five Great Lakes. Of the 2,446 miles of the Missouri River, only 149 miles still flow freely, while the remainder of the river has been tamed by dams. The Colorado River basin has been impounded to such an extent that, with vast portions of its flow diverted, little water reaches its outlet in the Gulf of California. The Columbia has been reduced to a succession of reservoirs, with little or no moving water in between.

Dams are constructed by several Federal agencies. The U.S. Army Corps of Engineers is currently working on over 300 dam projects. In the West, most dam construction is carried out by the Bureau of Reclamation. The Bureau, established at the turn of the century, has had its powers expanded over the years from that of irrigation to the point where it now operates some of the largest dam systems in the country. The Tennessee Valley Authority, a major political force in the Southeast, has built some 50 dams throughout the river's basin.

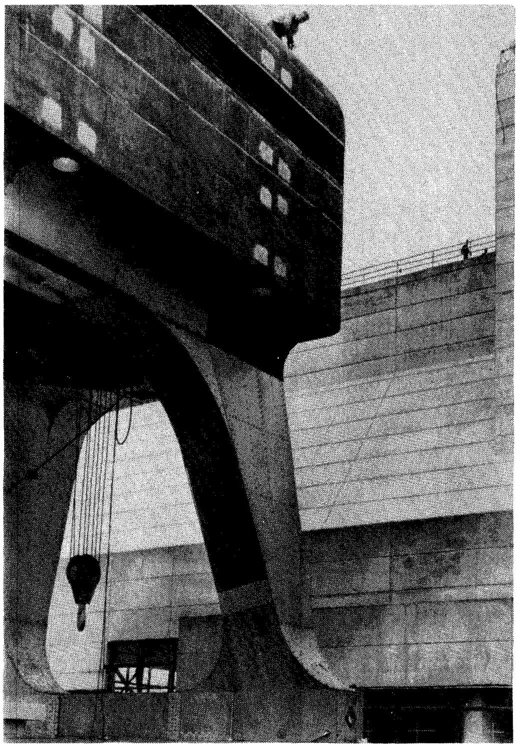
In his book, *A River No More,* Philip L. Fradkin explains the vested interests that support Federal dam building: "The power and the glory, not to mention money, center around water and the means to convey it. Woe to any president who tries to cut back this system. . . . It represents billions of dollars of water projects and a political system to procure them that has yet to be successfully thwarted."

Federal dam builders often claim that dams are needed for flood control. But this often begs the question: a dam is built so that industry and development can move in, making another dam necessary to protect the development encouraged by the first dam, and so forth. In *The River Killers,* Martin Heuvelmans explains how the Corps of Engineers perpetuates its own needs in flood control: "When an area is drained or a dam is built, 'new' land is created, and it is soon crowded with people. These people demand greater protection from the very thing the Corps sought to alleviate. More pretentious projects are started which, in turn, attract more people. The cycle continues and grows more calamitous with each move."

The Cossatot River in western Arkansas is a case in point. The Gilham Dam was justified largely on the basis of the flood damage it would prevent. Yet the 49 square miles of flood plain below the dam had almost nothing to protect: a few barns, a summer shack or two, a handful of gravel roads, and a pasture with several hundred head of cattle. There had never been a recorded flood death on the Cossatot. But the dam prevailed, even though it would have been much cheaper simply to purchase the entire flood plain.

The use of dams for flood control is rarely justifiable from an economic standpoint, since dams are enormously expensive. Under a free market system, such dams would rarely be built because the land to be protected against flooding is usually not worth the cost of the dam. A

Mr. Kuhne is an attorney in Amarillo, Texas.



Cherokee Dam, Tennessee Valley Authority

"In short, private enterprise—that is, voluntary cooperation among free persons—would neither build the pyramids in Egypt nor TVA in Tennessee."

—*Dean Russell,* The TVA Idea

more rational approach is for landowners to purchase private insurance to protect themselves from natural hazards such as floods, or to refrain from developing land in an area prone to flooding.

