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IDEAS ON LIBERTY

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PERSPECTIVE

Why the Soviet Economy Is Still in Trouble

Recent reports from the Soviet Union indicate that the Soviet economy has faltered under Mikhail Gorbachev's perestroika, or restructuring. The news is puzzling to Western journalists, as it must be to the Soviet governors themselves. After all, the regime has promoted more efficient management of the economy and waged a major campaign against the corruption that affects every level of Russian life. But instead of the expected flowering of production, distribution, and consumption, things have gone from bad to worse. Today, even in privileged Moscow, such basic items as beef, sugar, tea, coffee, toilet paper, and gasoline are usually scarce and often nonexistent, at least in the stores open to ordinary people.

Such a development, however—or rather, such a lack of development—will not surprise the economically alert. It is the essence of perestroika to be a restructuring of the Soviet managerial economy, an assertion of power from the top down. Indeed, perhaps to facilitate his task, Gorbachev has been increasing the already tremendous powers granted to him under the system inherited from his predecessors.

The Soviet leaders and their legions of Western admirers do not see, however, that they are taking precisely the wrong actions to achieve prosperity. The fundamental problem of the Soviet economy is that it is too heavily centralized, too thoroughly managed. The spontaneity needed to meet consumer demand, introduce new products, and adjust prices to each other simply cannot happen under these circumstances. In fact, one of the few things that keeps the Soviet economy running at all is corruption, for, in a society where nearly all economic activity has been made criminal, corruption is almost the only way in which goods and services can be freely exchanged. So, by cracking down on corruption, perestroika has chilled the only area of Soviet life in which genuine economic behavior is possible.

At the same time, the few "market-oriented" reforms tried have been half-hearted and enmeshed in threats against those who seek to

"profiteer." In a nutshell, people are terrified to start businesses, for they never know when even the slight incentives offered might be revoked, and those who have taken advantage of them persecuted as criminals.

Gorbachev may or may not be a good man who sincerely desires to improve the lot of the peoples of the Soviet Union. What is certain is that Gorbachev is wholly on the wrong track with the policy of perestroika both as stated and as implemented. What the Soviet economy needs is not "restructuring" but destructuring; not more government control over the economy, but less. If Gorbachev and his henchmen could bring themselves to simply leave the Soviet people alone to grow, to produce, to invent, to buy, and to sell, they would soon find themselves sitting on top of an economic colossus, and it wouldn't take a penny of Western aid.

—NICHOLAS DAVIDSON

Why the Russians Didn't March

There is a joke in which an American and a Russian argue about who has more freedom. The American says, "I can come up to the White House and yell, 'Down with the President of the United States!'" The Russian says, "Well, I can come up to the Kremlin and yell, 'Down with the President of the United States!' too!"

This joke is a completely inaccurate reflection of Soviet realities: Soviet citizens do not even have that kind of freedom. Here is a typical episode.

In the year of the fiftieth anniversary of the founding of the USSR, the Party organizer at one of the departments of Moscow State University declared at a meeting that Communist enthusiasm was waning in our society: no one had even thought of organizing a parade to mark an event of such importance. The Party organizer called on the department to fan the dying flames by holding a march, on their own initiative, in honor of the anniversary of the Soviet state. Signs and posters had already been prepared, and the time was set for the march to begin. But the procession did not take place. When the dean's office found out about the proposed unauthorized event, they were horrified. The march was banned, the posters confiscated, and the Party organizer reprimanded.

Why were the authorities so horrified? The hapless Party organizer had unwittingly violated one of the chief principles of Communist rule: a doctrine that contains absolute truth cannot give the individual any freedom at all, not even the freedom to support the doctrine on his own free will.

—GLEB ANISHCHENKO, writing in *Glasnost*, a dissident publication founded in Moscow in 1987. Translation provided by the Center for Democracy in the U.S.S.R., 358 W. 30th Street, Suite 1-A, New York, NY 10001.

Social Security

Today's workers should keep in mind that the payroll taxes they pay will not finance their social security benefits. Rather, tomorrow's workers will pay for these benefits through payroll, or other taxes. Furthermore, in order to pay currently promised benefits, tax rates will have to rise. Depending upon future economic and demographic conditions, payroll tax rates may well have to double or triple to cover social security benefit payments.

Future workers, however, may object to ever-rising taxes. Faced with opposition, politicians will alter the structure of social security, as they did in 1983 when social security benefits were taxed for the first time and the retirement age was raised. Because social security is neither an annuity nor a legal guarantee, today's workers may well find that the social security benefits they actually receive will be less than what is currently promised. Moreover, because of the detrimental economic effects of higher tax rates, today's workers will face a lower standard of living all along the way.

—ALDONA E. ROBBINS, writing in *The ABCs of Social Security*, published by the Institute for Research on the Economics of Taxation.

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Crime and Consequences

by Robert James Bidinotto

Part I: Criminal Responsibility

During the past Presidential campaign, the issue of crime loomed large—due, in part, to this writer's *Reader's Digest* article on the now-infamous Willie Horton case.[1] That story offers a fitting introduction to the subject of America's seemingly intractable crime problem, and what's wrong with our criminal justice and correctional systems.

Horton was a habitual criminal, sentenced in Massachusetts to "life with no possibility of parole" for the savage, unprovoked knife slaying of a teen-age boy. However, like many other alleged "lifers" in that state, after only 10 years in prison he was transferred to an unwalled, minimum-security facility. There, he became eligible for daily work release, as well as unescorted weekend furloughs, from prison.

Following the example of 10 other "life-without-parole" killers over the years, Horton decided not to return from one of his furloughs. Instead, months later, he invaded the home of a young Maryland couple, where for nearly 12 hours he viciously tortured the man and raped the woman.

Not even a "life without parole" sentence for a gruesome murder had been enough to keep a killer off the streets—a fact which incensed enough Americans to become a major election issue. It also reopened the public debate about the criminal justice system in America. For as the campaign rhetoric grew heated, many citizens began to discover that the Horton episode was not an isolated exception. Instead, they learned that, in today's criminal justice system, justice is the exception.

Now that public awareness of, and concern about, such matters is intense, it seems an opportune time to reconsider the way in which we approach the problem of crime.

Permit me to begin on a personal note. My work on the Horton story put me in touch with police, parole and probation workers; with politicians, prosecutors, and prison reformers; with judges and jurists, therapists and theorists, corrections officials and—most important—crime victims. The faces of victims have haunted me for over a year. So at the outset, let me declare my bias without apology: it is for them. Today, they are too often the forgotten people in our legal system; and their cries for justice must be heard and answered.

For months, the more I learned, the more I realized that what happened in the Horton episode was symptomatic of a whole approach to crime which has gained sway during the past three decades. In this article, and those in the next two issues of *The Freeman,* that approach will be explored in its many facets:

- the reasons for the surge in criminality during the past three decades;
- the various theories which purport to "explain" crime;
- the nature of criminals;

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•the criminal justice system which confronts them;

•the correctional system which tries to reform them; and

•the ways in which our approach to crime might be changed.

The Crime Explosion

Across the nation, our system of dealing with crime has utterly broken down.

To put things in perspective, we must first grapple with some numbers. Crime itself continues to increase, with no end in sight. The number of crimes reported in 1987 was 12 percent higher than in 1983 and 21 percent higher than in 1978.[2]

Not only is the number of crimes increasing; so is the crime *rate*—the number of reported crimes per 100,000 people. From 1964 to 1980, the property crime rate increased nearly 2.5 times, while the rate of violent crime tripled.[3]

Though these rates declined somewhat during the first half of this decade, they have been rising steadily since.[4]

Such statistics tend to depersonalize the issue. It's quite another matter when you are personally assaulted or robbed; when your wife or daughter is raped; when your neighbor's home is burglarized; when an employee embezzles funds from your business. Such things happen to us more frequently than we realize. In 1986 alone, about one household in four was touched by some kind of crime—meaning that at least someone in each of those homes fell prey to a criminal.[5]

Another gauge of the crime explosion is the rapid growth of prison populations. In 1960, there were some 200,000 inmates in Federal and state prisons; by 1987, there were 581,609.[6] This might seem proof of a growing "get-tough" attitude toward crime. Yet the percentage of serious crimes committed which resulted in imprisonment actually fell sharply throughout the 1960s and 1970s. In 1986, the ratio of prison commitments to total crimes was 32 percent lower than in 1960.[7] This means that a third fewer of total crimes were being punished with imprisonment. It also means that, despite rapidly increasing prison populations, the crime rate is growing even faster than we've built cells to hold all the new criminals.

And in fact, even these statistics paint too rosy a picture.

The Federal Bureau of Investigation (FBI) announced that, in 1986, 13.2 million serious crimes, from murder to auto theft, were reported to local authorities.[8] However, the FBI's statistics cover only eight specific "index crimes." Moreover, its numbers reflect only those incidents reported to police. In fact, the FBI's annual Uniform Crime Reports grossly understates the total number of crimes which actually occur.

In an effort to get more reliable numbers, the American Bar Association (ABA) recently compiled information from various sources, including crime-victim surveys. The ABA estimated that, in reality, about *34 million serious crimes* had been perpetrated nationally during 1986—some 2.5 times what the official numbers indicate.[9]

This means that other official data—such as computations of arrest and imprisonment rates—do not begin to convey how serious the crime problem is. For example, FBI statistics show that only one of every five serious crimes reported to police are "cleared" by an arrest.[10] But if the ABA is correct, we must multiply by 2.5 to account for *unreported* serious crimes. This reveals that there is actually *only one arrest for every 12.5 serious crimes committed.* Put another way: only eight serious crimes in 100 result in so much as an arrest.

What are the chances that even this small percentage of arrested criminals will ever see the inside of prison? Consider now what happens within the criminal justice system.

"Criminal Justice": An Overview

Of the eight felons per 100 serious crimes who are arrested, one or two are teenagers who are routed to the juvenile justice system (which is far more lenient than the adult system). This leaves only six or seven adults apprehended for every 100 serious crimes committed. Of these, many are released for lack of sufficient evidence or on technicalities; a few are acquitted after standing trial. Of the tiny number remaining who plead guilty or are convicted, most receive dramatically reduced sentences, or are allowed simply to "walk" on probation, thanks to "plea-bargain" arrangements.

The results? According to the federal government, for every 100 serious crimes *reported* in 1986, only 4.3 criminals went to prison.[11] But ad-

justing once again to account for *unreported* crimes, we find that in 1986, only 1.7 percent of the most serious crimes were punished by imprisonment. In other words, only 17 perpetrators were put behind bars for every 1,000 major felonies.

In calculating his chances of being punished, then, any would-be criminal would logically conclude that the odds are definitely on his side—that today in America, crime *does* pay.

Hence the phenomenon of the career criminal. Most crimes are committed by repeat offenders, often arrested but rarely imprisoned. For example, in 1986, Massachusetts state prison inmates each had an average of 12.6 prior court appearances. Since, as we have seen, the typical criminal gets away with 12.5 felonies for his every arrest, simple multiplication (12.6 X 12.5) suggests that, on average, many of the Massachusetts inmates had committed well over 100 crimes. Few of these inmates were teenagers: their average age was 31. Yet despite their status as career criminals, 47 percent of them had never before been incarcerated as adults.[12]

The career criminal knows, too, that even in the unlikely event he's ever sent to prison, all is not lost. If he's been convicted of multiple felonies, he stands a good chance of getting "concurrent sentences," to be served simultaneously instead of consecutively. This greatly reduces the time he'll spend behind bars. And he also knows that prison sentences almost never mean what they say.

In most jurisdictions, parole eligibility comes after serving only a fraction of the nominal term handed down by a judge. In addition, from the time he enters prison, the inmate is offered a *de facto* bribe of *automatic deductions from his sentence* for each day of good behavior (called "good time"), as well as additional deductions for blood donations or participation in various rehabilitation programs. These may count either against his prison term itself, or his post-release parole supervision time.

Furthermore, virtually every state offers the inmate a wide array of outside release programs. After serving only part of his sentence, the inmate can become eligible to leave prison walls and work at a job (work release), or attend classes (education release), or simply visit his family and friends for several days at a time (home furloughs). The public's image of the hardened criminal leaving prison handcuffed to an armed guard is many years out of date. In many current release programs, even dangerous killers (such as Willie Horton) are simply turned loose without any prison escort—presumably in the "custody" of a family member or friend.

In summary: even among that small percentage of hardened, repeat offenders who are apprehended, convicted, and imprisoned, few will spend very long under lock and key. And within a short time after release on parole, most resume their criminal careers. Proof of this lies in many studies showing that paroled inmates have high rates of "recidivism" (or relapse into crime). Depending on how recidivism is measured, fully a third to half of all paroled inmates are returned to prison within a year or two—and this despite the very low chance of being arrested for any of their subsequent crimes.

As every criminal knows, the "criminal justice system" is a sham. As we shall later see, the consequences are undermining the motivation and integrity of those who man the institutions of the law. Worst of all, millions of victims, who hope for justice, find that some of the worst crimes against them are perpetrated *after* they go to court.

Irrationality of this magnitude doesn't "just happen." Nor would it long be tolerated, without a complicated framework of abstract rationalizations to soothe, confuse, and dismiss critics. Like most compromised institutions, today's criminal justice system is the handiwork of what I call the "Excuse-Making Industry."

The Excuse-Making Industry

This industry consists primarily of intellectuals in the social-science establishment: the philosophers, psychological theorists, political scientists, legal scholars, sociologists, criminologists, economists, and historians whose theories have shaped our modern legal system. It also consists of an activist wing of fellow-travelers: social workers, counselors, therapists, legal-aid and civil-liberties lawyers, "inmate rights" advocates, "progressive" politicians and activists, and so on.

It was this industry which, in the 1960s and 1970s, initiated a quiet revolution in the criminal justice system. Its proponents managed to rout

the last of those who believed that the system's purpose was to apprehend and punish criminals. Instead, the Excuse-Making Industry was able finally to institutionalize its long-cherished dream: not the punishment, but the *rehabilitation* of criminals.

Prisons were renamed "correctional facilities," and state bureaus of prisons became "departments of correction." Many aspects of the legal and prison systems, outlined above, were implemented about this time. These reforms dovetailed with other products of the industry: massive government spending programs to eradicate what it called "the causes of crime." Welfare programs mushroomed; academic standards declined so as not to "discriminate" against the "disadvantaged"; "elitist" moral standards were scorned by various "liberation" movements.

