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THE FREEMAN

IDEAS ON LIBERTY

FEATURES

COLUMNS

DEPARTMENTS

THE FREEMAN
IDEAS ON LIBERTY

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PERSPECTIVE

Liberty and Individual Potential

Man wants liberty to become the man he wants to become. He does so precisely because he does not know what man he will want to become in time. . . . Man does not want liberty in order to maximize his utility, or that of the society of which he is a part. *He wants liberty to become the man he wants to become.*

—JAMES M. BUCHANAN
"Natural and Artifactual Man"
What Should Economists Do?
(Liberty Press, 1979)

Freedom and Responsibility

In a free society, individuals should have the right to make choices, even if their choices might harm them. With freedom comes responsibility, and if we turn our responsibility over to the government, we turn our freedom over at the same time.

—RANDALL G. HOLCOMBE
Public Policy and the Quality of Life
(Greenwood Press, 1995)

Theory into Practice

We can successfully ride [a bicycle] without knowing how we do it. Moreover, we can hold a totally erroneous theory about bicycle balancing without getting into any trouble, unless we try to design the bicycle in accordance with our faulty theory. That is when we will get into trouble. In the economy, we can enrich one another without knowing how we do it. And we can maintain completely fallacious views of how any economy works without creating any great difficulties for anyone. But if our practical success generates excessive confidence in our erroneous theory, and we try to use that theory to improve the operation of the system, we can do a great deal of damage. When we put faulty theories about bicycle riding into practice, we are instantly refuted. Few of us are either stubborn or stupid enough to persist in a faulty theory that is skinning our elbows or bruising our bottoms. We admit our ignorance. There is nothing similar, however, to correct faulty theories that are applied to the reconstruction of economic systems. The links between causes and effects are too numerous and too difficult to trace.

—PAUL HEYNE
"Why Johnny So Rarely Learns Any Economics," in Richard M. Ebeling, Ed., *Economic Education: What Should We Learn About the Free Market?* (Hillsdale College Press, 1994).

Competition and Cooperation

Now what the critics of economic competition overlook is that—when it is conducted under a good system of laws and a high standard of morals—it is itself a form of economic cooperation. . . . General Motors and Ford are not cooperating directly with each other; but each is trying to cooperate with the consumer, with the potential car buyer. Each is trying to convince him that it can offer him a better car than its competitor, or as good a car at a lower price. Each is "compelling" the other—or, to state it more accurately, each is stimulating the other—to reduce its production costs and to improve its cars. Each, in other words, is "compelling" the other to cooperate more effectively with the buying public. And so, *indirectly,—triangularly*, so to speak—General Motors and Ford cooperate. Each makes the other more efficient.

—HENRY HAZLITT
The Foundations of Morality

The New Manifest Destiny

Traditionally, the nation-state provided two major benefits, both of which tended to increase with the state's territory . . . physical protection against external enemies and an extensive internal market. . . . But the first . . . is becoming less important with the spread of democratic forms of government, because democracies are highly disinclined to make war on their neighbors; and the second is becoming less important with the growth of international trade and commerce—some of it due to the liberalizing actions of governments, some of it due to the emergence of technologies resistant to government control, all of it tending to make the economic benefits of extended markets available without regard to the geographic size of the individual state.

—CHRISTOPHER DEMUTH
President of the American Enterprise Institute. *The American Enterprise*, Vol. 6, March/April 1995.

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The Trouble with Keynes

by Russell Shannon

"*In the long run* we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is long past the ocean is flat again."
—*John Maynard Keynes* (1923)[1]

Keynes' remark about the inevitability of death is now famous. It is, however, a statement not of defeat but of denial. Rather than indulge in resignation and gloom, Keynes urges action. The market economy, he believes, may at least occasionally require some judicious nudging. If we can temper the impact of economic malaise, why wait?

At first glance, this position seems reasonable. Why *not* use human intelligence to alleviate problems? After all, isn't that what we do with medicine? Then why not let the doctors of economics prescribe remedies appropriate for our economic ills? Did not the founder of modern economics, Adam Smith, suggest a strong dose of laissez faire?

There are, however, at least two distinct problems with Keynes' activist approach. First is the question of whether or not we can rely on the political system to act in the recommended way. In light of Keynes' comments on other occasions, his optimism on this issue is both uncharacteristic and unwarranted.

Yet if we put this critical matter aside, another equally urgent issue emerges. To resolve today's problems, might we not create or exacerbate future problems? If we indulge in a drunken spree tonight, don't we risk a considerable probability of awakening tomorrow to a wretched hangover? In economists' stark terms, we must ask ourselves if the benefits will outweigh the costs. Let us consider each of these matters in turn.

The Proclivities of Politicians

As to the role of the state in economic matters, Keynes repeatedly expressed disillusion with, and even disdain for, laissez faire. In his most influential work, *The General Theory of Employment, Interest and Money*, he plainly stated that he favored "a somewhat comprehensive socialization of investment" as "the only means of securing an approximation to full employment."[2]

That remark is not unique. In an essay published in the *Yale Review* in 1933, Keynes turned his back on economists' traditional enthusiasm for free trade: "let goods be homespun," Keynes wrote, "whenever it is reasonably and conveniently possible."[3] Here, too, he suggested that the path to economic prosperity is paved by government intervention.

Just how extensive Keynes wished this political involvement to be is a matter of question. He expressly repudiated widespread government ownership of industry. No question, he wrote in his essay "The

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End of Laissez-faire," is "so really unimportant, so irrelevant . . . as the Nationalization of the Railways."[4] And in the *General Theory*, he asserted that "it is not the ownership of the instruments of production which it is important for the State to assume."[5]

But Keynes did espouse active involvement of government policy makers in economic matters. He held to what his early biographer Roy Harrod referred to as the "presuppositions of Harvey Road"—a reference to his childhood home as the son of a Cambridge don in England. "Reform," says Harrod, "was to be achieved primarily and principally by the discussion of intelligent people."[6] Thus Keynes offered suggestions to make financial credit and job information more abundant.[7]

Trust Not in Politicians

Yet these proposals had to be implemented through the political process, and Keynes had abundant experience to warn him against heavy reliance on politicians. After all, he attained prominence with the publication of *The Economic Consequences of the Peace*, which denounced the arrangements political leaders had made in the Versailles Treaty after the First World War. In this book, Keynes excoriated Woodrow Wilson for acceding to the imposition of terms so harsh on Germany that, he predicted, the entire European economy would suffer. Wilson was, to Keynes, a "blind and deaf Don Quixote."[8]

Keynes' comments on Britain's leader, Lloyd George—"this goat-footed bard, this half-human visitor to our age from the hag-ridden magic and enchanted woods of Celtic antiquity"[9]—were so strong that Keynes deleted them from the final manuscript. (They were published over a decade later.)

Nor are these the only instances when Keynes expressed dislike of politicians. In 1911, following a trip to Ireland, he wrote to his friend Duncan Grant, "You have not, I suppose, ever mixed with politicians at close quarters. They are *awful*. I think some of them must have been dregs anyhow, but I have discovered, what previously I didn't believe possible, that politicians behave in private life and say exactly the same things as they do in public. Their stupidity is inhuman. . . . [Most of them have] minds and opinions as deplorable as their characters."[10]

When Great Britain returned to the gold standard following World War I, Keynes objected to the harm wrought by the overvaluation of the pound. He referred to statements made by the Chancellor of the Exchequer, Winston Churchill, as "featherbrained."[11] And during the Great Depression of the 1930s, Keynes was constantly frustrated that President Franklin Roosevelt was not getting his message, even going to the extent of sending an open letter to him via the *New York Times*.[12] In fact, Herbert Stein, President Nixon's economic adviser, points out that it was not until well into Roosevelt's second term, and following additional personal letters addressed from Keynes, that Roosevelt finally accepted the Keynesian prescription of running *deliberate* budget deficits to alleviate the Depression.[13]

One might argue, then, that the policy proposals that Keynes does make fall far short of state socialism because his faith in the political system was so limited. Reducing interest rates to promote business investment and running federal budget deficits were, after all, rather simple tasks requiring no great deal of intelligence. But even then, matters can go awry.

The Myopia of Meddling

Let us suppose that Keynes' fantasy is realized, so that we do get in responsible positions knowledgeable and caring people who seek to ameliorate economic problems. What can we expect? If they refuse to sit back and wait for the economy to work out its long-run adjustments, what measures might they take, and with what effects?

For example, consider Keynes' proposal in the *Yale Review* that we reduce our dependence on foreign imports. If the government imposes tariffs and quotas to protect domestic industries from foreign competition, what will happen?

In the short run, we might expect a boost to our economy, as consumers switch from the now more-expensive imported products to domestic ones. More jobs will be available for workers in these firms, so the unemployment rate will fall.

But to see only these effects is to suffer from acute myopia. Henry Hazlitt, one of Keynes' harshest and most outspoken critics,[14] diagnoses this myopia in his small but significant book, *Economics in One Lesson.* Hazlitt emphasizes that *"The art of economics consists of looking not merely at the immediate but at the longer effects of any act or policy; it consists in tracing the consequences of that policy not merely for one group but for all groups."*[15] Hazlitt followed up this point in his larger work, *The Foundations of Morality*, where he addresses the importance of developing rules that produce desirable *long-run* outcomes.[16]

Of course, when the United States adopted more restrictive trade policies in the Smoot-Hawley Act of 1930, other nations retaliated. This game of tit-for-tat destroyed the benefits we hoped to gain from higher trade barriers.[17] But such policies may backfire even in the absence of retaliation.

If we reduce our purchases of foreign goods, what happens to the people in foreign countries who formerly used dollars to buy from us? Having fewer dollars, they will likely import fewer American goods, so our export industries will suffer job losses, which will offset or even cancel the gains in our import-competing industries. Further, if we restrict imports of raw materials or semi-finished products, such as steel, then domestic firms that use these inputs, such as the automobile industry, will find themselves at a competitive disadvantage with the foreign rivals who can still buy supplies at lower prices. So, Ford will lose sales to Nissan, and GM will be hurt by BMW.

And what about our poor? Keynes worried about them, but restricting imports of "cheap" products will be especially devastating to the poverty-stricken.

For another example, take Keynes' suggestion that credit be made more abundant in order to stimulate investment and generate "multiplier" effects on the economy. In times of great recession, such a program might obviously serve us well. But we run the risk that monetary expansion will be excessive, either in amount or duration, thereby provoking inflation and a need to reverse course, which will *create* unemployment. As Milton Friedman and Anna Schwartz have documented, the monetary authorities may behave in perverse ways, as they did during the Great Depression of the 1930s, starving the economy.[18]

Efforts to use compensatory budget policies, running deficits during recessions and surpluses during periods of excessive activity, have also foundered on the reefs of political reality. The tax cuts of the early 1960s were almost impossible to reverse when the sluggish economy became overheated during the Vietnam War. Replacing the rule of an annually balanced federal budget with the Keynesian version which recommends balancing over the course of the business cycle has led to such persistent deficits that, in the 1990s, we may resort to a constitutional mandate to restore the old rule of fiscal integrity.

To take one final example of the short-run versus long-run dilemma, consider welfare. Leaving children undernourished and ill-educated will likely create long-run problems of dependence and crime which society would surely like to avoid. But payments to parents of children in such a plight encourages the production of more such children. Relieving parents of the need to provide for their families can also set an example which their children may emulate. Here we exchange one long-run problem for another, yet in our sympathy for the youth of today, we risk increasing the population of such wretched people in years to come.

In the 1920s and 1930s, when Keynes wrote, capitalistic countries passed through an era of malaise. Dramatic experiments in the Soviet Union and elsewhere had the allure of novelty. Keynes denounced Stalin's system at the end of his *Yale Review* essay, but he did not eschew experiments.

Now, following the collapse of Communism and the retreat from socialistic policies in many nations, the superiority of the market seems to be more widely accepted. The recent attempt to establish a system of comprehensive health care in the United States indicates, however, that the activist impulse is not dead.

In Alfred Hitchcock's witty movie, *The Trouble with Harry*, a man is found dead, lying in the woods on a bright New England autumn day. During the course of the film, there is much concern about how Harry got into his present state, and what to do with him. Eventually, he gets a proper burial, and the people are able to go about their normal lives.

Keynes, of course, has been dead for almost 50 years. During his life, and since, his writings did much to stimulate creative and useful thought among economists. In some ways, the discipline is richer for his insights. But his preference for political activism and short-run policies is a questionable and even a dangerous legacy. For them a decent burial seems overdue. □

1. John Maynard Keynes, *Monetary Reform* (New York: Harcourt, Brace, 1924), p. 88. English edition published in 1923.
2. John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Harcourt, Brace, 1936), p. 378.
3. John Maynard Keynes, "National Self-Sufficiency," *Yale Review*, 22 (June, 1933), p. 758.
4. John Maynard Keynes, "The End of Laissez-faire," in Keynes, *Essays in Persuasion* (New York: W. W. Norton, 1963), p. 316. This essay was first published in 1926.
5. Keynes, *General Theory*, p. 378.
6. R. F. Harrod, *The Life of John Maynard Keynes* (New York: St. Martin's Press, 1963), p. 3. On this matter, see also James M. Buchanan and Richard E. Wagner, *Democracy in Deficit: The Political Legacy of Lord Keynes* (New York: Academic Press, 1977), pp. 78ff.
7. Keynes, "The End of Laissez-faire," p. 318.
8. John Maynard Keynes, *The Economic Consequences of the Peace* (New York: Harcourt, Brace and Howe, 1920), p. 41.
9. John Maynard Keynes, "Mr. Lloyd George: A Fragment," in Keynes, *Essays in Biography* (New York: W. W. Norton, 1963), p. 35. This fragment was first published in 1933.
10. Harrod, *The Life of John Maynard Keynes*, pp. 157–58.
11. John Maynard Keynes, "The Economic Consequences of Mr. Churchill," in Keynes, *Essays in Persuasion*, p. 246. First published in 1925.
12. *New York Times*, December 31, 1933, Sec. 8, p. 2XX. When Keynes met Roosevelt at the White House in 1934, Roosevelt's Secretary of Labor had the impression that the two men were mutually unimpressed. See Frances Perkins, *The Roosevelt I Knew* (New York: Colophon Books, Harper and Row, 1964), p. 225.
13. Herbert Stein, *The Fiscal Revolution in America* (Chicago: University of Chicago Press, 1969), pp. 108ff.
14. See Henry Hazlitt, *The Failure of the "New Economics": An Analysis of the Keynesian Fallacies* (Princeton: D. Van Nostrand, 1959 [Foundation for Economic Education, 1995]).
15. Henry Hazlitt, *Economics in One Lesson* (New York: MacFadden Books, 1961), p. 12. First published in 1946.
16. Henry Hazlitt, *The Foundations of Morality* (Los Angeles: Nash Publishing, 1972), pp. viii and Chapter 7. First published in 1964; republished by the Foundation for Economic Education, 1994.
17. See Jude Wanniski, *The Way the World Works* (New York: Simon and Schuster, 1978), Chapter 7. Wanniski argues that the New York Stock Exchange reflected the adverse anticipation of the impact of Smoot-Hawley.
18. See "The Great Contraction" in Milton Friedman and Anna Jacobson Schwartz, *A Monetary History of the United States, 1867-1960* (Princeton: Princeton University Press, 1963), Chapter 7.