The need for hydroelectricity is also used to justify dams—even though an area may not be willing to purchase the power. The Alaska Power Authority, for example, proposed hydroelectric dams on the Susitna and several other rivers, despite the fact that it didn't have contracts with the local utility companies. The reason there were no contracts was simple: it was cheaper to generate electricity by burning oil or gas. However, since the federal government provides private developers of hydroelectric dams not only with cash subsidies but guaranteed markets (whether or not the power is actually used), hydroelectric dams have a way of being built. And it's no coincidence that in the past 20 years, the demand for electricity has been nowhere near the levels projected by the dam proponents.

Electric power is obviously important to a developing region, but the question which should be asked is whether the electricity will be purchased at rates sufficient to pay for the dam. Only a free market can determine that issue in a fair manner. Hydroelectric dams should be constructed by utility companies, or by private developers planning to sell the electricity to utilities, who are willing to pay the huge sums necessary in the hopes of making a profit—with no assurances from the government that it will provide a market for the power generated. As things stand now, the government has no incentive not to build inefficient hydroelectric projects, since the eventual losses will be borne by the taxpayers as a whole.

Federal dam builders also cite the need for irrigation. But Federal irrigation projects often amount to enormous agricultural subsidies—water that may have cost the government $70 to $100 per acre foot to develop is sometimes sold to the farmer for as little as $3 to $4 per acre foot. Furthermore, these water projects themselves often destroy farmland—it is sometimes suggested that the Bureau of Reclamation has dug up and drowned more farmland than it has ever irrigated.

The decision of whether to build a dam for irrigation purposes is made simple by a free market approach. If farmers are willing to pay the price of the water necessary to recoup the costs of the dam, then the dam should be built; if not, the dam should stay on the drawing board. Let private investors decide.

In a free market, no dam would be built without the consent of all the property owners involved, and without investors being convinced that it will show a profit. Isn't that how it should be? □

Tom Paine's Revolution

by J. Brian Phillips

Advocates of freedom often despair at the political inertia that must be overcome to achieve their goals. At times, it seems as if the freedom movement is progressing too slowly to reverse current political trends. In this regard, the American Revolution provides an important lesson.

Even after the Revolutionary War had begun, most Americans, including many colonial leaders, favored reconciliation with England. Most Americans still considered themselves to be loyal British subjects, and were willing to continue to do so, if only the King would correct his most grievous transgressions. In early 1776—more than eight months after the Battle of Lexington—colonists suddenly began to support the idea of American independence. This dramatic change can be largely attributed to the work of one man: Thomas Paine.

Paine was an undistinguished Englishman when he arrived in Philadelphia in November 1774 armed with several letters of introduction from Benjamin Franklin. Aided by Franklin's letters, Paine quickly found work as an editor and chief writer for *Pennsylvania Magazine*. Sharing Franklin's interest in science, Paine wrote about the newest inventions of the day, as well as political issues, but he remained relatively obscure.

However, in January 1776 that began to change, when Paine anonymously published a pamphlet titled *Common Sense*. While the ideas expressed in the pamphlet weren't new, the approach and comprehensive treatment were.

"[G]overnment," Paine wrote, "even in its best state is but a necessary evil; in its worst state an intolerable one."[1] The purpose of government, he held, is to insure the security of the citizenry by protecting their rights. The central issue of the war, he believed, was over what form America's government should take. He went on to write: "I draw my idea of the form of government from a principle in nature . . . that the more simple a thing is, the less liable it is to be disordered, and the easier repaired when disordered." (p. 68)

To those who urged reconciliation because England was the "parent country," Paine replied, "Even brutes do not devour their young, nor savages make war upon their families." (p. 84) Then Paine became one of the first to publicly proclaim, "The authority of Great Britain over this continent, is a form of government, which sooner or later must have an end." (p. 87)

Loyalists reacted quickly to *Common Sense*, declaring the pamphlet's author to be ignorant of modern history and thought. Some said that Negro slaves, and Quakers and other pacifists wouldn't support the war effort. Charles Inglis argued that Paine's conception of man's inherent goodness was as flawed as the Hobbesian view that only force and violence could induce men to live under a government.

Much as the Loyalists despised Paine, many supporters of the Revolution held him in higher contempt. Indeed, John Adams would later call him "that insolent blasphemer of things sacred and transcendent libeler of all that is good. . . ."[2]

Wealthy colonists feared that Paine's ideas were too democratic, that he would advocate forcible redistribution of wealth. Paine, how-

Mr. Phillips is a free-lance writer based in Houston, Texas.