Summing up the unintended consequences of these efforts, Charles Murray has written: "The changes in welfare *and* changes in the risks attached to crime *and* changes in the educational environment reinforced each other. Together, they radically altered the [social] incentive structure." This became especially evident in the area of crime: crime rates began to take off while penalties for crime lessened. Soon, "a thoughtful person watching the world around him. . . was accurately perceiving a considerably reduced risk of getting caught. . . . It was not just that we had more people to put in jails than we had jails to hold them. . . ; we also deliberately stopped putting people in jail as often. From 1961 through 1969, the number of prisoners in federal and state facilities—the absolute number, not just a proportion of arrestees—dropped every year, despite a doubling of crime during the same period."[13]

Clearly, it wasn't the intention of the social-science establishment that crime rates soar. The Excuse-Making Industry is no diabolical, centrally directed conspiracy, harboring some warped, unfathomable desire to foster criminality. Rather, it's a sprawling intellectual consensus, consisting of many diverse, competing, and often conflicting elements—but united in a single premise: that the criminal isn't responsible for his behavior.

There are many variations on the theme that binds the Excuse-Making Industry.

There are sociologists, who hold that environmental, racial, social, and economic factors have "driven" the criminal to his anti-social behavior—a view echoed by economists, usually of a Marxist inclination, who argue that criminals are formed by their membership in an "exploited" economic class.

There are Freudian psychologists, who contend that criminals are helpless pawns of emotional drives rooted in childhood; and behavioral psychologists, who believe criminals are clay, shaped by "negative reinforcers" in their families and neighborhoods.

There are biologists, who cite the alleged correlation between criminal behavior and possession of a so-called "mesomorphic body type"; other biologists and geneticists, who think criminality is caused by genetic, physiological, or biochemical deficiencies; still others, who believe there may be a racial or ethnic "propensity" to criminality.

There are eclectics, who think a combination of such "causes" can "explain" crime.

But whatever the variation, the theme is a constant. The criminal is not responsible for his actions, because man is not a causal agent in any primary sense. Forces and circumstances outside his control "cause" him to behave as he does. He should be forgiven, or treated therapeutically, or placed in a better environment, or counseled to "cope" with his uncontrollable inner demons. But he must not be held accountable for his actions—and, under *no* circumstances, punished for what he "couldn't help."

For all its internal bickering, the Excuse-Making Industry's common theme may be summed up in a single cry: "He couldn't help it, because. . ." Arguments arise only in answer to the question: ". . . because *why*?"

Consider some of the commonly advanced "explanations" for criminal behavior.

The Sociological Excuse

In the musical *West Side Story*, one juvenile delinquent incisively satirizes the sociological theory of crime, telling the local cop, Officer Krupke: "We're depraved on accounta we're deprived."

Former U.S. Attorney General Ramsey Clark offered a more formal summary of the view that crime is "caused" by external social and economic factors:

> If we are to deal meaningfully with crime, what must be seen is the dehumanizing effect on the individual of slums, racism, ignorance and violence, of corruption and impotence to fulfill rights, of poverty and unemployment and idleness, of generations of malnutrition, of congenital brain damage and prenatal neglect, of sickness and disease, of pollution, of decrepit, dirty, ugly, unsafe, overcrowded housing, of alcoholism and narcotics addiction, of avarice, anxiety, fear, hatred, hopelessness and injustice. These are the fountainheads of crime. They can be controlled. As imprecise, distorted and prejudiced as our learning is, these sources of crime and their controllability clearly emerge to any who would see.[14]

This is probably the most widely held view of criminal causation—and probably the easiest to refute. Whatever might be said of the prevalence of unsavory social conditions today, surely they were even more prevalent in decades and centuries past, and are more prevalent today in Third World nations. Yet despite the fact that conditions and circumstances have been constantly improving for the vast majority of people, crime today is *increasing*; and it is increasing faster in America and other developed countries than in most poorer parts of the world.[15]

The sociological excuse (of which Marxist "class warfare" theory is a subset) flies in the face of common sense and empirical evidence. Even within the same poor, inner-city families, some youngsters become criminals, while the majority do not. Sociology (including Marxism), based on the collectivist premise that men are interchangeable members of undifferentiated groups, cannot account for such obvious diversity in individual behavior under identical circumstances.

Or consider the following example: "During the 1960s, one neighborhood in San Francisco had the lowest income, the highest unemployment rate, the highest proportion of families with incomes under $4,000 per year, the least educational attainment, the highest tuberculosis rate, and the highest proportion of substandard housing of any area of the city. That neighborhood was called Chinatown. Yet in 1965, there were only five persons of Chinese ancestry committed to prison in the entire state of California."[16] Clearly, factors other than economics and ethnic status affect the propensity toward criminality.

How, then, do we explain the disproportionate numbers of poor and black inmates in prisons?

For one thing, those who are better-off financially can afford better lawyers, and manage to "beat their raps" more consistently than those forced to rely upon court-appointed attorneys or legal-aid lawyers.

We might also consider a heretical thought: not that "poverty causes crime," but that *criminality causes poverty.*

While most poor people behave responsibly and work hard to better themselves, some do not. The majority's responsible behavior has a much greater likelihood of leading many of them out of poverty; but the minority's irresponsibility is an almost sure path both to continued poverty, and to criminality. Irresponsible youths tend to be self-indulgent and short-range in their thinking. They disrupt their classes, drop out of school, develop criminal associations, drink, gamble, get involved with drugs, malinger on the job, or simply refuse to work at all. These are hardly habits that lead to upward mobility or which keep one out of trouble. Also, the ranks of the poor are infused daily with new members: people who were once better-off, but whose irresponsible attitudes and actions have caused them to lose their jobs or families, to become addicted to drugs, or to associate with people of bad character.

If good people have a much greater likelihood of ascending from poverty, and if bad people have a much greater likelihood of sinking into or remaining in poverty, is it any wonder that the ranks of the poor contain a disproportionate number of criminals? Character, it has been said, is destiny. It should come as no surprise that prisons are filled disproportionately with people who are both criminal *and* poor. But it was their criminality which caused their poverty, not the other way around.

There is empirical evidence to support this hypothesis. In a classic study of male criminality, Sheldon and Eleanor Glueck conducted in-depth surveys of 500 young delinquents, matching them with 500 non-delinquent boys of similar ages, ethnic backgrounds, I.Q.'s, and housing in comparable slum neighborhoods. Even so, the delinquent boys' homes were more crowded and less tidy, and had lower average family earnings, fewer breadwinners, lower educational levels for par-

ents and grandparents, greater histories of family discord, higher incidences of public welfare support. . . and crime.[17]

These facts may be characterized as symptoms of *irresponsibility.* Since the boys' impoverished environments were virtually identical, the chief differentiating factor between the two groups seemed to be exposure to differing sets of attitudes, values, *morals.* Even though all the boys came from the slums, the "bad boys" more frequently came from homes in which irresponsibility and criminality were prevalent; and those factors were correlated with even lower income and living standards. This bears out the "crime causes poverty" hypothesis.

Moreover, these influences by no means had a uniform impact on the boys: plenty of the "good boys" were exposed to bad moral influences, too; and many of the "bad boys" came from better moral environments. This is a telling argument against the collectivist premises of the sociologists. "Influences" are not the same as "causes": one's response to his environment (these facts seem to say) is *individual.*

As for the reasons why members of racial minorities constitute a disproportionate share of the inmate population, the facts lead to interpretations other than "racism."

As mentioned earlier, Charles Murray has presented overwhelming evidence that welfare-state programs increase incentives for irresponsible behavior among their presumed beneficiaries.[18] Historically, such programs have been directed toward the poor, particularly blacks and other minorities. Murray shows that during the 1960s and 1970s, when government programs for these social groups expanded enormously, a host of symptoms of irresponsible behavior among these same groups followed—including a virtual explosion of criminality.[19]

Based upon such evidence, we can safely conclude that the disproportionate incarceration rate of minorities is caused, not by their having some "racial predisposition" to criminality, nor by a "racist" legal system singling them out for arrest and imprisonment. It stems, rather, from the pernicious, unintended consequences of welfare-statism, which has increased incentives for irresponsibility among targeted minorities—most notably, urban blacks.

The sociological "deprivation" theory of crime also cannot explain the fact that "white-collar" crimes are increasing as fast as street crimes. From 1978 to 1987, forgery and counterfeiting went up 23.5 percent, fraud soared 41.8 percent, and embezzlement skyrocketed 56.3 percent.[20] Such crimes are not typically perpetrated by those languishing in the social environment lamented by Mr. Clark. The bookstores are currently loaded with similarly sordid tales of "high society" crimes, crimes by doctors and Wall Street con artists, crimes by high-living drug lords. One wonders how sociologists would have accounted for the crimes and perversions in the courts of Nero and Caligula: clearly, these folks weren't "depraved on accounta they're deprived."

As Robert M. Byrn put it: "Not all criminal offenders come from a deprived background, and only a small portion of our disadvantaged citizens become criminals. Organized crime was not reformed when it moved into legitimate business. White-collar offenders frequently hold good jobs and live in respectable neighborhoods. Could it be, after all, that the problem is moral as well as social?"[21]

The point is simple. In various places at various times, there may arise a statistical correlation between crime and any number of socio-economic factors. But criminality cannot be *causally* attributed to external social and economic factors alone. To excuse criminals because of poor social environments leaves unexplained the crimes of those from good social environments. And the sociological excuse is an insult to millions of others from the poor backgrounds, who have *not* turned to crime.

The Psychological Excuse

Where the sociological excuse for criminality blames forces *outside* the criminal, the psychological excuse blames forces *inside* the criminal. Both, however, share the view that whatever these forces are, the individual has no power to resist or control them.

Whether we treat criminals punitively or therapeutically depends upon the issue of "criminal responsibility"—whether the individual has control of his actions. This issue is at the core of the debate over punishment vs. rehabilitation. For if the individual is not responsible, then we should not

engage in what famous psychiatrist Karl Menninger denounced as "the crime of punishment." Such psychological determinists believe "the idea of punishment must be completely eliminated."[22]

Freudian Psychoanalysis. Most of us would agree that some people are so mentally impaired they shouldn't be held accountable for acts normally regarded as criminal. But the notion, promoted by many psychological theories, that virtually *all* people are driven to act by inner forces beyond their control, undermines the very premise of criminal responsibility.

This notion is the legacy of the father of psychoanalysis, Sigmund Freud. Freud authored the view that the individual "can't help himself" because he is driven by dark inner forces beyond his control, that frustration of these basic inner "drives" is the source of mental illness.

"I feel," he wrote, "that the irrational forces in man's nature are so strong, that the rational forces have little chance of success against them." To Freud, *human nature* was, at root, virtually criminal. "Every individual is virtually an enemy of civilization. . . . Men are not gentle creatures who want to be loved, and who at the most can defend themselves if they are attacked; they are, on the contrary, creatures among whose instinctual endowments is to be reckoned a powerful share of aggressiveness. As a result, their neighbor is for them not only a potential helper or sexual object, but also someone who tempts them to satisfy their aggressiveness on him, to exploit his capacity for work without compensation, to use him sexually without his consent, to seize his possessions, to humiliate him, to cause him pain, to torture and kill him."[23]

Freud's influence on American psychiatry, and on the culture in general, has been nothing short of enormous. In a society groping for meaning and direction, his explanation of human behavior became dominant. By the late 1960s, a national survey found that "Sigmund Freud's is the only doctrine that has had any wide acceptance in psychiatry today. . . ." Another psychiatrist wrote in the *International Journal of Psychiatry* that "as far as the large segment of educated opinion in the United States is concerned, the attitude of acceptance of Freud's theory has won out." Likewise, Richard LaPiere, a Stanford sociologist, wrote in 1959 that the Freudian ethic is "the ethic that is most commonly advocated by the intellectual leaders of the United States," and described it as "the idea that man cannot and should not be expected to be provident, self-reliant, or venturesome, and that he must and should be supported, protected, socially maintained."[24]

This ethic remains a cornerstone of the Excuse-Making Industry's efforts to rehabilitate criminals (and, incidentally, to replace American capitalism with a paternalistic socialism). Yet how effective has the theory of psychological causation been in actually rehabilitating psychiatric patients?

In 1959, psychologist Hans J. Eysenck analyzed 19 reports covering 7,000 psychiatric patients from 1927 to 1951. He found that the rate of improvement or cure was only 64 percent. The spontaneous recovery rate for patients receiving no psychotherapy was 66 percent. In another study, Canadian psychiatrist Raymond Prince spent 17 months with Nigerian witch doctors—and concluded that their rates of therapeutic success rivaled those of North American clinics and hospitals.[25]

More pertinent is the effectiveness of psychotherapy in rehabilitating criminals. In the most ambitious effort ever made to evaluate criminal rehabilitation efforts, Robert Martinson, Douglas Lipton, and Judith Wilks surveyed 31 different programs between 1945 and 1967. These employed individual or group psychotherapy (Freudian psychoanalysis as well as other techniques) to reduce criminal recidivism rates—the percentage of inmates who, once released, return to crime.

Their conclusion: "With few and isolated exceptions, the rehabilitative efforts that have been reported so far have had no appreciable effect on recidivism." For group therapies in particular, there were "few reliable and valid findings concerning their effectiveness." Individual psychotherapy only seemed to improve certain criminals who had been judged "amenable" to treatment; but in other cases, criminality actually *increased* after treatment. These findings have been confirmed in a number of other studies.[26]

Theories are only as good as their demonstrable relationship to the facts of reality. Most psychological theories are based upon sweeping inferences drawn from dubious causal assumptions. The main problem is that these can't be demon-

strated. At root, the psychological excuse simply boils down to the truism that all actions are motivated. But this doesn't tell us much. It doesn't tell us whether those motives are causal primaries, or simply the results of something else, over which we have a measure of volitional control. And it doesn't tell us whether those motives, once they arise, can be overridden or channeled by the individual.

We're often tugged by competing emotions. To say that somebody had an impulse or inclination to commit some crime, tells us no more than the fact that "he felt like it." Well, we already know that. The existence of civilization, however, is evidence that we do have some power, at some level, to choose which emotions will prove decisive.

But the psychological excuse assumes that emotions are causally irreducible and irresistible. In effect, it equates all desires with *compulsions.*

Another problem with the psychological explanation is that it isn't one explanation. There are many psychological theories, each contradicting all the others. In practice, this means that no two psychologists or psychiatrists seem to agree on the specific "causes" of any given person's actions.

