THE FREEMAN

IDEAS ON LIBERTY

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Phone (914) 591-7230 FAX (914) 591-8910
President: Hans F. Sennholz
Managing Editor: Beth A. Hoffman
Guest Editor: Ronald H. Nash

Editor Emeritus
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PERSPECTIVE

Our Continuing Duty

Editor's note: November 28, 1994, marks the 100th anniversary of the birth of Henry Hazlitt, renowned author of Economics in One Lesson *and Founding Trustee of FEE.*

In responding to the tributes of friends who had gathered for his 70th birthday celebration, Mr. Hazlitt issued a stirring challenge to defenders of freedom. Thirty years later, his words are even more appropriate:

I suppose most of you in this room have read that powerful book, George Orwell's *1984*. On the surface it is a profoundly depressing novel, but I was surprised to find myself strangely encouraged by it. I finally decided that this encouragement arose from one of the final scenes in it. The hero, Winston Smith, is presented as a rather ordinary man, an intelligent but not a brilliant man, and certainly not a courageous one. Winston Smith has been keeping a secret diary, in which he wrote: "Freedom is the freedom to say that two and two makes four." Now this diary has been discovered by the Party. O'Brien, his inquisitor, is asking him questions. Winston Smith is strapped to a board or a wheel, in such a way that O'Brien, by merely moving a lever, can inflict any amount of excruciating pain upon him (and explains to him just how much pain he can inflict upon him and just how easy it would be to break Smith's backbone). O'Brien first inflicts a certain amount of not quite intolerable pain on Winston Smith. Then he holds up the four fingers of his left hand, and says, "How many fingers am I holding up?" Winston knows that the required answer is five. That's the Party answer. But Winston can't say anything else but four. So O'Brien moves the lever again, and inflicts still more agonizing pain upon him, and says, "Think again. How many fingers am I holding up?" Winston Smith says, "Four. Four. Four fingers." Well, he finally capitulates, as you know, but not until he has put up a magnificent battle.

None of us is yet on the torture rack; we are not yet in jail; we're getting various

harassments and annoyances, but what we mainly risk is merely our popularity, the danger that we will be called nasty names. So, before we are in the position of Winston Smith, we can surely have enough courage to keep saying that two plus two equals four.

This is the duty that is laid upon us. We have a duty to speak even more clearly and courageously, to work harder, and to keep fighting this battle while the strength is still in us. But I can't do better than to read the words of the great economist, the great thinker, the great writer, who honors me more than I can say by his presence here tonight, Ludwig von Mises. This is what he wrote in the final paragraph of his great book on socialism 40 years ago:

"Everyone carries a part of society on his shoulders; no one is relieved of his share of responsibility by others. And no one can find a safe way out for himself if society is sweeping towards destruction. Therefore, everyone, in his own interests, must thrust himself vigorously into the intellectual battle. None can stand aside with unconcern; the interests of everyone hang on the result. Whether he chooses or not, every man is drawn into the great historical struggle, the decisive battle into which our epoch has plunged us."

Those words—uncannily prophetic words—were written in the early 1920s. Well, I haven't any new message, any better message than that.

Even those of us who have reached and passed our 70th birthdays cannot afford to rest on our oars and spend the rest of our lives dozing in the Florida sun. The times call for courage. The times call for hard work. But if the demands are high, it is because the stakes are even higher. They are nothing less than the future of human liberty, which means the future of civilization.

—HENRY HAZLITT (1894–1993)

To commemorate Mr. Hazlitt's life and work, FEE has brought out new editions of several of his books. For further information, see this month's *Notes from FEE.*

A Beacon

For what I suppose are millions of readers, Henry Hazlitt's *Economics in One Lesson* continues to shine like a beacon in the dark night of liberal and statist nonsense. If the bureaucrats and politicians in Washington would just once ask Hazlitt's basic question, "What will be the long-range consequences of this action?", we might once again begin to have some hope for our nation's future. Alas, we continue to learn that economic wisdom is the last thing—or one of the last things—we can expect from those who worship at the shrine of big government and bad economics. Whenever we chance upon a graduate of America's schools who can read, we ought to consider placing in that youngster's hands a copy of Hazlitt's book. At least, this will give that student a fighting chance when he goes to do battle with the statists who reign supreme in what we still choose to call our colleges and universities.

—RONALD H. NASH

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Health Care and the Chronically Ill

by Hope Hodson

The health plans currently floating through Congress, which would financially coerce our poorest and sickest chronically ill into HMOs, will prove an unmitigated disaster. I have been a lupus patient for 27 years; for six years I served as a certified Lupusline counselor at the Hospital for Special Surgery in New York City. My own personal experience, as well as that of my many clients, has convinced me that HMO medical care causes unnecessary suffering and physical harm to the incurably ill.

Lupus is characterized by a totally unpredictable course which will vary greatly from one individual to another. Therefore, each patient's treatment must be individualized to their specific needs and symptoms. Our physicians are constantly on alert and respond whether it is 2:00 in the morning or during a Sunday football game. We develop close, long-term doctor/patient relationships, with an arsenal of specialists woven into a tight-knit care group. This care team must be specially trained in their specific disease area and be aware of all the numerous medications their patient is receiving. It takes years of trial and error to bring this team together.

With each illness progression, our doctors face the fact that their previous treatment is no longer working. They then truly practice the art of medicine—searching for the combination of medications which will save their patient's life. After the crisis passes, they must then find a way to help us adapt, not only to the damage done during the latest episode, but also to the side-effects of the drugs we now need. Our physicians are at the forefront of medical research, with each treatment a double-edged sword, requiring them to constantly balance its risk/benefit ratio.

So, what is my experience at HMOs and why am I so terrified that my fellow lupus patients and others with chronic ailments will be forced into them?

First, I have repeatedly found that HMO physicians and allied health providers lack a basic knowledge of lupus and other complex disorders. They often fail to diagnose these diseases, and when they do make the diagnosis, they fail to institute appropriate treatment. They routinely refuse to give referrals to specialists, because in their ignorance they deem it unnecessary. In addition, they misprescribe drugs, seemingly unaware of the vast array of dangerous medications their patients use.

Secondly, the ten minutes HMOs allow for appointments is insufficient for almost anyone, but especially the seriously ill. In this hasty encounter, the doctor must do his review of patient history, ask any questions, conduct his examination, make his decision for appropriate treatment, and explain it all to the patient. With an incurable illness, this

Ms. Hodson resides in New York City.

cannot be done. Yet I have been told by HMO doctors that ten minutes is all the time they are allowed—regardless of medical need.

Lastly, there is uniformly a lack of continuity and consistency in care. I enlisted in an HMO eight years ago. During this period, I have never seen the same physician twice. In dermatology alone, I've had eight different doctors. I gave up any hope of ever receiving competent medical attention at this HMO last July. I called saying I had a rash on my face and was developing a bald spot on my head—symptoms indicating lupus activity and the need to see a dermatologist. With full knowledge that I have lupus, but lacking the ability to care for a lupus patient, I was given the first available appointment, three months in the future. I called my private-practice dermatologist who has cared for me for 23 years. He saw me that day, gave me a steroid shot and free samples of the prescriptions I needed.

Since my diagnosis, my team of private-practice physicians have responded daily to my many medical needs. Never have I had to wait for an appointment. Never have they failed to institute appropriate treatment. It is only because of this kind of dedicated care by my team of independent physicians that I am alive today. Had I been restricted to HMO care, I would not have survived. If medical care for the low and moderate income chronically ill is restricted to HMOs, I fear for my life and for the lives of those I counsel and care for. □

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Socialized Health-Care Nightmare

by Yuri Maltsev and Louise Omdahl

In 1918, the Soviet Union's universal "cradle-to-grave" health-care coverage, to be accomplished through the complete socialization of medicine, was introduced by the Communist government of Vladimir Lenin. "Right to health" was introduced as one of the "constitutional rights" of Soviet citizens. Other socioeconomic "rights" on the "mass-enticing" socialist menu included the right to vacation, free dental care, housing, and a clean and safe environment. As in other fields, the provision of health care was planned and delivered through a special ministry. The Ministry of Health, through its regional Directorates of Health, would pool and distribute centrally provided resources for delivery of medical and sanitary services to the entire population.

The "official" vision of socialists was clean, clear, and simple: all needed care would be provided on an equal basis to the entire population by the state-owned and state-managed health industry. The entire cost of medical services was socialized through the central budget. The advantages of this system were proclaimed to be that a fully socialized health-care system eliminates "waste" that stems to "unnecessary duplication and parallelism" (i.e., competition) while providing full coverage of all health-care problems from birth until death.

But as we have learned from our own separate experiences, the Russian health care system is neither modern nor efficient.

In contrast to the impression created by the liberal American media, health-care institutions in Russia were at least fifty years behind the average U.S. level. Moreover, the filth, odors, cats roaming the halls, and absence of soap and cleaning supplies added to an overall impression of hopelessness and frustration which paralyzed the system. The part of Russia's GNP destined for medical needs is negligible[1] and, according to our estimates, is less than 2.5 percent (compared to 14 percent in the United States, 11 percent in Canada, 8 percent in the U.K., etc.).

Polyclinics and hospitals in big cities have extremely large numbers of beds allotted for patients reflecting typical megalomania of bureaucratic planning. The number of beds in big cities would usually range from 800 to 5,000 beds. Despite the difference in average length of stay, less than one-half were utilized. In the United States hospital stays for surgery are three to seven days; in Russia stays average three weeks. American mothers typically leave the hospital a day or two after giving birth. New mothers in Russia

Dr. Maltsev gained his insight as an adviser to the last Soviet government on issues of social policy, including health care, and as a patient in the system. He teaches at Carthage College in Kenosha, Wisconsin. Louise Omdahl, a nursing educator and manager, is actively involved in humanitarian assistance through nursing contacts in Russia and has visited numerous Russian health-care facilities.

remain for at least a week. It was explained that the length of stay was necessary due to unavailability of follow-up care after hospitalization. A physician was reluctant to discharge a patient before the majority of healing had occurred. In addition, there was no financial incentive for early discharge, as reimbursement was directly related to *number* of "patient-days," not the *necessity* for those days.

Scarce Supplies, Inadequate Personnel

Supplies are painstakingly scarce—surgeries at a major trauma-emergency center in Moscow that we observed had no oxygen supply for an entire floor of operating rooms. Monitoring equipment consisted of a manual blood pressure cuff, no airway, and no central monitoring of the heart rate. Intravenous tubing was in such poor condition that it had clearly been reused many times. The surgeon's gloves were also reused and were so stretched that they slid partially off during the surgery. Needles for suturing were so dull that it was difficult to penetrate the skin. All of this took place in 95 degree F temperature with unscreened windows open; though the hospital was built less than twenty years ago, there was no air conditioning.

Utilization of medical/nursing personnel was very different from our model. The ratio of nurses to patients in the ordinary hospitals was 1 to 30, compared to 1 to 5 in the United States. Duties of the nurse ranged from housekeeping to following medical orders. When asked for her "best nurse," a head nurse in Moscow helped a young woman up from scrubbing the floor. Five minutes later she was practicing intravenous insertions with equipment donated by us. Both of these functions were in her "job description," however unofficial that may be. Nurses are unlicensed and are not considered an independent profession in Russia. As a result, all their duties are delegated, with assessment and most documentation completed by physicians. The education of nurses occurs at an age comparable to the last two to three years of American high school.[2] Nurses are educated by physicians, not other nurses. A separate body of scientific knowledge in nursing does not exist.

The role of a patient advocate, heavily assumed by nurses in the United States was distinctly lacking in Russia. Nurses were subjugated to medical bureaucracy. Patients' rights and patients' privacy were all but ignored. There is no legal mechanism to protect patients from malpractice. To our amazement we were asked to photograph freely in patient-care settings without seeking patient consent. Patient education and informed consent were dismissed by the socialized system as an unnecessary increase in time and the cost of care. If the society does not respect individual rights in general, it would not do it in hospitals. The Russian medical oath protects the "good of the people," not necessarily the "good of the person."[3]

Apathy and Irresponsibility

Widespread apathy and low quality of work paralyzed the health-care system in the same way as all other sectors of Russian economy. Irresponsibility, expressed by a popular Russian saying ("They pretend they are paying us and we pretend we are working.") resulted in the appalling quality of the "free" services, widespread corruption, and loss of life. According to official Russian estimates, 78 percent of all AIDS victims in Russia contracted the virus through dirty needles or HIV-tainted blood in the state-run hospitals. To receive minimal attention by doctors and nursing personnel the patient was supposed to pay bribes. Dr. Maltsev witnessed a case when a "non-paying" patient died trying to reach a lavatory at the end of the long corridor after brain surgery. Anesthesia usually would "not be available" for abortions or minor ear, nose, throat, and skin surgeries, and was used as a means of extortion by unscrupulous medical bureaucrats. Being a People's Deputy in the Moscow region in 1987–89, Dr. Maltsev received many complaints about criminal

negligence, bribes taken by medical apparatchiks, drunken ambulance crews, and food poisoning in hospitals and child-care facilities.

Not surprisingly, government bureaucrats and Communist party officials as early as 1921 (two years after Lenin's socialization of medicine) realized that the egalitarian system of health care is good only for their personal interest as providers, managers, and rationers, but not as private users of the system. So, in all countries with socialized medicine we observe a two-tier system—one for the "gray masses," and the other, with a completely different level of service for the bureaucrats and their intellectual servants. In the USSR it was often the case that while workers and peasants would be dying in the state hospitals, the medicines and equipment which could save their lives were sitting unused in the nomenklatura system.[4]

A "Privileged Class"?

Western admirers of socialism would praise Russia for its concern with the planned "scientific" approach to childbearing and care of children. "There is only one privileged class in Russia—children," proclaimed Clementine Churchill on her visit to a showcase Stalinist kindergarten in Moscow in 1947. The real "privileged class"—Stalin's nomenklatura—were so pleased with the wife of the "chief imperialist" Winston Churchill that they awarded her with an "Order of the Red Banner." Facts, however, testify to the opposite of Mrs. Churchill's opinion. The official infant mortality rate in Russia is more than 2.5 times as large as in the United States and more than five times that of Japan. The rate of 24.5 deaths per 1,000 live births was questioned recently by several deputies to the Russian Parliament who claim that it is seven times higher than in the United States. This would make the Russian death rate 55 compared to the U.S. rate of 8.1 percent per 1,000 live births. In the rural regions of Sakha, Kalmykia, and Ingushetia, the infant mortality rate is close to 100 per 1,000 births, putting these regions in the same category as Angola, Chad, and Bangladesh. Tens of thousands of infants fall victim to influenza every year, and the proportion of children dying from pneumonia is on the increase. Rickets, caused by a lack of vitamin D and unknown in the rest of the modern world, is killing many young people.[5] Uterine damage is widespread, thanks to the 7.3 abortions the average Russian woman undergoes during childbearing years.

After seventy years of socialist economizing, 57 percent of all Russian hospitals do not have running hot water, while 36 percent of hospitals located in rural areas of Russia do not have water or sewage. Isn't it amazing that socialist governments, while developing sophisticated systems of weapons and space exploration would completely ignore basic human needs of their citizens? "It was no secret that on many occasions in the past 70 years, workers' health had been sacrificed to the needs of the economy—although the cost of treating the resulting diseases had eventually outweighed the supposed gains,"[6] stated Russian State Public Health Inspector E. Belyaev.

Man-made ecological disasters like catastrophes at nuclear power stations near Chelyabinsk and then Chernobyl, the literal liquidation of the Aral Sea, serious contamination of the Volga River, Azov Sea and great Siberian rivers, have made unbearable the quality of life both in the major cities and the countryside. According to Alexei Yablokov, the Minister for Health and Environment of the Russian Federation, 20 percent of the people live in "ecological disaster zones," and an additional 35–40 percent in "ecologically unfavorable conditions."[7] As a sad legacy of the socialist experiment, we observe a marked decline in the population of Russia and experts predict a continuation of this trend through the end of the century. From Russian State Statistical Office data, it appears that in 1993 there were 1.4 million births and 2.2 million deaths. Because of inward migration of Russians from the "near abroad"—former "republics" of the Soviet empire, the net fall in population was limited to 500,000. The dramatic rise in

mortality and significant decline in fertility is attributed primarily to the appalling quality of health services, and the deteriorating environment. The head of the Department of Human Resources reckons that the fertility index will remain at around 1.5 until the end of the century, whereas an index of 2.11 would be necessary to maintain the present population.[8] But, "the only lesson of history is that it does not teach us anything" says a popular Russian aphorism. Despite the obvious collapse of socialist medicine in Russia, and its bankruptcy everywhere else, it is still alive and growing in the United States. It possesses a mortal danger to freedom, health, and the quality of life for us and generations to come.

Incentives Matter

The chief reason for the dire state of the Russian health-care system is the incentive structure based on the absence of property rights. The current lack of goods and education within health care has caused Russians to look to the United States for assistance and guidance. In 1991 Yeltsin signed into law a Proposal for Insurance Medicine.[9] The intent is to privatize the health-care system in the long run and decentralize medical control. "The private ownership of hospitals and other units is seen as a critical determining factor of the new system of 'insurance' medicine."[10] It is moving to the direction the United States is leaving—less government control over health care. While national licensing and accreditation within health-care professions and institutions are still lacking in Russia, they are needed for self-governance as opposed to central government control.

Decay and the appalling quality of services is characteristic of not only "barbarous" Russia and other Eastern European nations, it is a direct result of the government monopoly on health care. In "civilized" England, for example, the waiting list for surgery is nearly 800,000 out of a population of 55 million. State of the art equipment is non-existent in most British hospitals. In England only 10 percent of the health-care spending is derived from private sources. Britain pioneered in developing kidney dialysis technology, and yet the country has one of the lowest dialysis rates in the world. The Brookings Institution (hardly a supporter of free markets) found 7,000 Britons in need of hip replacement, between 4,000 and 20,000 in need of coronary bypass surgery, and some 10,000 to 15,000 in need of cancer chemotherapy are denied medical attention in Britain each year.[11] Age discrimination is particularly apparent in all government-run or heavily regulated systems of health care. In Russia patients over 60 years are considered worthless parasites and those over 70 years are often denied even elementary forms of the health care. In the U.K., in the treatment of chronic kidney failure, those who were 55 years old were refused treatment at 35 percent of dialysis centers. At age 65, 45 percent at the centers were denied treatment, while patients 75 or older rarely received any medical attention at these centers. In Canada, the population is divided into three age groups—below 45; 45–65; and over 65, in terms of their access to health care. Needless to say, the first group, who could be called the "active taxpayers," enjoy priority treatment.

Socialized medicine creates massive government bureaucracies, imposes costly job-destroying mandates on employers to provide the coverage, imposes price-controls which will inevitably lead to shortages and poor quality of service. It could lead to non-price rationing (i.e., based on political considerations, corruption, and nepotism) of health care by government bureaucrats. Socialized medical systems have not served to raise general health or living standards anywhere. There is no analytical reason or empirical evidence that would lead us to expect it to do so. And in fact both analytical reasoning and empirical evidence point to the opposite conclusion. But the failure of socialized medicine to raise health and longevity has not affected its appeal for politicians, administrators, and intellectuals, that is, for actual or potential seekers of power. □

1. Pavel D. Tichtchenko and Boris G. Yudin, "Toward a Bioethics in Post-Communist Russia," *Cambridge Quarterly of Healthcare Ethics*, No. 4, 1992, p. 296.
2. C. Fleischman and V. Lubamudrov, "Heart to Heart: Teaching Pediatric Cardiology and Cardiac Surgery to Nurses in St. Petersburg, Russia," *Journal of Pediatric Nursing*, Vol. 8, No. 2, April, 1993, p. 135.
3. Pavel D. Tichtchenko and Boris G. Yudin, "Toward a Bioethics in Post-Communist Russia," *Cambridge Quarterly of Healthcare Ethics*, No. 4, 1992, p. 298.
4. Here in the United States the system of fully socialized medicine is not yet complete, but we already observe the "parallel" system of health care for bureaucrats who enjoy coverage practically unseen in the private sector. Referring to this system, Dr. Stuart Butler of the Heritage Foundation remarked: "Why reinvent the wheel? If a working health-care system already exists, that's good enough for official Washington, why not to use it as our model, improve upon it and let the rest of America enjoy the same kind of program as members of Congress and Clinton's White House staff." *Heritage Today*, Winter 1994, p. 4.
5. N. Eberstadt, *The Poverty of Communism* (New Brunswick: Transaction Books, 1990), p. 14–15.
6. *The Lancet*, Vol. 337, June 15, 1991, p. 1469.
7. *The Economist*, November 4, 1989, p. 24.
8. *Radio Free Europe-Radio Liberty Daily Report*, February 16, 1994.
9. George Schieber, "Health Care Financing Reform in Russia and Ukraine," *Health Affairs*, Supplement 1993, p. 294.
10. Michael Ryan, "Health Care in Moscow, *British Medical Journal*, Vol. 307, September 1993," p. 782.
11. Joseph L. Bast, Richard C. Rue, and Stuart A. Wesbury, Jr., *Why We Spend Too Much on Health Care and What We Can Do About It* (Chicago: The Heartland Institute, 1993), p. 101.