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Macroeconomics Reconsidered

by Kyle S. Swan

Mark Skousen's reconstruction in *The Freeman* of the debate between the Austrian and Monetarist schools on the trade cycle challenges the economics profession. In recent "Economics on Trial" columns, Skousen hands down the verdict to modern economics: *put capital back into your macroeconomics.* John Maynard Keynes, of course, took capital out of macroeconomics, masking with crude aggregates the micro foundation of the productive process. However, in the Austrian school, capital never left. Austrians consistently recognize the necessity of capital theory, especially one emphasizing the role of time. And capital and time are central to a proper understanding of the trade cycle.

The standard story of capital theory begins by defining capital as the total stock of productive wealth (identified in mainstream models as k and reckoned as a monetary value). Capital is increased by saving, and the greater is the stock of capital, the greater is output. An economy's rate of economic growth depends upon k. The marginal productivity of capital is reflected in the interest rate; capital generates interest. In this mechanical system where k is (assumed to be) automatically productive, saving necessarily generates growth. Consequently, planning for the future occurs only when individuals make conscious decisions to save.

In his debate with the American economist John Bates Clark, the Austrian Eugen von Böhm-Bawerk countered these mechanical theories by emphasizing the importance of time. Capital is the form multi-period plans take as these plans materialize. Essentially the same debate was repeated years later between Frank Knight of the Chicago school and F.A. Hayek.

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Knight, who taught Milton Friedman, described capital as a self-perpetuating fund—as a stock generating a continual flow of output in perpetuity. Like the Energizer bunny, it keeps going and going and going. . . . Ownership of capital assures a steady income. This interest income can be saved in order that a capital good may be replaced when its durability wanes. In this sense, capital reproduces itself and provides for its own maintenance.

Austrians have a very different view of production. For Austrians, production using capital is a process of converting higher-order goods (e.g., wheat) into lower-order goods (e.g., bread) to satisfy consumer demands. In the broadest sense, the economic process refines and utilizes nature's resources for the fulfillment of individual goals. Something is important and attains goods-character only if it is perceived to contribute to the satisfaction of consumer demands. The production process, therefore, depends on the purposeful decision-making and planning of entrepreneurs and investors seeking profits by using resources and other inputs to better satisfy consumer wants. Knight's vision of automatic capital maintenance ignores the very *raison d'être* of production: individual planning and decision-making to satisfy consumer demands. Also, Knight ignores the central question of economics in his capital theory: how does complex plan coordination take place, especially through time?

Knight saw no analytic advantage in emphasizing time or multi-period planning. If you have the shirt on your back, seven shirts at the laundry, and seven at home, it takes no time at all to get clean shirts. You go to the laundry with seven dirty shirts, hand them over, and immediately get seven clean shirts. If you have the productive stock (15 shirts), there is no need to plan and time is irrelevant. If the average period of production is calculated, the economic process is synchronized. There is simultaneous production and consumption. In forestry, loggers synchronize cutting and planting. Real time is zero. The forest is a permanent source of wood.

The Importance of Time

Austrians resist this notion of capital as an aggregate stock of productive wealth, always emphasizing the importance of time. Something is not capital in virtue of its physical characteristics, but because of its economic functions; i.e., the degree to which people perceive their dependence on command of it for the satisfaction of their goals. It isn't the case that a person expects seven clean shirts at the laundry merely because he brings in seven dirty shirts. Rather, a person takes seven dirty shirts to the laundry in order that he may get them back clean in a week's time. Logging companies plant trees expecting that they will grow and be cut down many years later. Here, capital retains its subjective character. Rather than a stock of things, capital is a manifestation of human production plans. Output does not flow automatically as in Knight's example of fruit from trees. Individuals' plans initiate and drive a process taking place in real time and subject not only to imperfect foresight, but to human error as well.

Furthermore, the conception of an aggregate stock of *k* ignores the process by which value is imputed at different stages of completion. Hidden in these aggregates are the purposes and plans of millions of people. An aggregate of purposes and plans makes no sense.

But the claims of the standard neoclassical approach must be addressed at even a deeper level. Austrians who simply mock and dismiss mainstream capital theory as "breakfast-cereal theories of capital" (*Special K*) miss an important point. Mainstream economists are not naive. They recognize that it takes a week for shirts to be cleaned. Mainstream economists are not mystics who believe that capital is a magical substance that *just is* productive. Rather, they maintain that there is no *analytic* advantage in emphasizing multi-period planning; that it is unnecessary to focus on this aspect. Time, in this view, is analytically unimportant. Why insist on emphasizing multi-period planning if doing so further complicates or even invalidates neoclassical modeling and adds nothing to the analysis?

Thus, to effectively respond, Austrians must expose the costs of ignoring time and individual plans and preferences. They must show that the mainstream practice generates error or oversight, while the Austrian "lens" brings relevant features of economic reality into fuller or sharper focus.

Consider the Austrian trade-cycle theory. The capital combination at any time reflects the plans and preferences of individuals. Given current prices, expectations of future prices, and the interest rate, businesses arrange their capital resources in ways that hopefully will meet with the most favorable response from consumers. However, if the central bank lowers the interest rate below the natural rate by increasing the money supply or lowering the discount rate, this move sets in motion a self-reversing process where the boom turns into the inevitable bust.

Here's how. At first, production schedules are guided toward longer-term projects in response to the false price signals created by central-bank money creation. (Lower market interest rates falsely promise a more generous supply of funds for capital investment in the future.) Projects are undertaken today with the expectation that complementary capital goods will be available when needed tomorrow. However, these longer-term projects do not reflect the true preferences of consumers who, it turns out, don't save as much of their incomes as would be necessary to keep the interest rate as low as it was driven by the central bank. The entire structure of production is distorted as central bank policy directs resources away from projects consumers find more valuable toward projects of less value. The complementary goods of longer-term projects that businesses have undertaken will be unavailable. Therefore, not all of these projects will be completed. Businesses, finally seeing the handwriting on the wall, must halt, regroup, recoup, and liquidate as the correction phase begins.

This explanation of the trade cycle hinges on several key factors tied intimately to capital theory. First, production takes time. In non-instantaneous production, error is costly. The longer the malinvestment, the greater the necessary correction. Second, capital goods are heterogeneous and are often appropriate for only a small range of uses. If a business overinvests or malinvests in one period, it cannot easily divest or change production or investment projects in the next. Third, capital goods have a limited range of competing uses, and production plans often necessitate complementary goods for their fulfillment. Because resources are scarce, many projects must fail when false signals draw complementary goods away.

A theory of capital that ignores time and hides the relevant information in crude homogeneous aggregates can't very well explain the trade cycle. The Austrian emphasis on the time structure of production based on individual purposes and plans enriches the story of boom-bust cycles. It should be no surprise that Milton Friedman does not see any significant correlation between an inflation and a recession. His capital theory does not allow him to see the process at the micro level that makes the link.

However, work towards this kind of recognition has only barely begun as evidenced by many of the experts quoted by Dr. Skousen. Moreover, Skousen's charge to rethink capital theory is a big challenge. Capital theory within the Austrian paradigm is probably the least developed area. Hayek's *Pure Theory of Capital* (1941) and Ludwig Lachmann's *Capital and Its Structure* (1956) are the only modern comprehensive studies of the subject.[1] If we agree that capital is key to understanding phenomena such as the trade cycle, we must devote more effort towards formulating a defensible capital theory. □

1. A few excellent article-length treatments of Austrian capital theory exist. See Roger W. Garrison, "Time and Money: The Universals of Macroeconomic Theorizing," *Journal of Macroeconomics*, Vol. 6 (Spring 1984), pp. 197–213, and Garrison, "A Subjectivist Theory of a Capital-using Economy," in Gerald P. O'Driscoll, Jr., and Mario J. Rizzo, *The Economics of Time and Ignorance* (New York: Basil Blackwell, 1985), pp. 160–187.

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Cholecystectomy, How Is It Made?

by Leonard A. Metildi

In the spirit of Leonard Read's essay on the pencil—how no one knows how pencils are made—it is interesting to investigate a surgical operation (a cholecystectomy—removal of the gall bladder) to show that no one knows how *it* is made. As the pencil is a relatively simple item, yet its manufacture and distribution are so hopelessly complex that a centralized economy could not begin to duplicate the market's efficient performance of these functions, medical surgery is likewise so complex that no central-planning authority could ever ensure that it is readily available at reasonable prices.

A few simplifying assumptions are useful:

1. The clinical case is straightforward and simple—the patient is otherwise healthy with single organ system involvement.
2. The diagnostic workup is done efficiently.
3. The operation and the post-operative course are uneventful.
4. The standard surgical instruments (forceps, scissors, knife handles, needle holders, etc.) are made by the same manufacturer.

A 50-year-old male with symptoms of gallbladder disease is the patient. His medical history is fine and he is on no medications. To confirm the diagnosis, the surgeon obtains an ultrasound of the gallbladder (done on a Accuson 128 with a Matrix video imager using conduction medium by Parker). Surgery is scheduled. For the pre-operative laboratory work, the patient has an EKG (Hewlett-Packard), chest x-ray (GE and Kodak), complete blood count (Coulter T890), chemistry profile 18 (Kodak Ektachem), and a urine analysis (Ames Multistix).

The patient is admitted to the hospital on the morning of surgery. An Imed pump is used to start an intravenous of Ringer's lactate (solution, polyvinyl bag, and tubing from Abbott, catheter from B-D Corporation, alcohol pads from Kendall). The patient is given a shot of subcutaneous heparin from Elkins-Sinn, a dose of Kefzol from E. I. Lilly, syringe and needle from B-D, and anti-embolic stockings from Kendall are put on. In the operating room, the patient is placed on a Skytron Elite 6001 table and given several medicines (sodium pentothal-Abbott, fentanyl-Janssen, succinyl choline-Abbott, pavulon-Gensia) as well as oxygen by mask from a Narkomed 2 anesthesia machine manufactured by North American Drager. (The mask is from Bay State Anesthesia.) He is then endotracheally intubated using a Welch Allyn laryngoscope, a Mallenckrodt Critical Care endotracheal tube, a tongue blade from General Medical Corporation, and an oral airway from Sun Medical Inc. The patient is then given oxygen and nitrous oxide from MG Industries, and isoflurane from Anaquest.

An open cholecystectomy with an intra-

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operative cystic duct cholangiogram is performed using the following items:

1. Bard Parker scalpel blade
2. Surgical instruments from V. Meuller
3. Silk suture from Ethicon
4. Vicryl suture from Ethicon
5. Skin staples from Richard Allen
6. Ray-tec sponges from Kendall
7. Laparotomy pads from Medical Action
8. Saline irrigation from Abbott
9. Syringes from B-D
10. Valley Labs Electrocautery unit
11. Contrast material from Winthrop
12. Kodak x-ray film
13. General Electric portable x-ray machine
14. Cholangiocatheter from Duvall
15. Dressing sponges from General Medical Corporation
16. Tape from 3M Corporation
17. Operating lights from Angieneaux
18. Betadine surgical scrub from Purdue Frederick
19. Hebiclens from Stuart
20. Scrub brushes from Bectin-Dickensen
21. Surgical gowns, caps, laparotomy sheets from Kimberly Clark
22. Face masks from General Medical Corporation

An anesthesiologist monitors the patient using the following equipment:

1. EKG monitor by Datascope
2. Oxygen saturation monitor by Datascope
3. Carbon dioxide monitor by BOC Health Care
4. Blood pressure monitor by Datascope.

During the two-day hospital stay following surgery, no other lab work or blood drawing is needed. The patient's pain is relieved with shots of demerol from Elkins-Sinn and vistaril from Lyophomed. Later, he gets oral pain medication (percocet from Roxanne). The patient's skin staples are removed. (The staple remover is from Superior Healthcare Group, Inc.) Steri-strips from 3M are applied to the wound using tincture of benzoin from Humco on the day of discharge.

Were the operation done laparoscopically, as most are today, the complexity of the equipment used would have been much greater: CO_2 insufflator, 10-mm straight laparoscope, video camera, televisions, light cables, operating trocars, suction irrigation system, sequential compression stockings, grasping instruments, dissecting instruments, cholangiocatheter, Foley catheter, nasogastric tube, and electrocautery instruments. The patient would then be discharged within 24 hours.

Of course, the engineering behind the design and manufacture of each of these instruments is impossible to document—and this account ignores the multitudinous equipment and chemicals used to sterilize and package the instruments. Questions about the origin of all of the raw materials used to make the equipment and components of the instruments, as well as the machinery needed to mine and manufacture these materials, are even more complex.

In addition, consider the companies that have sold the supplies to the hospital. Think of all the engineers, assembly-line personnel, salesmen, marketing representatives, and distributors employed by these companies. Think of the men and women who invent, design, manufacture, and also create software for the CT scanners and MR machines that are used daily to improve the diagnosis and treatment of disorders, frequently rendering unnecessary costly open surgery with its attendant morbidity and mortality.

Americans spend what they do on health care because they have the wealth to satisfy the public's demand for high-quality medical and surgical specialty care. Third-world countries may have the demand for health care as well as for food, clothing, housing, and consumer goods, but they do not have the supply. Americans *could* spend on a per-capita basis no more on health care than is spent by citizens of poor countries; that is, Americans could choose to purchase *only* first aid and comfort care. But is this really what the public wants? To think that one is going to get high quality general and specialized medical care whenever one needs it without having well-paid doctors, nurses, technicians, paramedics, scrub techs, is delusional.

The only way to control costs and reduce waste from costly and medically unnecessary or low-yield tests and treatments, is not to regulate from above, but to put the patient in charge. Have the patient spend his own money and the physician/patient relationship will be instantly restored. The patient will demand to know the relative risks, costs, and benefits for any proposed test or treatment. The *patient* will then decide to proceed or not. Physicians will moderate their fees to attract patients.

Patients today aren't very sensitive to costs because the typical patient pays only 15 cents of every dollar spent on his health care. However, millions of patients footing their own medical bills would more efficiently determine which medical goods and services are available and in what qualities and locations. Whatever one's economic philosophy, recent history shows that the rationing achieved by market forces is far more benign than that achieved by government or bureaucrats, no matter how noble the intentions.