In a review of the relevant literature on the reliability of psychiatric diagnoses, Wisconsin Circuit Court Judge Ralph Adam Fine reported the following:[27]

In one study, pairs of psychiatrists diagnosed 427 psychiatric patients, and were able to agree only 50 percent of the time; in another study, 54 percent of the time.

Case histories of 34 patients at the UCLA Neuropsychiatric Institute were given to 10 staff psychiatrists, 10 psychiatric residents, and 10 untrained college students with diverse backgrounds. There was no statistical difference in the rates at which any of the groups selected the right diagnosis.

Two University of Oklahoma researchers filmed an actor playing a happy, problem-free scientist. They showed the film to 156 undergraduate students, 40 law students, 45 graduate students in clinical psychology, 25 practicing clinical psychologists, and 25 psychiatrists. Each group was told that the man looked normal, but had been previously diagnosed as "quite psychotic." Result: the actor was diagnosed as mentally ill by 84 percent of the undergraduate students, 90 percent of the law students, 88 percent of the graduate psychology students and clinical psychologists, and 100 percent of the psychiatrists. Later, five identically composed groups were shown the same film of the same actor—but were told that he "looked like a healthy man." *All of them* diagnosed the actor as free of mental illness.

A final example. Eight normal volunteers, led by a Stanford psychology professor, presented themselves to 12 psychiatric hospitals in five states, complaining of hearing voices that said "empty," "hollow," and "thud." Except for their identities, they answered all other questions truthfully. All were admitted, at which point they behaved normally. Their hospitalizations lasted from seven to 52 days, upon which time they were released with diagnoses of "schizophrenia in remission." However, 35 of 118 actual mental patients in the same hospitals voiced suspicions that the eight were utterly sane people sent to "check up on the hospital."

These anecdotes make some serious points. If supposed "experts" in the psychiatric field cannot even tell if a person is basically sane or insane, how can they tell what subtle "forces" cause him to act as he does? If they cannot reliably or objectively "explain" the causal antecedents of any given individual's actions, on what grounds do they justify their general theories purporting to "explain" so complex a thing as criminal behavior? On what grounds do they presume to offer "expert testimony" in courtrooms concerning the motives of defendants, or to design "rehabilitation" programs for criminals?

At present, psychological theories of causation have more in common with demonology than science: they excuse outrageous behavior, but explain little.

Behaviorism. Thanks to the failure of Freudian and neo-Freudian therapies, there has been a flourishing of competing theories of causation—the most notable being behaviorism. In its most pure form (as in the theories of B. F. Skinner), behaviorism proposes an almost mechanical model of human action—that man is little more than a stimulus-response machine, like a rat or pigeon, instead of a conscious, thinking entity with some power of choice. This billiard-ball approach to human causality, say behaviorists, is "objective" and "scientific," unlike the "subjective" approach of psychoanalysis.

Behaviorism thus ignores the "inner state" of an individual or his past history, concentrating on altering his present behavior strictly by "conditioning" him with rewards and punishments (called "reinforcers"). It is not going too far to say that the behavioral approach to human change is essentially the same as that used by dog trainers.

Whereas Freudian psychology is the foundation for the "therapeutic" approach to crime, behaviorism "reinforces" the sociological approach. It lends weight to such environmental excuses for criminality as poverty, "peer pressure," racism, and the like. Behaviorists believe that people will change their "responses" if we change the "reinforcing stimuli" in the external environment. (Some have taken this to mean the eradication of the profit motive and capitalism.)

But proceeding on the premise that individuals are no more complex than pigeons apparently has its limitations. For one thing, so-called "behavior modification" programs don't seem to have much more lasting impact on criminals than do those based on conventional psychology.

One study examined 24 such programs between 1965 and 1975, all aimed at altering the behavior of institutionalized delinquent youths by use of rewards and punishments. Almost all succeeded—while the youths remained in the institutions. But when four of the programs followed up on their subjects after they were returned to the community, three reported no significant, lasting reduction in the young criminals' recidivism rates. The fourth program reported such a reduction, but it wasn't a carefully controlled sample. Other similar studies have been unable to demonstrate any lasting impact of behavior modification.[28]

It seems, then, that even criminals are more complex than dogs. Behaviorism, in refusing to consider that an individual's thinking and values might play a role in his motivation, joins conventional psychology as another failed theory of human action. While both provide a wealth of excuses for criminal behavior, neither helps us understand, alter, or prevent it.

The Biological Excuses

This last group of excuses for criminality consists of variations on the "bad seed" theory: the view that one is genetically or constitutionally predisposed toward criminality. In fact, these theories have more empirical support than do sociological and psychological theories.

There are certain physical attributes which repeatedly have been shown to correlate statistically with increased criminality: being male, having lower-than-average intelligence, having certain temperamental traits (such as hyperactivity), having a certain body type (heavy-boned and muscular). In addition, evidence from the studies of twins tends to show that the likelihood of finding a criminal twin, if the other twin was criminal, was statistically significant—and even greater for identical twins than for fraternal twins. This held true even in studies which discounted for environmental factors. A systematic Danish study of over 14,000 adopted children also showed that adopted children whose biological parents had been criminals had a measurably greater likelihood of becoming criminals themselves—even more than if their adoptive parents were criminals. This held true even for adopted siblings raised apart.

The best summary of such evidence appears in James Q. Wilson and Richard J. Herrnstein's comprehensive examination of criminal causation, *Crime and Human Nature*. They conclude that while "the average offender tends to be constitutionally distinctive," he is "not extremely or abnormally so." But as moderate behaviorists, they believe such "predispositions toward crime. . . are expressed as psychological traits and activated by circumstances."[29]

In fact, these interesting correlations are far from being causally decisive. Even in the studies cited by Wilson and Herrnstein, the correlations occurred in only a small minority of cases. Whatever effect such traits have on personality, the link to criminal behavior is statistically weak. Inherited factors, for example, may predispose someone toward aggressiveness, a high degree of physical energy, and a short temper. But why do some individuals with such traits become professional football players, while others become street criminals? A family argument might "cause" one short-fused man with a heavy, muscular body to storm out of the house, cursing, and "let off steam" by chopping wood—while another similar man will begin to batter his children.

Personality traits only define general capaci-

ties. There's no evidence that what one *does* with those capacities is predetermined. Hence, even the "biological explanations" do not pose convincing excuses for criminal behavior.

Determinism, Free Will, and Criminal Responsibility

Like the characters in the fable of "The Blind Men and the Elephant," each member of the Excuse-Making Industry grabs onto one part of human nature, then assumes it constitutes or explains the whole. Psychologists focus on a person's emotional life; biologists focus on his brain, genes, or anatomy; sociologists and behaviorists focus on his family and neighborhood. Each of these does so in the name of "science," rejecting free will—the premise that the individual can make some primary, irreducible choices about his thoughts, feelings, or actions—as "unscientific" or mystical.

The Excuse-Making Industry is premised on the philosophical doctrine of *determinism*. Determinists hold that, in any given moment, there's only one action that an individual can take—an action determined by the sum total of all the causes operating on him up to that point. To a determinist, human thoughts, feelings, and actions are all necessitated by antecedent factors; the individual has no choice about them. By contrast, a free will theory posits that some action, or choice, or thought is *not* necessitated by antecedent factors, but is under the direct, volitional control of the individual.[30]

This is no digression. The issue of free will versus determinism is *the* key to resolving any argument about the causes and cures of crime. If determinism is true, then man truly "can't help" what he is or does; he is not the sculptor of circumstances, but the clay. Then, the entire idea of criminal responsibility—and of a criminal justice system to punish wrongdoers—is absurd. If, on the other hand, man has some measure of irreducibly free control over his thinking, feeling, or behavior, then he *does* ultimately bear responsibility for what he does—and the quest for justice makes sense.

Determinism certainly *sounds* scientific: it seems firmly rooted in cause-and-effect thinking. Everything requires a cause; thus human thoughts, feelings, and actions require antecedent causes. By contrast, at first blush, free will (or volition) sounds "causeless"—hence, unscientific. How can any human decision be "causeless"?

As many philosophers have noted, however, the apparent conflict between "causality" and "free will" rests upon a dubious view of causality—what has been called the "billiard-ball" theory. By this view, certain *events* are caused by preceding *events*. The action of one billiard ball hitting another causes the second to move. Likewise, the action of a man stabbing someone is caused by preceding events—in his childhood (the psychological excuse), in his neighborhood (the sociological excuse), or in his biochemistry (the biological excuse). In the first case, the struck billiard ball had no choice but to move; in the second case, the "affected" man had no choice but to stab.

There is, however, an alternative view of causality. By this view, it isn't actions which cause subsequent actions; rather, *entities* cause actions. This leads to a much more complex interpretation of causality, in which "external forces" acting on an entity are only one element "causing" subsequent events. The most important cause, however, is *the nature of the entity itself*: its matter, form, properties, and potentialities, in conjunction with outside forces.

This theory of causality, then, would hold that there are a number of forms of causality in nature. Inanimate objects respond passively; organisms are goal-directed from within; animals act on the basis of perceptual-level consciousness, showing psychological causation; while man has the additional abilities to think, introspect, and direct his awareness.

By this theory, man has final self-control in certain areas. This doesn't violate the law of cause-and-effect, since we act completely in accord with our nature as conscious, reasoning entities. Human volition, then, isn't an affront to the law of causality: it's an instance of it.[31]

There are various doctrines and theories of free will, of course. Some posit total control over thoughts, feelings, and actions; some suggest that only thoughts might be under direct control; still others argue for a more narrow control, over the level and focus of consciousness. For our purposes here, resolution of this question doesn't matter. What does matter is whether determinism is a respectable intellectual alternative. It is not.

No, free will cannot be "proved." That's because *proof presupposes free will.* It's impossible to prove or to know anything if one's thinking processes aren't free—if the outcome of our thinking is predetermined by forces beyond our control. Volition lies at the starting point of all knowledge and proof—not at the conclusion of some logical chain. It doesn't need to be "proved," because it's a building block of proof itself.

This poses a fatal dilemma for determinism, and for the whole Excuse-Making Industry which stands upon it. Knowledge presupposes the freedom to validate or refute a belief by a self-directed thinking process. However, those who claim to know that determinism is true must logically concede that they, too, "can't help" what they think, feel, or do. Yet if that is the case, then they can't claim to "know" that determinism is true—because *they were forced to believe in its validity.*

The dilemma is inescapable: the excuse-makers are slaves to their own theory. To claim knowledge of the validity of determinism, or to try to persuade others, presupposes a freedom which their own theory denies them. Determinists want to have their free will, while eating it.

It's therefore no wonder that the Excuse-Making Industry has failed dismally in its efforts to reform criminals. By not taking into account the free will of the criminal, it's ignoring the very factor which is *decisive* to his criminality: his responsibility for his actions. Instead, it has shaped the institutions of the law to excuse him from justice—as we shall see in the next segment. □

Next month, Mr. Bidinotto examines the criminal justice system.

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6. *Ibid.,* p. 154, Fig. 5.2.
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27. Ralph Adam Fine, *Escape of the Guilty* (New York: Dodd, Mead & Co., 1986), pp. 203-208.
28. Wilson and Herrnstein, pp. 381-384.
29. *Ibid.,* pp. 102-103. See especially chapters 3-7.
30. David Kelley, "The Nature of Free Will," recorded lecture given in Toronto, Canada in October 1986. (Published by Uncommon Sense Services, 59 Poplar Crescent, Aurora, Ontario L4G 3M4.)
31. The author is indebted to David Kelley for the general argument presented in this section.

Section 89: Tax Code Limits Workers' Choices

by Roy E. Cordato

Over the last decade workers have come to benefit by an invigorating dose of competition and choice with respect to health insurance plans. While most companies once offered their employees one health insurance policy—take it or leave it—most workers now have the opportunity to choose among dozens of options. Workers can now make trade-offs between higher or lower wages and more or less extensive health care insurance coverage. They can tailor their compensation packages to their own needs. If they are young, single, and at low risk, they have the opportunity to accept more of their compensation in the form of wages and less in the form of extensive health care insurance coverage. Conversely, if they have a family or are older workers who may be at higher risk, they can make other trade-offs. Clearly, these kinds of options have helped the average wage earner.

One section of the Internal Revenue Code threatens to take a good part of that freedom away by penalizing both employers and employees in workplaces where these kinds of options are available. The justification for Section 89, instituted as part of the Tax Reform Act of 1986, is based on knee-jerk egalitarianism. The tax system is being used here to reduce "employee-benefit discrimination," i.e., to see to it that lower paid workers get the same health care coverage as higher paid workers. In order to comply with Section 89, employers will have to correct disparities in health care coverage that is freely chosen by lower and higher paid workers. If these disparities are not corrected, those higher paid workers with more extensive plans will have to pay a tax penalty. The virtues of free choice are turned into vices by the tax code.

There are many problems with the Section 89 requirement, not the least of which is the underlying assumption that all employees within a workplace should have the same level of health insurance coverage. The fact is that when free choice is allowed, it is likely that equality of result will never be achieved. People make choices based on their own needs and preferences, which always differ from one person to another. Policies that attempt to force equality of result at the expense of free choice can never make people better off. Section 89 is no exception.

But even from an egalitarian perspective, this provision in the tax code doesn't make much sense. Its intent is not to ensure that everyone's level of compensation is the same, but to equalize one component of everyone's compensation package in a given workplace. In fact, however, the after-tax dollar value of workers' compensation packages isn't likely to be any more "equitable" after than before Section 89's leveling process takes place.

If lower paid workers are forced to take more extensive health insurance coverage, it will be at the expense of money wages or some other benefits. The issue for employers is how much it costs them to compensate labor, not what form that compensation takes. The value of a worker's compensation package is determined by how much the worker contributes to the production process. Without an increase in productivity from

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the worker, there is no reason to expect that the dollar value of his compensation package would be increased.

This would be especially damaging to very low paid employees, working at or near the minimum wage. Since their wages could not be lowered, those whose productivity does not justify a higher valued compensation package would lose their jobs. In cases where higher paid workers have to take less extensive coverage, wages or other benefits would have to be increased in order for employers to retain their services. Section 89 would neither make compensation among workers more equitable nor make workers better off.

Obviously Section 89 is no deal for employers either. Many companies offer their employees hundreds of health insurance options. Remember, simply offering health insurance plans in a nondiscriminatory way is not good enough for the social engineers who crafted Section 89. Companies will have to determine if the dollar value of the insurance plans that their employees actually choose is distributed among them in such a way that lower paid employees do not have lower valued plans. As with nearly all government programs, free choice is the enemy of Section 89.