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The Immorality of Government-Mandated Health Care

by Paul A. Cleveland

As America's politicians debate the issue of health-care reform, one element seems strangely missing from their deliberations: the question of the morality of government-mandated health insurance. Is it moral for government to institute such insurance or to force employers to provide it? The current debate assumes that it is. Discussion has centered primarily on how far coverage can be extended, with no effort to defend the *morality* of mandated coverage.

To examine the morality of the proposed health reform we must ask the following questions: What is the role of government and what are its moral bounds? Also, how do these bounds apply to the current health-care reform debate? If, in this examination, it is discovered that government has no proper authority to insure the availability of goods and services generally, then all health-care reform proposals seeking to establish the provision of health insurance should be rejected.

The uncritical acceptance of the proposition that a major purpose of government is to insure the provision of some goods or services is related to another popularly held proposition. That notion, either conscious or unconscious, is that government can miraculously generate resources to provide for people's needs. But, how is that possi-

Dr. Cleveland is Professor of Economics and Finance at Birmingham-Southern College in Alabama.

ble? Can government actually create material prosperity where none existed beforehand? Can it cause by fiat an increase in the number and kinds of products produced without harm? It should be self-evident that the answer to these questions is no. Government cannot create by mandate. It relies on its power of taxation and coercion to provide material benefits to selected citizens. In order for it to provide some benefit for an individual it must impose a cost of equal or greater value either on that individual or on someone else. Nevertheless, the mythical concept that government can provide cost-free benefits continues largely on the basis of wishful thinking and covetousness.

No Consumption Without Production

In reality there is no effortless production of anything. We can only consume that which is produced by the sweat of someone's brow. Furthermore, our government was not primarily instituted for the purpose of production. Its primary role with respect to the economy is to punish people who use force and deceit for their own gain. History is testimony to the extent to which some individuals will inflict pain and hardship on others in order to obtain what they desire. Thus government's primary role as an institution is to thwart this behavior by punishing the perpetrators of injustice. To that end, government uses force. Citizens are required to pay taxes to support the police function of government since society benefits from the ensuing order and peace which allow for civil relations among people.

Regrettably, this same force can be put to illegitimate ends. This occurs when the government begins to play favorites among the citizens by extending benefits to some while confiscating property or curbing the rights of others. The most obvious contemporary cases revolve around the many welfare programs established by the government. Benefits are extended to some by taxing away income from others. The costs of such benefits always exceed the costs of purchasing the benefits directly because of the bureaucratic overhead needed to administer the programs. Current health-care reform plans follow the same approach. Therefore, the question of the morality of any government provision of health care, or of mandated health insurance, can only be resolved by considering whether or not government redistribution of wealth is justified.

Do the Ends Justify the Means?

It is tempting to say that the ends aimed for are good and argue, therefore, that such government action is good. After all, what decent person would not desire to see some basic provision of food, clothing, or needed medical care provided for all those who could not pay? But to conclude that government intervention is good on this basis is to argue that the ends justify the means. The ends, in and of themselves, are not a sufficient reason for concluding that government provision of goods and services is just.

I recently had a conversation with a fellow professor about the health-care situation. My colleague expressed the common view. She argued that adequate health care is a right, "because we are human." But such a statement begs the question: How does being human, in and of itself, generate any rights? It is clear that being human alone cannot justify any rights for humans. David Hume once noted that "the rules of morality are not the conclusions of our reason." Therefore, if we carry Hume's statement to its logical conclusion, we must conclude that if any human rights exist, they exist only as they have been endowed. Thus rights must be defined apart from ourselves. Ultimately they must be defined by the One who has the power of being in and of Himself, since He alone is in a position to establish such license. We are then dependent upon His proclamation of right and wrong to discern the rights of the individual. Apart from such an endowment, there are no rights! This view was expressed in the Declaration of Independence as well as many other writings and documents of the time.

Rights of Individuals

What are an individual's rights? As expressed in the Declaration, the individual is endowed with the right to life, liberty, and pursuit of happiness. These rights allow each individual to use his talents and his property freely to the ends he personally has in mind so long as he does not violate the rights of others. In this context, people can voluntarily interact and trade with others on mutually agreeable terms to further their own interests.

The Judeo-Christian heritage substantially affirms this understanding of individual rights. The Bible requires its reader to respect the property rights of others. "Thou shall not steal,"[1] and, "Cursed is the man who moves his neighbor's boundary stone,"[2] are its admonishments. In other places the Scriptures encourage hard work and honest dealings with others. Taken as a whole, the Bible prohibits the use of force to obtain what we wish to consume for ourselves. But this is exactly what transpires when government mandates a plan to provide health care services to everyone! As already shown, the government by definition employs force. It is a coercive institution. Thus when government begins the process of providing, or mandating the provision of, goods and services in society, it ceases to perform its primary function of thwarting and punishing wrongdoers and actually begins to participate in the very plunder that it was supposed to stop. By using force to take from one person in order to give to another, it is involved in stealing.

Why has government more and more compromised its position by engaging in legal plunder when it is clear that such action is wrong? There are two reasons.[3] The first is selfishness. People would rather have someone else pay for their consumption than work hard and purchase things for themselves. This is as true for health care as it is for any other consumable. This was demonstrated during the last presidential campaign when a man phoned a radio talk show. Bill Clinton was well ahead of George Bush in the polls and he had promised to bring about government-mandated universal health insurance. To this situation the man proclaimed, "I can't wait 'til Bill Clinton is elected president and gets his health-care reform through Congress. Then I won't have to pray to God that my children don't get sick."

The caller had no intention of revealing his true character that day; but he did. In his proclamation we find a deeper problem. It is not that he lacks health insurance or that he cannot afford medical care. The real problem is that he does not want to pay for it himself. Rather, he wants someone else to pay, not as a matter of mercy shown to him, but as a matter of coercive force. Selfishness which leads to systematic thievery will destroy a nation. A nation can survive and prosper when there are a few thieves, but as more people leave productive endeavors to participate in government largess, production wanes and economic hardships increase. This is the inevitable outcome of all government schemes aimed at providing some benefit for some citizens at the expense of others.

The second is perhaps the most pervasive reason for the government's drift toward promoting welfare programs in general, and for its current consideration of mandating the provision of universal health insurance. Americans have traditionally been compassionate. Generosity for those in need has been a hallmark feature of the American experience. Private charities, churches, nonprofit organizations, and the volunteerism associated with them have been a salient feature of our culture. Stated simply, the American people have a passion for helping out those in need. This spirit is the reason why most of our hospitals developed as nonprofit institutions. Yet it is this very passion which threatens to undermine the fabric of our society when charity is pursued by way of governmental mandate.

It is not hard to see how this situation can arise. At any given point in time, the available resources to meet our ends are always limited. That is, we can always imagine a better circumstance than the one we are presently in. If this is true for individuals,

how much more true is it for voluntary groups seeking to do good? It is, therefore, easy to see the temptation facing people who desire to show mercy and compassion toward others: to use voluntary contributions to lobby for government action rather than devoting them directly to the cause in mind. If the efforts are successful, the organization can tap into the much larger pool of resources available in the public treasury to promote their cause. If passion for the cause blurs their vision, then they may well use government force and, as a result, inflict harm upon the neighbors they aim to help. Such is the state of American "do-goodism" in the twentieth century—coercive charity.

This movement has been greatly aided by the religious community. One cannot read the Bible for long without realizing that it calls its followers to show mercy and compassion toward others. As a result, well-meaning people have often pushed for government intervention because they see the public treasury as the only institution which has a pool of funds large enough to meet the need. However, the Bible never suggests that the government is the means through which mercy is to be shown. Actually, the evidence indicates that such action is more than inappropriate. When Satan offered to place Jesus in political control of the kingdoms of the earth, Jesus rejected the offer arguing that it was sin to have other gods above God.[4] Jesus understood that mercy and compassion are voluntary responses motivated by love and that no government is capable of forcing people to love their neighbors. He understood that any such attempts were nothing more than a false image intended to mimic the real thing.

National health-care insurance, or its mandated provision, is unjust. It is nothing more than a forced charity, which is no charity at all. In this vein we might flatter ourselves into believing that we are doing good works, but it simply is not true. True mercy is extended as a matter of voluntary choice. It is not forced. Government mandates which require some to provide for others is false philanthropy. It is fundamentally selfishness unleashed and it will thwart future prosperity. If health insurance is extended the quality of medical care will decline. The end result will be exactly the opposite of what such schemes purport to offer. Instead of provision and prosperity, pain and hardship will follow. □

1. Exodus 20:15.
2. Deuteronomy 27:17.
3. Frederic Bastiat refers to these two reasons for government involvement beyond its real purpose in his book, *The Law* (Irvington-on-Hudson, N.Y.: The Foundation for Economic Education, 1950).
4. See Luke 4:1–13.

Legal Plunder

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How is . . . legal plunder to be identified? Quite simply. See if the law takes from some persons what belongs to them, and gives it to other persons to whom it does not belong. See if the law benefits one citizen at the expense of another by doing what the citizen himself cannot do without committing a crime.

Then abolish this law without delay, for it is not only an evil itself, but also it is a fertile source for further evils because it invites reprisals. If such a law—which may be an isolated case—is not abolished immediately, it will spread, multiply, and develop into a system.

—FREDERIC BASTIAT, *The Law*

THE FREEMAN
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What NBC Didn't Tell You About Health-Care Reform

by Jane M. Orient

How much education will $2.5 million buy on prime-time network television?

The NBC two-hour special "To Your Health," aired June 21, promised to provide a "vigorous, energetic discussion" that would "speak clearly" about "the most complex issue in our lifetime." The sponsor was the Robert Wood Johnson Foundation (RWJF), the nation's second largest tax-exempt philanthropic organization.

RWJF has played a crucial role enabling the passage of health-care reform legislation in various states. Key members of the President's Task Force on Health Care Reform also were funded by RWJF. (The secret war-room operation of the Task Force is being challenged in federal court as a government violation of the Sunshine laws, in the case of *Association of American Physicians and Surgeons*, et al., *versus Hillary Rodham Clinton*, et al.)

The sponsor's role in the televised "town hall" was simply to provide money for education. NBC was responsible for the content of the program—except for choosing the general subject matter.

RWJF did *not* fund a program on rising illiteracy, declining morals, welfare-state failures, government corruption, or other pressing issues. Just coincidentally, the subject involves a mammoth piece of legislation that the Administration is desperate to pass—urgently, quickly, before potential patients find out what it will do to them. The star of the show was the foremost proponent of that legislation: Hillary Rodham Clinton.

The vigorously stage-managed presentation had some huge blind spots. The most important one was what *health-care* reform would do to the patients who told their sad stories to a national audience.

Naturally, the audience would assume that *health-care* reform is supposed to *help* people who have lost their insurance and come down with cancer.

Not so.

The reformers stated their agenda, but you might not have understood: our current system has a *sickness* orientation. They want to change it to a *health-care* or *wellness* orientation.

What does this mean to a person who cannot benefit from a school-based clinic, a blood-pressure check, or a substance abuse program? What about that uninsured, wheelchair-bound man who was too ill to come into the auditorium?

A spokeswoman for the model Oregon rationing program, a featured panelist, could have told the audience what was in store for that man under *her* program. But she didn't. And people like me, who provided "balance" by sitting in our assigned seats in the audience, were not allowed to ask her.

Dr. Orient practices private medicine in Tucson. She is also Executive Director of the Association of American Physicians and Surgeons.

On the Oregon Prioritized List of Physical Health Services, "cancer with distant metastases" (the man had lung cancer that had spread to his brain) is number 672 out of about 700.

The man in the wheelchair was bald due to the chemotherapy he had received, albeit with a few weeks' delay. According to the narrator, he had accumulated some $30,000 in medical bills, which probably will never be paid. (That's about one percent of the cost of the television program. But don't bother to apply to the RWJF for a grant. As a matter of policy, they do not help individuals.)

Under the Oregon plan, the man might have been in a coffin, but at least he would still have hair. His wife wouldn't have medical bills to worry about—although she might have less money because of being forced to pay premiums for the "health" plan.

The $30,000 that might have paid for this patient's care would be allocated to things with a higher social priority: for example, sterilization operations (number 88–89); preventive services (141 and 174); abortions (279); and the bureaucratic infrastructure to enforce the priorities.

For its cynical (or unthinking) exploitation of human tragedy, NBC's educational effort merits an "F."

There were also other failings. The spectrum of views was by no means complete.

The featured dissenters were zealous and disruptive advocates of a government takeover of insurance and medicine (the "single-payer" system).

On the other side, small business executives spoke eloquently about the harmful effects of employer mandates. Unfortunately, some viewers might conclude that hardened businessmen were the only obstacle standing between health care and the poor. It is hard to find someone with the insight to say, "I lost my job because the government ruined my employer's business, and now I'm on welfare."

Senators Dole and Mitchell provided an appearance of bipartisan balance by sitting together on the stage and saying very little. Senator Mitchell spoke glowingly of the success of Medicare, despite its monstrous costs and NBC's technically brilliant exhibition of its paperwork forest.

Absent from the discussion (save for the briefest mention of Medical Savings Accounts) was any proposal to replace the current system of prepaid consumption with economically sound insurance. *No one* spoke of the proven benefits of putting decisions—and money—back in the hands of *patients*, wresting it away from the new elite managerial class that has caused much of our current problem.

There is one way to defeat this idea, which can reduce costs while preserving freedom: keep it a secret.

After viewing the NBC program, on location and on television, I would revise my question:

How much propaganda value can $2.5 million in tax-exempt educational funding buy? □

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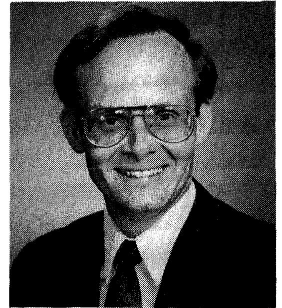

Of Meat and Myth

Advocates of the spontaneous order of freedom and free markets are forever stomping out the fires of fallacious reasoning, anti-capitalist bias, and twisted history. It seems that as soon as we put out one fire, opponents of the market manage to ignite ten others.

We spend as much time explaining the workings of the market as we do debunking myths and clichés about it. Statists and interventionists spout an endless stream of put-downs and one-liners that pass as thorough critiques of the market, each one requiring a time-consuming, painstaking response and appeal to reason. We are constantly rewriting prejudiced accounts of history to match what really happened.

Nearly ninety years ago, muckraking novelist Upton Sinclair wrote a book titled *The Jungle* which wove a tale of greed and abuse that reverberates to this day as a powerful case against laissez faire. Sinclair's focus of scorn was the meatpacking industry. The objective of his effort was government regulation. The culmination of his work was the passage in 1906 of the famed Meat Inspection Act, enshrined in most history books as a sacred cow (excuse the pun) of the interventionist state.

Were Sinclair's allegations of a corrupt industry foisting unhealthy products on an unsuspecting public really true? And if so, should the free market stand forever indicted and convicted as a result? A response from advocates of freedom is long overdue. Here's a healthy start.

The Jungle was, first and foremost, a novel. It was intended to be a polemic—a diatribe, if you will—and not a well-researched and dispassionate documentary. Sinclair relied heavily on both his own imagination and on the hearsay of others. He did not even pretend to have actually witnessed the horrendous conditions he ascribed to Chicago packinghouses, nor to have verified them, nor to have derived them from any official records.

Sinclair hoped the book would ignite a powerful socialist movement on behalf of America's workers. The public's attention was directed instead to his fewer than a dozen pages of supposed descriptions of unsanitary conditions in the meatpacking plants. "I aimed at the public's heart," he later wrote, "and by accident I hit it in the stomach."[1]

Though his novelized and sensational accusations prompted later congressional investigations of the industry, the investigators themselves expressed skepticism of Sinclair's integrity and credibility as a source of information. President Theodore Roosevelt wrote of Sinclair in a letter to William Allen White in July 1906, "I have an utter contempt for him. He is hysterical, unbalanced, and untruthful. Three-fourths of the things he said were absolute false-

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Dr. Reed, economist and author, is President of The Mackinac Center for Public Policy, a free market research and educational organization headquartered in Midland, Michigan.

hoods. For some of the remainder there was only a basis of truth."[2]

Sinclair's fellow writer and philosophical intimate, Jack London, wrote this announcement of *The Jungle,* a promo that was approved by Sinclair himself:

> Dear Comrades: . . . The book we have been waiting for these many years! It will open countless ears that have been deaf to Socialism. It will make thousands of converts to our cause. It depicts what our country really is, the home of oppression and injustice, a nightmare of misery, an inferno of suffering, a human hell, a jungle of wild beasts.
>
> And take notice and remember, comrades, this book is straight proletarian. It is written by an intellectual proletarian, for the proletarian. It is to be published by a proletarian publishing house. It is to be read by the proletariat. What *Uncle Tom's Cabin* did for the black slaves *The Jungle* has a large chance to do for the white slaves of today.[3]

The Jungle's fictitious characters tell of men falling into tanks in meatpacking plants and being ground up with animal parts, then made into "Durham's Pure Leaf Lard." Historian Stewart H. Holbrook writes, "The grunts, the groans, the agonized squeals of animals being butchered, the rivers of blood, the steaming masses of intestines, the various stenches . . . were displayed along with the corruption of government inspectors"[4] and, of course, the callous greed of the ruthless packers.

Most Americans would be surprised to know that government meat inspection did not begin in 1906. The inspectors Holbrook refers to as being mentioned in Sinclair's book were among *hundreds* employed by federal, state, and local governments for more than a decade. Indeed, Congressman E. D. Crumpacker of Indiana noted in testimony before the House Agriculture Committee in June 1906 that *not even one* of those officials "ever registered any complaint or [gave] any public information with respect to the manner of the slaughtering or preparation of meat or food products."[5]

To Crumpacker and other contemporary skeptics, "Either the Government officials in Chicago [were] woefully derelict in their duty, or the situation over there [had been] outrageously over-stated to the country."[6] If the packing plants were as bad as alleged in *The Jungle,* surely the government inspectors who never said so must be judged as guilty of neglect as the packers were of abuse.

Some two million visitors came to tour the stockyards and packinghouses of Chicago every year. Thousands of people worked in both. Why is it that it took a novel written by an anti-capitalist ideologue who spent but a few weeks there to unveil the real conditions to the American public?

All of the big Chicago packers combined accounted for less than 50 percent of the meat products produced in the United States; few if any charges were ever made against the sanitary conditions of the packinghouses of other cities. If the Chicago packers were guilty of anything like the terribly unsanitary conditions suggested by Sinclair, wouldn't they be foolishly exposing themselves to devastating losses of market share?

Historians with an ideological axe to grind against the market usually ignore an authoritative 1906 report of the Department of Agriculture's Bureau of Animal Husbandry. Its investigators provided a point-by-point refutation of the worst of Sinclair's allegations, some of which they labeled as "willful and deliberate misrepresentations of fact," "atrocious exaggeration," and "not at all characteristic."[7]

Instead, some of these same historians dwell on the Neill-Reynolds Report of the same year because it at least tentatively supported Sinclair. It turns out that neither Neill nor Reynolds had any experience in the meatpacking business and spent a grand total of two and one-half weeks in the spring of 1906 investigating and preparing what turned out to be a carelessly-written report with preconceived conclusions. Gabriel Kolko, a socialist but nonetheless an historian with a respect for facts, dismisses Sinclair as a propagandist and assails Neill

and Reynolds as "two inexperienced Washington bureaucrats who freely admitted they knew nothing"[8] of the meatpacking process. Their own subsequent testimony revealed that they had gone to Chicago with the intention of finding fault with industry practices so as to get a new inspection law passed.[9]

As popular myth would have it, there were no government inspectors before Congress acted in response to *The Jungle* and the greedy meatpackers fought federal inspection all the way. The truth is that not only did government inspection exist, but meatpackers themselves supported it and were in the forefront of the effort to extend it!

When the sensational accusations of *The Jungle* became worldwide news, foreign purchases of American meat were cut in half and the meatpackers looked for new regulations to give their markets a calming sense of security. The only congressional hearings on what ultimately became the Meat Inspection Act of 1906 were held by Congressman James Wadsworth's Agriculture Committee between June 6 and 11. A careful reading of the deliberations of the Wadsworth committee and the subsequent floor debate leads inexorably to one conclusion: Knowing that a new law would allay public fears fanned by *The Jungle,* bring smaller competitors under regulation, and put a newly laundered government stamp of approval on their products, the major meatpackers strongly endorsed the proposed act and only quibbled over who should pay for it.

In the end, Americans got a new federal meat inspection law. The big packers got the taxpayers to pick up the entire $3 million price tag for its implementation as well as new regulations on their smaller competitors, and another myth entered the annals of anti-market dogma.