Thomas Paine

Thomas Paine was born in Norfolk, England, in 1737. During his lifetime, he was a sailor, teacher, exciseman, and inventor, as well as the premier propagandist for republican government in England, France, and what would become America. His pamphlets Common Sense *and the series* The Crisis *united idealists with those interested in the economic advancement of the country, and gave great support to the morale of the common soldier in "the times that try men's souls." He died in 1809, almost forgotten, but eulogized by Thomas Jefferson as one who did as much as any man "to advance the original sentiments of democracy."*

ever, never advocated such a policy, and was an ardent supporter of free trade.

Despite these criticisms, *Common Sense* had an unprecedented influence on the minds of the American people. Paine estimated that 150,000 copies were sold in the first year; other estimates went as high as 500,000 copies. With fewer than 3 million people in the colonies at the time, either figure is astounding. Nearly every adult read the pamphlet, and less than seven months after its publication independence was declared. Significantly, Thomas Jefferson consulted Paine while he was drafting the Declaration of Independence.

Paine, of course, wasn't the only writer to exert influence on colonial Americans. However, what he accomplished provides an important lesson for modern advocates of liberty.

The parallels between Revolutionary America and modern America are striking. Most Americans today complain about high taxes, government interference in their personal affairs, welfare fraud, inflation, and other manifestations of overextended government. Opinion polls show that most Americans favor less government, at least in theory. When questioned about specific programs and policies, however, Americans favor the continuation of the status quo.

Just as colonial Americans were willing to reconcile with a despotic King, modern Americans are willing to tolerate a despotic Congress. As Jefferson wrote in the Declaration of Independence: "all experience has shown that mankind are more disposed to suffer, while evils are sufferable, than to right themselves by abolishing the forms to which they are accustomed." It wasn't greater tyranny on the part of the King that led colonial Americans to embrace freedom, but an awareness of just how terrible conditions actually were. Modern patriots can achieve similar results, but only if we remain confident that our goals are attainable.

I hasten to add that we cannot expect laissez-faire capitalism to emerge shortly after the publication of a modern version of *Common Sense*. Statism, and its ethical roots, are too deeply ingrained for that to occur. However, if we are more cognizant of the history of freedom, then our struggle is far more tolerable. And more significantly, the length of that struggle may be shortened.

Philosophically, the American Revolution was a product of the Enlightenment. More than any other writer of his time, Thomas Paine made the ideas of the Enlightenment—individual rights and economic freedom—accessible to the public. These ideas remain a part of the American culture, if only implicitly. The emergence of the entrepreneur as a modern hero is evidence of this, as is a greater willingness to consider private alternatives to functions traditionally performed by government.

More than 200 years ago, one man—Thomas Paine—provided the key that unlocked the door to freedom. When our cause seems hopeless, we should remember this, for the knowledge that success is possible is the fuel that will propel us to our ultimate goal: freedom in our time. □

1. Thomas Paine, *Common Sense* (New York: Penguin Books, 1985), p. 65. Subsequent quotations are from the same edition, with page references given in parentheses.

2. John Adams, *The John Adams Papers* (New York: Dodd, Mead & Co., 1965), p. 86.

A REVIEWER'S NOTEBOOK

Faith and Freedom

by John Chamberlain

Ben Hart, the son of Dartmouth's Professor Jeffrey Hart, is one of those editors who got their training on the off-campus *Dartmouth Review,* a conservative publication that has turned out more good newspapermen in recent years than any of our graduate schools of journalism. He is also an indefatigable scholar in the off-hours when he is not working for the Heritage Foundation in Washington. In a writing regime that has begun for him daily at six every morning he has produced an excellent book called *Faith and Freedom: The Christian Roots of American Liberty* (Lewis and Stanley Publishers, 384 pp., $18.95).

The book makes a case for the claim that our constitutional liberties are historically rooted in the Christian faith. But Thomas Jefferson, who wavered between Deism and Christian beliefs, preferred to speak of a nondenominational "Creator" who had endowed us with "certain unalienable rights." The common people in the colonies who objected to taxation without representation could have been secular in demanding that the "rights of Englishmen" going back to Magna Carta must be respected. But in any case there was a consensus: individual citizens had the right to representative government.