Given that the administrative costs of this process will be very high, it may be cost effective for companies to take what might best be called the noncompliance option. If a company decides not to put itself through the battery of tests that the IRS requires, or if the IRS determines that inequities still exist, those employees earning over $75,000 (as low as $45,000 under some circumstances) who have higher valued plans will be taxed on a portion of those benefits. Since this would be tantamount to a pay cut for these workers, it is likely that employers, in order to retain them, would increase their wages to compensate for the added tax burden. It may be less expensive for an employer to do this than to bear the costs associated with strict compliance. Of course the Treasury is hoping that many employers will take this option because it is these tax penalties that are supposed to make Section 89 a $300 million revenue raiser for the government.

This suggests that Section 89 was put in the tax code more for its possibilities as a revenue raiser than as a means of achieving social justice. The government benefits from Section 89 to the extent that it is not complied with. This could provide the logic behind why it has been made so complicated.

Section 89 also might be a back-door method of implementing a mandated health insurance program. As with proposals to mandate health insurance, the formula that is used to determine if the values of health insurance policies are distributed equally includes part-time employees working more than 17.5 hours per week. This means that many part-time employees, who typically haven't qualified for health insurance benefits, must be provided with the same plans as full-time workers.

This could impose real hardships on these workers. In particular, it would create an incentive for employers to offer part-time employment that entails less than 17.5 hours of work per week. Workers who desire less than full-time employment, but more than just a few hours a week, may have to piece together an income from several different sources. Those employees who remain part-time, but work more than 17.5 hours per week, will probably have to trade off lower wages in exchange for their health insurance benefits. Since most people who work at part-time jobs do so for the extra cash, not for the benefits, this kind of trade-off would clearly make them worse off.

As social policy, Section 89 of the IRS Code has no justification. It presumably is meant to improve living standards for lower paid workers. But in reality it will make workers in all income categories worse off by restricting their liberty to choose the compensation package that best fits their needs and to freely negotiate labor contracts. In addition it will raise labor costs to business, which will mean slower growth and job creation rates for the economy as a whole. □

Deposit Insurance Déjà Vu

by Kurt Schuler

The mess in the savings and loan industry is the worst thing to happen to the American banking system since the Great Depression. As an indication of how severe the problem is, government estimates of the cost of bailing out bankrupt savings and loans, which were $30 billion a few months ago, rose to $60 billion, then to $160 billion. And the cost is rising by $1 billion for every month that the federal government lets 350 bankrupt savings and loans stay open because it hasn't budgeted the money to pay off their depositors.

American taxpayers will be footing the bill for this because the federal government guarantees almost all bank deposits. The rationale of deposit insurance is that it is cheaper than the banking panics that supposedly would result without it. But the history of deposit insurance in the United States and other countries indicates that it is neither necessary nor desirable. Outside the United States, deposit insurance, even where it exists, has not been needed. Competition has forced foreign banks to develop nationwide branch networks and to diversify into lines of business forbidden to American banks. This has resulted in the creation of large banks that are very secure because they spread their risks among many regions and types of activity.

In the United States, deposit insurance has been rarely self-financing because government regulation has prevented competition from evolving the strongest banks possible. Indeed, deposit insurance crises are almost as old as deposit insurance itself. The Federal Savings and Loan Insurance Corporation's current problems have many precedents. Besides Federal deposit insurance, the United States has had about 30 state deposit insurance schemes. Nearly half operated before the Great Depression, and half since. Their experience has been dreadful. All but a few have gone broke. A brief look at their history shows what we can expect again if Congress doesn't use the current Federal bailout as an opportunity to free our financial system from the stranglehold of regulation.

New York State started the first deposit insurance system in 1829. Banks paid a tax of 3 percent of their capital into a common "safety fund." New York City banks, which were among the largest and most stable in the nation, opposed the fund. However, the more numerous rural banks influenced the state legislature to establish it. The safety fund's purpose was to instill public confidence in bank notes, although it also covered deposits. (Apparently, the legislature did not intend deposits to be covered, but they were because the law it enacted was careless on that point.) The safety fund benefited rural banks most, because their profits depended more on note circulation. Five other states imitated New York in setting up compulsory bank insurance systems before the Civil War.

The first to fail was Michigan's. It had been in operation only a year when the panic of 1837 dragged down most of the state's banks. Payments into Michigan's insurance fund barely covered supervisory costs, so creditors of failed banks got nothing. A few years later, 11 bank fail-

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ures depleted the New York fund. The state government eventually issued bonds to bail it out, much as the Bush administration has proposed doing for the FSLIC. But some creditors waited as long as 21 years for payment. A single failure was enough to bankrupt Vermont's fund in 1857. Creditors there got less than two-thirds the value of their claims.

Michigan, New York, and Vermont effectively closed their insurance funds when the funds went broke. Indiana, Ohio, and Iowa had funds that stayed solvent. Oddly, the solvent funds had more potential for causing trouble than the others. Healthy banks were liable for paying failed banks' creditors if the insurance funds should be exhausted. Hence, severe losses at a few banks could have wiped out all banks in the state. However, strong industry pressure counteracted the temptation, in effect, to play fast and loose with other banks' capital.

In contrast to the systems that went broke, where bank examiners were government employees, in the solvent systems examiners were largely chosen by and responsible to the banks. The number of banks was small — 41 in Ohio, 20 in Indiana, and 15 in Iowa. That made group action against imprudent banks possible. Today, when Federal deposit insurance covers thousands of banks, savings and loans, and credit unions, this element of the successful state systems would be impossible to duplicate. Ohio and Iowa also reduced the risk to their funds by guaranteeing only notes, which were being eclipsed by deposits as the chief type of bank liability.[1]

By 1866, changes in Federal banking law induced most banks to switch from state charters to Federal charters. Despite a Federal prohibition on branch banking, Federal charters were attractive because they allowed banks to continue issuing notes. State-chartered banks, in contrast, faced a 10 percent tax on note issue that made it prohibitively expensive. The Indiana, Ohio, and Iowa insurance funds closed still solvent when their members got Federal charters. The savings and loan industry began in earnest at the same time, as a product of a provision in the same law that severely restricted Federally chartered banks' ability to make mortgages. (These restrictions lasted until the 1970s. Since then, most of the other legal barriers separating banks from savings and loans have fallen as well.)

Bank notes effectively carried a Federal guarantee from the 1860s until Federal Reserve notes replaced the last of them in 1934. Issuers had to back notes 100 percent or even 110 percent with Treasury bonds, kept in a Treasury vault. But notes were becoming decreasingly important compared to deposits as the main form in which almost everybody held money.

"Honesty Taxed to Pay for Dishonesty. . ."

The federal government did not insure deposits, despite many proposals in Congress from 1886 onward that it do so. William Jennings Bryan and other populist politicians favored deposit insurance as a way of protecting small depositors and small banks. Leading bankers thought differently. Near the turn of the century, the First National Bank of Chicago's president expressed their objections to deposit insurance in these words: "Is there anything in the relations existing between banks and their customers to justify the proposition that in the banking business the good should be taxed to pay for the bad; ability taxed to pay for incompetency; honesty taxed to pay for dishonesty; experience and training taxed to pay for the errors of inexperience and lack of training; and knowledge taxed to pay for the mistakes of ignorance?"[2]

Such arguments deterred the federal government from insuring deposits, but not some states. Oklahoma established deposit insurance in 1908. Seven southern and western states followed suit within the next decade. Their systems insured from 100 to 1,000 banks apiece.

Washington's, the last started, was the first to crack. The depression of 1921 depleted its insurance fund. Since the system was voluntary, many healthy banks deserted it rather than suffer the high fees it would have imposed, and it shut down. The same happened to the other voluntary fund, in Kansas. In the other states, where deposit insurance was compulsory for state-chartered banks, low crop prices throughout the 1920s broke many rural banks, leaving depositors clamoring for their money. By 1930, all the funds were bankrupt. Texas's system eventually paid off depositors in full, but elsewhere depositors lost at least 15 percent of their claims. The North Dakota fund, the worst of the lot, paid only $1 of

every $1,000 in claims, and even after a tax-financed bailout, depositors lost three-quarters of their money.[3]

Despite the unfavorable experience of the state deposit insurance systems, the federal government established nationwide deposit insurance in 1934. The failure of nearly 10,000 banks since the Great Depression had begun in 1929 put pressure on the federal government to do something. Many prominent economists and bankers advocated branch banking as the best cure for the American banking system's instability. They pointed to foreign systems that allowed branch banking, where failures had been few. In particular, they saw Canada, where no banks failed during the Depression, as a model for the United States to emulate.

However, the political clout of small banks and the worse than usual public image that big business had at the time kept branch banking from getting political consideration commensurate with its economic merits. Federal deposit insurance, once established, seemed to stabilize the banking system. The banking panic of 1933 was responsible for much of the good reputation that Federal deposit insurance enjoyed. It wiped out the weak banks that would have put the greatest strain on Federal insurance funds had they begun in 1933 instead of 1934, when the panic was over.

Since 1934, 14 states have chartered deposit insurance systems for certain banks and savings and loans not covered by Federal insurance. Though nominally private, most state insurance systems have been so enmeshed in local politics

as to be in reality off-budget government agencies designed to shelter members from the rigors of competition. Their history has been as blighted as that of their predecessors.

New York and Connecticut closed relatively short-lived funds intact decades ago when their members voluntarily switched to Federal insurance. Funds have failed in half of the remaining states — Hawaii, Nebraska, Ohio, Maryland, Colorado, and Utah. The 1985 Ohio and Maryland failures required millions in tax money to pay depositors in full. The aftershocks prompted most states with solvent insurance systems to require all participants to switch to Federal insurance by 1990. Only three funds still offer insurance for banks lacking Federal coverage. One, in Kansas, is winding down as its members leave it. The others, in Pennsylvania, cover just a handful of tiny banks. State deposit insurance is in effect dead.[4]

Success in Massachusetts and North Carolina

The only truly successful state funds were those of North Carolina and Massachusetts. Their good performance was the result of incentives more closely resembling those of the free market than other state systems faced. The story of North Carolina's Financial Institutions Assurance Corporation is particularly interesting because the fund started in 1967 as "a good old boys' hideout from Federal regulation," as one of its officers later recalled. A new president appointed in 1977 brought in a new management philosophy. The law governing the fund was changed to require a majority of its board of directors to be unaffiliated with member institutions. (The lack of such a provision in the Ohio and Maryland deposit insurance funds encouraged self-dealing. Unlike the pre-Civil War Ohio fund, the latter-day Ohio and Maryland funds had no counterbalancing liability features to make their members keep an eye on each other's operations.)

The North Carolina fund began basing the premiums it charged its members on the riskiness of their portfolios. It increased the minimum net worth for members to qualify for insurance from it. Furthermore, it closely monitored members' lending practices. For instance, it induced members to reduce their investment in fixed-rate mortgages several years before the rest of the savings and loan industry began having problems with fixed-rate loans. In every respect, the North Carolina fund's actions contrasted sharply with those of the FSLIC, which was vulnerable to political pressure from members, did not adjust insurance premiums for risk, had lower net-worth requirements, and did little to prevent members from making reckless loans.

The North Carolina fund's record was outstanding. Its stress on preventative measures, and the incentives it gave for its members to avoid making overly risky loans, kept any of them from failing. However, the Ohio and Maryland collapses cast a pall over all state deposit insurance systems. The North Carolina fund closed voluntarily, without losses, when many of its members decided to get Federal insurance. At about the same time, the Massachusetts funds, which benefited from that state's long tradition of conservative banking, switched roles from substitutes to supplements to Federal deposit insurance.[5]

Of all state deposit insurance systems, then, few have been really successful. The others have existed too briefly to undergo a true test of strength, have folded up at signs of trouble, or have failed. Now Federal deposit insurance is duplicating state deposit insurance's sorry record. The cause is the same: too many insured banks, mostly small, unable to withstand bad luck and bad management.

Deposit Insurance in Other Countries

Other countries, by allowing nationwide branch banking, have gained the stability the U.S. hasn't been able to achieve. Competitive pressures have resulted in very large banks, so solid that they have not needed deposit insurance and, in most places, have not had. It is true that West Germany's small Bankhaus Herstatt failed in 1974 and Italy's scandal-ridden Banco Ambrosiano failed in 1982. But there have been no other noteworthy bank failures in developed nations. Britain, which has had nationwide branch banking longer than almost any country, has not experienced a major bank failure since 1878.

Every large Western country except Italy has deposit insurance. But in all except the United

States, deposit insurance is a recent innovation, dating from the 1960s or 1970s. The banking systems of those countries took their present shape, and enjoyed stability, long before they got deposit insurance. Furthermore, foreign deposit insurance systems encourage depositors to monitor the health of their banks, which the American system does not. In some countries — notably West Germany — the systems are voluntary, so banks that fear that imprudent rivals are trying to take advantage of the system can quit it. In Britain and Switzerland, insurance doesn't pay for the full amount of depositors' losses, but only for, say, three-quarters.

Common to all foreign deposit insurance systems is that they have much lower maximum limits than the American system — from one-half to one-tenth as much — and that foreign governments are more serious about imposing those limits in practice than the American government has been. The possibility of suffering losses encourages depositors to entrust their money only to well-managed banks. Depositors abroad rely mainly on the quality of the banks themselves rather than on government insurance for protection.[6]

The exception that proves the rule occurred in Canada, whose federal deposit insurance system is most like that of the United States. In 1985, two Canadian banks went bust in Alberta — that country's equivalent of Texas. Previously, no bank had failed since 1923. The Alberta firms, both founded in the oil boom of the mid-1970s, were small and undiversified, resembling U.S. banks more than the five nationwide giants that have 80 percent of Canadian deposits.

Canada instituted compulsory deposit insurance in 1967 despite the protests of its large banks, who foresaw that it would be their premiums that would pay for small rivals such as the Alberta banks. The government guarantee helped convince depositors to let the Alberta banks take imprudent risks with their money. The failure of the Alberta banks threatened to deplete the deposit insurance fund. To prevent a run on the two banks, the Canadian government pressured the big banks to take them over. When losses turned out to be larger than expected, the government backed out of its previous assurances to the big banks (which technically were not binding), causing them to bear the costs of the small banks' bad management.