What does a cholecystectomy cost today? I break it down into physicians' fees and hospital costs. I will not discuss hospital reimbursement and Diagnosis Related Groups, nor Medicare or Medicaid prices. First, the physicians' fees: surgeon open—$1,500, laparoscopic—$2,000; assistant open—$375, laparoscopic—$500; anesthesiologist—$800 for 1.5 hours. Hospital charges: operating and post-anesthesia recovery room charges—$1,550; room charges open—$975, laparoscopic—$375; medicines used—$10; gowns, masks, etc.—$42; disposable equipment for laparoscopic surgery—$473; lab costs—$480; dressings and syringe costs—$5. Thus, the cost for open cholecystectomy with a six-week recovery time is $5,737; the cost for laparoscopic cholecystectomy with a two-week recovery time is $6,235.

Which is the preferred procedure and for whom? If government pays for it, then the government will ultimately decide whether or not the patient has this surgery and, if so, which kind he will have. Minimizing costs, government will likely choose open cholecystectomy. However, if the patient pays for his own surgery, then the markedly less invasive but marginally more expensive laparoscopic cholecystectomy will most likely be chosen. The operative word here is choice, i.e., the patient's. Is the extra cost worth it to this 50-year-old to get back to work and all normal activity with minimal post-operative discomfort? Only he can answer the question.

The reader should ask: how are bureaucrats and administrators to decide who makes the supplies and equipment, and how much of each item, used for this operation? Expand the query to include all areas of medicine and surgery today and one can see that it can't be done in any way other than through the market. Only through the pricing mechanism of free markets can the necessary information be speedily transmitted everywhere so that proper decisions can be made by the manufacturers, suppliers, and users of the goods and services used in modern medicine and surgery, just as only through the pricing mechanism can pencils be manufactured and distributed in the proper quantity and at the proper price.

Market forces could best be employed in the health-care field by doing the following: (1) enacting medical savings accounts combined with catastrophic insurance coverage; (2) allowing tax deductions for individual insurance premiums in order to separate medical insurance from employment, thus making it personal and portable; (3) allowing choice so that individuals could choose among HMO's, employer-based insurance, medical savings accounts, and fee-for-service with and without managed care. In short, the best reform is to free market forces so that the pricing mechanism can work.

There seems to be no shortage of arrogance from those who think that they can direct everyone's actions, that they know what is best for the population as a whole, that they can singlehandedly solve "health care problems" by deciding what will and will not be available, and that simply by forcing 50 percent of all medical students into primary care, quality and access will be improved.

Such simplistic solutions are, of course, woefully misguided. I sincerely hope that the reader pauses to reflect on the complexity of medicine and surgery, and on how these services are best handled by the interplay of voluntary choices of affected individuals within a free market. □

THE FREEMAN
IDEAS ON LIBERTY

A Sales Pitch for Laissez-Faire Health Care

by Daniel B. Klein

What would it mean to establish liberty of property, consent, and contract in the area of health care?

It would mean the repeal of FDA drug-approval requirements, prescription laws, drug-development regulations, and restrictions on the dissemination of information. It would mean the repeal of state and local regulations in the following areas: medical schools and hospitals, occupational licensure, diagnosis and referral, the employment of doctors by for-profit firms, nonphysician ownership of medical firms, the use of brand names, the operation of multiple branch offices, the location of health-care facilities, and marketing practices. For prepaid health plans and hospitals, it would mean the repeal of regulations on benefit packages, enrollment requirements, rate setting, and facility expansion.[1]

Here I speculate on the desirable features of such a regime.

Education and Training of Practitioners: Private and public institutions would issue degrees, certificates, and other credentials to candidates meeting their requirements. Many training programs would be intensive programs for specific skills. Training would expand and diversify drastically, perhaps even reaching down to basic training for lay people. The profile of practitioners would thus expand. It would permit practitioners the flexibility to adapt their human capital to the opportunities of time and place. Costs to the consumer would drop considerably. To make sense of this blossoming of health services, people would rely on knower-intermediaries, information disclosures, brand names, and so on.

Drug Development and Availability: Costs would plummet, timeliness would improve and the profile of drugs would expand. Strong safety and quality incentives would flow from the umbrella of the pharmaceutical brand name and the tort system. Knower-institutions—perfectly analogous to Underwriters' Laboratories—would develop to certify safety. Doctors and pharmacists, acting as knowers and middlemen, would use their expert knowledge of drugs in advising the consumer.

The market would serve as an experimentation process—sometimes people would be killed by unsafe drugs (and companies would pay dearly), but such consequences belong to a benign process. There is a saying for people who frequently use air travel: If I never miss a plane I know I'm spending too much time in airports. At present, the FDA is the Chauffeur whose pre-eminent incentive is to get the passenger to the airport on time. The consequence is that it gets us to the airport three days before the flight, and charges us dearly for the ride. The deaths of 100 children from Sulfanilamide in 1938 pale when compared with the annual death toll from the FDA's curtailment of drug availability. One study catalogues 192 generic and 1,535 brand-name tested drugs available abroad but not approved for sale in the United States.[2] How many thousands of deaths per year does such delay cause? Sam Kazman of the Competitive Enterprise Institute estimates that the FDA delay of just two drugs, misoprostol (which reduces gastric ulcers) and streptokinase (which dissolves blood clots in heart-attack victims), has caused thousands of deaths.[3]

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Information and the Active Patient: Drug information would be improved by freedom to self-disclose in labeling and advertising. At present, consumer access to medical information is expanding, in the forms of health-care literature, medical libraries, online information services like Internet, referral services like Prologue, and services like The Health Resource, which generates for a fee thick packets of medical literature to customers specifying a diagnosis.[4] In a freer market consumers would have easier access to opportune and pointed knowledge.

Commercialization: Brand-name and franchised clinics, medical groups, hospitals, and insurance plans would flourish. Milton Friedman prophesied in 1962: "[T]hey could organize medical care efficiently, combining medical men [and women] of different degrees of skill and training, using technicians with limited training for tasks for which they were suited, and reserving highly skilled and competent specialists for the tasks they alone could perform."[5] Consumers would obtain at low cost gatekeeper diagnosis, referral, and second-opinion. Friedman's early vision of "department stores of medicine" would be proven prophetic.

Medical Groups and Insurance: Currently, medical groups employ utilization review and peer monitoring to police quality. Intermediaries (such as employers, membership organizations, and so on) serve as middlemen and agents, shopping over medical plans, helping large sets of ignorant consumers discriminate between better and worse health care. In a regime of freedom *and enforcement* of contract, health plans and insurers could write better patient-enrollment contracts and patient-performance contracts. They could mitigate member-selection problems by using more refined screening and pricing techniques. Perhaps firms would emerge to research, compile, and verify individuals' medical histories. Health plans and insurers could mitigate moral-hazard problems by requiring flu shots, check-ups, and other programs to promote prevention and early treatment.

Independent Knower Organizations: Data banks, consumer information bureaus, referral services, reporting literature, drug-testing facilities, and auditing firms would evolve more swiftly. Local organizations would emerge to rate health-care providers through undercover monitoring, patient interviews, or treatment reviews. Such a service might be supported by patients, analogous to *Consumer Reports*, or by physicians, analogous to Underwriters' Laboratories or Moody's. Consumers would reward those organizations that help them assess credentials and discriminate among the array of available health services.

Lay Awareness: There would be medical education without sacerdotal restraints. Basic medicine could be part of the high school curriculum. All manner of health-care education and training could be offered in community colleges and private institutes. Entrepreneurs have already developed medical software that responds to a list of symptoms with possible diagnoses and treatments.[6] This program is based on data that are more extensive, more accurate, and more current than any doctor could hope to command. Informal courses might teach lay people how to use such programs. People would have better information to assess their needs and opportunities, and they would have the power to self-medicate.

In 1963, the famed economist Kenneth Arrow could write: "It is the general social consensus, clearly, that the *laissez-faire* solution for medicine is intolerable."[7] Nowadays there is no such general social consensus. □

1. Paul J. Feldstein, *Health Care Economics*, 4th ed., Albany: Delman Pub., 1993, p. 321.
2. Kenneth Anderson and Lois Anderson, eds., *Orphan Drugs* (Los Angeles: The Body Press), 1987.
3. James Bovard, "Double-Crossing to Safety," *The American Spectator*, January 1995, pp. 24–29.
4. Brigid McMenamin, "An Educated Consumer Is Her Best Patient," *Forbes*, June 21, 1993, p. 118.
5. Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962).
6. Stephen S. Hyde, "The Last Priesthood: The Coming Revolution in Medical Care Delivery," *Regulation*, Fall 1992, pp. 70–74.
7. Kenneth J. Arrow, "Uncertainty and the Welfare Economics of Medical Care," *American Economic Review*, 53, December 1963, p. 967.

Block Grants Are Not the Answer

If you want something done in your community, would it ever occur to you to send a check to Washington, D.C., first, so that the federal bureaucracy could take a cut before sending back the rest?

Welcome to the new world of "block grants"—the latest fashion that has Congress and state legislatures buzzing. The motivation is commendable: reduce federal micromanagement and allow states to innovate by giving them large dollops of federal money with few strings attached. In place of failed, one-size-fits-all programs run rigidly by Washington, the states would function as 50 "laboratories," generating new approaches that would work better because states are closer to the people. Congress, before the year is out, may reorganize and consolidate many federal programs this way—from welfare to crime control.

The block grant idea per se is not really new, but now the Congress is moving toward implementing it in a massive way. Less than 20 percent of the $200 billion Washington sends back to the states now goes in the form of block grants, and all of that went for operating or capital expenses for local or regional projects. The congressional leadership now wants to take the next step and convert "entitlement" programs into block grants. These are programs whose spending requirements are determined not by some fixed appropriation the Congress decides it wants to make, but by the "needs" of those whom the law says are "entitled" to the cash. Welfare-state proponents argue that without an automatic entitlement written into the law, the amount the federal government sends to the states may prove insufficient to meet the "needs" of all the people who qualify for the programs.

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The states respond by saying, "Give us the money without all the expensive and ridiculous mandates and rules and we'll make enough savings to do at least as good a job for even less money." All other things equal, they're probably right, but that's not the end of the story.

If less federal meddling in how programs are locally run is the primary objective of the block-grant approach, it may be easy to achieve at the start but difficult to sustain. As the old saying goes, "He who pays the piper calls the tune." Congress will always be tempted to add conditions and clarifications each time appropriations bills containing block grants come up. It is not hard to imagine state and local officials complaining, a few years from now, "Where did all these strings come from?"

The truth is that block grants would do little to address the inherent flaws in our current system of multi-layered bureaucratic structures. Laundering the people's money through two or three levels of government is a make-work scheme for administrators. One study showed that, of the

$226 billion spent by federal, state, and local governments on welfare in 1990, only 35 cents of every dollar ever made it into the hands of the poor. On the farm, that's called *feeding the sparrows through the horses.*

Furthermore, block grants would actually reduce the accountability of government because they separate the raiser of the tax revenue (the federal government) from the spender of it (state and local governments). If something goes awry, Washington will blame the states for not spending the money wisely, and the states will blame Washington for not providing enough money to do the job. Taxpayers and users of government services will be left wondering who is responsible for what.

It is generally true that because states and municipalities are closer to the people than the federal government, they are more accountable and responsive to individual citizens and local concerns—as long as they are spending local money. Not even the most diligent of local politicians, however, will spend money from Washington as carefully as they spend what they are accountable for raising themselves.

Some of us in Michigan learned that lesson years ago. In the late 1980s, one township with no downtown accepted federal block grant funds earmarked for "downtown revitalization." The money went for a parking lot at the township hall. The same officials accepted another block grant to construct "barrier-free improvements" on the same site, but used the money not to assist the handicapped so much as to enhance their own work environments. Fifteen of the 23 block-grant programs enacted by Congress since 1966 are still on the books, shoveling out $35 billion yearly and raising plenty of questions about their wisdom in the process. What makes Washington think that federal welfare for state and local governments can work any better than federal welfare for individuals?

In the 1980s, Congress debated a less half-hearted reform known as "turnbacks." Under that idea, the federal government turns back to state and local governments both the spending responsibility for programs now run from Washington *and* the revenue sources, too. Instead of "We'll raise it and you spend it," with turnbacks Washington says, "*You* raise it and *you* spend it."

Economist Dean Stansel of the Cato Institute points out, for example, that the Reagan administration once proposed ending federal responsibility for highways and repealing federal gasoline taxes, giving states the option of raising their own gas taxes. It wasn't enacted, but if it had been, states like mine would not be sending nearly twice as much gas tax money to Washington as it gets back each year.

Of course, even the turnback idea assumes from the start that transferring a program from one government to another—federal to state, primarily—is the ultimate reform. We ought to be raising more fundamental questions with regard to everything the federal government does: Is this a legitimate function of *any* government? Why should this activity be coercively funded at all? Would it be more in accord with the principles of individual liberty and sound economics to leave this activity to the willing participation of free people who choose to conduct it on their own?

If Congress is serious about putting an end to the billion-dollar paper blizzard that afflicts federal programs, and restoring accountability to our system of government, block grants are *not* the answer. Firing the federal middleman *is*. Once we do that, let's give a lot of thought to why we would want a state or local middleman before we authorize any level of government to take our money. □

THE FREEMAN
IDEAS ON LIBERTY

Is Environmental Pollution the Principal Environmental Problem?

by Hugh Macaulay

Ever since Rachel Carson published *Silent Spring* in 1962, Americans have been actively concerned about environmental pollution. Congress has enacted laws requiring clean water and clean air, and the Environmental Protection Agency has been established to enforce these laws. Activist environmental groups, such as the Sierra Club and the Natural Resources Defense Council, were organized to prevent pollution and to ensure that laws prohibiting it are vigorously enforced. To accuse someone of polluting the environment is akin to a charge of racism; each is considered a sin against society.

When the push for purity began soon after Miss Carson's book was published, the field was dominated by biologists and engineers who saw the problem as simply measuring impurities and then devising ways to remove them. A few economists argued that a better solution would be to charge for the emission of impurities and then allow the polluters either to decide best how to eliminate the emissions or to pay for any impurities they discharged into the environment. Early environmentalists argued that charging for emissions was merely paying to inflict injury on innocent parties and was immoral.

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The environmentalists have largely prevailed. With cleanliness next to godliness, who could support dirty water, unclean air, or any variation on these themes? Consequently, the Federal Water Pollution Control Act Amendments of 1972 required a zero level of waste discharged into the nation's waterways by 1984, and the Clean Air Act of 1970 forbade the discharge of any emission that would cause harm to citizens. Further, in many cases, the government prescribed just *how* these requirements would be met, such as by mandating scrubbers on the smokestacks of electric utility power plants.