To his credit, Upton Sinclair actually opposed the law because he saw it for what it really was—a boon for the big meatpackers.[10] Far from a crusading and objective truth-seeker, Sinclair was a fool and a sucker who ended up being used by the very industry he hated.

Myths die hard. What you've just read is not at all "politically correct." But defending the market from historical attack begins with explaining what really happened. Those who persist in the shallow claim that *The Jungle* stands as a compelling indictment of the market should clean up their act because upon inspection, there seems to be an unpleasant odor hovering over it. □

The author wishes to thank Professor Timothy G. Nash of Northwood University in Midland, Michigan, for his research assistance in the preparation of this column.

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2. Roosevelt to William Allen White, July 31, 1906, Elting E. Morison and John M. Blum, editors, *The Letters of Theodore Roosevelt*, 8 vols. (Cambridge: Harvard University Press, 1951–54), vol. 5, p. 340.
3. Mark Sullivan, *Our Times: The United States, 1900-1925*; vol. 2: *America Finding Herself* (New York: Charles Scribner's Sons, 1927), p. 473.
4. Stewart H. Holbrook, *The Age of the Moguls* (Garden City, N.Y.: Doubleday & Company, Inc., 1953), pp. 110–111.
5. U.S. Congress, House, Committee on Agriculture, *Hearings on the So-called "Beveridge Amendment" to the Agriculture Appropriation Bill*, 59th Congress, 1st Session, 1906, p. 194.
6. *Ibid.*
7. *Ibid.*, pp. 346–350.
8. Kolko, p. 105.
9. *Hearings*, p. 102.
10. Upton Sinclair, "The Condemned-Meat Industry: A Reply to Mr. J. Ogden Armour," *Everybody's Magazine*, XIV, 1906, pp. 612–613.

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Four Myths About America's Great Depression

Ronald H. Nash

America's Great Depression is often cited as the primary example of the failure of free market economics. According to the official liberal interpretation of the Depression, both the economic collapse that began in 1929 and the nation's eventual recovery prove that the American government must never again allow its economy to operate in a free market mode. The common view is that the 1920s in America was a period of unbridled free enterprise. In order to restore stability to the nation's economy and bring the nation out of the depths of the Depression, the government had to step in and do what businessmen could not or would not do to correct the weaknesses of the free market system. The decade of the 1930s proves the importance of governmental control over the economy and justifies continuing interventionist or statist measures.

It would be difficult to imagine an explanation that is more in conflict with the evidence. This essay will examine four myths that ground this mistaken explanation of the Depression. Once the myths are recognized for what they are—an intentional distortion of the truth—one of the major ploys used by academicians and politicians to deceive the American people into supporting bigger government will be exposed.

Myth Number One: The Case of Business Cycles

The first myth can be summarized as follows: *A free market is notoriously unstable and leads inevitably to economic cycles in which periods of prosperity are followed by recessions and depressions. These irregularities in a nation's economy can be either eliminated or made less severe by proper government intervention.*

The recurrence of business cycles is one of the most frequently cited reasons for the need of governmental intervention with the economy. The often unstated and always unproven assumption behind this claim is that business cycles and, more specifically, economic depressions are caused by free market economics. This assumption is clearly false.

Business cycles in general and depressions in particular are caused not by free markets, but by governmental intervention with a nation's economy, specifically with its money supply. As nations expand credit and the money supply, a pattern becomes apparent. First, there is a governmentally induced period of economic expansion as

Dr. Nash, Professor of Philosophy at Reformed Theological Seminary-Orlando, and a Contributing Editor to The Freeman, is this month's guest editor. He has published more than 25 books including Poverty and Wealth (Probe Books), Social Justice and the Christian Church *and* Freedom, Justice and The State *(both published by University Press of America).*

easy credit and a larger money supply mislead businessmen into making bad investments. Markets unhampered by governmental intervention keep sending signals to astute investors and entrepreneurs. The rise or decline in prices along with the cost of borrowing money (interest rates) can tell a wise investor whether a particular opportunity is a good risk at that particular time. But governmental intervention in the form of monetary and credit expansion affects the reliability of normal market signals. Interest rates may be artificially (and temporarily) reduced while inflation causes many prices to rise. The rise in prices eventually affects the prices of capital goods required for business expansion. This increase in business costs finally affects the profitability of many businesses, leading them to find ways to cut costs. In the later stages of the boom, interest rates begin to rise, which also increases the cost of doing business and often affects loans incurred when money was much cheaper.

Because governmental intervention with the economy sends the wrong signals to businessmen and investors, their subsequent investment in the wrong things at the wrong time makes a day of reckoning inevitable. While that day can be postponed by even more expansion of credit, it cannot be postponed forever. When the quantity and degree of bad investments in any economy passes a certain point, the economy can no longer absorb them. Ventures must be terminated; businesses must be closed; bills must be left unpaid; workers must be laid off; unemployment will increase; savings will be depleted.

A recession or depression therefore is a necessary step in an economy's return to normal after the misinformation and distortions caused by monetary inflation during the boom have produced a large amount of malinvestment. The recession or depression that follows periods of governmentally induced booms is a necessary time of readjustment. Prices must be readjusted to new consumer preferences. Interest rates must be readjusted to reflect the new demand for savings along with the actual supply of savings. Bad investments must be reduced through such means as greater managerial efficiency or lower labor costs. These lower costs may be reached through greater productivity; often they result from a business employing fewer workers. There must be a general cutting back across the board until businesses can once more be profitable, until investments can earn a proper return, and until the economy once more functions efficiently. What people call a recession or depression, therefore, is actually an adjustment of the economy to the wasteful and mistaken errors made during the boom. The process of adjustment is a return to a more sane set of economic arrangements which means, among other things, that many of the bad investments are liquidated.

There is a common thread that runs through every period of economic decline in American history, namely, governmental manipulation of the money supply. The obvious culprit in these economic downturns was not the free market but the government—indeed, the very government responsible for the downturns in the first place. What then should one think of economists and politicians who appeal to such periods of economic decline as justification for increased amounts of the very types of economic interventionism that produced the depressions?

But what about the Great Depression? As everyone thinks they know, the decade prior to the economic collapse of 1929 was a period of unbridled economic freedom. It was, so the official doctrine goes, the extent of America's experiment with free enterprise in the 1920s that led to the greatest depression in our history. But this belief is also a myth that must now be unmasked.

Myth Number Two: The Unbridled Capitalism of the Twenties

According to the official liberal dogma, the seriousness of the Great Depression was in direct proportion to America's reliance

upon a noninterventionist economy during the decade of the twenties. The unparalleled economic freedom of the twenties did more than make the Great Depression inevitable; it also made it the worst depression in the nation's history.

Even a brief survey of the evidence, however, will reveal how mistaken the common wisdom about the twenties is. The decade that preceded the Crash of 1929 was anything but a period of unbridled capitalism. It was actually a time of continued governmental intervention with the money supply. The foundations for the Depression can indeed be found throughout the preceding decade. But the causes of the Depression were a string of governmental actions that resulted in an expansion of credit and the money supply that was similar to the interventionism that led to earlier economic downturns.

A good place to begin one's search for the causes of the Great Depression is the establishment of the Federal Reserve System in 1914. The Federal Reserve was given the power to increase the nation's money supply in response to what it regarded as justifiable circumstances. For most of the sixteen years following the creation of the Fed, the nation's money supply was subjected to an almost steady increase. Between 1914 and 1917, this took the form of massive amounts of credit extended to nations like England and France for their purchase of war materiel. Following America's own entry into World War I, the money supply was expanded even more as a way of paying for our own war effort. When the war was finally over, the now greatly expanded money supply produced the inevitable inflation.

The higher postwar prices led in turn to an increase in cheaper imports. But this hurt American businesses, which led businessmen, farmers, and labor unions to pressure Congress to do something about foreign competition. This pressure led to two unfortunate tariff acts (tariffs are clearly antithetical to capitalism). The Emergency Tariff Act of 1921 increased duties on such commodities as wool, sugar, and wheat. Another tariff act passed in 1922 imposed the highest duties to that time in the history of the nation. It also gave the President the power to change tariffs as he thought necessary. These high tariffs produced a serious instability in agriculture, other export industries, and the rest of the American economy.

All of this intervention with the economy had the effect of reducing foreign trade. Prospective foreign customers could not buy American products until they accumulated credits; but such credits could be accumulated only after they first sold their products to us, something the increased tariffs made much more difficult. In an effort to offset some of this harm, the government adopted cheap money policies. To make it easier for foreign buyers to purchase American goods (while still making it difficult for them to sell their goods in the United States), bankers floated enormous loans and bond issues in this country. Between the end of World War I and 1929, American lenders provided more than $9 billion in foreign loans, done largely to shore up America's sagging export markets which had been hurt as a result of earlier interventionist measures (the tariffs) to reduce imports. While the cheap money policy of the twenties produced temporary increases in exports, it was accompanied by a huge burden of internal and international debt.

The Federal Reserve System continued to follow an easy money policy during the second half of the twenties. Between July 1924 and 1929, the money supply increased more than 20 percent. Farm and urban mortgages increased more than $10 billion between 1921 and 1929. Because much of the new money created by the system was channeled into speculation in real estate and the stock market, rapid price rises occurred in the stock market and in real estate. (Other significant forms of statist intervention with America's economy that helped lay the foundation for the Depression must be discussed elsewhere, due to a lack of space.)

Often overlooked as a major contributing cause of the Depression was what became known as the Smoot-Hawley Tariff Acts. Even though Smoot-Hawley was not passed

until June of 1930, it makes sense to view the measure as a significant cause of the Crash. The bill had been widely discussed and debated in Congress throughout much of 1929. By the autumn of 1929, Wall Street had begun to realize that passage of the tariff bill was inevitable. It also realized that President Hoover would not veto the damaging measure. Hence, it seems clear, the damage from Smoot-Hawley was not confined to the period of time following its passage, as bad as that was. It also had a major effect on events prior to its passage, including the October Crash of the Stock Market.

As important as the Stock Market Crash of October 1929 was, it did not mark the beginning of the Depression. The economy actually began to recede during the summer of 1929. Economic troubles had been brewing long before the Crash. What the collapse of the stock market did was make those troubles visible and mark the end of an incredible period of speculation that had to end sometime.

The October Crash is often exaggerated with regard to its supposed effects on the Great Depression. While the Crash was clearly very bad for the many unwise investors and speculators who had been wiped out, America was still far from anything resembling what we now think of as the Great Depression. That was still to come; and like previous depressions, it would result from further governmental mismanagement. The collapse of the stock market provided clear evidence that badly mistaken policies had been followed. The time for necessary readjustments had finally come.

Even with the crash of the stock market, the economy was strong enough so that the nation should have entered a normal period of readjustment.[1] Even during 1930, unemployment averaged less than 8 percent of the work force. Barring mistakes on the part of the government, 1931 should have been the start of a recovery. Obviously it was not, and the reason can be found in the mistaken, often foolish policies of the federal government.

The economic decline that began at the end of 1929 could and should have been of short duration, if only Hoover and the Congress had acted in an economically responsible way. Unfortunately, they did not. Hoover and his administration were in no mood to admit their mistakes. Had they taken their medicine, paid their dues, and suffered through the severe but limited depression that would have followed, the economy soon would have made the proper adjustments. Instead, the Hoover administration piled error on top of error. Its mistakes plus the blunders of Congress plus the economic malfeasance of the Roosevelt Administration turned what would have been an economic downturn like every other one in the previous history of the country into an economic nightmare that lasted eleven years.

Myth Number Three: Hoover's Commitment to Free Market Economics Deepened the Recession

As we have seen, liberals want to lay all of the blame for the Depression at the feet of the free market. With such a convenient scapegoat available, they can then use the Depression to justify statist measures they wish to impose upon the economy in the future. Their rewriting of history requires, however, that they turn Herbert Hoover into a flaming advocate of free market economics whose stubborn refusal to adopt interventionist measures made the Depression worse until Franklin Roosevelt's courageous adoption of wise statist policies finally turned things around. Nothing could be farther from the truth.

In late 1929, the nation's economy was in need of a number of major readjustments. But these necessary readjustments all took the form of *decreasing* or *terminating* various interventionist measures of the twenties that had produced the Depression. What Hoover and his administration did however was reject the adjustments that should have been made and opt instead for a course of *more* governmental control over the economy.

Herbert Hoover was not a champion of a free market economics whose conservative principles helped first to produce the Depression and then caused it to worsen. In truth, Hoover was a proven interventionist whose interventionist policies helped bring about the start of the Depression and whose succeeding interventionist actions helped to make it worse.

Following the 1929 Crash, the Hoover Administration and Congress committed three major blunders that were to deepen and prolong the Depression. Each blunder was a typically *interventionist* measure.

(1) Hoover did everything he could to keep wages and prices high during 1930. For one thing, his administration took action designed to keep the prices of wheat, cotton, and other agricultural products up. The unfortunate result of these farm policies was to encourage larger crops and greater farm surpluses for which no markets could be found. This had the effect of depressing farm prices even more.

Also in 1930, Hoover attempted to persuade business leaders to keep wages and prices high. In place of cutting wages and prices—the normal practice in a time of recession—Hoover urged businessmen to increase their spending on wages and capital outlay in the belief that this would preserve the purchasing power of consumers. The Hoover Administration pursued a policy of deficit spending and public works projects. Local and state governments were asked to borrow money to support their own public works projects.

(2) The Hoover Administration instituted large tariff increases that had a disastrous effect on international exchange. With tariffs already higher than they should have been and a huge burden of international debt hanging over the world's economy, Hoover went along with Congress's passage of a huge tariff increase. Already high tariffs made it almost impossible for foreign goods to reach our markets. Hoover's acceptance of a new round of even higher tariffs was the major blunder that turned the recession of 1930 into the Great Depression. The Smoot-Hawley Tariff Act of June 1930 was the most protectionist law in the history of the nation. America's borders were effectively closed to foreign goods. The government's intentions with regard to the new tariff act no doubt seemed good at the time. It wanted to raise farmers' low incomes that resulted from the low prices they were getting for their products. But in economics, good intentions often produce disastrous results.

Other nations responded to the increase in our tariffs by raising their own. This had the effect of cutting off international markets and narrowing lines of trade. The new protectionist policies created enormous problems for countries that owed money and needed to pay off their debts with goods. Since so much of this mountain of debt was unsound to begin with, creditors could not collect. In the two years that followed passage of Smoot-Hawley, American exports declined by almost two-thirds. The politicians had ignored a fundamental principle of international exchange; exports pay for imports. If people in other nations cannot sell their goods to us, they cannot earn the money they need to buy our products. Closing the door to imports will result eventually in closing the door to exports.

While farm prices dropped precipitously throughout 1930, the sharpest decline followed passage of the Smoot-Hawley Act in June. While American exports had totaled $5.5 billion in 1929, they had by 1932 fallen to just $1.7 billion. All of this led to a collapse of American farming. Hundreds of thousands of American farmers lost their farms. America's recession was being turned into a world depression.

(3) The government proceeded to raise taxes, an incredible move under the circumstances. In fairness to Hoover, it should be noted that much of the blame for the tax increase belonged to the Congress. After the midterm elections of 1930, there was a Democratic majority in the House of Representatives.

The tax increase of 1932 was the largest increase in federal taxes in the history of the nation to that point. The income tax was doubled. Estate taxes were raised, corporation tax rates were increased, exemptions

were lowered, and postal rates were raised. There was also a 2 cent tax on checks, a 3 percent automobile tax, a tax on telephones and telegraph messages, and a 1 cent a gallon gasoline tax. Faced by declining revenues, state and local governments followed Washington's lead and imposed new taxes of their own. The total tax burden of the nation almost doubled in the period after 1932. If the politicians had been seeking a way to bring the nation's economy to its knees, they could not have found a better strategy. The huge tax increases guaranteed that the Depression would not end soon. Real Gross National Product fell by 14.8 percent in 1932, the year the tax increase went into effect. An unemployment rate that had averaged 3.2 percent in 1929 and 7.8 percent in 1930 jumped to almost 25 percent in 1932.

By the end of Hoover's term, unemployment had reached 25 percent of the work force or more than twelve million workers. The Depression had spread beyond the borders of the United States and had become a worldwide depression. Nations like Germany and Austria stopped making foreign payments and froze American credits. England ended gold payments in September 1931. Foreign bond values fell drastically, which led to a collapse of the bond market in America. This proved to be an additional blow at American banks, in this case, a blow at their own investments.

The collapse of so many American farmers put their major creditors—the rural banks—in jeopardy. Many of them were forced to close. Between August 1931 and February 1932, approximately 2,000 banks closed, still owing depositors more than $1.5 billion. Banks that did not close were often forced to take extreme measures. New loans were often refused, and old loans were pressured to make payment. This banking panic led to even greater pressures on the market as many banks dumped many of their own stock holdings.

Bank runs and other banking difficulties did not occur to any great degree until the fall of 1930. But once a number of Midwest and Southern banks failed, confidence in banks was undermined and many people rushed to withdraw their funds. In mid-1929, America had almost 25,000 commercial banks. By the time of Roosevelt's inauguration in 1933, this number had fallen to about 18,000. Another 3,000 were eliminated by the end of 1933.

There is no way to exaggerate the tragic desperation of the nation at the end of Hoover's Presidency. But Hoover and his administration refused to admit that the disaster was a result of their interventionist policies; they continued to blame businessmen and speculators. But the truth is that Hoover's economic interventionism had only made things far worse.

Myth Number Four: Roosevelt's Interventionism Ended the Depression

If anyone was an interventionist, Franklin Roosevelt was. The mythical component in our fourth claim concerns the mistaken belief that the ultimate end of the Depression resulted from any of Roosevelt's economic policies. The evidence makes it clear that late into the 1930s, Roosevelt's interventionist measures were only making things worse!

During his first one hundred days in office, Roosevelt and his administration refused to remove the barriers to prosperity raised during the Hoover years. Instead, he erected dozens of new ones. Roosevelt's first significant action with regard to the economy was to undercut the quality of the dollar by seizing people's private gold holdings. In 1933 and early 1934, private holders of gold were forced to turn over their gold to the government at a price well *below* the market price, but equal to the *official* price of gold. By this act of confiscation, the federal government gained legal and physical control of the nation's gold, which it replaced with certificates. The government's action was legalized theft. Later, in 1934, the government raised the *official* price of gold to $35 an ounce, which was above the market price. This devaluation

produced a de facto profit for the government of $2.8 billion. A dollar thus became worth whatever the government said it was worth.

Then Roosevelt's advisers proposed the National Industrial Recovery Act (NRA), instituted in 1933 as a way of increasing the purchasing power of American workers. The Act established minimum wages, prices, and rates for specific industries. Its purpose was to raise prices at the same time that it increased purchasing power. The government did this by forcing employers to increase their payrolls by means of shorter work weeks and a minimum wage. It also banned jobs for youth. This government-mandated increase in business costs acted as a further brake on economic recovery. Unemployment increased still more, to almost thirteen million. The minimum wage provisions of the law caused enormous suffering in the South, where approximately a half million blacks were forced out of work. In 1935, the Supreme Court declared that the NRA was unconstitutional. But the policies of the Act had given the economy another severe jolt which had the effect of postponing any recovery.

Roosevelt's results with American agriculture were just as bad. Congress passed the Farm Relief and Inflation Act, also known as the Agricultural Adjustment Act (AAA). It was supposed to increase the income of farmers by reducing the number of acres under cultivation and by destroying crops already in the field. Farmers were paid not to plant. The program spread rapidly from its original coverage of cotton to all basic cereals and meat and then to all cash crops. This expensive program was supposed to be paid for by a so-called "processing tax." The new tax that the AAA placed on the agricultural industry provided money that was used to destroy crops and livestock. Healthy animals were slaughtered, and fields of cotton, wheat, and corn were plowed under. Farmers were paid not to plant crops. Like all interventionist acts, the government thought it was aiding one group of people in the market. But of course this "aid" would have to come at the expense of the many others who were forced to pay for it. Even if the program had helped the farmers—which it did not—it would have done so at enormous cost to the millions who had to pay higher prices or had less to eat.

When the Roosevelt interventionists saw that things were not going as they had planned, they proclaimed that the ensuing disaster was not the result of their efforts. It was a result rather of their measures not going far enough. What the nation needed was more priming of the economy by the federal government. Roosevelt's budget message in January 1934 promised a $7 billion deficit in a total budget of $10 billion. This attempt to prime the economic pump failed to revive the economy. A slight recovery in the first half of 1934 was followed by a decline to an even lower economic level by September of 1934.

Roosevelt's Administration raised taxes in 1933, in 1934, and again in 1935. Federal estate taxes became the highest in the world. By now, it was clear that the increased taxation was aimed not at the production of more revenue but at the redistribution of wealth.