Unrestricted nationwide branch banking, such as Canada and other countries have, is scheduled to arrive in the United States in 1991. That will be too late to save hundreds of ailing banks and thrifts. Congress should remove barriers to branching now. In particular, it should allow any bank to buy any savings and loan. (Currently, banks can buy only ailing savings and loans.) Small banks and savings and loans would oppose such a step, because it would make them takeover targets for expanding money-center and "super-regional" banks. But the alternative for many of them is to go broke, putting further strain on the Federal deposit insurance system and on taxpayers.

Deposit insurance has repeatedly proven not to be self-financing under our artificially fragmented banking system. On the other hand, it wouldn't be necessary under a less regulated banking system. Ultimately, Congress should set a date — say, ten years hence — to abolish deposit insurance. At the same time, it should tear down the walls it has erected separating banking from securities, insurance, and commerce. Banks should be allowed to spread risk across lines of business just as branching enables them to spread risks across regions.

American banks are suffering at home and in world competition because they cannot engage in many profitable lines of business open to their foreign competitors. Given freedom, the U.S. banking system can become strong and flexible enough not to need deposit insurance. The alternative is to suffer another crisis when changing economic needs run up against outmoded regulations. □

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Privatize Deposit Insurance

by Jeffrey Rogers Hummel

Amidst all the groping and furor over the savings and loan crisis, no public official has pointed a finger at the ultimate culprit. The Bush Administration admits that the nation's ailing S & L industry will cost the government at least $90 billion. That would be the most expensive bailout in U.S. history—bigger than those for Lockheed, Chrysler, New York City, and Western Europe (through the Marshall Plan) combined, even after adjusting for inflation. But contrary to popular perceptions, the crisis stems not from too little regulation, but too much. It all can be traced to the perverse influence of government deposit insurance.

The federal government first insured deposits in reaction to the Great Depression. A scramble for currency among depositors had led to runs on nearly 10,000 banks. This liquidity crunch forced otherwise solvent institutions into emergency sales of their assets. Unnecessary bank failures, a one-third collapse in the money supply, and deflation were the result. To protect the economy from future panics, the newly established Federal Deposit Insurance Corporation (FDIC) guaranteed small depositors against any losses.

Comparisons with other countries now suggest that the regulations already existing in the 1920s were responsible for the precariousness of the American banking system. Canada, for example, permitted its commercial banks to open branches nationwide and had yet to set up a central bank. Not one Canadian bank failed during the Great Depression.

However plausible the justification of deposit insurance for U.S. commercial banks, it certainly did not apply to savings and loan associations. Unlike banks, S & L's at that time didn't offer checking accounts or any other deposit that served as a medium of exchange, nor were they plagued by runs. Yet S & L's got similar guarantees with the establishment of the Federal Savings and Loan Insurance Corporation (FSLIC) in 1934.

Government deposit insurance may have dampened the danger of bank runs, but only at the cost of incurring another danger. Private insurance companies have long been aware of what is called "moral hazard." If you protect someone from the painful consequences of risk, he will have less incentive to avoid risky actions. Insurance against fire or automobile accidents thus can be so complete that it fosters carelessness and leads to more fires and accidents.

One way insurance companies get around the moral-hazard problem is with a deductible, which makes the insured bear some of the cost of risky actions. Private insurance companies also vary premiums according to actual risks; otherwise they lose money. Government deposit insurance, in contrast, ignores these sound principles. It therefore subsidizes risk-taking by depository institutions. They pay the same premium regardless, and their depositors have no financial reason to impose market discipline by doing business elsewhere.

Not until the 1980s, however, did this moral-hazard time bomb explode. Pervasive government regulation protected banks and S & L's from competition while simultaneously restricting their portfolios to safe assets. Only after the inflation and climbing interest rates of the 1970s required these institutions to bid actively for de-

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posits did the government initiate financial deregulation. Unfortunately, deregulation did not go far enough. By leaving deposit insurance untouched (except to raise coverage), it rewarded the managers of banks and S & L's who gambled with their depositors' money. All the colorful headlines about cowboy bankers and corporate swindlers overlook the way that the regulatory environment distorts the normal market curbs against such behavior.

Government favoritism for insolvent banks and S & L's aggravates the crisis. If the FDIC and FSLIC were truly interested in protecting the small depositor, they would close insolvent institutions and pay off the depositors directly. Instead, they usually arrange purchase and assumption agreements that merge failed institutions with healthy ones. Big depositors are protected as well as small in a short-term solution that merely compounds long-term difficulties.

The crisis has reached such epic proportions among S & L's that the FSLIC no longer has enough resources even to arrange bailout mergers. Growing numbers of bankrupt institutions continue to compete with sound S & L's, driving the interest paid to depositors still higher. Genie Short and Jeffrey Gunther of the Federal Reserve Bank of Dallas point out in a recent study that "such policies penalize the more conservatively managed institutions over the more aggressive ones."

Indeed, no regulatory sleight of hand can magically transform bad loans into good. Without enough income from these loans, the failed but still operating "zombie" institutions can pay interest to their current depositors only with money from new depositors. The regulators thereby sanction an escalating chain letter that makes the final accounting ever more expensive. When they take over an S & L themselves, the regulators still are powerless to do anything else without outside funds.

None of the Administration's proposals address the root cause. Attempting to re-regulate the S & L industry by imposing, for instance, higher capital requirements, will simply destroy it. Market forces already are unleashed. The competitive survival of banks and S & L's compelled financial deregulation. The regulatory haven that gave banks and S & L's a tidy market-sharing arrangement cannot be reconstructed.

If Congress increases insurance premiums, the sound institutions will be the ones to pay. This will further punish the very kind of management that should be encouraged. Nor can government ever adequately administer variable premiums. "A rational system of risk-based insurance premiums offered monopolistically by a public agency is simply impossible," argues Gerald O'Driscoll of the Federal Reserve Bank of Dallas. Without the feedback of profit and loss, bureaucrats have neither the information nor the incentive for matching premiums to risk.

And foisting the cleanup bill on the taxpayer is not merely unjust but also tempts politicians and bureaucrats to try the same scam again. How much longer will the taxpayer be expected to cough up the cash for the government's self-serving and disingenuous pledges? How much higher will the price tag have to soar? Unfortunately, some undeserving group must take the hit for the irretrievable S & L losses, but the depositors at least voluntarily assumed a risk when they accepted fabulous political promises at face value. If the depositors want compensation, let them turn not to the much-abused and long-suffering taxpayer but to the managers of the failed S & L's, perhaps to the sale of government assets, and ultimately to the personal liability of the politicians and bureaucrats who perpetrated this outrage.

Only one solution can overcome moral hazards in the banking and thrift industries: private deposit insurance. The government must dissolve the FDIC and FSLIC and remove all remaining regulations upon depository institutions. The first step would permit the competitive forces of the market to arrange actuarially sound insurance that protects depositors without subsidizing insolvency. The second step would help depository institutions gain the geographical and asset diversity necessary to shore up liquidity during runs.

The S & L crisis is just the tip of the moral-hazard iceberg. Although not yet visible, deposit insurance creates the same perverse incentives for commercial banks. The FDIC already rates 10 percent of these institutions in the problem bank category, within an industry with $2 trillion worth of deposits. Unless deregulation proceeds to the privatization of deposit insurance, the nation soon faces a larger crisis throughout the banking industry. □

Personal Responsibility: A Brief Survey

by David C. Huff

"Freedom cannot be separated from responsibility."
– HENRY GRADY WEAVER

The idea of personal responsibility lies at the heart of a free society. When responsibilities are shunned at the individual level, there is an eventual impact on all those around us.

Let us examine some examples from key areas of public policy. In each case it should be clear, as Henry Grady Weaver has noted, that "Any attempt to give to government the responsibilities which properly belong to the individual citizens works at cross-purposes to the advancement of personal freedom. It retards progress—morally as well as along the lines of greater productivity."[1]

Before the beginning of government-supported education, parents fulfilled the duties of training their children in a variety of ways. While home schooling and church-based schools were common, education was also available through educational missionary societies, especially for the poor.

Interestingly, private and home schools haven't been eradicated by today's massive network of state-controlled education. One reason is that private education is responsive to the demands of the market—its survival is dependent upon its performance. If a particular school isn't educating students effectively, it will be replaced by one of better quality.

Educators in private schools tend to have more time to devote to teaching, meeting the requirements of parents rather than those of the education bureaucracy. Such a focus will always produce a better product—in this case, a quality education.

When parents began to delegate educational responsibilities to the government, a decline soon followed. A variety of educational options were lost through standardization; academic excellence gave way to decreasing quality; freedom of mobility and choice became hindered by such tactics as busing.

Probably the most sobering aspect of what happens to freedom when the personal responsibility for education is handed over to the state is the issue of authority. As Gary North has written:

> Naturally, parents have to delegate responsibility to someone. Few parents have the time or skills to educate their children at home. But the fundamental principle of education is the tutor. . . . Parents hire specialists to teach their children along lines established by parents. The private school is simply an extension of this principle, with several parents hiring a tutor, thereby sharing the costs. But the parents, not the tutor, are institutionally sovereign. Since sovereignty must bear the costs, education should be parent-financed. Anything else is a transfer of authority over education to an imitation family.[2]

Since the transfer of authority involves the transfer of control, the impact of our decisions in the area of education warrants serious examination.

Our prisons, and indeed our entire criminal justice system, would benefit greatly from a

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stronger emphasis upon personal responsibility. A philosophy of offender rehabilitation which simply attributes criminal acts to the "environment," while concentrating resources primarily on building more prisons, misses the crucial issues of responsibility and restitution. This helps explain the failure of most prisons to reform their inmates for a successful return to society.

The weaknesses inherent in such environmental determinism should be replaced by policies that require convicts to make adequate restitution to their victims whenever possible. Financial restitution, for instance, could be paid by the prisoner from his earnings through work in some type of prison industry. Coupled with sentencing that accurately reflects the degree of offense, thereby teaching accountability, such a program would encourage lasting rehabilitation based on personal responsibility.

As Charles Colson has pointed out: ". . . working with the purpose of paying back someone you have wronged allows a criminal to understand and deal with the real consequences of his actions. . . . Studies of model restitution programs demonstrate that they greatly reduce the incidence of further crime, since they restore a sense of individual responsibility, thus making the offender more likely to be able to adjust to society." [3]

The trend away from personal responsibility has also become evident in the health care and social service fields, where the state is increasingly viewed as a surrogate parent owing benefits to its citizen-children. Attempting to fulfill these demanding expectations, governments at all levels churn out program after program—Social Security, welfare, food stamps, Medicare, and the like.

This effort also generates an array of legislation aimed at businesses, forcing them to bear an increasing share of the costs of many forms of employee protection and benefits. In turn, these added expenses are passed along to consumers, both through outright price increases and bureaucracy-induced inefficiencies.

As with other services, health care and social welfare programs are most effectively provided by the private sector. Cotton Lindsay has written: "Long before governments took an active role in this area churches and charitable groups cared for the poor. I have seen no evidence that their health or anyone else's is better served now by our own or any other form of government medicine."[4]

Few areas of public policy impact our daily lives in so many tangible ways, and yet are more misunderstood and debated, than the broad field of economics. But it is here that the principle of personal responsibility has especially wide application. For instance:

- One of the foundations of free enterprise is the incentive of profit, as well as the risk of loss, for the entrepreneur. The entrepreneur's success or failure in the marketplace hinges on how responsibly he controls costs, manages workers, and guides his business toward satisfying the consumer. Government intervention or redistribution, in whatever form, hampers the accurate measure of a businessman's effectiveness in these areas. This allows marginal businesses to stay afloat by avoiding the market's consequences for their inefficiencies.
- Government unemployment programs are rife with abuse, allowing people to live off the state while taking an excessive amount of time to find employment. Such a situation rarely encourages workers to gain new, marketable skills, but it does allow responsibility to slip from the individual to the state.
- Taxation makes it difficult for many citizens to meet their personal financial responsibilities. As time passes, more and more families adopt an attitude of resignation, and fall back on government aid.

The concept of personal responsibility pervades every area of our public lives. Those who would promote the principles of freedom should always be alert to this concept, and seek to understand the importance of its application. □

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Thomas Erskine: Advocate of Freedom

by Sean Gabb

Though largely now forgotten, the name of Thomas Erskine (1750-1823) deserves a place in the heart of everyone who values freedom and the rule of law. But for his resolute stand in a moment of crisis, the subsequent course of English history might well have been very different—and very much less an inspiration to other peoples.

I speak of England, though Erskine, in fact, was a Scotsman. He was born the youngest son of the tenth Earl of Buchan. His father's title was grand, but his life was otherwise. The family lived, on £200 a year, in an upper apartment in one of the less fashionable areas of Edinburgh.

Taught at home, and then in various local schools, Erskine received what, by the standards of his day, was a patchy education. From his earliest boyhood, he read both widely and deeply in the English classics. But his Latin was never more than moderate, and he had no Greek. For a while, he studied mathematics and natural philosophy at St. Andrews University, but left before he could matriculate.

Though he wished to enter one of the professions, his father was too poor to assist him. Unable even to afford a commission in the army, in March 1764 he joined the navy as a midshipman aboard the *Tartar*. He sailed at once for the West Indies, and didn't see Scotland again until he was an old man.

He passed four years stationed in the West Indies, where he continued to read widely. He left the navy on failing to gain a promotion, and, his father now dead, laid out his entire legacy on a commission in the army. About this time he married. The next two years he spent with his wife on garrison duty on the island of Minorca, then a British possession.

In 1772 he went on leave to London. There, through his noble connections and engaging manner, he gained easy entry into polite society. He became acquainted with Samuel Johnson, James Boswell, Edmund Burke, Edward Gibbon, and the other great names of what was perhaps the most brilliant age of English prose. Shortly after, however, he made an acquaintance no less grand, but of infinitely greater importance to his future career.

One day, acting on a whim, he strolled into a courtroom where Lord Chief Justice Mansfield was presiding. Mansfield no sooner looked on Erskine than was captivated by his appearance. He went so far as to invite the young man to sit beside him on the bench and have the case in progress explained. His interest aroused, Erskine decided to take to the law. He enrolled in one of the Inns of Court, which are the ancient law schools situated on the north side of the Thames between the cities of London and Westminster. In spite of financial hardship and a growing family, he pressed forward with his studies, being called to the English bar in July 1778.