We are likely, however, to see the situation differently and to arrive at a more efficient and acceptable solution if we think of environmental pollution as an economic problem. Economics deals with scarce resources and how we may best use them. Water and air quality are scarce resources with many parties wanting to use them in different and mutually exclusive ways. Some people want to use these assets to carry away the smoke from their fires, the exhaust from their cars, the carbon dioxide from their breathing, the sewage from their homes, and the discharges from their factories, while other persons want to breathe fresher air, see more distant mountains on more days, and swim and fish in streams and lakes. The problem is not one of pollution but of who will be able to use the environment in his preferred way. Choosing among alternative uses of the environment, not pollution of the environment, is the principal environmental problem.

We gain considerable insight by casting the problem in terms of another natural asset with conflicting desirable uses: land. Many people want to use land as a site for their homes, gardens, parks, and hiking trails, while others seek places for their factories, hospitals, schools, and garbage dumps. Each of these uses competes with every other use. We solve the problem by asking each demander how much he will pay for his preferred use. Each particular site of land goes to that user whose offer exceeds those of other bidders. The decision is not made on the political popularity of a particular use but on the basis of its greater value to one user than to any other potential user.

Ardent environmentalists, and many citizens less concerned with environmental questions, continue to see pollution as the principal problem and will argue that the aim is to prevent emissions and discharges that are inimical to the good health of the population. Clean air and water have been concerns of the Public Health Service since early in this century, and it has effectively reduced water-borne pathogens and fatal air conditions such as that in Donora, Pennsylvania, in 1948. Public health is no longer seriously threatened by environmental quality. Still we have been concerned with the consequences of red dye no. 2, Chilean grapes, Alar on apples, acid rain, and asbestos in ceiling tiles, none of which can be characterized as a health problem, either public or private, of any consequence.

Clean, Cleaner, or Cleanest?

The question of environmental cleanliness raises an important economic principle. All economic decisions are made at the margin. Thus, the proper question is not whether we shall have *clean* air, but whether or not we shall have *cleaner* air. We practice this principle of marginalism in our daily decisions. Each of us wants a clean home. The real question is whether we should have our home cleaned more thoroughly, or perhaps relax our standards. Will an additional visit by a home-cleaning service each week or month be worth its cost? Because few of us use such a service daily, most of us have decided that additional cleanliness in the home is less valuable than the other things we could buy with the money daily home cleaning would cost. For a more recognizable case, we would all like our garage floors to be clean, but not to the extent that we could eat food placed on the floor. We do not seek perfection in our other public expenditures on national defense, education, crime prevention, public welfare, or highways. Nor should we seek perfection in the environment.

There is another economic lesson in deciding on how to use the environment. We know that the more of any good we produce, the more costly are additional units. Producing additional wheat requires more land, labor, and capital than was required to produce earlier bushels. Stated differently, we would have to give up more corn, soybeans, shirts, and parking lots for each additional bushel of wheat produced. The things we give up for more wheat may be more valuable than the added wheat we get.

The Law of Diminishing Marginal Utility also tells us that as we get more wheat, shirts, television sets, or anything else, the less valuable another one of any of these things is to us. Sometimes at restaurants we do not eat all the food on our plates; another bite of the food has now fallen below zero in value and is, literally, garbage. Once the water in our homes is clean enough to drink, there is little benefit from having it distilled. Our steam irons may prefer distilled water, but the human body finds the improvement of zero benefit.

The two forces just described give us our supply and demand curves and tell us that there is a point beyond which it is not worth producing more of a good. This principle is also true of environmental purity: we can have air and water that are wastefully clean. For most of us, common examples in other goods, such as watches, cars, and haircuts, are Rolex, Rolls Royce, and Mr. Clinton's clipping on the Los Angeles airport tarmac. These are all good products, indeed very good products, but most of us do not buy them because the extra quality is not worth the extra cost. Walter Williams astutely observes that while we love genuine diamonds of superior clarity, we more often choose to buy costume jewelry. We should apply this jewel of wisdom to our purchases of environmental quality as well. There is a best level of environmental cleanliness, and it is not perfect purity.

The most important question in determining environmental quality involves the price we pay for the use we enjoy. Environmentalists have taken 25 years to agree that emissions charges should be levied on polluters. Many environmentalists, however, argue that the charge should be set so high that there would be no emissions at all. This is not the price that most economists have in mind.

A system of charges on polluters has several advantages. Polluters are willing to pay because they benefit from their use of the environment. They will reduce emissions because each unit they discharge is costly to them. They will reduce these emissions in the most economical way, thus lowering the costs of greater cleanliness. There is less ill will and animosity toward government and environmentalists because polluters face a price for a service they use rather than an arbitrary and inflexible standard of purity imposed by politicians.

If we ask who uses the environment, rather than who pollutes it, we must recognize that those who desire a cleaner environment are also users, no less than are polluters. Environmentalists want to enjoy cleanliness, as much as those who buy air filters for their homes, bottled water for their tables, and yard services to make their lawns more attractive. In hundreds of ways every day we pay for greater cleanliness of our homes, cars, stores, and parks. The environment is no different. Those who want a cleaner environment should pay for the additional cleanliness they get, use, and enjoy.

As it did for the polluters, a system of charges on users enjoying greater cleanliness promises many advantages. If those desiring increased purity must pay for this benefit, they will conserve on their demand for it. Their love of purity and their moral superiority in publicly pressing for it would pale as it does for additional units of every other good they buy. Second, lovers of purity may find more efficient substitutes for environmental cleanliness. Community and private swimming pools may be much cheaper than making every stream swimmable. Third, environmental activists could devote more time to producing saleable goods desired by others so they could earn money to buy a cleaner environment. They would then spend less time lobbying politicians, organizing demonstrations, and supporting political pressure groups, none of which activities produces goods being bought by others. We have no assurance, and we have many reasons to doubt, that these activities result in environmental improvements that are worth their costs. Adam Smith's invisible hand again will guide us to a society with more goods, including environmental cleanliness, that people value highly. The lobbyist's visible foot, extended to the politician, results in fewer goods that, also, are of questionable value.

We earlier noted that land is also an environmental resource. If we treated land as we now treat air and water, we would price all land at zero and invite homeowners to take all they want. Any land left over would be allocated, or sold for a user charge, to business firms, but each firm would be restricted in the amount it received. Buildings and factories erected on the land would be designed by government to minimize land use. These buildings would be small in area and tall in height. We might produce steel in a factory occupying only one hundred square feet at ground level but rising forty-two stories. The cost might be exorbitant, but it would provide cleaner land—meaning more land without the impurity of factories—for use by homesite lovers.

The lesson is clear. The environment is a scarce, natural asset. Markets have been used for centuries to allocate scarce assets and they can be used to allocate the use of the environment as well. The public-good nature of environmental purity is similar to that confronting providers of lighthouses, television programs, music rights, church services, fireworks displays, and hundreds of other goods. If we apply market principles to environmental quality we can have a more efficiently used environment and citizens who are happier with the uses they voluntarily pay for and enjoy.[1] Free markets can be extended to this new area to bless the population with the same benefits delivered in more common applications. We need only see that the problem is not the pollution of the environment, but the use of the environment. □

1. For a more detailed discussion, see Hugh H. Macaulay and Bruce Yandle, *Environmental Use and the Market* (Lexington: Mass.: Lexington Books, 1977).

THE FREEMAN
IDEAS ON LIBERTY

The Greening of the Cross

by E. Calvin Beisner

Lately thousands of people across America, including me, have received a mailing asking us to become members of The Christian Society of the Green Cross, a new organization addressing ecological problems. People should think hard before joining or donating.

The recruitment/fundraising letter tries to establish the need for the organization by making claims about ecological crises. The claims are, without exception, subject to serious doubt.

• "Since 1945, Americans have consumed more of the world's resources than have all previous generations who have ever lived on the planet put together. *We have used more than our fair share*" (emphasis original). Here's a new twist on an old complaint. Ordinarily we are told that Americans use "more than our fair share" of the world's resources because we use more per capita than people in other countries. Now it is because we use more than our ancestors used. In either case, the argument is a classic *non sequitur.*

Americans do use more of some resources per capita than people in most other countries. And we do use more per capita than people of the past. But we also produce more resources per capita than people in most other countries and than people of the past. And, indeed, we consume no more than we produce. The long-term downward real price trends (for a truly representative example, inflation-adjusted copper prices

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fell by about 70 percent, and its price divided by wages by about 99 percent, from 1801 to 1990) of extractive raw materials (mineral, plant, and animal) show that our consumption of resources neither is outpaced by our production of them nor interferes with the ability of others to consume or produce them. In this case, the empirical claim (a misleading one at that) is logically irrelevant to the moral charge based on it.

• "Every day Americans turn 9 square miles of rural land over to development." Precisely what this means is difficult to guess, since—depending on who uses the term—"development" might mean making anything from a housing tract to a park. Furthermore, such raw numbers become significant only when set in a larger context.

The United States comprise 3,536,338 square miles of land, of which about 97 percent is undeveloped ("developed" land being defined by the U.S. Bureau of the Census as including urban and built-up areas in units of ten acres or greater, plus rural transportation). The conversion of 9 square miles of rural land each day therefore translates into 3,285 square miles per year. At that rate, total undeveloped land would be reduced by only about 9 percent—to about 88 percent of total land—in a hundred years.

Actually, the Green Cross's land-conversion figure is probably low. From 1960 to 1990 the conversion rate was about double what the Green Cross claims as the present trend. But there is good reason to expect that as U.S. population stabilizes and continues to become more concentrated in cities the conversion rate will fall yet more. Also, from 1960 to 1990, during the same period as the rapid conversion to developed land, the National Wildlife Refuge system meanwhile grew from about 15 million acres in 1960 to about 95 million acres in 1988; the National Parks system from about 20 million to about 70 million acres; and total public recreation lands from about 225 million to about 375 million acres. Certainly the data do not indicate a crisis of land conversion.

• "Every year, our agricultural practices waste over 1,000,000 acres of topsoil through erosion." We cannot know what the Green Cross means by "wasting" an "acre" of topsoil. Taken literally, their statement implies that every year erosion eliminates about a million acres of usable agricultural land. But that is certainly not true.

Probably this clumsily worded claim is meant to convey information about an amount of topsoil lost per year through erosion from all acres under cultivation. But it fails to communicate because topsoil is not measured in simple acres but in tons or cubic feet. (An acre of topsoil 1/16-inch thick, after all, is considerably less by weight and volume than an acre of topsoil 5-inches thick.) Nor does this statement tell us whether this is *gross* or *net* loss.

The latter distinction is crucial. Because of routine erosion-control measures, on almost all cropland in the United States new topsoil formation (from the combination of plant fiber decay and breakdown of deeper, denser soil and rocks) roughly matches loss from erosion, yielding almost no annual net change in topsoil. This is consistent with the fact that over the last 50 years higher and higher percentages of U.S. cropland have met the "prime" grade according to the U.S. Soil Conservation Service and with rising yields per acre. It should be no surprise. After all, soil is the farmers' most important resource; it is to be expected that they would use that resource wisely.

• "As there are more people, there is less farmland on which to grow food." The implication is that there is a cause and effect relation between the first and second halves of this sentence, but in fact there is not. American farmers plant fewer acres not because there are fewer acres available to plant but because agricultural production is so high that prices won't support cultivating more acres. While harvested U.S. cropland declined by 11 percent from 1978 through 1987, total crop production rose by about 25 percent. Thus, total yield rose by about 40 percent.

• "We are using up our [agricultural] resources in a way that cannot continue." Rising yields, declining losses from erosion, and rising quality of our nation's agricultural soils indicate precisely the opposite.

• "Within the lifetime of a child born in this decade, virtually all of the world's petroleum will be burned." The same sort of predictions have been made about running out of oil for nearly a century, and always they have proved false. They are contradicted by (a) falling long-term real prices of petroleum (down about 70 percent from 1870 to 1990) and (b) rising world oil reserves (up from about 100 billion barrels in 1943 to about 10 trillion barrels in 1989).

• "Still common minerals will be exhausted [in a lifetime], such as copper, tin, zinc, lead and nickel." But as for petroleum, so also here falling long-term real prices and rising reserves indicate the opposite. Despite intervening consumption, known reserves of copper rose by 179 percent from 1950 to 1970; of tin, by 10 percent; and of lead by 115 percent. I don't have handy access to figures for nickel, or to more recent figures for any of the minerals named, but I am confident, on historical and theoretical grounds, that we face no reasonable prospect of exhausting any of these minerals.

• "Water is increasingly tainted with chemicals." But in fact, the vast majority of these chemicals are harmless, and the percentage of the world's people with access to safe water has risen dramatically in the last century and continues to rise with increasing speed.

• "Over 60 percent of the world's great forests have been cut." Yes, and 100 percent of last year's wheat crop was cut in a single year! Yet next year there will be a whole new crop. Forests and wheat are analogous; the principal difference is that trees grow larger and more slowly. What the Green Cross alarmists don't mention is that total world forested area and total growing board feet of wood both are greater now than they were 50 years ago—and on the increase. And as plantation forestry increasingly replaces harvesting natural forests, pressure on natural forests will decline even more.

• "Atmospheric levels of heat-trapping carbon dioxide are 26 percent higher than pre-industrial concentrations and continue to climb; the results will be higher temperatures." Perhaps (data for the past are debatable), perhaps (data for the future are not yet in and projections differ widely), and perhaps (climatologists differ in their estimates of how much and whether global average temperatures will rise based on various assumptions of carbon dioxide increase).

But the letter does not mention (a) that roughly two-thirds of the *apparent* .45 degree C. increase in global average temperatures between 1880 and 1990 was attributable to natural causes, (b) that almost all of the total increase occurred before 1940, i.e., before the sharpest increases in carbon dioxide, indicating that there is not a direct correlation between carbon dioxide and temperature, and (c) that the most recent and refined models predict that most temperature increase will occur in the winter and at night, yielding little or no detrimental effect on ice caps, sea levels, and agriculture, and at the same time yielding slightly longer growing seasons, better agricultural yields with less water consumption (from higher carbon dioxide concentrations, crucial to photosynthesis and water retention), and less need for heating in winter.

• "The ozone shield in the upper atmosphere is thinning. . . ." There is a slight downward trend in stratospheric ozone concentrations for the period 1957–1992, but it is not known whether that trend is down from historically *normal* levels or from historically *high* levels. We simply *don't know*, and not knowing is not grounds for taking any particular action. (Data don't go back earlier than the 1950s, and 40 years is statistically insignificant as a sample of a dynamic system that is thousands or tens of thousands—let alone millions or billions—of years old.)

• ". . . the result is increases in skin cancers." No reliable data back this claim. Furthermore, the skin cancer associated with increased ultraviolet B exposure (resulting from ozone depletion) is mostly nonmalignant, and the increased cancer risk associated with the worst-case ozone depletion scenarios is about equivalent with the increased risk involved in moving 60 miles nearer the equator or a thousand feet higher in elevation—a risk so small as not to figure in the vast majority of decisions about where to live.