When the Supreme Court judged that both the NRA (in 1935) and the AAA (in 1936) were unconstitutional, two awesome burdens were removed from the American economy. The end of NRA helped to increase productivity and reduce labor costs. The end of AAA lowered taxes on agriculture and ended the destruction of crops and livestock. Unemployment began to come down in the mid-1930s. But the planners in the Roosevelt Administration had not yet learned anything from their past mistakes. Anxious to earn the support of organized labor for Roosevelt's re-election bid in 1936, Roosevelt and the Democratic majority in Congress gave them the Wagner Act of 1936, a price that Big Labor never forgot.

The Wagner Act or the National Labor Relations Act was a response to the Supreme Court's decisions with regard to NRA and AAA. The Act totally revolutionized labor relations in the country. No longer could labor disputes be settled in the

courts; they were now under the jurisdiction of the National Labor Relations Board, a new federal agency which served as judge, jury, and prosecutor. Following Roosevelt's re-election in 1936, the big unions began to consolidate the massive new powers granted them under the Wagner Act. Millions of workers were forced to join unions. While wages were forced up, worker productivity declined. Strikes idled many plants. The ensuing jump in labor costs produced another decline in economic activity. Unemployment once again passed the ten million mark. At the end of 1937, the American economy collapsed once more. The Roosevelt Administration had accomplished something never before achieved in history. It actually managed to produce a depression within a depression.

While it is true that Roosevelt inherited an unemployment problem, he certainly did not fix it. Unemployment in 1933 (25 percent) was higher than the year before. During three years of Roosevelt's Presidency, unemployment topped ten million. In only two of the seven years between 1933 and 1939 did unemployment drop below eight million. In 1938, unemployment jumped more than it did during the first year of the Depression, reaching 18.8 percent of the labor force or more than ten million workers. Viewed as an economic experiment to put people back to work, the New Deal was a fraud and a farce. The massive unemployment that still characterized the nation's economy after years of New Deal intervention with the economy was ended only by the nation's need to draft more than ten million men into the military.

The Depression did not result from some defect inherent within capitalism. It did not result from this nation's love affair with unbridled free enterprise during the twenties. The first two myths about the Depression that we examined are clearly untrue. As Lawrence Reed explains, "The genesis of the Great Depression lay in the inflationary monetary policies of government in the 1920s. It was prolonged and exacerbated by a litany of political follies: tariffs, taxes, controls on production and competition, destruction of crops and cattle, and coercive union legislation, to recall just a few. It was not the free market which produced twelve years of agony; rather, it was political bungling on a scale as grand as there ever was."[2]

According to Benjamin Anderson, the nation's failure "to get out of the depression in the years 1933 to 1939 [was] due to the great multiplicity of New Deal 'remedies,' all tending to impair the freedom and efficiency of the markets, to frighten venture capital, and to create frictions and uncertainties, and impediments to individual and corporate initiative."[3] Murray Rothbard ends his long study of the Depression by stating: "The guilt for the Great Depression must, at long last, be lifted from the shoulders of the free market economy, and placed where it properly belongs: at the doors of politicians, bureaucrats, and the mass of 'enlightened' economists."[4]

Our study of economic events during the 1930s has revealed more than the mythical character of Hoover's alleged commitment to free market economics and the supposed success of Roosevelt's interventionism. It has unmasked the extent to which the enormous suffering of the thirties was a consequence of bad economics—to be more specific, interventionist policies that were proposed and enacted with good intentions and horrific results. □

1. See Benjamin M. Anderson, *Economics and the Public Welfare* (Indianapolis, Ind.: Liberty Press, 1979 [1949]), p. 224.
2. Lawrence W. Reed, *Unraveling the Great Depression* (Caldwell, Idaho: The Center for the Study of Market Alternatives, 1985), p. 13.
3. Anderson, p. 483.
4. Murray N. Rothbard, *America's Great Depression*, 3rd ed. (Kansas City: Sheed and Ward, 1975), p. 295.

THE FREEMAN
IDEAS ON LIBERTY

Interest Rates and the Business Cycle

by Glen Tenney

The cause of the business cycle has long been debated by professional economists. Recurring successions of boom and bust have also mystified the lay person. Many questions persist. Are recessions caused by underconsumption as the Keynesians would have us believe? If so, what causes masses of people to quit spending all at the same time? Or are recessions caused by too little money in the economy, as the monetarists teach? And how do we know how much money is too much or too little? Perhaps more importantly, are periodic recessions an inevitable consequence of a capitalist economy? Must we accept the horrors associated with recessions and depressions as a necessary part of living in a highly industrialized society?

Concerns about aggregate money supply levels and aggregate spending might make for interesting conversation, and a discussion of these matters might even reveal certain threads of truth, but they are inadequate in arriving at the cause of the boom and bust cycle that seems to pervade the economy in modern times. Economists in the Austrian school of thought have provided an explanation that bases economic fluctuations on microeconomic theory that is firmly grounded in principles of human action. These economists have pointed out that macroeconomic fluctuations, or what have come to be known as business cycles, are caused by extraneous manipulations of interest rates in the economy.[1] This manipulation of interest rates might entail conscious actions by governmental authorities or merely the result of governmental actions taken with other goals in mind.

Interest Rates Reflect Time Preferences

The rate of interest in an economy is an important reflection of the time preferences of individuals. People are willing to forgo some amount of current consumption in order to invest in production processes which promise finished goods that are valued higher than the sum of the inputs to the production process. The spread between the amounts paid to the owners of the productive inputs and amounts obtained from the sale of the completed product is interest income to the businessman who advances money incomes to the resource owners in terms of wages and rents. The capitalist/businessman then provides current buying power to workers and owners of other productive inputs in exchange for an amount we call interest. And looking from the opposite perspective, workers and other resource owners are willing to take a discounted amount in payment for their productive inputs in order to have current

Mr. Tenney teaches economics at Northern Nevada Community College.

incomes rather than waiting for the completion of the product.

Of course in the market for loans, the interest rate also contains an entrepreneurial component which accounts for certain areas of uncertainty which are always present in borrowing and lending money. An inflation premium is included if the dollars to be repaid on the loan are expected to have less purchasing-power than the dollars that are lent. And a default-risk premium is included based upon the ability and/or willingness of the borrower to repay the loan as agreed. Thus the interest rate that is agreed upon in the loan market includes these entrepreneurial factors in addition to an amount sufficient to induce people to forgo current consumption in favor of consumption in the future.

The interest rate serves a coordinating function in the economy by providing useful information about the availability of credit and the profitability of investments to both lenders and borrowers. If, for example, people's rates of time preference increase, this change is reflected as higher interest rates, which encourages more saving and discourages borrowing at the margin. This means that individuals in general are requiring more of an incentive to forgo current consumption than they did previously. There are two ways in which this coordinating function is hindered by governmental action in the economy.

New Money Gives a False Signal

Money is primarily a medium of exchange in the economy; and as such, its quantity does not have anything to do with the real quantity of employment and output in the economy. Of course, with more money in the economy, the *prices* of goods, services, and wages, will be higher; but the real quantities of the goods and services, and the real value of the wages will not necessarily change with an increase of money in the overall economy. But it is a mistake to think that a sudden increase in the supply of money would have no effect at all on economic activity. As Nobel Laureate Friedrich A. Hayek explained:

> Everything depends on the point where the additional money is injected into circulation (or where the money is withdrawn from circulation), and the effects may be quite opposite according as the additional money comes first into the hands of traders and manufacturers or directly into the hands of salaried people employed by the state.[2]

Because the new money enters the market in a manner which is less than exactly proportional to existing money holdings and consumption/savings ratios, a monetary expansion in the economy does not affect all sectors of the economy at the same time or to the same degree. If the new money enters the market through the banking system or through the credit markets, interest rates will decline below the level that coordinates with the savings of individuals in the economy. Businessmen, who use the interest rate in determining the profitability of various investments, will anxiously take advantage of the lower interest rate by increasing investments in projects that were perceived as unprofitable using higher rates of interest.

The great Austrian economist Ludwig von Mises describes the increase in business activity as follows:

> The lowering of the rate of interest stimulates economic activity. Projects which would not have been thought "profitable" if the rate of interest had not been influenced by the manipulation of the banks, and which, therefore, would not have been undertaken, are nevertheless found "profitable" and can be initiated.[3]

The word "profitable" was undoubtedly put in quotes by Mises because it is a mistake to think that government actions can actually increase overall profitability in the economy in such a manner. The folly of this situation is apparent when we realize that the lower interest rate was not the result of increased savings in the economy. The lower interest rate was a false signal. The consumption/saving ratios of individuals and families in

the economy have not necessarily changed, and so the total amount of total savings available for investment purposes has not necessarily increased, although it appears to businessmen that they *have*. Because the lower interest rate is a false indicator of more available capital, investments will be made in projects that are doomed to failure as the new money works its way through the economy.

Eventually, prices in general will rise in response to the new money. Firms that made investments in capital projects by relying on the bad information provided by the artificially low interest rate will find that they cannot complete their projects because of a lack of capital. As Murray Rothbard states:

> The banks' credit expansion had tampered with that indispensable "signal"—the interest rate—that tells businessmen how much savings are available and what length of projects will be profitable. . . . The situation is analogous to that of a contractor misled into believing that he has more building material than he really has and then awakening to find that he has used up all his material on a capacious foundation, with no material left to complete the house. Clearly, bank credit expansion cannot increase capital investment by one iota. Investment can still come only from savings.[4]

Capital-intensive industries are hurt the most under such a scenario, because small changes in interest rates make a big difference in profitability calculations due to the extended time element involved.

It is important to note that it is neither the amount of money in the economy, nor the general price level in the economy, that causes the problem. Professor Richard Ebeling describes the real problem as follows:

> Now in fact, the relevant decisions market participants must make pertain not to changes in the "price level" but, instead, relate to the various relative prices that enter into production and consumption choices. But monetary increases have their peculiar effects precisely because they do not affect all prices simultaneously and proportionally.[5]

The fact that it takes time for the increase in the money supply to affect the various sectors of the economy causes the malinvestments which result in what is known as the business cycle.

Government Externalizes Uncertainty

Professor Roger Garrison has noted another way that government policy causes distortions in the economy by falsifying the interest rate.[6] In a situation where excessive government spending creates budget deficits, uncertainty in the economy is increased due to the fact that it is impossible for market participants to know how the budget shortfall will be financed. The government can either issue more debt, create more money by monetizing the debt, or raise taxes in some manner. Each of these approaches will redistribute wealth in society in different ways, but there is no way to know in advance which of these methods will be chosen.

One would think that this kind of increase in uncertainty in the market would increase the risk premium built into loan rates. But these additional risks, in the form of either price inflation or increased taxation are borne by all members of society rather than by just the holders of government securities. Because both the government's ability to monetize the debt and its ability to tax generate burdens to all market participants in general rather than government bond holders alone, the yields on government securities do not accurately reflect these additional risks. These risks are effectively passed on or externalized to those who are not a part of the borrowing/lending transactions in which the government deals. The FDIC, which guarantees deposit accounts at taxpayer expense, further exacerbates the situation by leading savers to believe their savings are risk-free.

For our purposes here, the key concept to realize is the important function of interest rates in this whole scenario. Interest rates serve as a regulator in the economy in the sense that the height of the rates helps businessmen determine the proper level of investment to undertake. Anything in the economy that tends to lower the interest rate artificially will promote investments in projects that are not really profitable based upon the amount of capital being provided by savers who are the ones that forgo consumption because they deem it in their best interest to do so. This wedge that is driven between the natural rate of interest and the market rate of interest as reflected in loan rates can be the result of increases in the supply of fiat money or increases in uncertainty in the market which is not accurately reflected in loan rates. The manipulation of the interest rate is significant in both cases, and an artificial boom and subsequent bust is inevitably the result.

Conclusion

Changes in the supply of money in the economy do have an effect on real economic activity. This effect works through the medium of interest rates in causing fluctuations in business activity. When fiat money is provided to the market in the form of credit expansion through the banking system, business firms erroneously view this as an increase in the supply of capital. Due to the decreased interest rate in the loan market brought about by the fictitious "increase" in capital, businesses increase their investments in long-range projects that appear profitable. In addition, other factors as well can cause a discrepancy between the natural rate of interest and the rate which is paid in the loan market. Government policies with regard to debt creation, monetization, bank deposit guarantees, and taxation, can effectively externalize the risk associated with running budget deficits, thus artificially lowering loan rates in the market.

Either of these two influences on interest rates, or a combination of the two, can and do influence economic activity by inducing businesses to make investments that would otherwise not be made. Since real savings in the economy, however, do not increase due to these interventionist measures, the production structure is weakened and the business boom must ultimately give way to a bust. □

1. For a detailed discussion of the phenomenon of interest and the corresponding relationship to the business cycle, see Ludwig von Mises, *Human Action*, 3d rev. ed. (Chicago: Contemporary Books, 1966), chapters 19–20; Murray N. Rothbard, *Man, Economy, and State* (Los Angeles: Nash Publishing Corporation, 1970), chapter 6; and Mark Skousen, *The Structure of Production* (New York: New York University Press, 1990), chapter 9.

2. Friedrich A. Hayek, *Prices and Production*, 2d ed. (London: George Routledge, 1931; Repr. New York: Augustus M. Kelley, 1967), p. 11.

3. Ludwig von Mises, *The Austrian Theory of the Trade Cycle* (Auburn, Ala.: The Ludwig von Mises Institute, 1983), pp. 2–3.

4. Rothbard, *Man, Economy, and State*, p. 857.

5. Richard Ebeling, preface to *The Austrian Theory of the Trade Cycle* by Ludwig von Mises, Gottfried Haberler, Murray N. Rothbard, and Friedrich A. Hayek (Auburn, Ala.: The Ludwig von Mises Institute, 1983).

6. Roger W. Garrison, "The Roaring 20s and the Bullish 80s: The Role of Government in Boom and Bust," *Critical Review* 7, no. 2–3 (Spring-Summer 1993), pp. 259–276.

THE FREEMAN
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The Discouraged Employer

by Murray Weidenbaum

For years, economists have written about discouraged workers who drop out of the work force because they do not believe suitable jobs are available for them. Now government has created a new category—the discouraged employer, discouraged by the host of government impediments to hiring people. Currently, there are more than eight million people out of work in the United States. Yet overtime worked, per employee, is at an all-time peak.

Why are so many employers willing to pay the penalty of time-and-a-half for overtime rather than hire another person? Sadly, the answer is because the government discourages the employment of people by making hiring more difficult and more costly. Put yourself in the shoes of an employer: to increase your work force, you have to go through such complicated processes as those of the Equal Employment Opportunity Commission (EEOC), the affirmative action program, and the Americans With Disabilities Act. But, in contrast, employers do not get sued if they just ask people to work overtime.

Employers are also better off hiring only if they are absolutely certain that the new employee will work out. That is so because if the company makes a mistake and then has to fire someone, it will face wrongful termination suits and if those dismissed are women, minorities, or over 40—EEOC litigation is likely. For most new hires, employers have to obtain unemployment insurance, workers' compensation, coverage under the Employees' Retirement Income Security Act (ERISA), set up federal, state, and local tax withholdings, and provide family leave coverage.

If that is not bad enough, employers have to deal with two new uncertainties. One is the proposed Comprehensive Occupational Safety and Health Administration Reform Act (COSHRA) endorsed by the Clinton administration. The second uncertainty is the threat of an employer mandate under the various health-care reform proposals.

Many of these government requirements—affirmative action, personal leave, and the Clinton health plan—take effect when the company hires its 50th worker. The result is that many small businesses deliberately keep their work forces down to 49 employees or less.

Of course, each government regulation has its own justification. But when all the expenses of compliance are aggregated, the overall economic effect is great. In addition to the direct costs which are estimated to come to hundreds of billions of dollars a year, regulatory activities reduce production, innovation, and competitiveness. For example, much of the government's social legislation has been written in a way that is oblivious to its negative impact on employment. If that undesirable side effect accompanied only one or two of these programs, perhaps it could be soft-pedaled. However, because the harm to employment is so

Dr. Weidenbaum is Mallinckrodt Distinguished University Professor and Director of the Center for the Study of American Business at Washington University in St. Louis.

pervasive and cumulative, it cannot be ignored.

Civil Rights Act

Of the numerous laws and regulations that discourage or slow down job creation, the most conspicuous example is the Civil Rights Act, including the affirmative action program. This law lengthens the amount of time that many jobs stay vacant. Any employer subject to affirmative action requirements who simply goes out and hires people does so at his or her peril. In order to reduce—but not eliminate—the likelihood of being sued, prospective employers must go through a lengthy and expensive process that includes advertising in specified types of media. The advertised position must stay open long enough to provide those interested with an adequate opportunity to respond.

Precise measures of the total costs imposed by civil rights laws and regulations are illusive. Nevertheless, Peter Brimelow and Leslie Spencer came up with an aggregate estimate of $236 billion a year or approximately 4 percent of the gross domestic product. Because the Brimelow-Spencer estimate is so dramatically large, it is useful to examine its individual elements. For example, the direct compliance expenses of private business necessary to respond to civil rights rules are estimated at a smaller but still substantial amount—$5–8 billion a year. Educational institutions spend $11 billion annually for the purpose. These direct costs are clearly very substantial. However, the truly huge costs imposed by these regulations—the remaining $220 billion plus—are indirect, such as the opportunities forgone because of the diversion of management time, energy, and resources.

Wrongful Termination Liability

If civil rights laws are an extremely conspicuous aspect of government's impact on the employment process, judicial narrowing of employers' right to fire is among the least publicized. Yet the repercussion of the resultant rise in wrongful-termination liability is very substantial. High costs have resulted from the tendency of state courts around the country to change traditional employment law and to take a more permissive attitude toward plaintiffs' actions.

As recently as a decade ago, courts in all but 13 states continued to recognize the long-standing common-law doctrine that allowed private employers to fire "at will" workers not protected by collective bargaining agreements or specific statutes. In recent years, a virtual landslide of cases has brought the law closer to the requirement that an employee can be fired only for cause. Courts have also been allowing plaintiffs to collect punitive damages as well as lost wages when they can prove wrongful conduct on the part of the employer. Rand Corporation researcher James N. Dertouzos sums up his findings: "In a nutshell, the efforts of the state judiciaries to protect workers' job security are altering employers' hiring and firing practices. And one of the results is less hiring."

Dertouzos and his colleague Lynn Karoly note that, due to the substantial costs associated with wrongful termination lawsuits, firms have responded by treating labor as a more expensive input to production. They estimate that, in the adjustment process, aggregate employment drops by 2 percent or more.

Family Leave Act

The Family and Medical Leave Act of 1993 is the most recent example of government-imposed costs on the employment process. It is fascinating to recall the debates on the bill as it wended its way through the Congress. Proponents kept asking, "How could anyone object to this obviously desirable measure which doesn't cost anything?" Just as soon as the bill became law, the public was "reminded" that employers are required to maintain health insurance coverage for employees on leave.

The General Accounting Office estimates this cost alone at $674 million a year. One

area of uncertainty is the ability of employers to recover the cost of the premiums they pay to employees who do not return from the leaves of absence mandated by the new law. Nor does this estimate cover the money involved in hiring and training temporary workers, who may be both more expensive and less productive than the employees on leave.

Research supports the thesis that the costs of mandated benefits such as employee leave are ultimately borne by the employees themselves. The result of the government's "generosity": the increased cost of the employee leave mandate was shifted to the women's wages, or to their husbands' if they had insurance. Similar effects have been shown from the passage of the 1978 Federal Pregnancy Discrimination Act, which extended comprehensive maternity coverage to insured women throughout the United States. The enactment of this government "freebie" results in lower employment, lower wages, and higher hours worked.

Mandated Health Care

The largest prospective government mandate on employment is health care. At this point, nobody knows what specific type of health "reform" will be enacted by the Congress, or even if such a bill will become law in the near future. The statisticians debate over how many millions of jobs the proposed Clinton health-care mandate would kill. It is intriguing to consider the notion of government officials blithely proceeding knowing that their proposals will eliminate a million or more private jobs.

Not surprisingly, low-wage industries (such as restaurants) would be hit especially hard by such mandates. The cost of the Administration's proposal—and of most suggested variations—is likely to be the same for a highly paid worker as for an employee with a more modest wage scale.

The short-term effects of imposing a health-care mandate on employers differ from the long-run effects in important respects. In the short run, the great bulk of the costs (80 percent in the basic Clinton plan) is paid by employers, which should reduce their demand for labor. In the longer run, those costs are largely shifted back to workers in the form of lower real wages and reduced nonmedical benefits. As a result, the effect on the supply of labor is likely also to be negative.

Minimum Wage Legislation

Without doubt, of all the governmental regulations affecting employment, the statutory minimum wage has been the focus of the greatest amount of professional attention. With a few, albeit conspicuous, exceptions, the great mass of the research has concluded that increases in the compulsory minimum wage cause a rise in unemployment. The segment of the work force most affected is those at or near the minimum wage. This is a group consisting primarily of teenagers and others with low skills who thereby lose the opportunity to gain their initial work experience.