Within a few months, poverty was behind him. This occurred quite by chance. One Thomas Baillie had accused Lord Sandwich, a Government minister, of corruption. Sandwich began a suit for criminal libel—a type of civil action that could end not only in damages but also in imprisonment. Out for an evening walk, Erskine was caught in a rain shower. He took refuge at the

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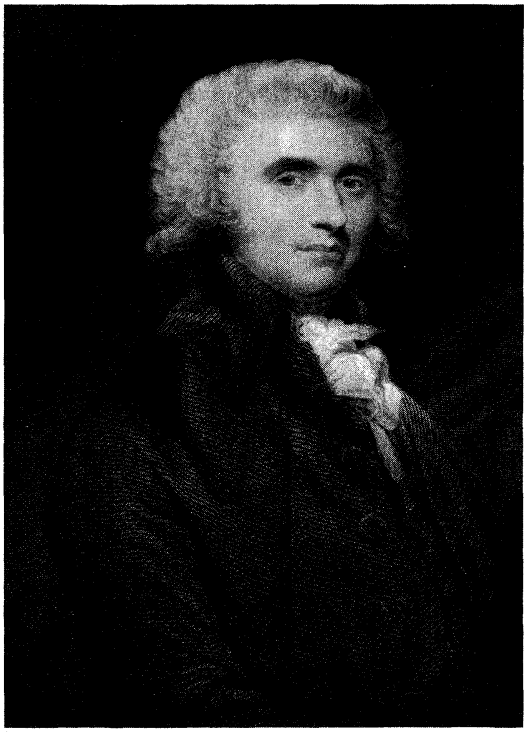

THE BETTMANN ARCHIVE

Thomas Erskine, 1750–1823

house of a friend, where Baillie was part of the company sitting down to dinner. The two struck up a friendly conversation. The next day, Baillie retained Erskine as one of his defending counsel.

The trial opened badly. Baillie's other counsel had advised settling out of court. Told by Baillie to fight the case to a finish, they used up an entire day in raising fine points of law. Next day, as the Solicitor General was about to reply, Erskine got to his feet. He found courage, he later said, by thinking of his children about him, plucking at his gown and crying for bread. In any event, he made a ferocious, if not entirely regular, attack on Lord Sandwich. His eloquence and bearing were such as to throw the court almost into a trance of amazement. Against all expectations, Baillie won. Erskine had achieved instant fame. Work flooded in, and he was a made man.

In 1779, he defended Admiral Lord Keppel on a charge of incompetence in the face of the enemy. (Great Britain at this time was at war with its American colonies and a coalition of European powers.) His defense succeeded, and he was given £1,000 by Keppel, an enormous fee.

Two years later, he defended Lord George Gordon on a charge of high treason. Gordon, whose mental state varied between the eccentric and the insane, had raised the London mob against the Government for having brought in a bill relieving Roman Catholics from some obsolete penal laws. Crying "No Popery," the mob had gone on a three-day looting and burning spree, which came to an end only with the arrival of armed troops diverted from embarking for the American War. Gordon's fate seemed assured. The court had sat all day and all evening, and, when Erskine opened to the jury, it was past midnight. But his speech, together with his manner of delivery, was so persuasive that he secured Gordon a complete acquittal.

Erskine continued his spectacular progress through the 1780s. He specialized in commercial law and—there being no regular divorce law until 1857—actions for adultery, or what then was called "criminal conversation." In 1783, Lord Mansfield's influence ever behind him, he was made a King's Counsel, receiving the coveted silk gown at an unusually early age. In the same year, he was appointed Attorney General to the Prince of Wales, a personal friend of his. By 1791, his annual income had reached an incredible £10,000. He was the highest paid counsel in the history of the English bar. It is not, however, on these successes that his claim to immortality rests.

The French Revolution

The French Revolution is an event too well known to need retelling. Everyone knows how it began with the fairest hopes, and slid into the frenzied bloodbath of the Terror. Certainly, the Old Regime was radically bad, and, when its financial collapse in 1788 showed the world exactly how bad, it was plain that only drastic reconstruction would do. But, of all conceivable groups, what became the French political class was perhaps the least suited to carry through any kind of reconstruction. Its collective head was stuffed with theories of absolute natural rights, applicable without regard to circumstances. As for practical wisdom, there was none. No institution that had existed before 1789 was left standing.

The results perhaps were inevitable. An established order, whatever its intrinsic merit, usually commands a certain respect. New ones have no such advantage. Approval depends on estimates of personal benefit. If everyone approves, all is

well and good. But anyone who disapproves has no restraining sense of loyalty. Given enough disapproval, the seeds are there for civil war. So it was in France. What consensus there was broke down over reform of the Church. At the same time, relations with the other European states drifted into war. This gave the extremists their chance, and what they called saving the Revolution involved butchering 370,000 French civilians.

The effect of this outside of France was to kill the European Enlightenment stone dead. For nearly half a century, it had been increasingly the fashion among the continental monarchies to preach, if not always to practice, a rather timid liberalism. After 1789, the mood changed. If as a practical doctrine the Rights of Man were a failure, their abstractness made them supremely portable. Wherever there were intellectuals able to read French, the revolutionary doctrines found an audience—and there were governing classes ready to take fright. Censorships were toughened, spies and informers encouraged, secret police established or reformed.

The intellectual tone of the old age had been set, in large degree, by Voltaire and his followers. The intellectual tone of the new, when it finally emerged, was set by the sonorous, if vapid, Chateaubriand, by the fanatical de Maistre, by the various Germans. Unless we are to see the metric system as sufficient reward, the French Revolution must be accounted an unmitigated disaster for European civilization.

The reaction in England, if less extreme than elsewhere, was nevertheless considerable. For some 30 years there had been a movement within the British Dominions dedicated to making government more responsive to the wishes of the governed. Its American branch had grown powerful enough to bring about a successful war of independence.

Efforts in England were concentrated on a reform of Parliament. The electoral system had evolved over three or four centuries, and now showed no obvious rationality. Manchester and Sheffield, towns fast growing wealthier and more populous than many foreign capitals, were unrepresented. Old Sarum, with seven electors, and Gatten, with two, each returned two Members.

Elections were usually an occasion for spectacular corruption. In some places, candidates bid openly against each other for votes. In others, seats were the virtual property of the wealthiest local family. The reform movement was widespread. In 1785, the Prime Minister himself, the younger William Pitt, introduced a modest Bill to redistribute seats. It failed, but the general idea, before 1789, seemed to be on the practical political agenda.

Events in France at first encouraged the reform movement. Here, after all, was a people casting off the chains of a thousand years, and advancing further toward liberty than the English had moved in a century. In their enthusiasm, the more radical reformers not only began a habit of fraternal correspondence with the French political clubs, but sometimes of following the new French habit of calling each other Citizen this and Citizen that.

This, however, was about the limit of approval for things French. Leaving aside an insignificant minority, the reformers knew that a revolution in England was neither necessary nor possible. Everything they wanted already was in the Constitution, only waiting until successful persuasion could bring it out. But, French veneer or none, advocacy of reform was fast going out of fashion.

Seeking Out "The Enemy Within"

Open hostility was first articulated by Edmund Burke. He saw on what wretched foundations the new order in France stood. In exposing them, he created the first great masterpiece of English conservative thought. As his predictions of the course of French events came true, the possessing classes took alarm. The reformers increasingly fell under suspicion of plotting revolution. After France declared war on England early in 1793, alarm ripened into panic, and the cry went up for suppression.

Pitt's Tory government found all this highly convenient. Arguments over France and domestic reform already had split the Whig opposition. Giving in to public opinion would only consolidate the Tory position. The radical reformers already were harried and spied upon. Now, defeat of "the enemy within" became a priority.

In the middle of 1794, the Government pounced. The reform leaders were arrested and their papers seized. The Habeas Corpus Act was suspended. Charges were made of high treason.

This was defined as having distributed the works of Tom Paine and the other radical philosophers, of having corresponded with the French Assembly before the outbreak of war—and therefore of being men of violent intention.

Anywhere else in Europe, the accused no sooner would have come under suspicion than been arrested and thrown without charge into prison. Any trials would have been held in secret, and for no better purpose than gathering names for other arrests. Those arrested in Scotland, for example, which had a legal system based on Roman law, and where juries were chosen from the bench, had the merest pretenses of trials.

In England, however, the accused had full benefit of the law. They were allowed counsel. Packing juries was difficult. Court proceedings were reported in the press. But, as some modern instances bear witness, even the best safeguards of justice can be ineffective against a general panic. By 1794, the mob had turned "patriotic," and assaulted anyone so much as suspected of radical intentions. There was perhaps only one man alive capable of taking on the prosecutions for high treason and defeating them.

Erskine was a Whig by birth and by conviction, and the close friend of Whig leaders Charles Fox and Richard Brinsley Sheridan. He had entered Parliament in 1783. Strangely enough, he never shone there. In court matchlessly eloquent, in the Commons, he was a wretched speaker—on one occasion even breaking down so badly that another had to continue for him. But he contrived to serve his ideals at the bar. In libel suits, he continued to submit that the question of whether or not a publication were libelous was for the jury and not the judge to decide. This led to the passing of Fox's Libel Act in 1792.

In Defense of Tom Paine

Erskine had visited France in 1790, and returned to England favorably impressed by the Revolution. His opinion of the Revolution changed over time, but his hatred of persecution never wavered. In 1792, he undertook the defense of Tom Paine on a charge of seditious libel. The second part of Paine's *Rights of Man* had come out earlier that year. The first part was left to circulate freely. But its sequel was alleged to insult the Constitution and the Royal Family, and moves were begun to suppress it. The trial began in December, the Attorney General prosecuting.

Erskine's speech for the defense had been a month in preparation, and was the greatest he had delivered so far. "[E]very man," he asserted, "not intending to mislead, but seeking to enlighten others with what his own reason and conscience, however erroneously, have dictated to him as truth, may address himself to the universal reason of a whole nation, either upon the subject of governments in general, or upon that of our own particular country."[1]

For all its magnificence, his speech was an utter failure. He was heckled throughout by the jury. As soon as he sat down, the foreman rose and stopped the trial. The Attorney General could reply if he wished, the foreman said contemptuously. But nothing more was required. A guilty verdict was brought in immediately. For his part in the proceedings, Erskine was dismissed from the Prince of Wales' service.

He had no better success with his defense the next year of John Frost, a lawyer who had uttered seditious words while drunk. Again, the jury convicted. If, in some other cases, he defeated the Crown, the balance was tilting steadily against the defense in state trials. Erskine knew, when he agreed to defend the reform leaders, that this was a last stand. If he should fail, and the accused be convicted of high treason, the whole principle of limited constitutional government would come into doubt.

The trials opened on October 28, 1794, at the Old Bailey, Lord Chief Justice Eyre presiding. First for hearing was the case against Thomas Hardy. A shoemaker by occupation, Hardy was a comfortable, quiet man just entering middle age. Though not a great writer or speaker, he had helped found a group called the London Corresponding Society in 1791. Its end was parliamentary reform. For this, he stood accused of compassing the King's death.

Sir John Scott, the previous year made Attorney General, and subsequently known as Lord Chancellor Eldon, prosecuted. He opened with a tremendous speech nine hours long. Hardy's acts were examined in minute detail, and treasonable intents deduced from them—a desire to import into England all the squalid horrors of the French Terror. Seized papers were read out, and the worst construction put on them. Scott

then examined the Crown witnesses—Government spies, informers telling evidence as they were paid. Set out over five days, the prosecution case had an obviously strong effect on the jury.

Erskine opened for the defense in what seemed an even weaker position than in Paine's case two years before.

His speech is beyond description. It must be read. He tore the Crown's case in pieces. Treason, he reminded the jury, was strictly to plot against the King's life, not simply to offend his government. Much had been said about Hardy's "further intentions" beyond reform, but a court of law had to proceed on facts, not on probabilities. "I am not vindicating anything that can promote disorder in the country," Erskine said, "but I am maintaining that the worst possible disorder that can fall upon a country is, when subjects are deprived of the sanction of clear and positive laws."[2]

The seized papers, Erskine pointed out, indicated a desire to reform Parliament, not to overthrow it. As for the oral evidence, it was worthless. Erskine paid particular attention to the testimony of George Lynam, a Government spy: "He professed to speak from notes, yet I observed him frequently looking up to the ceiling. When I said to him, 'Are you now speaking from a note? Have you got any note of what you are now saying?' he answered, 'Oh no, this is from recollection.' Good God Almighty! Recollection mixing itself with notes in a case of high treason."[3] He spoke for seven hours, his voice finally dying away to a near whisper. He had done his absolute best, and it was enough. All that remained of the trial was secondary. The jury was out for three hours, but returned with an acquittal.

The Government persevered. John Horne Tooke was tried next. An elderly clergyman, he was a friend and colleague of the Whig leaders, and had been working for parliamentary reform for 20 years. That he could have been a traitor was absurd. The proceedings sank from high drama to farce. Erskine let Tooke largely conduct his own defense. At one point, the Prime Minister was compelled to attend on a writ of subpoena. Had he and Tooke once collaborated in bringing forward a reform bill? Pitt twisted and equivocated. The public gallery rocked with laughter. It was a very sullen William Pitt who went back to Downing Street and the conduct of the war against France. The jury was out eight minutes, then returned another acquittal.

Still the Government persevered. John Thelwall, a young agitator, was the next to go on trial. He genuinely admired the French extremists. Had he been tried first, rather than Hardy, the prosecutions might have gone differently. But he came after, and Erskine already had shattered all belief in the Crown case. The Lord Chief Justice is said to have slept through the prosecution speech. The jury acquitted nearly automatically. The other radicals were released, all charges dropped. Certain of gaining convictions, the Government had drawn up 800 arrest warrants, of which 300 were signed. These were now scrapped.

Hardy's defense costs amounted to £25. In this, as in the other two cases, Erskine had given his services free of charge.

He lived nearly another 30 years, but his later career was an anticlimax. He became Lord Chancellor in 1806, but, ignorant of equity law, failed in the post. Thereafter, he passed his time in often unhappy idleness. His total earnings from advocacy had amounted to £150,000. His Chancellor's pension was £4,000 a year. But, ever careless of money, Erskine invested much of his fortune in very bad American stock, and lost every penny. He was reduced first to embarrassment, then to actual poverty. He died in Scotland, on a visit to his elder brother, the eleventh Earl, and is buried in the family tomb at Uphall, Linlithgow.