• "Entire species of plants and animals are vanishing." Perhaps, but the most thorough attempt at a worldwide study of field data on extinction rates—*Tropical Deforestation and Species Extinction*, edited by T. C. Whitmore and J. A. Sayer (London and New York: Chapman & Hall, 1992), commissioned by the International Union for the Conservation of Nature and by no means skewed by an anti-environmentalist bias—generated this general reckoning (in the foreword) by IUCN Director-General Martin Holdgate:

> The coastal forests of Brazil have been reduced in area as severely as any tropical forest type in the world. According to calculation, this should have led to considerable species loss. Yet no known species of its old, largely endemic, fauna can be regarded as extinct. Genetic erosion has undoubtedly taken place, and the reduced, remnant populations may be much more vulnerable to future change, but the study illustrates the need for very careful field documentation to compare with calculation in this and other situations.

Repeatedly the book's many authors state that, expectations to the contrary, field evidence for extinctions in recent decades is slight to non-existent.

None of the above implies either that Christians have no stewardship responsibility for the earth or that real problems don't exist. There *are* real problems, and Christians *do* have responsibility. But the assignment of stewardship over the earth was given in the Garden of Eden; claims of crisis, true or bogus, are unnecessary to remind Christians of that calling. And when an organization cries "Wolf!" too frequently, it loses credibility. □

THE FREEMAN
IDEAS ON LIBERTY

The Rise of Market-Based Management

by Jerry Ellig and Wayne Gable

> "Survival is very uncertain in an environment filled with risk, the unexpected, and competition. Therefore, a company must have the commitment of the minds of all of its employees to survive. . . . We know that the intelligence of a few technocrats—even very bright ones—has become totally inadequate to face these challenges."
> —*Konosuke Matsushita*[1]

Imagine a history class in the year 2095—perhaps some kind of "virtual class." The instructor is comparing two basic kinds of organizations prevalent 100 years earlier. One involved hundreds of millions of people; the other usually involved hundreds of thousands at most. One had no specific purpose; the other had a specific mission. One had no official "management"; the other had a president, profit centers, and lots of managers. One had no bank accounts, no owners, no legal identity—it was called a "society." The other had all of these things—it was called a corporation.

Despite these major differences, the two shared some similarities. Both were made up of people who wanted to live and work together in harmony to accomplish their individual goals. In both, the people had to coordinate their actions to accomplish their goals.

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Experts constantly debated how to improve these two types of organizations. For society, the twentieth century produced two alternative models: the hierarchical, authority-driven command model, and the decentralized, self-organizing free enterprise model. By 1995, the command model had failed miserably in every society that tried it. For the corporation, the command model dominated management thinking for most of the century. But by 1995, the command model had failed in business too. By the end of the century, corporations organized according to the command model were recognized as suffering from many of the same problems as command-based societies. But where would business leaders look for a new paradigm?

We believe history will show that a growing number of executives looked to the free market system for new management insights. Centrally planned economies collapsed because they failed to use the knowledge that is dispersed in the heads of many individuals and often hard to communicate to the central planners. Centrally planned business firms face a similar fate, for similar reasons. Just as socialism lost the allegiance of most of its citizens, so too have "command-and-control" management principles lost the allegiance of many executives. Companies both at home and abroad are searching for a new management paradigm to replace the old view based on hierarchy, top-down planning, and the giving of orders.

Over the years, a growing number of businesses have shifted to organizational forms and management methods based on the principles of a free society and market economy. This emerging management approach, which we call "Market-Based Management," promises to outperform older management paradigms for the same reasons that free economies have outperformed planned economies: it makes better use of the knowledge that is dispersed among many people in the organization.

The Old Paradigm: Scientific Management and Central Planning

For years, American business was dominated by a central-planning paradigm credited to Frederick Taylor.[2] Taylor argued that management is a science that can be taught. In search of higher productivity, Taylor advocated systematic study to improve upon the best prevailing production practices of his day. Aided by time-and-motion studies, managers would ascertain the best way to perform each task, select the best people for each task, and teach them the one best way. Taylor laudably sought to increase business productivity so that both wages and profits would rise. Thus, he sought to replace labor-management confrontation with a harmony of interests founded on greater productivity.

In Taylor's view, managerial direction was key to enhancing productivity, because manual laborers were generally incapable of understanding the best way of doing their jobs. In a discussion of handling pig iron, for example, Taylor noted,

> This work is so crude and elementary in its nature that the writer firmly believes that it would be possible to train an intelligent gorilla so as to become a more efficient pig-iron handler than any man can be. Yet it will be shown that the science of handling pig iron is so great and amounts to so much that it is impossible for the man who is best suited to this type of work to understand the principles of this science, or even to work in accordance with those principles without the aid of a man better educated than he is.[3]

This situation was not unique to pig-iron handling; "in almost all of the mechanic arts the science which underlies each workman's act is so great and amounts to so much that the workman who is best suited actually to do the work is incapable (either through lack of education or through insufficient mental capacity) of understanding this science."[4] Taylor's methods generated significant productivity increases when applied to uneducated workers doing repetitive tasks. But followers tried to develop his ideas into a universal approach to be used in contexts quite different from the ones Taylor originally studied. A school of thought, "Scientific Management," emphasized that management's job is to give orders, while labor should follow these orders. This worldview has shaped labor-management relations for most of the twentieth century.

Advocates of Scientific Socialism also cited Scientific Management in support of their grand vision for society. In the Soviet Union, both Lenin and Trotsky admired Scientific Management and thought it was one of the important features of capitalism that socialists should imitate. In their view, centralized planning of the entire economy was just a logical extension of centralized planning within the factory.[5]

In democratic countries, advocates of greater government planning also seized on Scientific Management in support of their views. Rexford Tugwell, a prominent adviser to Franklin D. Roosevelt, declared that the greatest economic event of the nineteenth century occurred when Taylor first timed some shovelers in a steel plant so that he could instruct them how to do their job more efficiently. Tugwell and many other New Deal intellectuals believed that

Scientific Management "would, in the hands of the state, provide the tools for the renovation of the economy at the practical organizational level, for the overall rationalization so long awaited to repair the damage done by an unplanned business order."[6]

In 1932, H.S. Person, managing director of the Taylor Society in New York, endorsed the employment of Scientific Management to plan society as efficiently as industrialists planned factories. Taylorism, he believed, ushered in a "surplus economy" of material abundance. The Great Depression occurred because industrialized nations had not yet adopted the appropriate social-management techniques. Policymakers needed to enunciate a social objective of "production for measured demand at the least social cost" and institute conscious organization to accomplish the objectives.[7]

Though motivated by humanitarian concern, Scientific Management possessed a major blind spot: it ignored the importance of dispersed and tacit knowledge. In an organization of any significant size, authoritarian managers can be little more effective than central economic planners, because they lack the requisite knowledge. Much relevant knowledge is dispersed in the heads of many people in the organization, and much of it cannot be communicated to a central point for processing. Firms built on the central-planning model suffer from the same "fatal conceit" that afflicts centrally planned economies.[8]

The Reckoning

Given the commonalities between Scientific Management and central planning, it is no surprise that authoritarian firms encountered trouble when challenged by rivals using management methods more consistent with the principles of a free society:

• In the automobile industry, American companies found themselves out-competed by Japanese companies during the 1970s and early 1980s. The principal reason was that quality improvement methods pioneered by Japanese firms required them to reorganize the workplace in ways that let workers and work teams use their local knowledge to improve production processes.[9]

• In the steel industry, large integrated steel mills lost enormous ground in the 1980s to "mini-mills" like Nucor Corporation, based in Charlotte, North Carolina. Nucor rewards its teams of plant workers with weekly performance-based bonuses, and workers apply their own tacit knowledge to get more output from production machinery than even the machinery's manufacturer thought was possible.

• In the oil industry, Wichita-based Koch Industries grew into a $24 billion company while many major oil companies experienced massive layoffs. The firm's chairman and CEO, Charles Koch, leads a companywide effort to apply the insights of Ludwig von Mises, Friedrich Hayek, and other free-market scholars to all aspects of the firm's business.[10]

For 50 years, management researchers have criticized Scientific Management, proposing alternatives under such varied names as "human relations," "Theory Y," "Theory Z," and even "Liberation Management."[11] Market-Based Management proposes a new, alternative model thoroughly grounded in the principles of a free market and free society. To some extent, market-based management is consistent with earlier critiques, but it also adds a new, systemic approach that allows managers to identify the concepts and tools most consistent with market principles.

Elements of Market-Based Management

Several key elements account for the superior quality of life in a free society, and analogous elements exist inside organizations. The accompanying table identifies significant elements contributing to the health of both market economies and organizations.

• **Comparative Advantage and the Firm's Mission System**

In 1776, Adam Smith argued that the fundamental factor explaining economic prosperity is an advanced division of labor.

Six Key Systems in Market Economies and Organizations

Market Economy	Organization
Specialization through comparative advantage	Mission system
Rules of just conduct	Values and culture
Property rights	Roles and responsibilities
Price system	Internal markets
Market incentives	Compensation and motivation
Free flow of ideas	Generation and use of knowledge

Many economists have elaborated this theme into the theory of comparative advantage, which demonstrates how each individual can expand the wealth of society by specializing in activities in which he can create the most value at the lowest sacrifice of alternative products or services. F.A. Hayek added another dimension by emphasizing the division of knowledge: every individual is an expert on something, and overall prosperity depends crucially on each person's ability to make the decisions that he alone has the best knowledge to make.[12]

The organizational equivalent of specialization by comparative advantage is the "mission system." This system includes strategic planning—an understanding of how the firm's core competencies allow it to create value, and at what cost. But the mission system also includes a dissemination of this understanding to every individual in the organization, such that every person knows how his actions advance the mission of the organization. Like specialization in a market economy, the mission system creates situations allowing individuals to simultaneously serve society while serving themselves.

Koch Industries is one company working to implement a strong mission system. Various business units develop their own missions that are broadly consistent with the overall corporate mission. Individual employees are also expected to develop personal missions linking their own knowledge, skills, and aspirations with the mission of their business. In this sense, the mission is less an inspirational device than a compass guiding thousands of employees' independent decisions. The compass metaphor is especially apt, because the mission does not *direct* people to do specific things; rather, it helps them orient their activities to those of everyone else in the organization.

- **Rules of Just Conduct, Values, and Culture**

Investment, production, and exchange do not occur in a vacuum. A society's "rules of just conduct" that define acceptable and unacceptable behavior exercise a powerful influence on economic activity.[13] Where plunder is practiced and lying goes unpunished, people have strong incentives to refrain from productive activity and long-term commitments. On the other hand, if a society's formal and informal rules are grounded in respect for the individual, they unleash tremendous creative forces. Values that promote prosperity—in societies and in organizations—include respect for personal dignity and property, intellectual honesty, humility, openness to new ideas, and the freedom to question established practices.

These values may sound like "motherhood and apple pie," but the real challenge is implementing them in practice. A Brazilian-based company called Semco provides some examples of management's respect for spontaneous order. The company abolished time clocks and official work hours in its plants. Instead, groups of employees set their own work hours, based on their own preferences. When group members need to be in the plant at the same time, they all show up, even though no manager tells them to do so. Work groups are measured on the amount they produce, rather than the hours they work. The company's principal owner, Ricardo Semler, argues that adults manage to coordinate their activities outside the workplace without managerial supervision, so spontaneous coordination of work hours and other matters in the workplace should be no big surprise.[14]

- **Property Rights, Roles, and Responsibilities**

In a free market, property rights play a key role in both mobilizing knowledge and providing incentives. Private property divides control over resources into distinct spheres, within which individuals can use their own knowledge and judgment. Those who find better ways of using their property to serve consumers tend to earn profits, gain control over resources, and hence make more significant decisions as time passes. Those with poor judgment tend to lose control of their property and, hence, lose the ability to make decisions about the use of resources.

Companies too can employ these principles in thinking about roles, responsibilities, and authorities. In many companies, a person's ability to make decisions depends on his position on a hierarchical organizational chart, length of service, corporate politics, or pure luck. In a market-based firm, one's ability to hire, fire, spend money, and manage assets depends on a past track record, much as a homeowner's ability to borrow money depends on a credit record.

Tamko Roofing Products, based in Joplin, Missouri, puts these principles into practice when it decides who can spend how much money. The company has never used budgets to plan how much will be spent or what it will be spent on. As Ethelmae Humphreys, the company's CEO, puts it, "If we need to spend money, we spend it. If we don't, we don't." Managers and employees throughout the organization have spending authorities that allow them to exercise wide discretion about corporate purchases. As successful people take on new responsibilities, they may well receive new levels of spending authority needed to do the job.

- **The Price System and Internal Markets**

The term "market-based management" often conjures up the image of employees charging other employees prices for products and services inside the firm. And indeed, an internal price system is one critical element of market-based management.

Private property rights give individuals the opportunity to exercise their own judgment, and the price system helps ensure that one individual's independent decisions are coordinated with those made by millions of other people. The informational benefits of prices in markets are well known, but the benefits of pricing inside the firm are often less fully appreciated. In reality, many parts of large business firms operate much like bureaucracies: top management provides resources for services like accounting, public affairs, and information services, and these departments are then sent forth to do good for the company. Since the internal customers for these services pay no prices, the results are predictable: shortages, queuing, and growing overhead as top management shovels more money into enterprises that are effectively giving away their services.

A wide variety of companies have decided to change this system by making internal customers pay prices for the "overhead" services they formerly consumed for free. Companies using internal prices for corporate services include Bell Atlantic, Koch Industries, Clark Equipment, Weyerhaeuser, and Pump Systems. These companies range from small to large, and they span a wide range of industries. Companies adopting internal pricing cite several benefits, including reduced overhead expenses, closer relationships between internal customers and suppliers, and continuous "rightsizing" as voluntary transactions reveal which corporate services can be better acquired on the outside market.[15]

- **Market Incentives and Motivation**

Entrepreneurs earn profits by thinking up new ways to create value for others. No one orders them to be creative; they simply find that they can make themselves better off by making their customers better off as well.

In business, though, employees frequently get raises and promotions for following orders, building political skills, attaining a specific rank, or simply hanging around for a long time. Some of this occurs because of union contracts, but such incentives are also widespread in managerial compensation schemes. As one corporate executive noted, "There must be better reasons for giving raises than the fact that the earth went all the way around the sun again."

Nucor Corporation has found a better way. At Nucor, substantial employee bonuses, paid weekly, are tied to production results that specific teams of employees can directly affect. Higher output leads to higher bonuses, and bonuses can easily exceed a worker's base pay. As a result, workers show up for work early to ask the previous shift how the equipment is running. They take extra care in maintenance and discourage each other from taking unnecessary sick days. In short, the incentives of Nucor's work teams are so well aligned with the corporate mission that little "management" of employees is required.[16]

- **Free Flow Ideas and the Use of Knowledge**

Freedom of action and freedom of exchange are critical elements of a market economy, and so is freedom of speech. Prices summarize a great deal of information, but because real-world markets are disequilibrium markets, prices do not summarize everything entrepreneurs and customers need to know. As a result, individuals need the freedom to exchange ideas, debate new suggestions, and advertise their products and services to potential customers.