On the basis of analyzing a great number of studies, the Minimum Wage Study Commission concluded in 1981 that a 10 percent increase in the minimum wage generates a 1–3 percent increase in the unemployment among those holding minimum wage jobs, mainly teenagers. A smaller adverse effect was noted for 20–24 year olds, mostly because a smaller percentage of that age group earns the minimum wage. Confidence in the commission's estimates is enhanced by the fact that a recent study replicated the 1981 findings using panel data from all 50 states over a period of 15 years.

Several economists have demonstrated that the benefits of the minimum wage—to those receiving it—are offset by reductions in other benefits. A study of the 1967 rise in the statutory minimum wage showed that workers gained 32 cents an hour in money income, but lost 41 cents an hour in training benefits, for a net loss of 9 cents an hour in total compensation.

Studies of retail establishments in New York found that many stores responded to increases in the minimum wage by reducing

commission payments, eliminating bonuses, and cutting paid vacations and sick leave. One researcher estimated that, for every 1 percent increase in the minimum wage, restaurants reduced shift premiums by 3.6 percent, severance pay by 7 percent, and sick pay by more than 3 percent.

Other Regulation of Employment

In many other ways, government imposes costs on the job creation process.

Disability Insurance. An analysis of Social Security disability insurance beneficiaries showed that they rarely return to work. Once initial eligibility is established, the program resembles an early retirement system. In recent years, fewer than one-half of one percent of the beneficiaries successfully complete a trial work period—and thus stop receiving their monthly Social Security check. It is not surprising that the more generous the benefits, the less willing are the recipients to seek employment.

OSHA. While the disability benefits reduce the supply of labor, the rules and activities of the Occupational Safety and Health Administration (OSHA) operate to reduce the demand for labor. That feat is accomplished by increasing the indirect costs of maintaining a company work force. Virtually every serious study of OSHA concludes that, although the costs are substantial, the benefits, if any, are modest.

At the present time, Congress is considering an ambitious extension of OSHA, the proposed Comprehensive Occupational Safety and Health Reform Act. This bill would amend the existing OSHA statute to require each employer of 11 or more (an estimated 1.6 million firms) to undertake two new initiatives. The first is to create a joint labor-management safety and health committee which is granted broad authority to influence workplace safety and health programs. The second is to establish and implement a detailed written safety and health program.

In addition, OSHA inspectors would no longer have to go to court in order to get the authority to order an immediate shutdown if they considered a business operation unsafe. Each inspector would have discretion to do so. Also, the pending bill would preclude any consideration of economic impact in setting job safety or health standards.

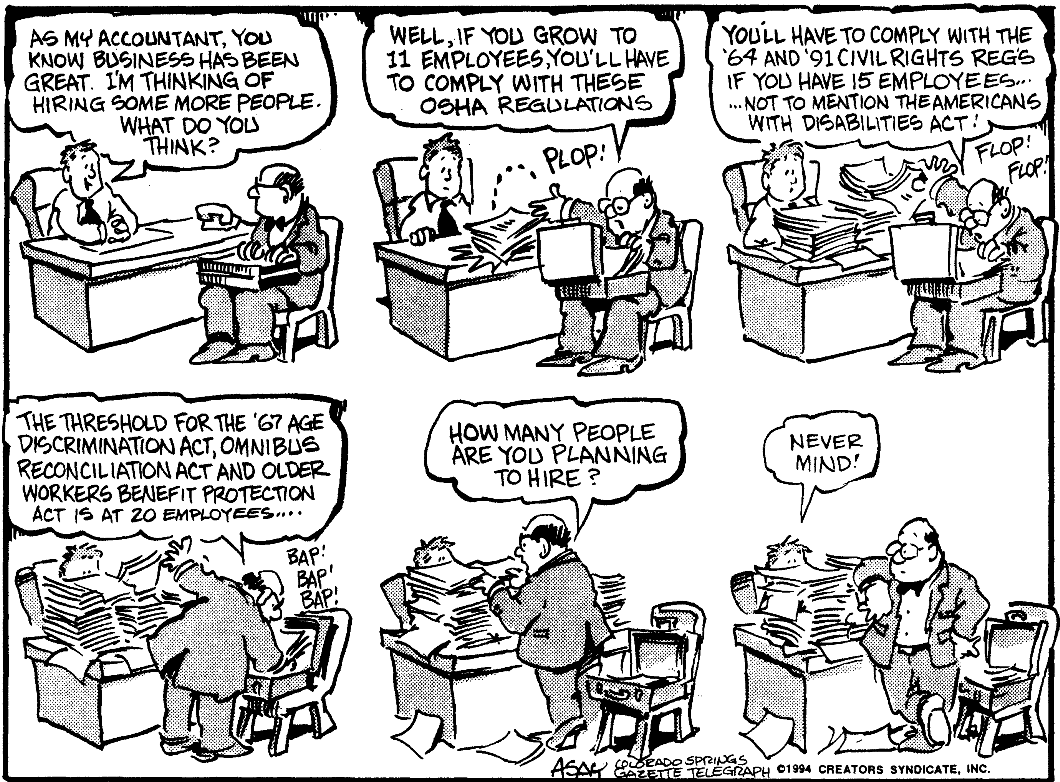
The Employment Policy Foundation has estimated that this package of changes in employment regulation would cost the American economy nearly $62 billion a year, including over $8 billion for litigation.

Workers' Compensation. Another expensive burden on the employment process, and one whose cost is rising very rapidly, is workers' compensation. In real terms, the cost of workers' compensation more than doubled from 1977 to 1991. During the same period, lost work time due to injuries and illnesses rose far more modestly, from about 60 days per 100 workers per year to approximately 70 days per 100 workers. Even taking into account the rise in unit medical costs, the workers' compensation program is an increasingly generous one—and extremely costly to employers.

Some legislation affecting jobs is so recent that it is premature to attempt to estimate the specific impacts on labor costs and on labor supply or demand. An example is the Americans With Disabilities Act (ADA), which took effect on July 26, 1992, in the case of employers with 25 or more workers (and on July 26, 1994, in the case of employers with 15 or more workers). The officials charged with carrying out the statute explain that it will take extended litigation to determine the full scope of the vague and often sweeping provisions of the law, which covers an estimated 43 million Americans. However, early experience indicates that the costs will be substantial. The Equal Employment Opportunity Commission is now receiving about 1,000 ADA claims each month—on top of its already heavy caseload dealing with other discrimination claims.

Conclusion

An important and overlooked factor in the continued high level of unemployment is the



rising load of regulation, mandates, and payroll taxes that government is imposing on business and other employers. The direct cost of meeting employment mandates imposed by the federal government has been rising twice as fast as wages and salaries.

The indirect costs of employment regulations—many of which are both substantial and hidden—all share a common characteristic: they make adding workers to the payroll more expensive. At least initially, they also create a substantial gap between the cost to the employer and the benefit to the employee.

In the words of University of Chicago law professor Richard A. Epstein, "Public discourse proceeds as if employment laws are unrelated to wage levels, job creation, or labor output. . ."

There is specific evidence to support the close—and inverse—relationship between onerous government regulation and the willingness to hire. For example, the Schonstedt Instrument Company of Reston, Virginia, a profitable, high-tech firm, deliberately keeps its work force below 50 employees. It does so in order to avoid having to file Form EEO-1 every year. An excerpt from a letter from the company's president makes the point effectively: ". . . a friend went over 50 employees on a government contract. He gave me his EEO file . . . it weighs more than 8 pounds. . . . I have kept my employment under 50."

With rising regulation, rising employer mandates, and rising payroll taxes, the time has come to reverse that trend and to undo the serious damage that government is inflicting on the job front and on economic activity generally. □

THE FREEMAN
IDEAS ON LIBERTY

Data Manipulation as Crisis

by Robert W. Pulsinelli

By now everyone should know that many politicians and others with a liberal-socialistic bent are fond of discovering crises. A crisis provides an excuse for drastic and immediate action—by the government. Often misinterpretations of economic data (wittingly or not) have been used to transform problems into crises and to expand the role of government.

To understand the "crisis" mentality, consider the following illustration. Suppose you visit your local grocery store and note that there are 300 cans of soup on the shelf. You return one month later and observe that there are still 300 such cans. Can you safely conclude that this store has a "crisis" because it isn't selling any soup? A moment's reflection tells you that such a conclusion would be a *non sequitur because the present cans may not be the same cans that were there last month.* Before drawing any conclusions, you would need more information.

A simple stock-flow model indicates that if the store sells 100 cans of soup every month and replaces those 100 cans monthly, the stock will remain at 300 cans. Clearly, if the inflow of cans exceeds the outflow (sales), then the stock (inventory) rises; if the inflow is less than the outflow, then the stock falls.

While this model is so obvious that it seems trivial, an understanding of this stock-flow model can help put some recently labeled "crises" in perspective, particularly unemployment, health care insurance, and the distribution of income.

Dr. Pulsinelli is Professor of Economics at Western Kentucky University, Bowling Green. He is the co-author (with Roger Leroy Miller) of Understanding Economics *(West Publishing Co.).*

Unemployment

Assume that the size of the labor force (the number employed plus the number unemployed) is 100 and assume that every month a survey is taken. The January survey indicates that four people are unemployed; hence, the unemployment rate for January is 4 percent. In February, suppose those four people find jobs, but four *others* become unemployed; the unemployment rate is again 4 percent. Assume further that every month something similar happened: the four who were previously unemployed find jobs but are replaced by four others who have become unemployed. The unemployment rate remains at 4 percent all year long.

If one merely observed the unemployment rate, one might conclude that a crisis existed in the economy because the unemployment rate remained at 4 percent. Indeed, a problem *might* exist if *the same people were unemployed each month,* all year round. It seems to me that before we can talk about an unemployment problem, we need to know the number of heads of households who have been unemployed for longer than one year. Clearly, if the unemployment rate were 6 percent and that number consisted only of heads of households who have been unemployed for three years, a serious problem might well exist. But that is hardly the problem in the United States.

In recent years, it is not unlikely that in any given month millions of people will become unemployed (as job losers, job leavers, re-entrants, and new entrants into the labor force), and millions will find jobs (or leave the labor force). Or, looked at in another way, of the 7.764 million people who were unemployed in December of 1993, 2.764 million had been unemployed for fewer than 5 weeks and only 925 thousand had been unemployed for 52 weeks or longer. The point is that before one can talk about an unemployment problem (much less a crisis) it is important to know how many *chronically* unemployed there are.

Understanding the simple stock-flow model helps to clear up another issue. Because the stock of unemployed is *positive* at any given moment, most people came to believe that full employment is never attained. Hence, John Maynard Keynes' contention that capitalism is associated with chronic unemployment—with the attendant implication that government must create jobs—seems to be vindicated month after month. The fact is that although it is possible for a surplus of labor (a shortage of jobs) to exist for *some* jobs (because wage rates are set by unions or governments above market-clearing levels), it is extremely unlikely if not impossible, for a *general* shortage of jobs to exist.

Health Insurance Coverage

It is widely reported that 37 million people in the United States do not have health insurance coverage, and this statistic is said to reveal a crisis that justifies the Clinton health care plan (read socialized medicine). Even if we accept that (dubious) figure of 37 million, it is not indicative of a crisis.

Every month, there are inflows into the stock of uninsured (people who have just lost their jobs, who have just graduated from high school or college and are no longer covered by their parents' family plan, and so on), and, there are outflows from that stock (people who accept jobs, who became older and decide that it is now worthwhile to purchase health insurance, who die, and so on).

The crucial information here is the number of people who are *chronically* uninsured and who *want* to purchase insurance but truly cannot afford to do so. If this number were large, it might make sense to look for radical solutions; the number of chronically uninsured Americans is probably between 2 and 3 million.

Perhaps because 37 million people did not indicate a sufficient crisis, President Clinton decided to prolong the flow period and reported that 52 million people were without insurance at one time or another during a one-year period.

Distribution of Income

Income inequality, probably more than any other "problem," has been used to justify government encroachment on private property and liberty. Data indicate (with some variability) that over very long periods in the United States, the lowest 20 percent of the distribution has received 5 percent of total income, and the upper 5 percent has received about 20 percent of total income. Let's skirt the issue as to whether such inequality is "fair" or "unfair" and merely note that such studies usually measure *pre-tax* income. By excluding income-in-kind and government transfers (food stamps, rent subsidies, Medicaid, etc.) they overstate inequality.

What is germane here, however, is the stock-flow model implications. Note that the same families do not continue to occupy the same positions in the income distribution; intergenerational social mobility occurs. Furthermore, such data overstate intra-generational income inequalities as well.

Age/Earnings Profiles. An abundance of evidence indicates that most people reach relatively low incomes in their youth, relatively high incomes in their middle years, and relatively low incomes near and after retirement. Consider now a fictitious economy in which the *only* determinant of income is age; all 17-year-olds earn $5,000 per year, all 25 year-olds earn $12,000 per year, and so on.

Assume that there are people of all different ages in this economy. Data taken at any given time (cross-section data) will indicate a considerable amount of income inequality in this (conjured) economy, whereas zero *lifetime* inequality exists. In short, income distribution studies that don't explicitly adjust for age are biased toward inequality because an age/earnings profile exists for most people, and over a lifetime there will be inflows and outflows through each age (and therefore income) bracket.

Transitory Income Effects. Consider an economy consisting of clones, in which everyone has the same skills and earns the same income. Income differences result only from temporary phenomena (illness, luck, temporary periods of work strike, temporary industry-specific recessions and expansions, and so on). Using Milton Friedman's terminology, everyone has the same permanent income; measured income differences result only from transitory income differences. In any given year, some people will be pushed below their permanent income levels and others will be pushed above theirs; hence, a certain amount of income inequality exists in a given period even if people have identical lifetime incomes. We conclude that unless income distribution studies consider only permanent (or lifetime) income, they will be biased toward measuring inequality; studies analyzing measured income overstate income inequality. Stated in another way, because of the vicissitudes of life, there will be continuous inflows and outflows through each income bracket. But because there will be (a lot of) different people in each bracket, income inequality will be overstated.

Conclusion

Demagogues will always use data for their own purposes. The rest of us need to be aware of how data can be misused and abused. Unfortunately, it is a lot easier (and the rewards are higher) to emote and shout "crisis" or "unfair" than it is to analyze data and put them into perspective for the uninitiated. Perhaps that is one reason the story of the twentieth century is largely about "crises" that induce people to hand power to governments who keep that power long after the alleged crisis has disappeared. □

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THE FREEMAN
IDEAS ON LIBERTY

The Piper Will Be Paid

by Charles D. Van Eaton

When God told Adam, "In the sweat of your face you shall eat your bread until you return to the ground, for out of it you were taken; you are dust, and to dust you shall return," He was not congratulating him. Maybe it's because I was a Biblical Studies major during my first tour through college, years before I returned to do it all over again as an Economics major, that I'm often drawn back to the ancient text to find economic lessons. If there ever was an economics lesson in Scripture, this early text (Bible students don't need to be told where it's located) is it. Life, it teaches, is not going to come easy. But that's OK because economists know that one of the good things about the hard life is that it teaches lessons to those who are willing to learn. The first lesson is this: make the right choices and there can be more bread with less sweat; make the wrong choices and there will be less bread but more sweat. Lesson two automatically follows from the first: deny the need to learn the first lesson and, sooner or later there will be no bread for anyone regardless of how much we all have to sweat.

What is this, an essay in economics or theology? Actually it's both because what both have in common is this axiom: "Sow to the flesh and you will reap corruption," but "Sow to the Spirit and you will reap life." In the jargon of economics the same tale is told another way: all choices have costs. Consequently both the Biblical and economics lesson come to the same conclusion: some choices cost more than others, so pay attention and don't keep making the same dumb mistakes over and over again.

But what happens when the old lessons are cast aside? Two events some seven years apart tell the story.

Turning Values Upside Down

In the years before the Supreme Court's 1954 landmark Brown versus Board of Education decision outlawing racial segregation in public schools, Washington, D.C., a deep-south city in many respects, maintained two public school systems; one for black children and one for non-blacks. For ambitious young black scholars interested in technical subjects, McKinley Tech was the place to be just as equally-famous Dunbar High was the choice of those interested in the arts and literature. As was true of Dunbar, admission to McKinley was highly competitive. Not everyone could get in, but those who did went on to become physicians, lawyers, nurses, research scientists, dentists, business leaders, and government officials.

Even though both Dunbar and McKinley were open only to black students, both were segregated schools—except the separation factor was not race, it was individual excellence. Distinctions were made on a grand scale and distinctions of this sort favored the few over the many. With the advent of that political vision known as the Great Society, we learned better. Things were changed,

Dr. Van Eaton is McCabe/UPS Professor of Economics at Hillsdale College, Hillsdale, Michigan.

and a new process was set in motion which made McKinley what it is today. What is that?

In September 1987, the *Washington Post* assigned Athelia Knight, one of their very bright young black reporters, to spend a year at McKinley to examine the day-to-day life of young people in this once-famous high school. Her four-part series stunned this committed *Post* reader: things had changed since the 1950s.

Knight focused on the efforts of McKinley's Principal, Bettye Toops, to improve standards and attendance. Despite her daily efforts to make McKinley what it used to be, matters were getting worse every day. For example, during an assembly held to honor outstanding students, those who had earned honor-roll status would not come forward when their names were called. They were afraid to be honored for academic accomplishments because their peers did not approve. "What Toops saw that day was a dramatic example of how academic values have been turned upside down. . . . Somehow, an environment had emerged that discouraged excellence and encouraged mediocrity. Complacency had won out over creativity; good students didn't want to be singled out because their peers wouldn't allow it." What was once a place of excellence had, in one generation, become a place of fear and failure.

Muting the Old Signals

Move forward seven years to 1994. On May 26, 1994, *Wall Street Journal* staff reporter Ron Suskind visited Washington D.C.'s all-black Frank W. Ballou Senior High School.* Two young men were featured. One, Cedric Jennings, is the child of a very religious single-parent mother and a father who was serving time for drug dealing; the other, Phillip Atkins, is the son of a hard-working, church-going mother and father who constantly teach him and his six sisters to work hard, study hard, and pray for guidance. While Cedric carries an amazing 4.0 grade point average with solid courses in math, physics, chemistry, and biology—accomplished by hard work in the laboratory before and after school with the full support of his teachers and mother—Phillip barely passes and will probably not graduate despite the fact that his test scores on national examinations are better than Cedric's.

As was true even years earlier at McKinley Tech, failure is pervasive at Ballou Senior High. There is good reason for this. Most of the children in this school come from homes in which welfare is the main source of purchasing power. Their environment has taught them that there really is no such thing as bad choices which must automatically yield bad outcomes, and good choices which carry the promise of good outcomes. Those old signals have been muted because the world they see all around them is one in which choosing not to participate in the day-to-day world of work does not cause one to lose access to food, housing, medical care, and cash income—government takes care of all these things.

Here in the world of Cedric, Phillip, and all their peers, an event occurred which could have been scripted from Ms. Knights's old report from McKinley. When students were called together for an assembly to honor academic achievers, few of the winners showed up. Why? Too risky. "When one hapless teen's name was called, a teacher had to run to the bleachers and order him forward as others jeered him and called him Nerd!" When Cedric's name was called, he was nowhere to be found. "Doing well here means you had better not show your face. I was honored last year and I didn't go; I just couldn't take the abuse." Phillip's name wasn't called. "Being openly smart," he told the *Journal* reporter "will make you a target, which is crazy at a place like Ballou. The best way to avoid trouble is to never get all the answers right on a test."

But neither Cedric or Phillip is the most intellectually gifted young man at Ballou. That honor belongs to Delante Coleman, who is the leader of one of the most dangerous street gangs in the community. As intellectually capable as he is, Delante gave up long ago. Now he likes to "toy with the

*A condensed version of Mr. Suskind's story appeared in the September 1994 *Reader's Digest*, pp. 49–53.

'goodies' who carry books home and walk alone." (Cedric is alone all the time. He has no friends at Ballou.) "Everyone knows they're trying to be white, to get ahead in the white man's world," Delante said. "In a way, that's a little bit of disrespect to the rest of us."

In his classic *Losing Ground: American Social Policy, 1950-1980* (Basic Books, 1984), Charles Murray predicted that something like this was bound to happen. Status and money are the tools society has traditionally used to manage behavior. Indeed, for many people, the dominant motive for working hard is the belief (right or wrong is beside the point here) that money can buy status. But perhaps the most important function of status, Murray argued, was to "reward the virtuous," whatever their level of income might be. Among the poor—which was the dominant group in society for most of our history—status was socially conferred on those who behaved responsibly. It was assumed that all people are always to be held personally responsible for their actions and are to take care of their own families as best they could. Thus a person might work hard and still be poor by the usual income standards, but society conferred status upon that person precisely because he worked and did the best he could. "Poverty," Murray argued, "had nothing to do with dignity." Break the connection between personal effort and status, particularly the connection between academic excellence and status which is so critical for young people, and soon there will be no academic excellence, no personal responsibility, and no dignity. In its place there will only be fear and pervasive failure.