"We are fortunate," says Ben Hart, "that the American Republic was created at a time when there was such unanimity of opinion on what constitutes good government. The disagreements were over specifics, not fundamentals; means, not ends." Whether it was Jefferson's deistic "creator" or the God of the Bible who was the source of our liberties did not really matter.

What was important, in Hart's view, was that America, at the end of the eighteenth century, "was overwhelmingly Protestant, and of the dissident variety." In 1775 there were 668 Congregational churches, 588 Presbyterian, 494 Baptist, 310 Quaker, 159 German Reformed, 150 Lutheran, 65 Methodist. The Anglican Church, with 495 congregations, was in decided minority. Only 1.4 percent of the population was Roman Catholic, and three-twentieths of one percent Jewish.

Fully 75 percent of all Americans at the time of the Revolution belonged to churches of Puritan extraction. These Americans believed they had the right to face their God directly, without institutional barriers intervening. The greater part of Hart's book is devoted to exploring the faiths of churchgoers who looked back to John Wycliffe's and William Tyndale's tradition of translating the Bible into contemporary English and reading it for themselves. In America the pivotal document in the development of constitutional government was the Mayflower Compact, which was signed by almost all of the adult men on the Pilgrims' voyage. This, says Hart, disproves the impression left by historians that the "social compact" was an idea invented by John Locke in 1688, when the Era of the Enlightenment was dawning. Locke's "social compact" theory, says Hart, "was not really a theory at all, but was derived mainly from Scripture and his experience with the Congregational church."

What really mattered was that Locke and the Mayflower Compact people came from the same source. The Puritans, who sailed to the Boston area ten years after the Pilgrims had settled in Plymouth, had a leader in John Winthrop who wanted to build a government on biblical principles. Winthrop, who envisioned a "shining city on a hill," was a republican rather than a democrat. He believed there must be safeguards preventing a tyranny of the majority. Winthrop's way of avoiding a tyranny was to divide his law-making body into a House of Assistants and a House of Deputies, which represented the first bicameral legislature in North America.

Winthrop's hopes that his "shining city" would hold Puritans close to the Boston area were doomed by what Edmund Burke at a much later date would refer to as the "dissidence of dissent." The Reverend Thomas Hooker, though a good friend of Winthrop, petitioned the Massachusetts General Court to allow his congregation to move to Connecticut. Winthrop said Hooker was breaking a covenant in leaving, but he couldn't stop him.

The Fundamental Orders

The Puritans in Boston had their own charter, which they had had the foresight to take with them from England, well out of the reach of Stuart monarchs. In Connecticut, Hooker established his Court without a charter. His General Court inspired the so-called Fundamental Orders of Connecticut which was the first written constitution in America. The Fundamental Orders created a pattern for the Federal Constitution.

The Fundamental Orders set up a working government by the people themselves, without any concession from a previously existing regime. The Orders provided for regular elections but set strict limits on the power of those elected. Madison, Hamilton, and Jefferson, the Founding Fathers, had a lot of precedent to go on when the final break with England came in the late eighteenth century.

What Hart is intent upon doing is to establish the idea that the American and French revolutions were two entirely different things. The American revolution was really a counter-revolution, aimed at preserving a dispensation that had been in effect since Winthrop's and Hooker's day. It was George III, with his archaic divine right of kings, who was the revolutionist in 1776. The French revolution, coming out of the Enlightenment, had no ancient roots in Protestant insistence on the right to face God directly. It collapsed into Bonapartism after Robespierre's guillotine had done its nefarious work.

The majority opinion in America was Protestant, but there were so many sects that it was necessary to create a government which would not favor one Christian sect over another. Hence the separation of church and state that is found in the First Amendment. Modern judges get it all wrong when they say that the First Amendment means that government forbids State encouragement of religion in general. All that the Amendment says is that there shall be no specific religion.

Some of the states, in 1787, had official churches, but this didn't last. In 1786 Jefferson's and Madison's state bill in Virginia disestablished the Anglican Church, which had become a minority sect in Virginia anyway.

Hart wonders how the posting of the Ten Commandments on school walls, or how publicly expressing thanks to our Creator for all He has given us, threatens the liberties of anyone. He hopes that different judges appointed by President Bush will bring an end to petty squabbling about such things as a moment of silence in schools. As he puts it in a concluding chapter on "the true Thomas Jefferson," ". . . one would have to have a very warped perspective on American history to believe the Founding Fathers intended or foresaw the federal government being used to bludgeon Christianity."