Most corporations today espouse these ideals, but many would do well to ask themselves questions like the following.

- Do operating units supply detailed operating data to headquarters?
- Are employees directed because they lack access to information they need to make business decisions?
- Are accounting systems designed for management control instead of furnishing information to operating personnel?
- Do performance evaluations include only the views of the boss, instead of information from all of an employee's major "customers"?

An organization that can answer "yes" to these questions is fundamentally channeling information to the decisionmakers at the top of a pyramid, instead of letting employees make decisions based on their own local knowledge.

Concluding Comments

The failure of command-based societies provided one of the most powerful lessons of the twentieth century. The downfall of Soviet central planning confirmed the flaws in the command paradigm. The striking differences in living standards between West and East Germany, or mainland China and Hong Kong, should persuade any skeptic that socialism's failure was not due to unique aspects of Russian history or culture. Instead, the blame rests with fundamental flaws in the command approach—an approach that bears striking similarities to the dominant corporate management paradigm of the twentieth century.

Human experience has shown that market economies produce prosperity through the interaction of specialization, rules of just conduct, private property, the price system, incentives, and open communication. Given the size of many business organizations, it seems logical to adapt free market principles to improve management practice.

The idea of market-based management is part prediction and part prescription. The prediction is that firms will become more market-based to compete in the global economy. The prescription is that firms can shorten their learning process by applying lessons already learned in free societies. □

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3. Taylor, pp. 40–41.
4. Taylor, p. 41.
5. Peter J. Boettke, *The Political Economy of Soviet Socialism* (Boston: Kluwer Academic Publishers, 1990), pp. 105–6.
6. Judith A. Merkle, *Management and Ideology: The Legacy of the International Scientific Management Movement* (Berkeley: University of California Press, 1980), pp. 260–61.
7. H.S. Person, "The Approach of Scientific Management

to the Problem of National Planning," *Annals of the American Academy of Political and Social Science* Vol. 162 (July 1932).

8. Friedrich Hayek, *The Fatal Conceit* (Chicago: University of Chicago Press, 1988); Don Lavoie, *National Economic Planning: What Is Left?* (Cambridge: Ballinger, 1985); Peter Boettke, *Why Perestroika Failed* (London: Routledge, 1992).

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10. Charles Koch also coined the term "market-based management" and is the first CEO we know of who has explicitly tried to adapt market principles to change his organization across the board. For more information, see Wayne Gable and Jerry Ellig, *Introduction to Market-Based Management* (Center for Market Processes, 1994) and Tyler Cowen and Jerry Ellig, "Market-Based Management at Koch Industries," Center for Market Processes Working Paper (1993).

11. See Chris Argyris, *Integrating the Individual and the Organization* (Transaction Publishers, 1990 [1964]); William Ouchi, *Theory Z* (Reading: Addison-Wesley, 1981); Tom Peters, *Liberation Management* (New York: Ballantine, 1992).

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13. Friedrich Hayek, *Law, Legislation, and Liberty, Vol. II: Rules and Order* (Chicago: University of Chicago Press, 1979).

14. Ricardo Semler, "Managing Without Managers," *Harvard Business Review* (Sept.–Oct. 1989), pp. 76–84.

15. For more information, See Jerry Ellig, "Internal Pricing for Corporate Services," Center for Market Processes Working Paper (Sept. 17, 1993).

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THE FREEMAN
IDEAS ON LIBERTY

The Economic Safety Net
(a parable)

by Jes Beard

Once upon a time, far, far away, people lived in a village on an island where life was difficult. But the people were good and worked hard and the village grew. The people called their island "Economy" and they were happy.

On one side of the island of Economy was a big lagoon. The lagoon had warm, crystal clear blue water and beautiful beaches, but the lagoon also was home to dangerous sharks. And the beach had quicksand that could swallow a person clean away, so fast they could not be pulled out before they vanished, never to be seen again. Because everyone on Economy knew of the sharks and the quicksand, almost no one went to the lagoon. They stayed away even though it was the most beautiful place on the island, where the sun was always bright and the birds gave their songs in wondrous and enchanting voices.

At first, life in the village of Economy was so hard almost no one ever had time to do anything but work, and no one thought about the lagoon. When they did think about the lagoon they always thought about how dangerous the sharks and quicksand were and stayed away. People saved and planted crops and made buildings where they could work better. Life became easier, but only a little.

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By and by, the people in the village came to have enough food and shelter that they did not need to work unceasingly. Sometimes one of the foolish young men of Economy went to the lagoon, never to be seen again. Each time it happened, perhaps once or twice a year, people of Economy would be sad and would cry about their loss. Then they warned their young again of the dangers of the lagoon.

And it came to pass that the village had a great leader who promised to make life better and safer for all on the island. The great leader said Economy was too rich and too strong to let young men be lost to the lagoon. He had a plan to stop it from happening.

He would cover the quicksand holes with safety nets to catch anyone who strayed upon the quicksand. Parents would still tell their children to avoid the lagoon, of course, but the great leader's nets would save the foolish who did not listen. He called his plan the Economic Safety Net.

The people applauded the plan. They said that it proved the great leader's greatness. Everyone said it was good to save foolish young men who went to the lagoon.

In the following years, his Economic Safety Net caught many young men before they slipped into the quicksand. But each year, young men became less afraid of the lagoon because of the efforts to keep them safe. And each year more and more young men went to the lagoon. For the first time, after the Economic Safety Net, some young women also strayed from the village to enjoy the beauty of the lagoon.

As more young people visited the lagoon, more also slipped into uncovered quicksand. This happened even though the great leader forever increased areas of the beach covered by the Economic Safety Net.

The great leader said Economy could not let this happen. He promised to cover the whole beach with a new safety net to protect everyone, but he said parents should still remind children of the lagoon's dangers.

The next year, after the great leader's new Economic Safety Net was in place, ever more curious young men and women went to the lagoon. For the first time some parents also went there. All who saw the lagoon were amazed by its beauty and wanted to return.

But the new safety net was imperfect. As ever more people went to the lagoon, still greater numbers disappeared into the quicksand. Some people slipped right through the safety net, though the net still made the beach safer than ever before. Some people felt so safe they went to the very edge of the lagoon's water. From the water's edge, some found the crystal clear blue water so beautiful they felt they had to go in.

Once in the water, the sharks often ate the people.

The great leader could not tolerate shark attacks. He called on the village of Economy to protect everyone from quicksand and sharks.

The great leader said Economy could do more to protect those going to the lagoon. He said he would make the whole lagoon safe. The people needed to give him more money for stronger nets. The biggest and strongest men of the village also needed to stop their village work so they could be special lifeguards at the lagoon. The special lifeguards would fight off sharks that attack villagers going into the water.

Some villagers didn't like the new plan. They said it cost too much. The biggest and strongest men of the village did not want to give up their work to be lifeguards. They said their families needed them on their farms and in their shops.

But the great leader said he was disappointed that people of Economy wanted to put a price tag on lives. He said that if his plan saved only one person it was worthwhile, and he convinced his people that no price was too great to save even one life.

The great leader moved on with his plan, assuring all villagers that together they could make the lagoon safer.

The biggest and strongest men of the village trained to fight the sharks, and Economy spent great sums to improve the Economic Safety Net.

Then the great leader said the improved safety net would save more villagers than ever, both from quicksand and sharks. He repeated his warning that people should avoid the lagoon. But those who did go would be safer than anyone had thought possible.

Now ever greater numbers of villagers than before went to the lagoon. The great leader's Economic Safety Net saved many, but with the large crowds now at the lagoon ever more still slipped away into the quicksand. The lifeguards also saved countless villagers, but the sharks grew fat both from villagers swimming in the crystal blue water and from lifeguards.

By now hard times returned to the village. More and more shops and fields lay idle because those who worked in them did not come back from the lagoon. Other shops and fields lay idle as the biggest and strongest men who had been working in them worked instead as lifeguards.

Years had passed since the great leader started the safety net. He was now weak and old. From his sickbed he said the village now had but two choices.

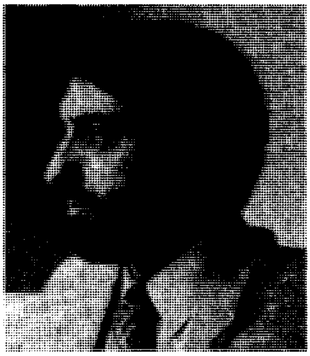
The great leader said Economy was close to completing his dream of a real Economic Safety Net. He said Economy could make the island safe by fully protecting everyone from the terrible dangers of the lagoon. Economy just needed to cover the beach more completely with yet heavier nets. Economy also needed more men as lifeguards and needed to pay for better lifeguard training for fighting the sharks. The safety net would then make the water safe if Economy built special shark-fighting boats for the lifeguards. The lifeguards could use the boats to lower wooden shark-protection cages around swimmers in danger. The great leader said his long years at building safety nets showed only that Economy merely had not done enough to keep villagers safe. If Economy only again redoubled its efforts the Economic Safety Net would work.

The other choice was to give up efforts to make the lagoon safe. The great leader insisted that it was simply too cruel for the good people of Economy to let those going to the lagoon fend for themselves with no Economic Safety Net.

By now many villagers said all of the great leader's safety-net efforts were useless. Some even said the safety net was actually bad. They said more people were lost now to the lagoon than ever before, more than when the village of Economy did nothing at all to make the lagoon safe. Critics said Economy should return to doing nothing. They said it was better to have no safety net. With no safety net, they would tell their young that the beauty of the lagoon might be tempting, but that it hid terrible dangers from which there is no protection.

The great leader was now near death, but said Economy had changed since the simple days of the past and could not possibly return. He said too many people now went to the lagoon to end the Economic Safety Net.

With that the great leader died, and the people were left to decide between the two options. □



Beyond the Pale

Those of us who cherish freedom may disagree about many things, yet still consider ourselves allies. But if our positive philosophy of individual rights and liberty is to survive, we must distance ourselves from anyone whose aim is to undermine the rule of law upon which rights and liberty depend.

In the early 1970s, I joined several organizations whose avowed purpose was to limit taxation and halt governmental violations of individual rights. One day, the leader of one of the groups leaned forward in a gleefully conspiratorial manner, and confided: "My goal is to make people cynical about government."

I was disturbed by his negative focus. Cynicism, I knew, was a destructive emotion; mere "anti-governmentalism" was an empty substitute for a positive political philosophy and constructive agenda. I understood even then that *hostility toward government* was not the same thing as *defending individual rights*.

If anyone still needs to have that lesson driven home, let him consider the atrocity in Oklahoma City last April 19th. That horrifying event constitutes the dead end of cynical, mindless anti-governmentalism.

When evidence mounted that the Oklahoma killers were homegrown, most of us were stunned. How could Americans do this to fellow Americans? we wondered.

We have since learned something about the suspects, their associates, their sympathizers—and their motives. We have learned that the prime suspects are alienated loners and losers—socially marginalized and rootless men, with thwarted personal ambitions and spoiled private lives.

Philosopher Eric Hoffer once described these sorts as perfect candidates to become fanatical, nihilistic "True Believers": individuals who, unable to fulfill constructive roles in society, are drawn to hate groups, anti-social cults, and revolutionary crusades. As Hoffer explained it, such "causes" provide them with excuses for their personal frustrations and failings. Self-hatred can then be projected outward. Certain groups, or society and its institutions, become their scapegoats; tortuous socio-political rationalizations are concocted to fuel their fantasies of "revenge."

These misfits thrill to the grandiose delusion that social institutions, such as government agencies, have specially targeted them for destruction. This not only explains their own failures; it also inflates their sense of importance, while simultaneously granting them permission to strike back in "self-defense." Lost in nihilistic fantasies, such malcontents—like their left-wing precursors of the 1960s—fancy themselves as "soldiers" at war with American society. That is why they can target innocent citizens without qualm . . . why one suspect gave officials only his name, rank, and serial number.

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Hoffer's explanation is not only consistent with what we know of those arrested, but also with the statements of their excuse-making sympathizers. Within days of the blast—and despite mounting evidence against the native-born suspects—leaders of one private militia group speculated publicly that the real perpetrators were "the Japanese." Not to be outdone, others voiced suspicions that the killers were actually sinister U.S. government *agents provocateurs*, who had blown up their own government building solely to provoke a public backlash against private gun ownership and militia groups.

Some commentators, instead of condemning the bombing as pure murder, felt obliged to couple muted criticisms of the atrocity with excuse-making for the perpetrators. While mumbling perfunctory condolences to the families of the slaughtered and injured, they also suggested that the perpetrators were probably just decent, patriotic Americans, provoked to act in *self-defense* against a "tyrannical" federal government. The mass murders in Oklahoma City, they explained, were intended to avenge alleged *governmental* "mass murders" during the 1993 Waco, Texas, tragedy, and the 1992 shootout with the Randall Weaver family in Ruby Ridge, Idaho.

The gist of their "explanation"? Government interventions and improprieties were somehow *driving* otherwise upright citizens to desperate acts of violent reprisal.

What, ultimately, is the difference between the "left-wing" argument that common criminals are "driven" to steal and kill due to past social or economic repression, and this "right-wing" argument—that the Oklahoma terrorists were "driven" to bomb a day-care center due to past governmental oppression?

I confess that any subtle distinctions between these two camps continue to elude me. Call me simplistic; but as I see it, the only results in both cases are the bloodied bodies of innocents. Even if innocent children in Waco, Texas, had been deliberately murdered (which they weren't), how could that atrocity be set right by the murder of additional innocent children in Oklahoma City, or anywhere else? Need it be pointed out that one does not avenge the violation of individual rights by violating individual rights?

The cowardly Oklahoma bombing demonstrates the utter bankruptcy of a purely negative, "anti-governmental" focus. Whether motivated and rationalized by cynicism, hatred, paranoia, philosophical anarchism, or conspiracy theories, attacking government *per se* only undermines the rule of law—and is thus a *carte blanche* for the arbitrary, *private* initiation of force.

Exaggeration? In the aftermath of the bombing, one talk show host felt obliged to instruct his listeners in the fine points of how to shoot federal agents during raids. Another, attributing the Oklahoma blast to "CIA contractors," told an audience that "what they won't allow us at the ballot box can be won at the bullet box." Meanwhile, a militia group out West has been threatening to hang any judges or other public officials who fail to uphold the Constitution—as they interpret it.

Does anyone really believe that individual rights would be more scrupulously observed by such self-appointed vigilantes than by the officials they denounce? (Personally, given a choice, I'll gladly take my chances with the BATF.)