Sociology in One Lesson

There's a lesson in the stories from McKinley and Ballou—a lesson so clear and compelling that one would have to be spiritually blind to miss the point. The lesson is this: the American people, acting through their freely elected political representatives to create social programs aimed at reducing poverty and increasing opportunity for the poorest of our lot, have succeeded in virtually destroying an entire generation of black Americans—even though not one person in a million ever intended for it to work out this way. But it has happened precisely because the philosophy which has informed the modern welfare state from the beginning is one which has always been at odds with reality.

Murray, who was there in the beginning, has noted that those who created the "Great Society" programs of the mid-1960s believed that it was wrong to make distinctions between those poor who do the right thing and therefore deserve to be rewarded, and those who do the wrong things and deserve to be left to suffer the negative consequences of their own behavior. In place of distinctions and status based on personal behavior was the assumption that the "system," rather than the individual, is to blame for poverty. The "old-fashioned" notion that there is a fundamental difference between the so-called "deserving poor," and the "undeserving poor" was cast aside in favor of the view that the poor were to be seen as a homogeneous entity and distinctions based on personal behavior were not to be made.

Enter the Cedrics, Phillips, and Delantes of the inner city. If young people in this setting have been denied the chance to see any reasonable connection between individual effort and life outcomes, they will find it difficult to tolerate any other young person from the same environment who works hard and succeeds in school because this person's success tells the non-achiever that his failure has something to do with his own choices rather than with forces beyond his control. The achiever has to hide. The non-achiever has to be the enemy of the achiever, and the Delantes of the community have to enforce the rules of failure on everyone.

Despite the best efforts of the modern welfare state to tell an entire generation of the poor that government can and will change the old notion about eating bread in the sweat of your face, we have succeeded instead in doing one horrible thing—we have now essentially denied bright and energetic young blacks access to the powerful social status which historically attached to aca-

demic excellence and, in so doing, have denied a growing number of the poorest of our brethren any chance of accessing some of the best jobs in the manufacturing crafts and commercial trades—jobs which do not require post-secondary education but which do require solid skills in basic mathematics and reading comprehension. In a word, our social programs have done the opposite of what they were supposed to do: they have closed the door for many who could and would have walked through.

Hidden Costs

Economists who study the impact of regulation on the economy suggest that regulation may increase costs by as much as $300 billion a year. Professor Israel Kirzner of New York University reminds us that $300 billion, at best, only counts what can be counted. What cannot be counted are the enterprises, jobs, and incomes which might have been developed but were not because the heavy hand of government regulation raised start-up costs and increased risk and uncertainty far above what they would have been had pure market forces been left to send the signals needed to know when and where to act and when and where not to act. Because economists cannot count what might have occurred but did not, regulation's costs are far greater than our best numbers can measure.

In the same way, we can count the number of people dependent on government welfare programs today and compare that number with counts from earlier generations to get some idea of how "successful" these programs have been. For example, we can compare the number of persons dependent on food stamps and the dollars spent on food stamps today to the number and dollars the political advocates of this particular welfare program claimed we would be spending when the program began. In 1961 there were 50,000 million food stamp recipients and the program cost $825,000. Congressional supporters claimed that there would never be more than two million Americans receiving food stamps. By 1993 the number of recipients had risen to 27 million, costing $22 billion. Conclusion? Welfare programs have not worked: the dollars prove it.

That's not the whole story. What hard dollar figures cannot count are the number of persons who could, and most likely would, have moved out of poverty if the powerful teaching tools of life had been left free to send the right signals. With these signals working, the Cedrics of the poor neighborhoods would still be making good grades and be honored by their peers. They would be going on to college and contributing to the goods and services which are the measure of our material standard of living. The Phillips would not be afraid to show their intellectual skills. And the Delantes would probably be leading their graduating class instead of a street gang.

As it is, Cedric will make it and Phillip will barely graduate from high school, but will probably stay out of jail if for no other reason than the spiritual power of his parents to keep him alive. But Delante will not likely live to see age 21. The economic data will leave no record of what Phillip and Delante could have contributed to others in directly productive labor. If they could, we would find that the true cost of our modern welfare system is incomprehensibly higher than what our crude numbers now suggest.

If there is any hope for the next generation it must come from a restoration of the old and still completely true ethic which teaches that we reap what we sow. How to begin? There is only one way. The welfare state must be abolished by closing access to it for the next generation. If we believe we cannot suddenly deny it to those already caught up in it because they are there at our own invitation, we can at least deny it to those not already seduced by its monetary charms. We can expel students who jeer excellence and make life fearful for those who want to excel. In a word, we can succeed only if we stop, once and for all, doing what we always knew would necessarily lead to failure. That's life's lesson, and it's as old as life itself. □

THE FREEMAN
IDEAS ON LIBERTY

What Is a Dollar?

by Edwin Vieira, Jr.

The question "What is a 'dollar'?" seems trivial. Very few people, however, can correctly define a "dollar," even though a correct definition is vital to their economic and political well-being.

1. Why is a correct definition of the term "dollar" important?

In America's free-market economy, prices are expressed in units of *money*. Under present law, "United States *money* is expressed in *dollars*. . ."[1] Moreover, all "United States coins and currency (including Federal Reserve Notes. . .) are legal tender for all debts, public charges, taxes and dues."[2] Thus, defining the noun "dollar" is necessary in order to know what is the "money" of the United States and what constitutes "legal tender."

2. Do the present monetary statutes intelligibly define the "dollar"?

The present monetary statutes do not define the "dollar" intelligibly.

a. *Federal Reserve Notes*. Most people mistake the Federal Reserve Note (FRN) "dollar bill" for a "dollar." But no statute defines or ever defined the "one dollar" FRN as *the* "dollar" or even *a* "dollar." Moreover, the *United States Code* provides that FRNs "shall be *redeemed in lawful money* on demand at the Treasury Department of the United States . . . or at any Federal Reserve bank."[3] Thus, if FRNs are not themselves "lawful money," they cannot be "dollars," the units in which all "United States money is expressed."

b. *United States coins*. The situation with coinage is equally confusing. The *United States Code* provides for base-metallic coinage, gold coinage, and silver coinage, all denominated in "dollars." The base-metallic coinage includes "a dollar coin," weighing "8.1 grams," and composed of copper and nickel.[4] The gold coinage includes a "fifty dollar gold coin" that "weighs 33.931 grams, and contains one troy ounce of fine gold."[5] Finally, the silver coinage consists of a coin that is inscribed "One Dollar," weighs "31.103 grams," and contains one ounce of ".999 fine silver."[6] What is the rational relationship between this "dollar" of 31.103 grams of silver, a "fifty-dollar" coin containing 33.931 grams of gold alloy, and a "dollar" containing "8.1 grams" of base metals? Obviously, these are not the amounts of the metals that exchange against each other in the free market—that is, the different weights of different metals do not reflect equivalent purchasing powers. So, on what theory are each of these disparate weights, and purchasing powers, equally "dollars"?

c. *Currency of "equal purchasing power."* The *United States Code* mandates that the latter question should not even be capable of being asked. For the *Code* commands that "the Secretary [of the Treasury] shall redeem gold certificates owned by the Federal reserve banks at times and in amounts the Secretary decides are necessary to maintain the equal purchasing power

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Mr. Vieira is an attorney specializing in constitutional law. He is the author of numerous publications on monetary law.

This is a condensed version of the monograph "What Is a Dollar?," distributed by the National Alliance for Constitutional Money. All rights to this condensed version are reserved by the National Alliance for Constitutional Money, Inc.

of each kind of United States currency."[7] Obviously, the Secretary has defaulted on this obligation to keep all forms of "United States currency" at parity with one other—that is, to maintain a "dollar" of constant purchasing-power, whether it be composed of gold, silver, or base metals.

In sum, the monetary statutes do not define the noun "dollar" in a unique way. Instead, completely different things have the same name, things unequal to each other are treated as equivalent, and things that should have the same characteristics (*i.e.*, "equal purchasing power[s]") are quite different.

3. What does American history and the Constitution identify as the "dollar"?

History shows that the *real* "dollar" is a coin containing 371.25 grains (troy) of fine silver.

a. *The "dollar" in the Constitution.* Both Article I, Section 9, Clause 1 of the Constitution and the Seventh Amendment use the noun "dollar." The Constitution does not define the "dollar," though, because in the late 1700s everyone knew that the word meant the *silver Spanish milled dollar.*

b. *Adoption of the "dollar" as the "Money-Unit" prior to ratification of the Constitution.* The Founding Fathers did not need explicitly to adopt the "dollar" as the national unit of money or to define the "dollar" in the Constitution, because the Continental Congress had already done so.

The American Colonies did not originally adopt the dollar from England, but from Spain. Under that country's monetary reforms of 1497, the silver *real* became the Spanish money of account. A new coin consisting of eight *reales* also appeared. Known as *pesos, duros, piezas de a ocho* ("pieces of eight"), or Spanish dollars, the coins achieved predominance in the New World because of Spain's then-important commercial and political position.[8] Indeed, by 1704, the "pieces of eight" had in fact become a unit of account of the Colonies, as Queen Anne's Proclamation of 1704 recognized, when it decreed that all other current foreign silver coins "stand regulated, according to their weight and fineness, according and in proportion to the rate . . . limited and set for the pieces of eight of Sevil, Pillar, and Mexico" (forms of Spanish dollars).[9]

By the American War of Independence, the Spanish dollar had become the major monetary unit of the Colonies. Not surprisingly, the Continental Congress adopted the dollar as the nation's standard of value. On May 22, 1776, a Congressional committee reported on "the value of the several species of gold and silver coins current in these colonies, and the proportions they ought to bear to Spanish milled dollars." And on September 2 of that year, a further committee report undertook to "declar[e] the precise weight and fineness of the . . . Spanish milled dollar . . . now becoming the Money-Unit or common measure of other coins in these states."[10]

Meanwhile, the Continental Congress worked on a new national monetary system. In his letter to Congress of January 15, 1782, Robert Morris, Superintendent of the Office of Finance, recommended that "our money standard ought to be affixed to silver." Although Morris favored creating an entirely new standard coin, he recognized that, of "[t]he various coins which have circulated in America, . . . there is hardly any which can be considered as a general standard, unless it be Spanish dollars".[11]

In a plan published on July 24, 1784, Thomas Jefferson concurred that "[t]he Spanish dollar seems to fulfill all . . . conditions" applicable to "fixing the unit of money." "The unit, or dollar," he wrote, "is a known coin, . . . already adopted from south to north. . . . Our public debt, our requisitions and their apportionments, have given it actual and long possession of the place of unit."[12]

Yet Jefferson recognized the necessity of "say[ing] with precision what a dollar is. This coin as struck at different times, of different weight and fineness, is of different values." So, Jefferson suggested, "we should examine the quantity of pure metal in each [type of dollar], and from them form an average for our unit. This is a work . . . which should be decided on actual and accurate experiments."[13]

On July 6, 1785, Congress unanimously

"Resolved, That the money unit of the United States be one dollar."[14] On April 8, 1786, the Board of Treasury reported to Congress on the establishment of a mint:

> Congress by their Act of the 6th July last resolved, that the Money Unit of the United States should be a Dollar, but did not determine what number of grains of Fine Silver should constitute the Dollar.
>
> We have concluded that Congress by their Act aforesaid, intended the common Dollars that are Current in the United States, and we have made our calculations accordingly.
>
> * * * * *
>
> The Money Unit or Dollar will contain three hundred and seventy five grains and sixty four hundredths of a Grain of fine Silver. A Dollar containing this number of Grains of fine Silver, will be worth as much as the New Spanish Dollars.[15]

On August 8, 1787, Congress adopted this standard as "the money Unit of the United States."[16]

Many of the same people who served in the Continental Congress participated in the Federal Convention that drafted the Constitution. And even those members of the Convention who had not served in the Continental Congress knew what that Congress had done. Therefore, when the Convention used the noun "dollar" in Article I, Section 9, Clause 1 of the Constitution, it was with the tacit understanding of the relevant history. The lesson here is clear: The *constitutional* "dollar" is *a fixed weight of fine silver in the form of a coin.*

c. *Adoption of the "dollar" as the "Money-Unit" immediately after ratification of the Constitution.* Upon ratification of the Constitution, Congress and the Executive began work on a national monetary system.

On 28 January 1791, Secretary of the Treasury Alexander Hamilton presented to Congress his *Report on the Subject of a Mint.* Hamilton posed two questions, "1st. What ought to be . . . of the money unit of the United States?," and "2d. What [should be] the proportion between gold and silver, if coins of both metals are to be established?"[17]

On the first question, Hamilton referred to the resolutions of the Continental Congress and concluded that "usage and practice. . . indicate the dollar" as the money unit. As to "what precise quantity of fine silver" the dollar should contain, he surveyed the various dollar coins in circulation over the years, and recommended that "[t]he actual dollar in common circulation has. . . a much better claim to be regarded as the actual money unit."[18]

Turning to "the proportion which ought to subsist between [gold and silver] in the coins," Hamilton recommended the domestic market-ratio of "about as 1 to 15." "There can hardly be a better rule in any country for the legal than the market proportion," he explained, "if this can be supposed to have been produced by the free and steady course of commercial principles. The presumption in such a case is that each metal finds its true level, according to its intrinsic utility, in the general system of money operation."[19]

Hamilton recommended the minting of two coins: a silver coin of 371–1/4 grains of fine silver (the dollar), and a gold coin of 24–3/4 grains of fine gold. "[N]othing better," he wrote, "can be done . . . than to pursue the track marked out by the resolution [of the Continental Congress] of the 8th of August, 1786."[20]

Congress then enacted the Coinage Act of 1792,[21] embodying the constitutional principles that Hamilton had re-affirmed in his *Report.* First, Congress followed American tradition by continuing the use of silver and gold as money.[22] Second, it reiterated the judgment of the Continental Congress and the Constitution that "the money of account of the United States shall be expressed in dollars or units."[23] and defined the "DOLLARS OR UNITS" as "of the value of a Spanish milled dollar as the same is now current, and to contain three hundred and seventy-one grains and four sixteenth parts of a grain of pure . . . silver."[24] Congress also created a new gold coin, the "EAGLE," "each to be of the value of ten

dollars or units''[25] (*i.e.*, the weight of fine gold equivalent in the marketplace to 3,712.50 grains of fine silver). It fixed ''the proportional value of gold to silver in all coins which shall by law be current as money within the United States'' at ''fifteen to one, according to quantity in weight, of pure gold or pure silver.''[26] It made ''all the gold and silver coins. . . issued from the. . . mint . . . a lawful tender in all payments whatsoever, those of full weight according to the respective values [established in the Act], and those of less than full weight at values proportional to their respective weights.''[27] And it provided free coinage ''for any person or persons,'' and affixed the penalty of death for the crime of debasing the coinage.[28]

Thus, Congress did not create a ''gold dollar,'' or establish a ''gold standard,'' as the popular misconception holds. For example, the *Encyclopedia Britannica* erroneously reports that the ''dollar . . . was defined in the Coinage Act of 1792 as either 24.75 gr. (troy) of fine gold or 371.25 gr. (troy) of fine silver.''[29] The Act did no such thing. It defined the ''dollar'' as a weight of silver, and ''regulate[d] the Value''[30] of gold coins according to this standard unit and the market exchange-ratio between the two metals. Nowhere did the Act refer to a ''gold dollar,'' only to various gold coins of other names that it valued in ''dollars.''[31]

4. Where are we now?

This history demonstrates that official Washington, D.C., has no conception of what a ''dollar'' really is. The reason for this self-imposed ignorance is obvious. By reducing the ''dollar'' to a political abstraction, the government has empowered itself to engage in limitless debasement (depreciation in purchasing power) of our money. A ''dollar'' that must perforce of the Constitution contain 371.25 grains of fine silver cannot be reduced in value below the market exchange value of silver. A *pseudo*-''dollar'' that contains no fixed amount of any particular substance *per* ''dollar,'' on the other hand, can be reduced in value infinitely.

Because debasement of money amounts to a hidden tax, Congress' silent refusal to recognize the constitutional ''dollar'' amounts to the usurpation of an unlimited power to tax through manipulation of the monetary system. Thus, modern money has become a means for the total confiscation of private property by the government.

One need not be overly pessimistic to predict that misuse by politicians of the fictional, constantly depreciating *pseudo*-''dollar'' to expropriate unsuspecting citizens will continue until an economic crisis finally shocks an increasingly impoverished American people out of its slumber, and forces the people to ask the simple question: ''What is a 'dollar'?'' At that time, the answer will be no different from what it is today, and has been since 1704. □

1. 31 U.S.C. § 5101 (emphasis supplied). *See* Act of 2 April 1792, ch. 16, § 9, 1 Stat. 246, 248.
2. 31 U.S.C. § 5103.
3. 12 U.S.C. § 411 (emphasis supplied).
4. 31 U.S.C. § 5112(a), 5112(b).
5. 31 U.S.C. § 5112(a)(7).
6. 31 U.S.C. § 5112(e).
7. 31 U.S.C. § 5119(a) (emphasis supplied).
8. *See* Sumner, "The Spanish Dollar and the Colonial Shilling," 3 *Amer. Hist. Rev.* 607 (1898).
9. *See* An Act for ascertaining the rates of foreign coins in her Majesty's plantations in America, 1707, 6 Anne, ch. 30. § I.
10. 4 *Journals of the Continental Congress, 1777-1789* (W. Ford, ed., 1905), at 381–82; 5 *id.* at 725.
11. Propositions respecting the Coinage of Gold, Silver, and Copper (printed folio pamphlet presented to the Continental Congress 13 May 1785), at 4, 5.
12. "NOTES on the Establishment of a MONEY MINT, and of a COINAGE for the United States," *The Providence Gazette and Country Journal*, Vol. XXI, No. 1073 (24 July 1784), in Propositions, note 11, at 9, 10.
13. *Id.* at 11.
14. 29 *Journals of the Continental Congress* at 499–500.
15. 30 *Id.* at 162–63. After ratification of the Constitution, Congress made a more accurate determination of the value of the dollar, setting it at 371-1/4 grains of five silver (as described below).
16. 31 *Journals of the Continental Congress* at 503.
17. 2 *The Debates and Proceedings in the Congress of the United States* (J. Gales compil. 1834), Appendix, at 2059, 2060, 2061.
18. *Id.* at 2061–63.
19. *Id.* at 2066, 2068, 2069.
20. *Id.* at 2082.
21. Act of 2 April 1792, ch. 16, 1 Stat. 246.
22. § 9, 1 Stat. at 248.
23. § 20, 1 Stat. at 250.
24. § 9, 1 Stat. at 248.
25. § 9, 1 Stat. at 248.
26. § 11, 1 Stat. at 248–49.
27. § 16, 1 Stat. at 250.
28. § § 14–15, 1 Stat. at 249–50; § 19, 1 Stat. at 250.
29. Vol. 7, "Dollar" (1963 ed.) at 558.
30. *See* U.S. Cost. art. I, § 8, cl. 5.
31. For the correct interpretation of the Act, *See, e.g.*, A. Hepburn, *History of Coinage and Currency in the United States and the Perennial Contest for Sound Money* (1903), at 22.

THE FREEMAN
IDEAS ON LIBERTY

A Profit Without Honor

by R. C. Sproul, Jr.

My memories of my undergraduate days include an especially strange student who loved to wear a T-shirt carrying the slogan: "Human Need. Not Corporate Greed." Like most liberal slogans, this one seems at first blush to be sane and compassionate. Humans, after all, are far more valuable than make-believe legal entities. But as with most liberal ideas, closer scrutiny reveals underlying folly. The assumption behind the T-shirt's slogan is that profit is something that companies steal from consumers. Basic to this thinking is the myth that one man's profit is another man's loss, that free economic trade is a zero-sum game.

Henry Hazlitt, in his *Economics in One Lesson,* demonstrates that most errors in our economic thinking stem from a failure to see the big picture. We support tariffs against Japanese cars because we read about massive layoffs in Detroit. We overlook the massive layoffs that are spread thinly among smaller companies who can no longer export to Japan because of the tariffs. The same applies to profits. We imagine that Wonder Bread carefully calculates the cost of producing a loaf of bread, and then tacks on ten, fifty, or a hundred percent to the sales price. We see that profit as a pound of human flesh taken from the consumer. What we miss is the strength of our desire for that loaf of bread.

How important is a loaf of bread to you? If you really had to, how much would you be willing to pay? $2? $3? Imagine the folks at Wonder Bread wearing T-shirts with the slogan "Corporate Need. Not Human Greed." I pay $1 for a loaf of bread. Am I gouging Wonder? Is my gain Wonder's loss?

Free Exchange

The confusion stems from a failure to understand the nature of free exchange. Barter makes clear the mutual benefit of free trade. Suppose I am a shoemaker. On a given day I can produce ten pairs of shoes. If I'm married to the old woman who lives in a shoe, in a week I can provide shoes for me and my family. After another week I have a surplus of shoes. I notice, however, that while their toes are warm, my large brood is hungry. Meanwhile, my neighbor the butcher has a full stomach and cold toes. I could try to stir-fry some shoe leather. My neighbor could try to wrap some steaks around his feet. The better option is for the two of us to trade. I trade from my surplus of shoes; he trades from his surplus of meat. Clearly everybody profits.