The clear intent of the First Amendment, says Hart, "was to protect a religious people from government." □

PRIVATIZATION AND DEVELOPMENT
Edited by Steve H. Hanke

International Center for Economic Growth/ICS Press, 243 Kearny Street, San Francisco, CA 94108 • 1987 • 237 pages • $29.95 cloth, $12.95 paper

Reviewed by Robert W. McGee

This book is a "how-to" manual on privatization, which Hanke defines as "contracting with or selling to private parties the functions or firms previously controlled or owned by governments." However, whereas most privatization books emphasize how privatization has worked in developed nations, this book spends a good deal of time showing how privatization aids economic development in less developed countries.

But the book is not exclusively about privatization in the Third World. There are more general chapters on the role of divestiture in economic growth, political obstacles to privatization, property rights, legal and tax considerations, and financing and marketing techniques that apply to any privatization program. Each chapter is written by an expert in the field, and

Professor Hanke has done a good job of editing their work to make the chapters flow smoothly.

The first part of the book discusses the effects of privatization in the developing world. Hanke's introduction calls privatization a revolutionary innovation in economic policy, and mentions that the privatization concept has spread from Britain to France and to the "people's republics" in Africa and just about everywhere in between. Privatization will have a lasting impact in many places because it leads to structural change rather than cosmetic changes that can be easily undone by the next political administration.

There is something in privatization for everybody. Privatization promotes efficiency because private parties can do just about anything more efficiently than government, as long as they must compete in the marketplace. (If government grants a monopoly, that's another story.) Others favor privatization because it shrinks the size of government. Individuals from all parts of the political spectrum find privatization appealing once they can be shown what it is and what it can do for them.

Several chapters address this marketing question from different angles. Robert Poole points out the political obstacles to privatization—it is widely believed that there won't be enough suppliers to permit competition, public services are "natural monopolies," government must provide the service in question to ensure that the poor have access to it, and so forth. Poole answers these and other popular objections that have been raised against privatization.

One chapter provides a decision-maker's checklist of things to consider when preparing for privatization to avoid the pitfalls and maximize the chance of success. Another discusses successful privatization strategies and cites examples of how privatization has cut costs in a wide variety of areas.

For instance, it costs the Army \$4.20 to process a check, but a private company can do it for \$1. Private airlines in Australia carry 99 percent more tons of freight and 14 percent more passengers per employee than does Australia's state-owned airline. Government offices in Hamburg, Germany, saved 20 to 80 percent in custodial costs by privatizing. Fire protection can cost 50 percent less when provided privately. Preparing timber for sale on public lands costs \$80 to \$100 per 1,000 board feet, compared to \$10 on private lands. Construction costs for Veterans Administration nursing homes are 290 percent higher than for private nursing homes. Ohio's private property assessors can do the job for 50 percent less than the national average, but quality, as measured by the relationship between appraised values and actual property sales prices, is the highest in the nation. Many more examples are given.

From the evidence, it is obvious that privatization strategies can be used to reduce the cost of just about any government service. But part of the problem with trying to start a privatization program is to overcome the inertia of the status quo. Politicians and affected parties have to be convinced that they stand to benefit from privatization. This book describes techniques that have proven successful in winning over key groups.

The book also gives four case studies of countries that have privatized. The history of privatization in Britain is especially interesting because Britain has been at the forefront of the privatization movement. The British Columbian experience is interesting to read because of the novel approach that was used—transferring government assets to a holding company and giving its stock to the residents of British Columbia. Privatization in Turkey has led to both successes and problems. While intervention in the economy was reduced, it has been difficult to get the citizens to invest in anything other than gold and real estate because those were the only two investments they felt safe with. The Grenadan example shows what can be done when the proper groundwork is laid.

Privatization has had many successes since the late 1970s. The evidence is clear that government goods and services can be provided better and cheaper by the private sector. The major problem to be overcome is to convince those affected that they will be better off if their product or service is provided privately rather than by government. When this is done, privatization can succeed. □

Professor McGee holds a law degree and teaches accounting at Seton Hall University.