Our nation's Founders were not anti-intellectual opponents of government as such. Through our Constitution, they in fact *established* one with the positive aim of preserving and protecting individual rights. That's because they understood the vital connection between *individual rights* and *the rule of law*. Undermine the latter, and you jeopardize the former.

We in America do not live under pure laissez-faire; far from it. But we also do not live under tyranny. To contend otherwise trivializes the full horror of real tyranny. Here, we can write, speak, and vote freely. Regulated we are, but not enslaved.

As long as we have the freedom to address imperfections, even evils, in our political system with ballots, there is *no* justification for resorting to bullets. And there is *never* any justification for deliberately violating the rights of the innocent—nor in excusing the violators. Such is beyond the pale. □

THE FREEMAN
IDEAS ON LIBERTY

Special Interests and the Internment of Japanese-Americans During World War II

by Steven B. Caudill and Melody Hill

On February 19, 1942, President Franklin Roosevelt signed Executive Order 9066, approving the en masse relocation of Japanese and Japanese-American citizens from the West Coast into the interior of the country. The order was signed amid the hysteria following the Japanese attack on Pearl Harbor. The reason given at the time for the evacuation was concern about espionage, or so-called "fifth-column," activities of Japanese and Japanese-Americans on the Coast. But according to the government's own intelligence service, this concern over espionage was misplaced. That is, concern for national security was not the true reason for interning Japanese and Japanese-Americans during World War II. Instead, this internment was motivated by nothing other than interest-group politics.

When war erupted in Europe, FDR placed J. Edgar Hoover's FBI in charge of the nation's internal security. Before the attack on Pearl, the FBI and Naval Intelligence maintained lists of alien suspects. Though the lists contained 250 to 300 suspects, only 40 or 50 were considered real threats.[1] Within two days of the attack on Pearl, all of the suspects and many others were detained. The FBI contended that these measures adequately controlled any threat of espionage, and that the relocation of Japanese and Japanese-Americans was unnecessary.[2] As additional evidence that security was not the reason for the internment, note that no mass detainment of people of Japanese ancestry occurred in Hawaii, which is closer to Japan and home to many Japanese and Japanese-Americans. In Hawaii, only suspect Japanese individuals were incarcerated. If espionage was not the reason for the evacuation in California, what was the reason? The answer: special-interest groups seeking protection from the competition of Japanese and Japanese-Americans residing on the West Coast. Labor unions and farmers wanted the Japanese out of California and off the land long before the attack on Pearl. World War II and the bombing of Pearl Harbor provided a handy opportunity for these groups to complete a task that they started several years earlier.

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NOTES FROM FEE

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Degenerate Democracy

When all the mysticism is stripped away, the people who comprise the government (the legislators, administrators, judges, and policemen), are guided by human interests, desires, beliefs, notions, and prejudices, just like other people. They have neither superhuman wisdom nor extraordinary virtue. Nevertheless, they are expected to render an important service: to protect the life and property of each and every individual. They are to restrain wrongdoers, meet force with force, and punish peace-breakers. Toward that end, they are entrusted with the necessary instruments of coercion: the armed forces, police, and prisons.

Governments may be democratic or totalitarian, pluralistic or monistic, republican or monarchical. The form springs from the common notions of human behavior in society. Belief in a propensity to strife and conflict as a normal condition of human existence gives rise to authoritarian government. If social life consists of unending conflict, of war of all against all, society is in need of an authoritarian government as the best means of regulating the conditions of conflict. In contrast, belief in a harmony of interest of all members of society tends to give rise to limited government that merely seeks to restrain the peace-breakers.

No matter what the origin of government may be, the democratic form renders an important service that is lacking in all others forms. It provides a procedure by which individuals acquire power and are removed from power. Democratic government makes lawmakers dependent on the people's wishes, and thereby facilitates peaceful changes if conflict should occur. Changes are subject to majority rule. Yet, rule by "simple majority" differs from "constitutional democracy" that recognizes certain individual rights and gives them some form of constitutional protection, thereby placing limitations on the whims and wishes of the majority.

Majority rule inevitably raises the question of the scope and extent of majority power. Should the vote of a simple majority always prevail over the opposition? The advocates of majoritarianism readily answer in the affirmative; any other rule, they argue, enables a minority to frustrate the majority and thus, in a sense, rule and prevail over it. Requirement of more than a simple majority, they maintain, places undesirable obstacles in the way of government.

The opponents of unlimited majority power are quick to reply that Congressional representatives may not express the will of the majority of their constituents; guided by their own interests, they may not vote the wishes of the majority, but rather their own and those of their supporters. They may represent the interests of the largest bloc of voters who may actually constitute a minority of the population, or they may not even know the majority opinion because few voters may bother to form an opinion, which is probably true in most issues confronting legislators.

Strict majoritarianism tends to destroy the conditions of its own existence wherever the majority routinely violates the basic rights of individuals. It may suppress the basic freedom of expression and association, deny the minority any consideration and weight, deprive it of the right to participate in the political process, and refuse it fair treatment and "due process." It may even relegate minorities to inferior positions in political, social, and economic life, assign numerous duties and liabilities, and extract from them an inordinate share of their income and wealth. In possession of all the powers of coercion, majoritarian government may blithely ignore and defy the moral laws that proscribe all forms of harm to any and all individuals.

Social peace and harmony can be preserved only if all members of society are free to participate in democratic institutions and are treated equally before the law. Yet, many champions of majoritarianism never tire of criticizing this political and legal equality for being inadequate; they would extend the scope of equality to economic life through "fairer" distribution of income and wealth. They would forcibly reduce economic inequality, although their efforts would necessitate the use of much coercion and violence. After all, people differ in capacity, skill, strength, industry, and health, which necessarily results in unequal income and wealth. Individual inequality, in fact, is a great advantage to both the individual and society, bringing forth man's division of labor and social cooperation. To enforce equality is to deny human nature and work evil on everyone including those it is supposed to benefit.

A policy designed to enforce economic equality opens the doors for demagoguery and politics at its worst. It invites expedient politicians to stir up the resentment of the poor against the rich so that they may elect the demagogues to positions of power and largess. It appeals to envy and covetousness, and elevates demagoguery to an important device of democratic politics. In the end, politics is likely to become an art of promises, evasions, and systematic pursuit of expedience, making the body politic the primary source of social conflict and strife. All democratic societies have foundered on the rocks of moral decay and domestic strife.

Envy is more irreconcilable than hate. It is the most corroding of all political vices and also a great power in our land. The friends of freedom are content to be envied, but envy not.

Hans F. Sennholz

You cannot correct all the evils of the world, nor relieve all the poverty in the world.

You cannot comfort all in distress, nor support all the underprivileged.

But you can stand by FEE which brings the light of freedom to the world.

The Historical Backdrop to Japanese Internment

The story of the internment is really the story of immigration in California. A pattern was repeated, first with Chinese immigrants and later, Japanese immigrants. The state of California, through various laws, initially made it difficult for immigrants to enter the state and then, if they managed to enter, unattractive to remain. The main difference between the Japanese and the Chinese in California was the strong Japanese desire to own land. This difference led to special land-use legislation aimed at the Japanese.

Between 1850 and 1882, over 280,000 Chinese entered California.[3] The influx of Chinese occurred because the enormous growth in the California economy required a cheap labor source and the Chinese provided a solution. The Chinese were welcomed at first, but by 1869 the railroad opened up California to the eastern half of the United States, and a recession was beginning. Organized labor argued that the Chinese were no longer needed and lobbied for an end to Chinese immigration. As early as 1875, California enacted legislation halting Chinese immigration into California (though this statute was later declared unconstitutional by the U.S. Supreme Court). California and organized labor then turned to Washington for help. Their efforts were rewarded when, on May 6, 1882, the first Chinese Exclusion Act went into effect. This act eliminated the immigration of Chinese laborers for a period of 10 years; it also barred the Chinese from becoming naturalized citizens. The agitation leading up to the Chinese Exclusion Act made it clear to many that something drastic regarding Chinese immigration was about to occur, and even before passage of the Act, labor recruiters began visiting Japan to find replacements for the lost Chinese.[4]

The first large numbers of Japanese laborers who came to the U.S. territory were contract laborers. In 1884 and 1885 several hundred contract workers landed in Hawaii, which at the time was a protectorate of the United States. Californians were concerned that the Japanese might leave Hawaii for California. Consequently, on February 26, 1885, the U.S. Congress enacted a bill to "prohibit the importation and migration of foreigners and aliens under contract or agreement to perform labor in the United States, its territories, and the District of Columbia."

California on its own took steps making Japanese immigration difficult. The Congressional Act of August 3, 1882, imposed a head tax of fifty cents on all immigrants. Soon afterward labor union leaders turned their attention to the "Japanese problem." In 1905 the Asiatic Exclusion League was formed. Initially this group consisted mostly of union leaders and workers, but support eventually was widespread:

> On the second Sunday in May, 1905, delegates from sixty-seven local and nearby labor organizations met to form what became the Asiatic Exclusion League. From the day of the League's formation on May 14, 1905, until after the end of World War II, there was in California, an organized anti-Japanese movement that would eventually draw support from all segments of the state's population. In the beginning, the organized movement was an extension of San Francisco labor unions. The most prominent labor leaders attending the initial meeting of the league were Patrick Henry McCarthy, head of the Building Trades Council of San Francisco, and Andrew Furuseth and Walter MacArthur, both of the Sailor's Union. A satellite of McCarthy, Olaf Tveitmore, was named its president. All four of these men were immigrants from Europe.[5]

Immigration Restrictions

In an effort to reduce tensions, Japan attempted to voluntarily restrict immigration to the United States. In 1900 the Japanese government stopped issuing passports for laborers headed for the United States, but continued to allow immigration to Hawaii. In California there was again concern that Japanese would enter through Hawaii. Consequently, the Asiatic Exclusion League prompted the legislatures of other Pacific Coast states to adopt resolutions restricting Japanese immigration from Hawaii. In light of this agitation, the Japanese government started to limit immigration to Hawaii, and in April 1905 Japan temporarily suspended all immigration.

Other legislation was designed to make life in California unattractive to Japanese-Americans. In April 1905 the union-dominated San Francisco Board of Education submitted a plan to the board of supervisors to segregate Japanese public-school children. On October 11, 1906, with part of the city still in ruins from the earthquake, the board of education passed the segregation order. The move outraged Japan, and the U.S. government attempted to intervene. A compromise was reached and the problem was resolved with the passage of the Immigration Act of 1907. The Act listed 20 different classes of workers, collectively called contract labor, who were prevented from immigrating. The provisions of this legislation succeeded in keeping Japanese laborers from entering the United States through a third country or territory.

The next political issue was direct immigration. Restrictions on direct immigration of Japanese were achieved through the "Gentleman's Agreement" of 1908. Japan agreed to limit immigration to "relatives," "former residents," and "settled agriculturalists." The term "settled agriculturalists" is defined to mean "a person who had invested capital in the enterprise, and whose share in its proceeds, if it is carried on in partnership, will be in proportion to the amount of his investment."

The Gentleman's Agreement achieved an immediate decline in immigration. Soon, departures exceeded arrivals. This changed in 1913 when large numbers of "picture brides" immigrated. The number of Japanese entering the country slowed to a trickle. Efforts now focused on legislation making life in California unattractive to Japanese-Americans. A large part of this effort was aimed at land-ownership restrictions.

During the 1909 legislative session in California, at least 17 anti-Japanese bills were introduced, and the 1913 session was flooded by more than 30 anti-Japanese measures. Most proposals dealt with the holding of agricultural land. Out of this session emerged the Heney-Webb Alien Land Law of 1913, tying land ownership to citizenship. This statute also provided that aliens ineligible for citizenship could lease land for no more than three years. State Attorney General Webb, co-sponsor, was not shy about its intent, stating,

> It is unimportant and foreign to the question, whether a particular race is inferior. The single and simple question is, is the race desirable. . . . It [the law] seeks to limit their presence by curtailing their privileges which they may enjoy here: for they will not come in large numbers and long abide with us if they may not acquire land. And it [the Act] seeks to limit the numbers who will come by limiting the opportunities for their activity when they arrive.[6]

The 1913 Act prohibited aliens from acquiring, possessing, enjoying, transmitting, and inheriting real property. Japanese-Americans began to put land titles in the names of their U.S.-born children who were citizens and thus entitled to hold property.

In 1919, state senator J. M. Inman introduced an alien-land law designed to plug this loophole. The heart of the new act was that it was now illegal for an alien to provide funds to purchase land if the title was held in the name of another person and if the intent was to avoid the law. The act also prohibited leasing any land to persons ineligible for citizenship. The measure was placed on the ballot in the general election of 1920 in the form of an initiative. On November 2, 1920, the measure passed by a vote of 668,483 to 222,086.

Still, white Californians were unsatisfied. They hoped to put an end to all Japanese immigration (as they had done earlier with the Chinese). That goal was achieved when on May 15, 1924, a bill that became known as the Japanese Exclusion Act of 1924 passed the House of Representatives.