Money muddies the matter. A professor at a seminar asked his audience this: "If it costs a shoemaker $20 to make a pair of shoes, and he sells them for $40, who makes the profit?" The vast majority responded that the shoemaker profited. He did, but so did the consumer. We saw the value of the shoemaker on his shoes. What we missed was the value of the buyer on the shoes. He must have valued the shoes more than $40, else the trade would not have happened.

Mr. Sproul is editor of Tabletalk Magazine *and the author of* Dollar Signs of the Times *(Baker Books, 1994).*

Remember that even this exchange is ultimately barter. Where did the $40 come from?

The buyer had to sell something else to get the money, either his labor, or some good. He traded his labor or good for the shoes. Money is only a means for barter. It is the promise of future goods.

So why all the fuss if it is this simple? While we never pay more than we are willing to pay, we always pay more than we want to pay. Of course the same is true of the producer. He never sells for less than he is willing, but always sells for less than he would like.

Both Sides Gain

I recently spent a few days looking for a new car. I was unsuccessful. A dealer friend of mine suggested that I not negotiate for a car. He said that if I found a car I liked, I should just pay the asking price. The dealer, he explained, had to make a profit. I explained that the dealer would like to sell the car for $50,000. I would like to have the car for free. He, however, would be willing to sell the car for, say, $8,000. I would be willing to pay $10,000. Negotiating decides where in that intersection we end up. The closer to $10,000 we get, the more uncomfortable I become with the deal. Likewise the dealer becomes uncomfortable the closer we get to $8,000.

The beauty of free trade is that both sides profit. Suppose we had closed the deal at $9,000. Before the trade he had a car he valued at $8,000. I had $9,000 in cash. Our total value together was $17,000. After the trade I would have a car I valued at $10,000, and he would have $9,000. Our total value would be $19,000. Each of us would have profited $1,000. The deal never happened, however, because my top was $8,000, his bottom $10,000.

The same is true of every free trade. Each time we buy a loaf of bread or a candy bar, each time we sell our labor or a used car, we receive more than we give and both sides profit. Profit then does not stand *against* human need, but actually supports it. There is nothing dark and sinister about the profit motive because in free trade profit can only be reached by causing others to profit.

The same is true in non-monetary exchanges. The profit motive woke me up this morning. Like many others I am engaged in the battle of the bulge. I got up early this morning to jog around my neighborhood. All things being equal, I would have preferred to sleep later. All things, however, are not equal. My waist size is not equal to my pants size. I freely exchanged my time and energy this morning for the benefit of a slimmer body. My jogging was a profitable venture. The only thing I lose is pounds.

Profit Saves the Day

Profit, however, does so much more. I have only begun to chronicle some of its outstanding qualities. Profit also communicates important information. Consider the massive flooding along the Mississippi River in the summer of 1993. Many people who are otherwise comfortable with the idea of profits were put off by what they considered obscene profiteering by some of the entrepreneurs who went into the ice or generator business in the aftermath of the flood. Thousands of families found themselves without electricity as the waters rained destruction down on the river towns. Ice became a hot commodity. News reports inveighed against those cold-hearted folks who charged $5 or $10 dollars for a bag of ice that once sold for $1. Surely this wasn't legitimate profit.

Consider, though, what those profits did. With so many people in need of ice, how long would ice last at $1 a bag? If you were in such a situation how many bags would you buy? It depends upon the cost, doesn't it? At $1 a bag I know that I could use ten bags. Two go in my refrigerator, two more in the freezer, two in my cooler, and four just in case I might need them later. At $10 a bag I discover I can do with two bags. I may even invite my neighbor to store his perishables with mine and split the cost of the bags. Multiply these numbers by the hundreds of families in need of ice and you'll see how vital the high cost of the ice is to

insure that there's enough to go around. Those high prices, rather than putting ice out of reach of those poor people, actually insured that more people would be able to get some needed ice. Profit saved the day.

The high cost of the ice, however, did more than keep the demand in check. It also served to increase the supply. Imagine yourself sitting in your easy chair in eastern Illinois watching the news reports on the flooding. In your driveway sits your refrigerated truck. Imagine first that the news reported that the government mandated that all ice be sold at $1 a bag in the troubled regions. What would you do? Nothing. Now suppose that you heard that ice was selling for $10 a bag. Because of the profit motive you would get out of your chair, run down to the local grocery store and buy out all their ice at $1 a bag. After filling your truck with the precious commodity you hit the highways and head west to seek your fortune. By the time you arrive you would probably find that others had had the same brilliant idea, and because the supply was better, ice was now selling at $5 a bag.

The profit motive not only reduced the demand for ice, but the profits earned alerted others of an opportunity, and the supply grew. Rather than taking unfair advantage of the flood victims, profit-makers actually served the victims' needs far better than an artificial price ceiling could have done. Profit brought the ice to those who most needed it. Remember also, that each and every bag of ice purchased—at any price—represented mutual profit for buyer and seller. Buyers paid more than they would have liked, but never more than they were willing.

Obscene Profits

There are obscene profits. When I was mugged several months ago, my assailant made an obscene profit. He traded my health for my money. To do so, however, he had to steal my health. It was not his to trade. In like manner the government makes obscene profits when it trades my freedom for my money via taxation. As with the mugger, I am given a choice: pay up or lock up. My freedom, however, is not the government's to trade. They first had to steal it from me.

The same is true even when the government pays for what is mine. Suppose the government wants to build a highway through my house. Suppose also that they give me the fair market value for my land. This is obscene profit. Obviously I value my land more than the fair market value. If not, I would have sold it. What the government stole from me was the difference between the market price for the land, and the price at which I would be willing to sell it. Even if the government pays me ten times the market value for my land, if I value it at eleven times the market value, the government has earned an obscene profit. (All this, of course, excludes the other illicit profit of the government. They are buying my property with money they first took from me. It is like a mugger forcing me to sell him my watch I value at $50 with the twenty dollars cash he just stole from me.)

Only governments and criminals have the power to engage in coerced exchange. The only difference is that one is legal, the other is not. The only other way for profit to be obscene is if the free trade involves fraud. If a soda company marks a can at 12 ounces and it only contains 11 ounces, they have earned an obscene profit. If I sell a car with an odometer that reads 50,000 miles, and the car has 150,000 miles on it, I have earned an obscene profit. If the government tells me that I can redeem a bond in twenty years for $50, and then inflates the money supply such that twenty years later the bond has only $10 of purchasing power, it has earned an obscene profit.

The difference between an obscene and a legitimate profit has nothing to with the percentage of the profit. If Jackson Pollack invests $10 in paint and canvas, and half an hour of his time to create a masterpiece that I value at $10,000 dollars, that is no obscene profit. The eleven-ounce soda is obscene profit.

Greed and Wealth

What about the wealth that profit can create? Is that not obscene? Is there not

something intrinsically obscene about opulence? Perhaps our friend in the T-shirt was not so offended by the idea of profit, but by the radical disparity between the excess of Beverly Hills and the squalor of nearby Watts, between Manhattan and Harlem.

The difference is so stark that it is difficult to explore dispassionately the reason for it. Liberals would have us believe it is this monster, "corporate greed." Greed does explain the wealth of the wealthy. What we miss is the more proximate cause of the wealth. In a free market, wealth can only come from one source: meeting the needs of others. It is, in large part greed which drives the movie moguls. That hunger for wealth, however, is met not by oppressing the people of Watts, but by meeting their desires. The drive for profit in a market system always translates into the drive to meet the wishes of others.

Consider Henry Ford. It would stretch our credulity to suggest that Mr. Ford created his company because of his deep and abiding concern for convenient transportation for the common people. It seems far more likely that Mr. Ford, like most of us, wanted to be rich. The desire of Americans for a convenient means of transportation was but the means to the end of Mr. Ford's personal fortune. He assessed the situation and realized that by mass producing automobiles he could reap huge profits, and enjoy a life of enormous wealth. The result was that millions of people exchanged a certain amount of their wealth, which Mr. Ford valued more than his cars, for Mr. Ford's cars, which the people valued more than their money. Everyone wins.

Mr. Ford's greed did not lead him into tyranny. Rather it forced him to become a suitor. To satisfy his greed he had to satisfy the buying public. To maximize his profit he had to maximize the desirability of his product. To satisfy his corporate greed, he had to meet human need. Where profit rules, democracy rules. Every dollar is a vote by the buying public.

The plight of the urban underclass also has its root in greed. In this instance the poor are in part poor because of obscene profits. The profiteers, however, are not businessmen but bureaucrats. The professional poverty pimps profit by perpetuating the misery of the underclass. Their profits are obscene because they are engaged in fraud. They profit by selling the lie that government can help them out of their poverty by stealing from others. It is not profit that causes their poverty but the plundering of profits by politicians.

Ivan Boesky made headlines when he announced, "Greed is good." Greed, if understood as the desire or willingness to do anything, including lie or steal, to profit, is not good. After all, "What profit is it to a man if he gains the whole world, and loses his soul?" If, however, greed is merely the desire to increase one's wealth through meeting the desires of consumers in a free exchange, greed is not bad. The profit motive drives all that we do, from working long hours at the office, to Mother Teresa's works of compassion. Even she profits, for she values the privilege of serving her God far more than her other options. Even our T-shirted friend, however he may now be endeavoring to meet "human need," does so out of a profit motive. Driven by profit, he seeks to destroy profit. Corporately, all that we do freely, we do for profit.

Profit created our friend's T-shirt; it even drove him to wear the shirt which despised profit. Profit created the college where he studied. I only wish he had profited more from the education available to him. Profit, finally, drove you to invest your time and energy in reading. I hope you found your reading to be profitable. □

THE FREEMAN
IDEAS ON LIBERTY

Hoarders, Speculators, and Other Scapegoats

by Roger Clites

Enemies of society. That is what most people have been conditioned to think about hoarders, speculators, ticket scalpers, and various others whose activities are actually beneficial. Among the others are savers, whom John Maynard Keynes seemed to equate with those who hold money idle.

Even a quick analysis shows that each of these groups is composed of people who provide a useful service to their fellows.

Hoarders

What is a hoarder? During World War II hoarders were painted as people who gained from, or possibly were even responsible for, shortages of such things as coffee and sugar. Someone who had even a small amount of sugar on hand when the announcement was made that sugar was to be rationed was required to declare it so that it could be counted among the rations to which he was "entitled."

Does that make sense? Does his having sugar deny it to other people? No! Much to the contrary, if there is actually a shortage of something the person who already has the product on hand does not have to compete with others to obtain it from a seller. It might be better to turn around the emphasis and say that someone who needs to buy it does not have the hoarder competing with him for it.

The hoarder actually reduces the impact of a shortage by reducing demand during the time of shortage. Foresight caused him to purchase previously, during a time of greater availability. That enables him to avoid standing in line, searching from store to store, or otherwise competing for the scarce item with those who are in immediate need to acquire it.

People who have an urgent need for the product that is in short supply should actually be grateful to the hoarder.

We must not overlook still another point: The person who hoarded or stocked up might have anticipated incorrectly. A surplus could have developed and pushed the future price downward. Then the hoarder would have paid a higher than necessary price for the product plus he would have given up use of his funds during the period of stockpiling. So-called hoarders take on a risk for themselves as well as provide a service for others. Castigating them is irrational.

Speculators

Similarly, speculators are almost universally reviled. Yet, they, too, act in a beneficial way. Contrary to widespread belief, they do not destabilize markets, cause gyrations in prices or profit at the expense of

Professor Clites teaches at Tusculum College in Tennessee.

others. Simply stated, a speculator tries to buy when prices are relatively low and sell when they are relatively high. Like the hoarder the speculator also takes a risk. He may buy only to discover later that he was wrong. He may be forced by future circumstances to sell at a still lower price, to take a loss.

But, suppose that a speculator does succeed in buying low and selling high. If price is low it is because demand is low relative to supply. The speculator by purchasing at that time adds to demand and keeps price from falling quite so far.

If price is later at a relatively high level it is because supply is short relative to demand. By selling at that time the speculator keeps price from rising quite as far upward.

Thus, the speculator reduces the amplitude of price swings, supporting prices when they are low and holding them down when they begin to climb to higher than usual levels.

Scalpers

Scalpers are a specialized type of speculator. When they perceive that tickets to an event will bring a higher-than-original-price on the free and open market. Scalpers try to buy tickets with the objective of reselling them for a higher price.

A scalper may be wrong in his analysis. He may find himself stuck with tickets that he must resell at a lower price than he paid for them, if he can sell them at all.

Often a scalper cannot just walk up to a box office and buy all of the tickets he wants. They may be rationed at so many per buyer. In that case he may have to pay a premium price himself to obtain them initially. Or he may have to wait in line for them, possibly even have to wait all night in an extreme case.

The person who buys from the scalper is paying for a service. He is obtaining something that he might not have been able to obtain directly for himself. Or he may be avoiding waiting in line for hours, perhaps even overnight, to obtain highly valued tickets. In any event, he willingly pays the scalper's price. He is not forced to buy from the scalper. He prefers the tickets to the money that he pays.

What the scalper has done is bring together the two sides of a market in which the initial price was set too low to bring about market clearing. The price may have been set too low because of misjudgment or it may have been due to social pressure. Whatever the reason, the marketers of the event set the price below the market clearing level and caused an artificial shortage to develop. The speculator guessed that this was the situation and tried to profit by correcting the error.

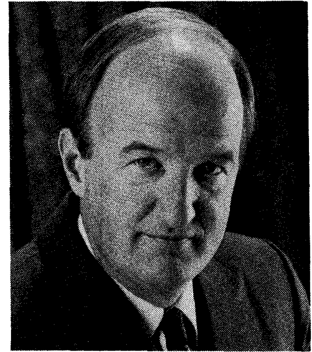
Remember, it is always possible that the scalper may lose. Regardless of the outcome the scalper is not an exploiter. He is a benefactor. Even when he is wrong he helps someone. He helps the seller to sell more tickets than he otherwise would have.

Savers

Even savers are looked on with disfavor. Keynes postulated that savers reduced the flow of spending and that in doing so they reduced the level of economic activity. Savers seldom hold their money idle. They may invest the funds themselves. They may lend them to someone who will invest them in production or they may leave them with a bank or other lending institution which will lend them for productive investment. The saver gives up current consumption to bolster future production.

Even in the rare case in which a saver holds funds idle he does not injure others. He reduces demand. That holds prices to a lower level and benefits consumers.

The terms hoarder, speculator, scalper, saver—and even black marketer are used in an attempt to automatically discredit various people who actually perform useful economic services. When we hear such pejorative labels we must look into the motives of the person who is using them. □



The Perversity of Wall Street

"Strong employment gains tend to be negative for both stocks and bonds."
—Marty Zweig, *The Zweig Forecast*
July 29, 1994

GDP rises 5 percent? The market dives! Unemployment jumps to 7 percent? Hurray, bonds rally!

Why is it that good news on Main Street is bad news on Wall Street? And vice versa? Financial analysts and institutional investors are convinced that strong economic performance is bad for the financial markets. High economic growth or good jobs reports can only mean higher inflation down the road, they assume, which in turn will force the Federal Reserve to tighten money and raise interest rates. Presto, stocks and bonds decline on good economic news.

The real culprits, says *The New York Times* ("Why America Won't Boom," June 12, 1994), are the bondholders of America. "The American economy is governed by the bond market," Louis Uchitelle writes in *The Times,* and "the confederation [of bondholders] has ruled in recent months that the economy should lose strength, not gain it." Another recession may not be good for the country, but it's great for bondholders as interest rates decline and bond prices skyrocket.

Mark Skousen is editor of Forecasts & Strategies, *one of the nation's largest financial newsletters, and an economist at Rollins College, Winter Park, Florida 32789. His book,* Dissent on Keynes, *is available from Laissez Faire Books, (800) 326-0996.*

No wonder Wall Street suffers from a tarnished public relations image.

Surprisingly Good News

Fortunately, there is good news for both Wall Street and Main Street. Believe it or not, the United States can enjoy a booming economy without interest rates rising. In fact, interest rates can decline under the right circumstances, even as the demand of business expansion increases.

Latin America and many other emerging market economies have proven that economic growth and lower interest rates can go hand in hand. In Mexico, Chile, India, and many other rapidly developing nations, interest rates have declined in the face of strong economic expansion and a rising standard of living. How? While pursuing anti-inflation policies, their governments have cut tax rates, privatized government services, reduced tariffs, welcomed foreign capital, and deregulated business. In addition, some countries (such as Mexico and Argentina) have eliminated capital gains taxes altogether, thus encouraging saving and investing.

The Trouble with Easy Money

Unfortunately, the United States and other industrial countries are not following these sound principles of free-market capitalism. Instead, they are relying primarily on "easy money" policies to stimulate eco-

nomic growth. If a strong economic recovery is spurred by easy-money/low-interest rate policies, the fear of inflation is very real when the economy heats up. Hence, interest rates tend to rise once an inflationary boom gets started.

That is precisely what has happened in the United States during the early 1990s. To get the economy moving again, the Fed pushed short-term rates down to 3 percent, encouraging millions of savers to switch out of bank deposits and CDs and into stocks, bonds, and mutual funds. Obviously, this artificially low interest rate strategy could not last forever. As the Austrian economists point out, an inflationary policy will eventually *raise* interest rates and cut short the recovery. A boom must lead to a bust. In the first half of 1993, interest rates started increasing in the face of rising inflationary expectations.

Prosperity by Other Means

The key is to spur genuine economic growth by means other than easy money and artificially low interest rates. How then? By encouraging higher rates of saving and capital formation. This could be accomplished very easily by reducing or eliminating taxes on businesses, savers, and investors. A sharp reduction in the capital gains tax rate and the corporate income tax rate would do wonders for economic growth without raising interest rates. So would exemptions on interest and dividends, or expanding tax-deferred retirement programs.

As a result, the supply of saving and investment capital would expand, putting downward pressure on interest rates. Again, as the Austrian economists demonstrate, a longer-term time preference, as reflected in higher rates of saving, tends to drive interest rates lower.

Then, we could put an end once and for all to this myth on Wall Street that a booming economy necessitates higher interest rates.

Someday, when the United States gets its act together, we can look forward to this headline: "GDP jumps 10%. Dow skyrockets to 30,000, surpasses Nikkei." □

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Deadline for entries: January 31, 1995

The Institution for World Capitalism at Jacksonville (Florida) University is sponsoring this annual essay competition as part of its comprehensive education and public affairs program to advance democratic capitalism in America and around the world.

BOOKS

Are There Too Many Lawyers? And Other Vexatious Questions

by Joseph S. Fulda

Foundation for Economic Education • 1993 • 121 pages • $14.95 paperback

Reviewed by David M. Brown

In the title essay of this new collection, the author considers not merely whether we have "too many" lawyers, but what it is about *law* itself that makes it a different commodity than, say, shoes.

We wouldn't normally worry about whether there were too many shoemakers on the market (so long as an overproduction of shoes isn't being subsidized by the Shoe Ministry). But a proliferation of lawyers may signal a deeper problem: a problem with the legal system itself, with the license for abuse it permits certain participants, like plaintive plantiffs. As Fulda writes, "legal services are fundamentally different from other services, simply because lawyers must use the law—the State—to give plaintiffs the property of defendants. Today's plaintiffs' bar is expert at using the law to attain wealth by what Albert Jay Nock called 'the political means' rather than 'the economic means'—i.e, by the redistribution of existing wealth, rather than the creation of new wealth."

This kind of probing of essentials is, of course, what we expect from *The Freeman*, the journal from which most of these pieces are taken. The essays divide primarily into two sections: a review of the foundations of liberty and the libertarian psychology, and the practical application of individualist principles to current policy questions. A third section considers issues of "narrow ethics."

Libertarian readers will be inclined to nod their heads in agreement for the most part over the basic theory. As usual, it's when theory gets applied that the most evident disagreements between philosophical compatriots emerge.

For example, one can agree with Fulda's view in "Why Are There So Many Social Issues?" that our schools should not be an arena for governmental mediation of conflicting educational values. Certainly all schools should be private, free-market entities, not a vast agglomerated public domain subject to coercively uniform standards. We really wouldn't need to debate prayer in the schools if parents had real liberty to pick and choose among competitive schools with freely developed charters.

But . . . we do have a genuine problem now, which Fulda admits his perspective cannot "reach"; namely, what do we do about such value conflicts *now*, as they have been engendered and perpetuated within the existing public educational system? We can agree that the conflict may be insolvable under present circumstances, while yet noting it still needs to be *dealt* with. Do we tell parents, "Sorry, just keep squabbling until everything is privatized?" The courts have to make *some* kind of ruling when they get these cases, after all. A philosophy of individualism and freedom should be able to help us out here to some extent. Moreover, social issues tend to be a little more fundamental and persistent than I think Fulda allows for; the conflicts are not simply generated from scratch by the government's involvement. They are often what provoked that involvement in the first place.