But whose life would not be an anticlimax after the glories of 1794? The Government remained firmly in power. It brought in new laws against conspiracy and seditious libel. It did its considerable best to suppress the reform movement. It had also learned that, whatever the situation abroad—or even in the other two kingdoms of the British Crown—power in England was confined within certain impassable limits. Panicked by the example of France, the Government had opened the Pandora's box of proscription. Singlehandedly, Thomas Erskine slammed that box shut so tightly that it has never yet been reopened. The debt owed him by the English people is incalculable. □

1. *A Complete Collection of State Trials*, various editors, London, 1809-1826, vol. xxiii, col. 414-415.
2. *Ibid.*, vol. xxiv, col. 936.
3. *Ibid.*, col. 962.

Racial Tensions: The Market Is the Solution

by David Bernstein

"Relations between ordinary white and black Chicagoans, measured by the everyday small talk of people crossing paths, seem, if anything, to have become more cordial in the years since this city began pitting white candidates against black candidates. But in local politics . . . this city seems clearly to be moving closer and closer to a two-party system. And it is not the Democrats against the Republicans."

So concludes an article in *The New York Times Magazine* (February 19, 1989) about the racial animosities stirred up by the mayoral race in Chicago, which pitted a white candidate against a black candidate in the Democratic primary.

Similar troubles are expected this year in New York City, where Mayor Ed Koch, who is white, will face off against Manhattan Borough President David Dinkins, who is black, in the Democratic primary. Both cities' elections have been further complicated by the fact that in each city the black candidate needs the votes of liberal Jews to win, yet in each city black-Jewish political tensions also are on the rise.

There is no question that race relations have improved tremendously in the United States over the past 20 years. Indeed, the *Times* article acknowledges that interpersonal race relations even have improved in Chicago in recent years, despite the political tensions.

So if race relations generally are on the mend, why is this trend not reflected in the political news emanating from our major cities? The answer has to do with the coercive nature of politics.

Politics is a zero-sum game. The winning side gets the spoils, the losers get nothing. Of course, the typical voter actually gains little; indeed, he loses the tax money that goes to pay off the politicians' friends and supporters. Perception, however, is more important than reality when it comes to voting. Voters believe that candidates of their own race will "take care of their own," so they vote accordingly. Racial tensions therefore are inflamed when an election pits a white candidate against a black candidate.

It is important to contrast the divisive nature of politics with the integrating nature of free markets. In recent mayoral elections in Chicago, the majority of blacks voted for the black candidate, and most whites voted for the white candidate. But in their daily shopping, how many people patronize only members of their own race — or restrict themselves to goods that were made by a particular ethnic group? Any person who makes such a choice will deprive himself of an opportunity to get better products or services from merchants of another race.

The integrating effects of markets can be observed every Sunday and Tuesday during the summer at Aqueduct Race Track near my home in Queens, New York. On those days, the parking lot of the race track is host to a huge flea market. The track is located in a racially troubled area of South Queens, 10 minutes from Howard Beach, site of a racial attack in December 1987.

Yet, every Sunday and Tuesday, people gather from all over the area to buy a wide variety of merchandise. Customers and merchants repre-

Mr. Bernstein is a student at Yale Law School.

sent just about every racial, religious, and ethnic group, and are drawn from every social class. Immigrants from India and Korea mix freely with native blacks, Jews, Italians, and others. The merchants haggle with the customers over prices, and the exchanges sometimes get heated, but in the many years that I have been going to the flea market, I have never seen anything more than harsh words exchanged, and security is minimal.

The Mutal Benefits of Exchange

Why are such diverse people able to get along so well? Could it be that people who go to flea markets are drawn from a more tolerant group than the public at large? Of course not. The flea market brings together about as random a cross section of the population as you can possibly find. I have no doubt that many of the people who frequent the market harbor deep racial hatreds. So why don't these tensions ever blow up? The answer is that the flea market, unlike the political arena, brings people together for their mutual interest.

In a free market, exchanges are made only when each side believes that the exchange is in his best interest. The fact that everyone at the flea market, black and white, rich and poor, benefits from being there is a powerful incentive for people to forget their differences and get along. In the process, racial tensions are reduced, as a wide variety of people are able to observe each other close up and see how foolish stereotypes and hatred are.

Contrast the natural amity of the market to the natural discord of politics. In politics, the side with majority support wins, and forces the unwilling minority to go along. This can't help but cause bitterness and resentment on the part of the minority towards the majority. Moreover, because politicians have so much power over the everyday lives of individuals, minor political incidents can cause major upheaval.

For example, Steve Cokely, a black resident of Chicago, publicly claimed that Jewish doctors are infecting black babies with the AIDS virus. Normally, Mr. Cokely would be dismissed as a crank, and that would be the end of it. Unfortunately, Cokely was an aide to Acting Mayor Eugene Sawyer, who is also black. Jewish spokesmen demanded Cokely's dismissal. Segments of the black community, wishing to express their defiance off the "white power structure" urged Sawyer not to "give in." After some hesitancy, Cokely was fired, but not before black-Jewish relations were soured, at least in the public sphere. Thus, Cokely's speech, which would have gained little attention if he had been a private citizen, had grave consequences because of the divisive nature of power politics.

It is unfortunate that most of the leading advocates of improved race relations in the United States have been proponents of increased government intervention in the marketplace. As we have seen, free market forces naturally lead to integration and color blindness, because individuals find it in their self-interest to put aside their prejudices. When it comes to politics, however, that same self-interest leads to racial tensions, as each group tries to improve its standing at the expense of other groups.

Relations among individual members of diverse groups are steadily improving, as people see the foolishness of discriminating in the private sphere. But as the public sphere grows ever larger, those gains are limited by political tensions. The shrinkage of government in favor of markets would do much to increase racial harmony in American cities. If you don't believe it, come to the parking lot of the Aqueduct Race Track this Sunday. □

Readers' Forum

To the Editors:

Clint Bolick is warmly to be congratulated on his exceptionally lucid review of Ellen Frankel Paul's *Equity and Gender*, a most timely book (*The Freeman*, February 1989). He is also right to point out—as his sole reservation about the book—that it fails to "claim the moral high ground for adversaries of comparable worth." In one case, however, even the remedy he proposes concedes too much of that ground. I would like to address this point at the risk of nit-picking with an otherwise exemplary review.

Mr. Bolick suggests that "defenders of the market must . . . expose comparable worth as a paternalistic theory that assumes women are incapable of succeeding on the level playing field guaranteed by the present anti-discrimination laws." However, if you concede the moral legitimacy of "the present anti-discrimination laws," I suggest that you have already surrendered the high ground—and consequently undermined your case by accepting the opposition's premises. In reality, the present "anti-discrimination" laws should be repealed as well. It is completely indefensible that an employer who wishes to support the embattled traditional family by favoring married men is now a criminal. Similarly, if an employer believes that women's well-being will be facilitated by deliberately hiring more female employees, he (or she) should be entirely free to do so.

We forget too easily that modern economics was born in the eighteenth century as an outgrowth of a belief in natural law, which led to the conclusion that there are certain things best left to natural processes, including economic decisions. Employment decisions in a

free society—as, except for state oppression of blacks, the United States has always largely been—cumulatively reflect authentic individual choices. Very simply, the crucial reason that men make considerably more (on average) than women is that—as, for instance, a 1982 Harris Poll conducted for Virginia Slims demonstrated—approximately nine out of ten women (in contrast to men) do not desire full-time employment outside the home.

If those who believe that most women do not properly understand their own interests would limit their efforts to persuasion, one could simply address the plausibility of their belief. One could demonstrate its similarity with the Marxist notion of "false conscious-

ness," and note the contradiction that those holding this view often claim to represent the majority of women. However, when feminists add to persuasion the pervasive coercion of "anti-discrimination" legislation—whether it is called "equal pay for equal work," "affirmative action," or "equal pay for work of equal value"—that eternal vigilance which is said to be the price of liberty obliges liberty's defenders to take a stand, as both Clint Bolick and Ellen Frankel Paul have so eloquently done. I would only caution that this battle cannot be won if one concedes one's opponents' premises—and in this case, there is no need whatever to do so, on the contrary, they should be called to account.

NICHOLAS DAVIDSON
New York City

(*Note*: Mr. Davidson is the editor of *Gender Sanity: The Case Against Feminism* [University Press of America, 1989].)

Ellen Frankel Paul Replies:

Both Clint Bolick and Nicholas Davidson agree that I have somehow failed to "claim the moral high ground for adversaries of comparable worth." I really thought that I had, but apparently my statement in the Introduction that "justice and equity must triumph over efficiency" was too sketchy to convey my intent. What I meant was that even if the market is most efficient—which nearly everyone concedes—this wouldn't be enough, in the sense that if comparable worth carried the moral argument that would trump the efficiency case for the market. The final chapter of the book was written to demonstrate that, indeed, comparable worth cannot carry the moral argument, and therefore both considerations of morality and efficiency weigh in on the side of the market. I hope this clarifies my intent, at least, and I will have to leave it to others to judge whether I succeeded in making the case.

I must confess, though, that I am still puzzled by Mr. Bolick's criticism that I did not succeed in claiming the high ground, when in the very next paragraph he outlines what I should have argued to claim that ground, and this sketch turns out to mimic precisely the arguments that I did make in *Equity and Gender*, namely "expose comparable worth as a paternalistic theory," an "elitist concept, denigrating the value of blue-collar jobs," and "raise the Orwellian specter of a commission of 'experts' determining wages in some mystical fashion and supplanting the will of individuals." Perhaps I'm losing my touch as a writer, but then why did Mr. Bolick commend my "superb ability . . . to take complex issues and translate them into English." It's undoubtedly petty of me to carp about a highly favorable review, but I am genuinely mystified by this line of criticism.

With Nicholas Davidson's point that Mr. Bolick, by implying that the present anti-discrimination laws create a level playing field, has himself conceded the high ground, I am in total agreement. In fact, I am in the process of writing a much more ambitious and comprehensive book than *Equity and Gender* on precisely this topic of the moral legitimacy of anti-discrimination laws. I expect that Mr. Davidson will find this book much to his liking.

ELLEN FRANKEL PAUL
Bowling Green State University

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A REVIEWER'S
NOTEBOOK

ThePoverty of Communism

by John Chamberlain

Nick Eberstadt calls his challenging book *The Poverty of Communism* (New Brunswick, N.J.: Transaction Books, 315 pages, $29.95 cloth). For the most part he trains his spotlight on China, Cuba, the Soviet Union, and the satellite countries of eastern Europe, all of which have been under Marxist-Leninist-Stalinist rule for decades. There are, however, plenty of references to countries such as Panama, Chile, Uruguay, Jamaica, and Guyana that have been brushed by Marxist doctrine. This is a wide-ranging book that realizes ideologies go beyond physical boundaries, and it is the better for it.

But Eberstadt is confusing in the way he jumps from eyewitness evidence of poverty in Communist nations to the statistical averages of mortality tables. The eyewitness stuff, which takes us to Solzhenitsyn's Gulag, is dramatic and irrefutable. But the statistical evidence, to my mind, is unreliable.

To do Eberstadt justice, he himself is careful to indicate his skepticism about reliance on official numbers. He says the official Soviet life expectancy figure of 69 years would be lower than the most recent numbers quoted by the World Bank. Moreover, the countries that Eberstadt concentrates on are definitely not above playing politics with health and literacy figures. The Castro regime in Cuba is concerned with AIDS, the incurable disease that has jumped boundaries in sub-Saharan Africa. Since some 300,000 to 400,000 Cubans have been rotated through Africa between 1975 and 1985, there must have been considerable contact between Cubans and blacks in Ethiopia, Angola, and elsewhere. Eberstadt says that for "reasons of state" the Castro regime "might well wish to downplay AIDS' source of contagion. . . ."

While Eberstadt is to be commended for his distrust of the Communist use of mortality statistics, there are ironies that he ignores. One irony is posed by the arbitrary notion that fetuses are not living human beings. This allows governments that run their economic systems by top-down planning to exclude abortions from their figures bearing on life expectancy. The Chinese, at the moment, have decreed that their women must be limited to one child per family. Forced abortions are common, much to the dismay of the women. Dismaying or not, they enable the Peking government to make a good stab at controlling the population.

What population control of this drastic sort does is to make the life expectancy figures practically meaningless. If only one child per family is allowed to live, that child might easily have a favored life expectancy. He will get the best available nutrition. If he hits 70 years it will be no surprise. The average of such favored life expectancies would be high. But if the abortions of unnumbered fetuses were to be included in the averages, we would be dealing in negatives.

Skipping to the Soviet Union, Eberstadt says Russian women have an average of six to seven abortions. If these were to be factored into the general statistics, we would get minus-quantity life expectancies.

Despite the prevalence of epidemic diseases in Cuba, the mortality statistics offered in Havana seem to be in line with the general figures for the Caribbean region. But who should get the credit

for this? As Eberstadt knows, the conquest of yellow fever and malaria was a hard-earned by-product of the efforts to make it possible for the U.S. to build the Panama Canal. The French had been defeated by yellow fever. But President Theodore Roosevelt and George Goethals persisted in fighting the yellow fever and malaria mosquitos as the French had been unable to do. Once the scientific knowledge of mosquito control had become common, it was easy for local Havana hospital authorities to move in. Actual credit for finding the cause of malaria belongs to an English physician named Ronald Ross, who had addressed the problem of mosquito control in Secunderabad, India. The "poverty" of Castroite Communism would have been far greater if British and North American capitalism hadn't cleaned up the Canal Zone first.

Eberstadt is chary of making foreign policy recommendations beyond a broad caution that the West must stop "subsidizing the Soviet imperium." He is worried by the fact that "Japanese, European, and even American corporations and government bodies make the Soviet task of controlling its allies far easier than it might otherwise be by granting Moscow financial room to maneuver."

Eberstadt singles out Angola, where Soviet proxies are making "the jungles safe for . . . 'socialism.' This is an expensive task: by some estimates, it costs as much as $3 million per day. The U.S.S.R. has been spared the necessity of footing this bill. Instead, Gulf Oil has stepped smartly into the breach, and is currently paying $5 million a day in royalties to the Luanda government." Cuba, in short, has been allowed to spread itself in Africa by a capitalist American concern.

The Poverty of Communism is a combination of essays written at different periods for publication in a variety of magazines. While this gives a disjointed quality to the whole, the general tonal effect is not unduly impaired. The inevitable repetitions are acceptable in their various contexts.