Probably the most controversial essay in the collection will be "Abortion: Is Pro-Choice a Libertarian Position?" This is an issue that has seen endless wrangling in all ideological camps. Fulda rebukes the "pro-choice" position for ignoring the truth that freedom of action entails responsibility for the consequences of one's acts. And he calls abortion an "act of coercion," a claim that has been less mildly asserted in other quarters. Now, granted, the right of freedom, if it is to remain coherent, must incorporate a ban on initiatory coercion against others. But the question is, *which* others? The

strength of Fulda's case against abortion as legally permissible rests, obviously, on the nature and status of the fetus during the various stages of pregnancy. Exploration of that key issue is missing here.

But enough of wrangling! This volume also includes an essay-review of Michael Levin's *Feminism and Freedom*; helpful discussions of "freeloading" (externalities and all that), charity, scandals, and certain issues in higher education; and a brief essay on the hidden danger of getting too uptight about "appearances of impropriety."

These are bite-sized, lucid, often persuasive essays that are informed by a solid understanding of how freedom works and what is its moral justification. We can be grateful to FEE for publishing them under one roof, and to their author for the clarity of his insight. □

Mr. Brown is a free-lance writer.

The Economics and Ethics of Private Property: Studies in Political Economy and Philosophy

by Hans-Hermann Hoppe

Boston/Dordrecht/London: Kluwer Academic Publishers • 1993 • 265 pages • $59.95

Reviewed by N. Stephan Kinsella

In 1989, Professor Hans-Hermann Hoppe published *A Theory of Socialism and Capitalism: Economics, Politics, and Ethics* (Boston/Dordrecht/London: Kluwer Academic Publishers, 1989), arguably the most important book of the decade, if only for the revolutionary "argumentation ethic" defense of individual rights presented in Chapter 7, "The Ethical Justification of Capitalism and Why Socialism is Morally Indefensible." Hoppe continues to produce a significant assortment of articles elaborating on his argumentation ethic and the epistemology that underlies it, as well as on his impressive economic writings.

His new book, *The Economics and Ethics of Private Property*, is a collection of many of these related writings published up until 1992.

Because the chapters in the book were published separately as independent articles, there is some overlap between them, and thus some redundancy. A few times the text of several paragraphs in one article is reproduced verbatim in another article.

In the "Appendix: Four Critical Replies" section, Hoppe's responses to various criticisms, published in *Liberty* and the *Austrian Economics Newsletter,* are reprinted. However, the initial criticisms themselves (by David Osterfeld, Leland Yeager, David Gordon, Tibor Machan, David Conway, Loren Lomasky, *et al.*) to which Hoppe is responding are not published. This is unfortunate, because these criticisms are interesting and enlightening, and also make Hoppe's response to them more comprehensible.

The book is divided into two parts, "Economics" and "Philosophy." Because the second part contains Hoppe's most important ideas—his defense of individual rights—I will discuss his philosophical views first.

Philosophy: Argumentation Ethic

Hoppe's ingenious "argumentation ethic" theory states, briefly, that all truths, including ethics and normative statements, must be able to be arrived at through the process of argumentation. This is undeniable, as one would have to contradict oneself in using argument to deny this. Therefore, whatever facts or norms anyone must presuppose while engaging in argumentation cannot be contradicted by any proposed fact or norms. (pp. 180–181)

Several things are implied in argumentation whose validity cannot be disputed. One is, for example, the universalization principle, as formulated in the Golden Rule of ethics or in the Kantian Categorical Imperative, which states "that only those norms can be justified that can be formulated as general principles which without exception are valid for everyone." (p. 182) Another one of the things presupposed by anyone engaging in argumentation (or, indeed, any

discourse at all, even with oneself) is the right of self-ownership of all listeners and even potential listeners: for otherwise the listener would not be able to freely consider and accept or reject the proposed argument, which is undeniably a goal of argumentation. (p. 183)

The concomitant right to homestead private property is also presupposed by anyone engaging in argumentation: since the use of natural resources—i.e., property rights in land, food, water, etc.—is absolutely necessary for any listener to survive and be able to participate in an argument, and since homesteading unowned property is the only objective, conflict-free way to assign property rights, all arguers must also presuppose the validity of the homesteading of unowned property, the Lockean "mixing of labor" with scarce resources, for otherwise argumentation could not occur. (pp. 184–186) And of course the right to self-ownership plus the right to homestead justify the nonaggression principle and are the bases of laissez-faire capitalism.

Professor Hoppe's discovery of such a rock-solid defense of individual rights is a profoundly important achievement. So many of Hoppe's insights deserve further exploration and development, that one welcomes future writing by Hoppe and others building upon his work.

In the September 1988 issue of *Liberty*, Hoppe presented his argumentation ethic in an article entitled "The Ultimate Justification of the Private Property Ethic." A symposium discussing this article appeared in the November 1988 issue of *Liberty*, containing the critical comments of ten libertarian commentators.

Amazingly, almost all of these libertarian commentators were unimpressed by, if not downright hostile to, Hoppe's argument. Only Murray Rothbard gave Hoppe's thesis wholehearted endorsement and recognized its validity and significance. Why Hoppe's ideas, which are such an important advance in political and libertarian thought, have failed to cause more excitement or gain more adherents than they have is baffling. But the best solution to this is the publication of further elaborations and defenses, which is what Hoppe's newest book is.

Economics

Part One, on economics, contains five interesting and insightful chapters. In the first, Hoppe shows that the distinction between "private" and "public" goods is completely illusory, thereby removing any justification for state monopolization of the production of security, long held to be a "public" good.

In Chapter 2, "The Economics and Sociology of Taxation," Hoppe shows that taxation, by decreasing the marginal utility of producing wealth, leads to a shift away from the production of wealth, and towards consumption and leisure. Therefore taxation is a means for the destruction of property and wealth-formation. (pp. 28–29) Additionally, because of time preference—the fact that people prefer present goods over future goods—the decrease in the marginal utility of producing wealth leads to a shortening of the structure of production, and thus fewer valuable future assets are produced. (p. 34)

After showing that taxes reduce the standard of living of consumers, Hoppe discusses the sociological reasons *why* there is taxation, and ever more of it. Basically, there is taxation because a majority of the population either actively or passively support such governmental policies, and they do so because of the lack of (complete, principled) acceptance of a private property ethic, and because of government propaganda and methods such as democracy and welfare that amount to vote-buying.

His discussion of banking and the international economic order is the most provocative chapter in Part One. Here Hoppe explores how and why the state monopolizes money and banking, and shows the danger of the ever-approaching international monetary order. Here he explains why "[t]he monopolization of money and banking is the ultimate pillar on which the modern state rests." (p. 70)

Chapter 4 reinterprets the Marxist theory

of history from an Austrian economics perspective. Hoppe points out that Marx's theory of exploitation is flawed because, in maintaining that there is exploitation when a capitalist retains a surplus profit after paying a laborer, it does not take into account nor "understand the phenomenon of time preferences as a universal category of human action." (p. 97) The final chapter contains an illuminating discussion of the Austrian theories of employment, money, and interest, and demolishes Keynes's "new" theory with this intellectual ammunition.

Conclusion

The Economics and Ethics of Private Property contains cutting-edge economic theories and breakthroughs in epistemology and individual rights theories. As Hoppe points out, in the long run, immoral government policies depend upon the tacit support of the majority of the population. The only way to win more recognition and enforcement of our individual rights is to educate our fellow men of the truth and wisdom of freedom. The publication of works like Hoppe's, with an uncompromising, hardcore—and, more importantly, correct—defense of liberty, certainly advances this cause. □

Mr. Kinsella practices computer and software patent law with Schnader, Harrison, Segal & Lewis in Philadelphia. A more in-depth review of this book may be found at 25 St. Mary's Law Journal 1419 *(1994).*

The Dream and the Nightmare: The Sixties Legacy to the Underclass

by Myron Magnet

William Morrow & Co. • 1993 • 256 pages • $20.00

Reviewed by Lawrence Person

In 1984, Charles Murray's *Losing Ground* brought the topic of welfare reform to the forefront of political consciousness. With impeccable research and meticulous logic, Murray marshaled a vast array of statistics to support his assertion that the huge expansion of government welfare programs resulting from the Johnson Administration's "War on Poverty" had actually harmed those it had intended to help. By making welfare more attractive to single mothers than marriage or entry-level jobs, Murray argued, the federal government created "incentives for failure" which lured the poor, and especially poor blacks, off the economic ladder to success and into an intergenerational cycle of dependence and illegitimacy.

Though controversial when first published, large portions of Murray's thesis have come to be accepted among the political establishment, even in such unlikely places as the Clinton White House. Manhattan Institute Fellow and *Fortune* Editorial Board member Myron Magnet agrees with Murray, but only to a point. In *The Dream and the Nightmare*, he argues that Murray's purely economic analysis provides an incomplete picture of the true causes of the underclass, that Murray and other policy analysts have left "a hole in the theory." And in that hole, Magnet argues, you'll find "culture."

He argues that it is culture, or rather its lack, that has mired the underclass in perpetual poverty. Even faced with the perverse incentives to fail that welfare offers, most people would still choose work and marriage out of a sense of self-worth and respect for community standards. The reasons that the underclass has not done so, he argues, is that the counterculture of the 1960s turned traditional values upside down. Though this revolution was one carried out largely by the "Haves" in an effort to "liberate" themselves from what they perceived as the oppressive moral constraints of their parents' generation, Magnet argues that its long-term harm to most of the "Haves" was subtle, while its effects on the "Have-Nots" was devastating.

According to Magnet, it is this "poverty of spirit" which has turned large portions of America's cities into drug-infested, crime-ridden wastelands. Inner-city children grow up in households of single welfare mothers

who are incapable of teaching them the cultural values of hard work, thrift, and individual responsibility—the very values needed to climb out of poverty. To support that thesis, he presents an impressive array of statistical and anecdotal evidence to paint a devastatingly bleak picture of underclass life, and that portrait is the strongest portion of the book.

In painting that picture, Magnet describes the pathology of the underclass with an unwavering eye, exploding many myths in the process. Despite liberal protestations to the contrary, the underclass *does* exists, and is disproportionately composed of inner-city blacks. Lack of economic opportunity does not explain the existence of the underclass, since it first appeared during one economic boom and continued to grow during another. Moreover, the harsh conditions of the inner city haven't prevented Asian entrepreneurs from flourishing there. The homeless are not down-on-their-luck working families, they're mentally ill alcoholics and drug addicts—and their numbers are closer to 300,000 than the three million figure homeless "advocate" Mitch Snyder pulled out of the air one day.

But describing the underclass is only part of *The Dream and the Nightmare*, with much of the rest taken up by Magnet's explanation of how the Have-Nots came to live in such a condition of self-perpetuating misery. In this he seems to be shadow-boxing with *Losing Ground*, not because he feels Murray's thesis is fundamentally wrong, but because he's the only worthy opponent on the scene. Indeed, he calls the book "superb" and Murray "the profoundest of all commentators on the underclass." But ultimately Magnet does a less convincing job of presenting his case than Murray did of his. While Magnet's judgment about the lack of values among the underclass is quite convincing, his arguments about how they got that way are far less so. What's more, his prescriptions for restoring those values are either vague, nonexistent, or woefully misguided.

When Magnet speaks of the counterculture, he has in mind not Woodstock or anti-war protesters, but a shift in cultural opinions among certain American elites in the late 1950s and early 1960s. As such, Magnet's view of the counterculture is both highly selective and overbroad. We get no mention of Abbie Hoffman, Jerry Rubin, or Paul Krassner, but plenty of Norman Mailer, Michael Harrington, Paul de Man, William Ryan, and (more improbably) Thomas Szasz. It is these and other elite thinkers, Magnet argues, that gradually shifted the culture of the Haves toward belief in. . .

Well, there's the problem.

While Magnet spends several chapters documenting various social ills (crime, strained race relations, declines in higher education) then linking their origin to various influential books and academic theories, he never adequately articulates just what constitutes the "Sixties Legacy to the Underclass." Instead, he merely catalogs several disparate parts of this supposed legacy that never seem to coalesce.

In fact, the scope of Magnet's theory is eventually his undoing. Of the various harbingers of cultural change he cites, most have little in common save a vaguely leftist slant and (usually) a de-emphasis of personal responsibility. Indeed, the "Cultural Revolution" he speaks of is simultaneously so broad and so selective that just about any theory or cultural ill can be shoehorned underneath its rubric.

Besides being unable to prove its central theory, *The Dream and the Nightmare* also suffers from a number of lesser flaws. After debunking so many myths, Magnet falls prey to one of the most pernicious, that of the 1980s as a "Decade of Greed." Even though he once again lays blame at the feet of his cultural elites rather than the usual scapegoat of Ronald Reagan, by accepting the existence of some overreaching cultural *zeitgeist* characterizing each decade he succumbs to facile overgeneralization at its worst. Though adept at puncturing media myths about the underclass, his casual acceptance of this most overbroad of clichés leaves the impression that he is truly out of touch with the deep currents and eddies of the broader American culture with which he is so vitally concerned.

Part of this seems due to a distinctly "New York Centric" viewpoint. For example, when he states that the Hispanics making up the underclass are "primarily" Puerto Ricans, he displays a rather shallow knowledge of conditions in the other 49 states, especially California. And when Magnet says that "no one seems to have much good to say about the standard-issue eighties and nineties middle class youth," one gets the impression that he doesn't get out of New York much.

Finally, Magnet tends to ignore or downgrade important evidence that supports competing (i.e., economic) theories of underclass formation. Two of the three examples he puts forward as showing the primacy of culture in "The Hole in the Theory" (of Eugene Lang's offer of college scholarships to all students in an inner-city class who graduated from high school and of Kimi Gray's transformation of the Kenilworth public housing project) could easily be argued just as successfully from an "economic primacy" standpoint. Despite an otherwise excellent analysis of homelessness, he ignores William Tucker's landmark studies of the strong link between homelessness and rent control policies—a lapse that is especially puzzling since Tucker's work was partially underwritten by the Manhattan Institute.

As far as offering solutions to the underclass problem, Magnet's general ideas for restoring personal responsibility and individual rights are good, but what few specifics he offers are woefully misguided. His suggestion for creating government-run "group shelters" in the place of current welfare programs ignores the law of unintended consequences and the mischief that government is able to work with just about any social program. Likewise, his argument for "Head Start"-type programs for preschoolers in the same paragraph ignores the mounting evidence that these have little or no long-term effect.

Still, despite all the foregoing, *The Dream and the Nightmare* is a much better book than this list of flaws would lead you to believe. Though Magnet's reach has definitely exceeded his grasp, his book's virtues are great, its sins, more of omission than intent, relatively small. While his diagnoses of the causes and cures of underclass pathology are unconvincing, his description of the disease itself is valuable for its depth and accuracy. Though it doesn't replace *Losing Ground*, it does provide an extra dimension to the welfare debate, and functions as a handy source book for how that debate has developed over the last decade. □

Mr. Person is former editor of Citizens Agenda. *His work has appeared in* National Review, Reason, *and other magazines.*

Telecompetition: The Free Market Road to the Information Highway

by Lawrence Gasman

Cato Institute, Washington, D.C. • 1994 • 177 pages • $12.95 paperback

Reviewed by Raymond J. Keating

Technological change has pushed the telecommunications-information industry into a dramatic and exciting phase of development. Information has always been a most valuable commodity, and now the means of storing, moving, and manipulating it are advancing rapidly while costs plummet.

In turn, such developments are altering the world economy. The globe is shrinking as international competition intensifies. Rather than ensuring the ascendance of large multinational corporations or enhancement of government controls, as many have feared, the revolution in telecommunications and computers has empowered individuals and increased the mobility of capital. Both economic competition and the ability of labor and capital to avoid, for example, severe taxation and regulation are enhanced.

Ironically, however, just as technological developments are strengthening the power and productivity of the individual, the ques-

tion dominating current public policy debate is the extent of state's role in the telecommunications market. Should we be centrally planning a government-led telecommunications industrial policy, or turning to a competition-based, market-driven telecommunications industry? Persuasively weighing in on the side of deregulation and freer markets is Lawrence Gasman with his book *Telecompetition*.

Gasman makes a compelling case for how the convergence of industries and enhanced competition not only support, but necessitate the deregulation of telecommunications. Of course, deregulation also is called for due to the plodding nature of government, which remains a severe roadblock to expanding the reach of new technologies. In fact, Gasman declares: "The general ignorance of technological developments displayed by those who regulate the telecommunications industry is appalling. It also indicates why one cannot expect too much from the government when it comes to a successful industrial policy for the telecommunications industry." Another reason for low expectations is governmental ignorance of how markets work.

Telecommunications advancements are blurring the lines drawn by regulators who try to neatly separate industries. The author notes the fluid nature of information format and storage: "Once it is digitized, voice, video, text, and data are all much the same. . . . [N]ew forms of multimedia communications are emerging in which text, voice, and image communications are combined in a single interactive, user-friendly format." Gasman continues: "It is this fluidity of information formats that constitutes convergence. Convergence has resulted from both the recognition that all information can be converted into the same binary digital form and the development of microelectronics that makes such a conversion possible while providing the means for conveniently and economically manipulating digital information. Convergence is not only central to the Information Age, it affects every level of information technology—hardware, software, and services."

Gasman masterfully illustrates how convergence seriously undermines the government's rationale for extensive telecommunications regulation. For example, he argues that in light of alternative-access carriers and local wireless communications, it is becoming increasingly difficult to legitimately refer to a "local telephone monopoly." In this era, in fact, the source of any true monopoly power emanates from the government. Gasman observes the detrimental effects of an exclusive government franchise: "The existence of communications monopolies slows the introduction of new and innovative services by the industry. The cable-telco dispute is just one example of how government-created monopolies and misguided antitrust action can delay new services."

The author predicts that absent government interference, for example, "an eclectic industry structure for local video distribution might well grow up, designed to fit the needs of local markets. In some areas, telephone companies would supply both the video programming and the channels through which that programming is carried. In others, cable companies would supply programming through the telephone-company networks. . . . In a few areas we might see cable companies upgrade their own networks with switching gear to enable them to offer the kinds of advanced voice and video services that seem today to be the sole province of telephone companies."

Gasman argues for allowing local telephone companies to enter any local, regional, national, or international business they choose—"inside or outside the telecommunications field." Likewise, "any company financially and technically capable of offering local telephone service should be free to do so."

Gasman also makes a compelling case for a pure property-rights system regarding the broadcast spectrum, rather than the current government allocation and temporary licensing system. In lieu of suffering through government delays and politicization, "if spectrum allocation were left to market forces, the providers of new services would

bid directly for the spectrum owned by existing users." Gasman draws a straightforward analogy: "Just as landowners are given title to a particular piece of real estate, spectrum owners would receive a title, allowing them to transmit at certain frequencies with specified powers from given locations. And just as landowners can buy and sell properties, spectrum owners would be allowed to buy and sell their transmission rights. The result would no doubt be speedier deployment of new services responding to consumer rather than government interests." Again, the plodding hand of government must be replaced by the dynamics of the marketplace.

Proponents of a government information infrastructure also are refuted in *Telecompetition*. Instead of taking the telecommunications infrastructure on another trip down the misdirected path of industrial policy, Gasman sagaciously concludes: "Eventually private initiative will undoubtedly produce a network offering all the broadcast services infrastructuralists are so eager to produce with taxpayers' dollars. The difference is that private companies will be certain to produce services businesses and consumers want to buy."

As the author notes, much of telecommunications regulation springs from the economist's use of the perfect competition model. A perfectly competitive market where all companies are price takers and offer homogeneous products is an economic fairy tale. Unfortunately, it also can be turned into economic nightmare when wielded by government officials who seek to regulate when a market fails the perfect competition test. To the contrary, a dynamic, entrepreneurial economy will be flush with temporary monopolies—a result of creation, innovation, and competition. This should nowhere be more evident than in the telecommunications industry. If government establishes and protects property rights, and then largely gets out of the way, as Lawrence Gasman suggests, consumers and the economy will reap great rewards.

Telecompetition is a highly readable primer on the often complex subject of telecommunications public policy. One can only hope that such market-oriented writers as Gasman, along with George Gilder and Peter Huber, prevail in the government-vs.-the-market struggle in telecommunications. □

Mr. Keating is Director of New York Citizens for a Sound Economy.

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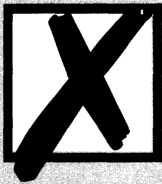
BEYOND POLITICS

Markets, Welfare and the Failure of Bureaucracy



William C. Mitchell & Randy T. Simmons

Foreword by Gordon Tullock

The Independent Institute

Orthodox public policy has held that "market failures" are rampant in society, necessitating government intervention to serve and protect the public good. In *Beyond Politics* however, the authors trace the anatomy of "government failures" and a pathology of contemporary political institutions as government has become the vehicle for private gain at public expense.

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