Overall, the book is reassuring to the West. The "poverty" of Communism, described in detail by Eberstadt when he gets away from analysis of statistics that he himself distrusts, is so obvious that one can be sure that Gorbachev in the U.S.S.R. and Deng in China will continue with their cautions, meanwhile allowing capitalistic motivations and incentives to creep in. □

THE THEORY OF MARKET FAILURE
Edited by Tyler Cowen

George Mason University Press, 4400 University Drive, Fairfax, VA 22030 • 1988 • 384 pages • $21.75 cloth

Reviewed by Jeffrey A. Tucker

Economists favoring government intervention often base their views on "market failures." These alleged failures occur when the free market appears unable to overcome certain barriers preventing goods or services from being satisfactorily provided through voluntary means. Some of these barriers are "externalities," "high transactions costs," or are inherent "public" qualities of the good or service.

The theory of market failure, it seems, has always been with us, but it wasn't until the 1950s that Keynesian economist Paul A. Samuelson, along with other elaborators, defined and formalized it. The argument they gave sounded compelling at the surface, but many scholars later showed it to be, in many respects, fallacious.

"Externalities" are a key part of the theory. They occur when an economic exchange affects someone not party to the original exchange. These can be positive or negative effects. For example, factory pollution creates a "negative externality," but when a neighbor improves his land and your property value goes up, you get a "positive externality."

Not all externalities are cause for worry, however: only those that create a large "divergence between private and social cost" which diminishes, in some mechanistic sense, social welfare at large. The free market can't solve this divergency, some economists say, because the "transactions costs" are too high. The factory, for example, cannot work out a satisfactory deal with every person in a city to correct the negative externality because of the costs involved in contracting, bargaining, and enforcing agreements. Government is therefore needed to correct the problem.

Similarly, the existence of transactions costs also plays a part in creating what economists call public goods, that is, those goods (or services) that everyone wants, but that the market "fails" to provide, because of the good's "special characteristics." Some traditional examples are nation-

al defense, fire departments, roads, and schools.

The lighthouse is a common example of a good that supposedly embodies all the problems associated with public goods. The lighthouse service can't be restricted to paying customers since when the beam is on, every ship in the harbor can see it. This is the condition of "non-excludability"; non-subscribing boaters receive the benefits of the lighthouse (a "positive externality") courtesy of the subscribing boaters. If the service is provided to one boat, it becomes useful to all. This creates what is called "non-rivalrous consumption," which in turn leads to the problems of shirking and free-riding.

Why should some lighthouse customers pay, while others receive a light they are not paying for, that is, when they can free-ride? And as long as there is the chance for free-riding, why shouldn't everyone try to shirk in hopes that someone else will pay for the service? Faced with these problems, say some economists, the market won't provide lighthouses. The only alternative, it appears, is to have the government provide the lighthouse and charge everyone equally for the service through taxation.

Fortunately not all economists accepted the theory of market failure at face value. The classical liberals had long provided critiques of the logic underlying market failure. But the newly formalized neo-classical theory of market failure called forth a formal response. Starting in the mid-1970s, and continuing to the present, a string of brilliant scholars have taken the model apart piece by piece. As a result, this once invincible case for government interference has severely malfunctioned. Some say the theory now stands on the verge of intellectual collapse.

In *The Theory of Market Failure*, Tyler Cowen has collected primary critiques of market-failure theory, most of which appeared in economics journals during the last 30 years, and organized them into an accessible volume. He also includes some previously unpublished essays that are especially notable. Cowen's excellent introduction details the important points of each article, explains the contribution each makes to the literature, and makes suggestions for further research. Contributors include Robert Axelrod, James M. Buchanan, Earl R. Brubaker, Steven N. S. Cheung, Ronald H. Coase, Harold Demsetz, Jerome Ellig, Kenneth D. Goldin, Jack High, Robert W. Poole, Jr., and Robert J. Smith.

As the contributors demonstrate, the market has an array of ways to overcome its alleged failures. The "special characteristics" of public goods turn out to be not so special, as Goldin points out, since most if not all goods can be supplied with either "restrictive access" or "equal access," which brings into question the inherent "publicness" of some goods over others. Demsetz shows that when "non-excludability" is not in question, as in a movie theater or park, entrepreneurs can charge consumers different prices based on differing consumer values. This allows public goods to be supplied privately. Similarly, Buchanan explains in a now-classic article how private clubs and social groups can provide public goods in ways never imagined by the market-failure economists.

But what about cases where the service of the public good cannot be excluded from nonpaying consumers? As a private solution, these goods can be connected, through tie-in arrangements, to other goods that *are* excludable.

For example, the lighthouse beam is not excludable but space in the harbor is. Harbor owners can charge a fee to boats entering the private port which can pay for the lighthouse. In fact, Coase shows that contrary to the assertions of economists, prior to 1842 British lighthouse services were provided privately through a port-entry charge. Coase concludes that "economists wishing to point to a service which is best provided by the government should use an example which has a more solid backing."

Another example of market failure debunked in these pages is that of the beekeepers and the apple-growers, whose services create externalities for each other (bees both eat and fertilize the apples). Economists use this example to illustrate how taxation and subsidies are the only way to correct some externalities. Cheung, however, demonstrates that beekeepers and apple growers have been arranging private contracts with each other for many years, with no apparent failures in the market.

The same is true for education, another alleged public good that government must provide. High and Ellig show how before the advent of government schools, in both Britain and the U.S., private enterprise did a fine job of providing education, even to the poor. Of special note, their

article describes how the government used public schools to crowd out competitive private ones. The contributions of Poole and Smith show how the "market failures" of fire protection, public parks, and nature conservation also have been privately provided.

As a caveat, most of the contributors to this volume are neo-classical economists and therefore assume the postulates of "perfect competition" and utility scales that are interpersonally measurable, both of which are untenable in a world of action. For a more fundamental critique of market failure, one that takes into account the insights of subjectivism, readers must look toward economists writing within the tradition of Austrian economics.

Cowen's volume is nonetheless an outstanding research tool. Many economists will continue attempting to justify government intervention by pointing to "market failures." But this collection puts them on the defensive. Their claims will not be regarded as self-evidently true, as they were only a few years ago. □

Mr. Tucker is a fellow of the Ludwig von Mises Institute.

MONOPOLY MAIL: PRIVATIZING THE U. S. POSTAL SERVICE
by Douglas K. Adie

Transaction Publishers, Rutgers University, New Brunswick, NJ 08903 • 1989 • 197 pages • $34.95 cloth, $19.95 paper

Reviewed by Melvin D. Barger

Once a venerated and honored government institution, the U.S. Postal Service is steadily losing public favor and support. With amazing speed, private competitors have outgunned it for market share in package and bulk mail, while the resourceful overnight services have created a new industry out of time-sensitive letters. The Postal Service has a last bastion of defense in its legal monopoly of first-class mail, but even that position is now under sustained attack. Either the Private Express Statutes that protect this monopoly will be repealed, or new electronic technologies may simply bypass the USPS and leave it with a shriveled husk of its former empire.

How did this come about? *Monopoly Mail*, sponsored by the Cato Institute, traces the major currents of change that are converging on the Postal Service. Author Douglas K. Adie, an Ohio University economics professor who took his doctorate at the University of Chicago, leaves little doubt that the current USPS is in great peril. And he insists that there's virtually no alternative but to change the organizational structure of the Postal Service. The only really workable solution is some form of privatization that will enable the service to survive and compete.

Professor Adie also offers convincing evidence that the legal mail monopoly—a seeming advantage—has been the Postal Service's Achilles' heel. The traditional justification for a government postal monopoly was its "public service" status and the need to bind the country together with effective communications. Whether this reasoning was sound or not in earlier days, Professor Adie shows that it's certainly outmoded in this day of multiple communications systems. He also shows that early private postal ventures were widely patronized and had the healthy effect of forcing the government service to improve its practices.

Private postal companies eventually disappeared, however, with passage and strict interpretation of the Private Express Statutes. The postal monopoly also prevailed because it had strong Congressional support that only began to wane in the 1960s. With the Postal Reorganization Act, which became effective in 1971, an exasperated Congress tried to shed its responsibility for the service and to make it a self-supporting government corporation.

Though it resembles a private corporation in form, the new USPS has never functioned like one. While losing ground in other classes of deliveries, the USPS still holds a monopoly on first-class mail which enables it to shift a large part of its costs to this group of users. Postal managers also have been either unwilling or unable to innovate, and efforts to improve or speed mail handling often fail. The worst malady is soaring labor costs which now comprise about 84 percent of postal expenses. The postal managers have been ineffective in opposing the demands of the powerful postal unions or were undercut later when arbitrators granted liberal increases. As a result, according to Professor Adie, USPS employees now get about 35 percent more pay than they

would receive in comparable private sector employment.

While the postal unions are still powerful enough to resist direct cuts and changes, they cannot prevail indefinitely. Professor Adie believes, for example, that the Reagan Administration's success in facing down the air traffic controllers' (PATCO) illegal strike set a new pattern in labor relations for Federal employees. Any President with enough backbone now has the public's support in resisting high pay discrepancies and refusing to support useless institutions.

There are also some excellent lessons for the Postal Service in the AT&T divestiture, in the deregulation of airlines, and in Canadian and British experiences with privatization and/or deregulation. Professor Adie shows how each change has been beneficial in its way.

The use of the AT&T example for monopoly divestiture is a bit ironic, because some of us once cited the Bell system as a standard while criticizing the poor performance of the Postal Service. We know today, however, that AT&T looked good only in comparison with government communications systems around the world. Once shed of its monopoly, AT&T could no longer force one class of telephone users to subsidize other classes. Market realities also force AT&T and others to move more quickly with innovations that will cut costs and improve service.

If the government finally elected to divest the Postal Service, how could it be done? Professor Adie does not propose selling the Postal Service as a single unit, because he feels its very size would make it too much of a competitive threat (as others feared AT&T would be if deregulated and left intact). He suggests spinning off its five regional divisions as independent Postal Operating Companies (POCs). This would precede the repeal of the Private Express Statutes, and might give the POCs breathing time to become competitive with the new delivery systems and technologies that would arise to challenge them in the market. Professor Adie goes on to suggest other methods that might characterize the new POCs and their processes for working together. He also argues that a privatized Postal Service would offer tremendous opportunities for profits. This prospect, of course, would tend to enhance the share prices of the new POCs following initial offerings.

What's most needed, however, is not a detailed plan for carrying out privatization, but simply a decision to do it. The postal unions and other vested interests still have some power to block a direct Congressional move to privatize the Postal Service. What they don't have is the muscle to block new technologies that are coming onstream as alternatives to first-class mail deliveries. The USPS and its unions also are in deepening trouble with the public, which is tiring of disproportionate increases in first-class mailing rates. And now they face the reality of new books, like Professor Adie's, that deal with private mail as an idea whose time has come. □

Mr. Barger was a business writer associated with Libbey-Owens-Ford Company and one of its subsidiary firms for nearly 33 years.

THE AMERICAN JOB MACHINE
by Richard B. McKenzie

Universe Books, 381 Park Avenue South, New York, NY 10016
1988 • 274 pages • $24.95 cloth, $12.95 paperback

Reviewed by Robert W. McGee

The issue of "jobs" has become a sacred cow. Politicians, business and labor leaders all advocate creating more of them, yet nobody dares advocate destroying them. But this outlook is shortsighted, as Richard McKenzie points out. Creating jobs is easy—just outlaw farm machinery. If the health of an economy is measured by the number of jobs its citizens have, then China should have the strongest economy on earth. Yet it does not, partly because of an absence of farm machinery.

Economies grow stronger through what Joseph Schumpeter called creative destruction. Some firms go out of business while others are born. By not allowing some companies to fold, government prevents resources from being freed for more productive uses. This book points out some unrecognized advantages of job destruction. The central message is that job creation and job destruction go hand in hand.

McKenzie destroys a number of myths about the U.S. economy. The pace of economic change is not accelerating, although increases in productive efficiency have enabled more workers to go into the service sector. Concern over the expansion of the service sector is mostly unwarranted

and misplaced. We are not becoming a nation of hamburger flippers.

Part of the problem lies in how we classify goods and services. Hamburgers are goods when purchased in a supermarket, but they are services when bought in a fast food restaurant. Computers are goods when they are purchased, but are part of a service when leased. Truck drivers are classified as manufacturing workers when they move their company's goods from one site to another, but are service workers when they work as independent contractors to transport the same goods.

America is not de-industrializing. Manufacturing output has varied between 20 and 24 percent of GNP rather consistently over the past 40 years. Yet manufacturing jobs, as a percentage of total employment, have been declining because companies can produce more goods with fewer workers, and because businesses have been changing the way they produce goods. For example, some accounting, payroll, and data processing functions that formerly were done internally have been contracted out to independent providers. The result is that jobs in the "goods" sector have declined while jobs in the "service" sector have increased. Yet the same jobs are being performed for the same companies. Furthermore, the relative decline in goods-producing jobs has not caused a general downward shift in income.

Government officials in recent years have stated that the displaced worker problem is large and that government should play a more active role in reducing this problem. Yet an analysis of the statistics shows that most displaced workers soon find jobs. Attempts to alleviate the problem, such as plant closing laws, may actually make matters worse.

The proliferation of low-income employment is generally seen as bad. But McKenzie shows that such a view is simplistic. One reason for the increase in low-income jobs is that the baby boom generation has entered the work force, and they had to start at the bottom, just like everybody else. Also, many students and housewives have entered the job market on a part-time basis, and older workers are cutting back to part-time work rather than retiring completely. The result is often that family income has improved, although the statistics show that more individuals are earning low pay.

The trade deficit "problem" may not be a problem at all. The trade deficit is measured by the difference between imports and exports, so a decline in exports will increase the trade deficit if imports remain constant. Yet exports may decline because an expanding internal economy has siphoned domestically produced goods away from world markets. American producers are selling to other Americans rather than to foreigners. So a trade deficit can be caused by an expanding domestic economy—which is a sign of economic health rather than sickness. McKenzie points out that attempts by government to restrict imports also have a tendency to hamper exports, so restrictions on trade tend to be self-defeating.

Many jobs in the textile and apparel industries have disappeared in recent years. But few of the job losses, especially in textiles, have been caused by imports. Mechanization and increased productivity have caused most of the job losses, and increased productivity has come about partly because of worldwide competition. Reducing the pressure of foreign competition by imposing trade restrictions will reduce the incentive to find additional ways to be more productive. In short, imposing trade restrictions is counter-productive.

In the final chapters, McKenzie exposes some fallacies in the popular thinking on minimum wage laws, government retraining, and mandated fringe benefit programs. The common thread that runs through each chapter is that government intervention and "tinkering" in the economy retard rather than expand employment. □

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