Despite this anti-Japanese legislation, the growth of the Japanese involvement in agriculture during this period was impressive. By 1940 Japanese farmers produced at least 90 percent of snap beans, celery, peppers, and strawberries. Japanese farmers also produced 50 to 90 percent of artichokes, celery, cucumbers, fall peas, spinach, and tomatoes for canning, and 25 to 50 percent of the asparagus, cabbage, cantaloupes, carrots, lettuce, onions, and watermelons.[7]

Agitation Increases

It is not surprising that when the attack on Pearl Harbor heightened agitation against the Japanese-Americans, the Caucasian farmers of California were eager for internment as well as for the land held by the Japanese. Austin Anson, the managing secretary of the Grower-Shipper Vegetable Association, a farm organization, is quoted as saying:

> We're charged with wanting to get rid of the Japs for selfish reasons. We might as well be honest. We do. It's a question of whether the white man lives on the Pacific Coast or the brown men. They came to this valley to work, and they stayed to take over. They offer higher land prices and higher rents than the white man can pay for land. They undersell the white man in the markets. They can do this because they raise their own labor. They work their women and children while the white farmer has to pay wages for his help. If all the Japs were removed tomorrow, we'd never miss them in two weeks, because the white farmers can take over and produce everything the Jap grows. And we don't want them back when the war ends, either.[8]

The fact that Japanese farmers were not welcomed back after the war contradicts the security arguments given for the evacuation. Security concerns certainly did not exist *after* the war. It is quite clear that some viewed the situation in California immediately following the attack on Pearl Harbor as a unique opportunity to get rid of competitors. In May 1942, O. L. Scott, another member of the Grower-Shipper Vegetable Association wrote to Congressman Anderson:

> If it were not for the "white-skinned Japs" in this country there wouldn't be any Japanese question. What can you suggest I do and thousands of Californians be led to do, that may make it possible to get rid of all Japs, sending them back to Japan either before or after the war is won. I am convinced that if it is not done or at least the action completed before the war is over, it will be impossible to get rid of them. . . . The Japanese cannot be assimilated as the white race [and] we must do everything we can to stop them now as we have a golden opportunity now and may never have it again.[9]

As a consequence of the evacuation, farms owned by Japanese-Americans were sold for a few cents on the dollar to Caucasian farmers. One estimate of the value of Japanese farmland in 1940 was over $72 million. After the war, internees were paid only a small fraction of the value of their losses. Attempting to remedy this situation, the government passed a bill in 1988 that did two things. First, the government apologized to Japanese-Americans for the internment, also admitting that the relocation was not justified for security reasons. Second, the bill provided that each of the 60,000 internees or their descendants be paid a lump sum of $20,000. Perhaps these funds should have come not from the taxpayers of this country at large, but from the farmers who benefited directly from the land and crops taken from the Japanese-Americans in 1942. □

1. See Roger Daniels, *The Decision to Relocate the Japanese Americans* (Philadelphia: Lippincott, Co., 1975).
2. See also Roger Daniels, *The Decision to Relocate the Japanese Americans.*
3. See Frank Chuman, *The Bamboo People: The Law and Japanese-Americans* (Del Mar, Calif.: Publisher's Inc., 1976).
4. See also Frank Chuman, *The Bamboo People.*
5. See Roger Daniels, *The Politics of Prejudice* (London: Cambridge University Press, 1961).
6. See also Frank Chuman, *The Bamboo People.*
7. See Theodore Salutos, "The Immigrant in Pacific Coast Agriculture, 1880-1940," *Agricultural History* 49 (January 1975), p. 192.
8. See Morton Grodzins, *Americans Betrayed* (Chicago: University of Chicago Press, 1949).
9. See also Morton Grodzins, *Americans Betrayed*, p. 20.

THE FREEMAN
IDEAS ON LIBERTY

Peace for Europe?

by William J. Watkins, Jr.

Since the end of the Second World War, there has been much discussion about European integration. What began as the European Coal and Steel Community (ECSC) in 1951 developed into the European Union (EU) with the ratification of the Maastricht Treaty in 1992. Unfortunately, the trend thus far has been toward centralization, but there is one more opportunity to restore the balance between the member nations and the ever expanding bureaucracy in the EU's capital, Brussels.

The year 1996 will witness an intergovernmental conference on the future of the EU and problems arising with the Maastricht treaty's one-size-fits-all remedies. If Europe is to develop a system that operates smoothly and secures the peace, next year offers perhaps the last chance to settle major constitutional issues.

Since the early post-war discussions about integration, Europe's explicit goal has been to bind Germany's future and prosperity to peace on the Continent. Hans-Dietrich Genscher, Germany's former foreign minister, called the EU's structure "a living model for a peaceful European order, with Franco-German cooperation as its centrepiece."[1] In light of the results of Prussian militarism in this century, it is understandable why France and the Benelux nations (Belgium, the Netherlands, and Luxembourg) are pushing for a stronger union in which they hope Germany will be content and contained. However, their centralizing efforts could generate the very conflict they seek to avoid as diverse peoples are forced together in unnatural political arrangements.

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Voices from Past

The threat of centralization and socialism to peace in Europe is not new. The guns of the Axis and Allies had hardly fallen silent before European socialists were holding conclaves in London and Paris regarding integration to promote "a socialist Europe which is economically and politically independent."[2] Little did these intellectuals realize that Europe once *was* economically integrated (though protective tariffs did cause stress) by a shared metallic monetary standard before World War I. This early integration emerged naturally "without super-plans, super-planners, super-bureaucracies, super-conferences, and without a super-state and 'High Authority.' "[3]

In the end, Europe's economic integration was "destroyed by an economic foreign policy which had its roots . . . in . . . collectivist-inflationary policy . . . that sailed under the flag of 'planned economy,' 'full employment,' 'cheap money,' and deficit spending."[4]

Some things seem never to change. Though there is much talk of free markets in Europe today, many of the same old collectivist policies of the welfare state remain in place. For instance, in EU countries, each 100 workers now labor to support 40 pensioners. By 2004 each 100 workers will support an additional 10 pensioners on top of the current 40.[5]

Unfortunately for Europe, the technocrats in Brussels, see "No discernible association . . . between either the level or growth of social spending in member states, on the one hand, and their trade performance, employment or unemployment, on the other." [6] This attitude explains why one-tenth of the workers in the EU are now jobless and why during the first year of the much vaunted single market the EU's GDP shrank by 0.3 percent.[7] Wilhelm Roepke's prediction that in any proposed European economic union "the highest degree of inflation in any member country will be adopted by the others along with the longest paid vacations and the greatest measure of intervention or planning," has fast become a reality.[8]

Because of the collectivist attitudes in Brussels, there will certainly be future trouble as member nations seek to revive their economies by abandoning the policies of the past. And if mechanisms are to be designed to allow a peaceful transition to nonintervention, the 1996 intergovernmental conference is the proper place to begin. Decisions made there will shape the future power arrangements of Europe for years to come.

Unfortunately, the French and the Germans—both with strong centralizing tendencies—along with the power-hungry European Parliament will make most of the Conference preparations. Nevertheless, there is an opportunity to curb the foolishness in Brussels that has led to edicts regarding everything from subsidies to the curvature of cucumbers.

National Veto

Ever since French recalcitrance over agricultural policy sparked the "Luxembourg Compromise" in 1965, nations have enjoyed a national veto in the Council of Ministers. This veto applies to areas such as taxation, treaties, the acceptance of new members, and foreign policy. Britain successfully used her veto to strike at plans for further centralization last year when she vetoed the appointment of Jean-Luc Dehaene to the presidency of the European Commission. Nonetheless, if each member nation is to retain her national sovereignty, the national veto must be strengthened against encroachments.

Encroachments will most likely come from the courts. The European Court of Justice claims the power to declare acts of member states and EU institutions void if they violate the Treaty of Rome (which formed the European Economic Community in 1957). From American history we learn the danger of a Supreme Court that claims final say over the constitutionality of state and national legislation. In the early days of the American republic, Thomas Jefferson saw the danger that the Supreme Court posed and correctly predicted that it would be "the engine of consolidation."[9] It should be a priority in 1996 to ensure that a European John Marshall will not have the power to alter the balance between Brussels and the member nations. The nations should have final say concerning the legitimacy of EU as well as their own legislation because they retain their sovereignty and have entered the compact as equal partners.

Such a power of nullification does, however, pose serious risks and could be deterimental to the very idea of a common market. Individual nations could nullify free-trade initiatives, which were the impetus for the EU in the first place, in order to protect local economic interests. Though this is a possibility and it would be regrettable if nations used their power of nullification for frivolous purposes, the risk is worth taking. A national government with exclusive power to judge the constitutionality and breadth of its powers will tend, as in the United States, to become consolidated. A single consolidated government would be deleterious to the peculiar local habits and customs that are at the heart of European culture.

Opt-Outs

Along with the precedent of a national veto, since Maastricht a precedent has been set for nations to opt out of certain EU programs that they feel are detrimental to their national welfare. For example, Britain has been exempted from Maastricht's onerous social chapter and any future European Monetary Union (EMU). Denmark is exempted from the final phase of the EMU, European citizenship, and common defense and legal policies. Even Germany, a self-described "core of the hardcore" regarding union, insists that her parliament have final say-so regarding the replacement of the mark with a common currency.

Nevertheless, opt-outs, in their current form, have drawbacks. For instance, since opting out of the social chapter of the Maastricht treaty, Britain has lost the power to block trade unions' demands for worker-consultation councils and other pro-union measures. These councils demand that workers be consulted about such things as restructurings, closings, or changes in production methods. Though British firms operating domestically are unaffected, British multinational firms operating in the EU are at the mercy of Brussels.

To check such excesses, member nations must retain their veto power over legislation emanating from Brussels whether they have opted out of the particular legislation or not. Member states should be allowed to retain their voices concerning any EU legislation that could affect them adversely.

Secession

The EU has already caused much tension and is held in disrepute by citizens of many member nations. In fact, 60 percent of the EU electorate opposed the Maastricht treaty and 65 percent of Europeans are against abandoning their national currencies.[10] Norman Lamont, former chancellor of the British exchequer, predicts that Brussels' centralizing tendencies "may mean one day contemplating withdrawal" from the EU.[11]

When nations finally decide to abandon welfarism and planning in favor of a more liberal alternative, such a decision will necessitate a withdrawal from the EU and its massive schemes of redistribution. And if the nation choosing withdrawal is not a net recipient of redistributed wealth (as will likely be the case), then the beneficiaries will no doubt try to stop their victim from escaping.

The EU's Common Agricultural Policy (CAP) is already causing divisions similar to the American sectional conflict of the nineteenth century. However, in Europe's case it is the agricultural interests that are exploiting the commercial interest. The CAP already eats half of the EU's budget with its guarantee of minimum prices to farmers. As the EU expands and admits the poorer nations of Eastern Europe, transfer payments will skyrocket. Under current policies, admitting Poland's five million farmers to the CAP would require a boost in the EU's budget of $74 billion.[12] Such transfers can and will breed only contempt from those who have their earnings confiscated by the technocrats in Brussels.

Tragedy looms ahead for Europe as incompatible cultures are thrust together in unnatural centralized arrangements. Once the intoxicant of political unity wears off, the nations of Europe must be able to coexist peacefully in a loose confederation or go their separate ways. The 1996 intergovernmental conference offers perhaps the last opportunity for EU nations to secure constitutional guarantees ensuring their sovereignty and future. For Europe to prosper, it must soon abandon the impoverishing policies of the welfare state. Because such an edict is not likely to be issued from the mismanagers in Brussels who thrive on power wrought from consolidation, the future of Europe rests on the power of the people acting within their nation-states to do so when the ideological climate finally changes. □

1. "Genscher calls for an end to European separation," *Manchester Guardian Weekly*, May 7, 1989, p. A4.
2. For an excellent discussion of the early socialist schemes regarding European integration, see Hans F. Sennholz, "The Socialist Movement for a United States of Europe," in *How Can Europe Survive* (New York: D. Van Nostrand Company, Inc., 1955).
3. Wilhelm Roepke, "How to Integrate Europe," *The Freeman*, May 18, 1953, p. 594.
4. *Ibid.*, p. 594.
5. "A job-destroying machine," *The Economist*, October 22, 1994, p. survey 5.
6. European Commission report quoted in "The enlightened welfare-seeker's guide to Europe," *The Economist*, March 12, 1994, p. 57.
7. "A singular market," *The Economist*, October 22, 1994, p. survey 15.
8. Wilhelm Roepke, "European Economic Integration and its Problems," *Modern Age*, Summer 1964, p. 237.
9. Jefferson quoted in Albert Jay Nock, *Mr. Jefferson* (Delavan, Wisc.: Hallberg Publishing Corporation, 1983), p. 163.
10. "No Shortcuts on the Way to a Closer Europe," *The Christian Science Monitor*, August 3, 1994, p. 19.
11. "European Unity Policy Splits Tories in Britain," *The New York Times*, October 12, 1994, p. A6.
12. Mark M. Nelson, "Extra Accommodations," *The Wall Street Journal*, September 30, 1994, p. R13.

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Economics 101: A True-False Test

by Ralph R. Reiland

Here's a quiz. Which of the following statements about the American economy during the 1980s are true?

1. From 1982 to 1989, 19 million net new jobs were created in the United States (more than the number of jobs created in Europe and Japan combined), two-thirds of them high- or middle-paying, resulting in the lowest unemployment rate in 16 years.
2. The economic growth unleashed by tax cuts increased federal tax revenues in the 1980s by $1.1 trillion.
3. These additional federal tax revenues contributed to the reduction of the federal deficit from 6.3 percent of GDP in 1983 to 2.9 percent in 1989. (A Congress loaded with pork peddlers blocked greater spending cuts.)
4. Presidents Kennedy and Reagan both enacted supply-side tax cuts on top income earners and job creators and produced the two longest economic expansions in American history.
5. The Reagan tax cuts "trickled down" to produce a 76 percent jump in new business investment in real (adjusted for inflation) dollars in the 1980s and tripled the rate of productivity growth.
6. Real per capita after-tax income rose by 19 percent in the 1980s, nearly double the rate of the 1970s.
7. Real family income increased each year from 1983 through 1990 in every income group (from the poorest fifth of households to the richest fifth), while median family income fell by 1.9 percent in 1993.
8. The real income in the bottom fifth of the income distribution increased by 12 percent in the 1980s, reversing a 17 percent slide between 1979 and 1983.
9. Eighty-six percent of the tax filers in the poorest fifth of families in 1980 moved out of that bottom quintile by 1988 (16 percent moved all the way to the top fifth of income earners).
10. Looking at income distribution as an individual matter, not as a group comparison, real median income increased by 5 percent between 1982 and 1988 for those who started in the top fifth of income earners, and increased 77 percent for those who started in the bottom fifth (primarily by moving out of that bottom quintile).
11. Real family income declined each year from 1979 until 1982, and has declined each year since 1991—the years sandwiched between these two periods of shrinking income, produced a real increase of $4,877 in median family annual real income.
12. Since 1988, the typical American household has lost $2,344 in real annual income, and the degree of income inequality is now at a post-World War II high.
13. After growing nationwide by 7 million people during the late 1970s, the poverty

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population declined by 4 million during the 1980s: reversing the downward trend, poverty in the '90s is rising again with over a million Americans falling into poverty in 1993.

14. The top income-tax rate was reduced from 70 percent to 28 percent in the '80s, but the top 5 percent of all earners paid more taxes, increasing their share of all federal income taxes paid from 36 percent in 1980 to 43 percent in 1990.

15. In the 1980s, the percentage of African-American families earning more than $50,000 in real dollars doubled from 7 to 14 percent, the unemployment rate for black teenagers fell by 21 percent and black employment in professional and managerial jobs expanded by one-third. After declining 10 percent between 1978 and 1982, the real median income of black families increased by 17 percent between 1982 and 1989.

16. From 1982 to 1987, the number of black-owned businesses increased by 38 percent, triple the overall business growth rate during that period. The number of new Hispanic-owned businesses soared by 81 percent.

17. The median weekly earnings of female workers grew 8 percent faster than male earnings in the 1980s, and women entrepreneurs ended the decade employing more people than all of the Fortune 500 companies combined. The number of women-owned firms expanded by 57 percent in the '80s and the sales volume of these firms tripled.

18. Following the double-digit annual inflation rates of 11.3 percent, 13.5 percent, and 10.3 percent during the Carter years, the annual inflation rate averaged 3.9 percent in the two Reagan terms.

Scoring: Each of the above statements is True. All information is based on Labor Department and Census Bureau studies. Readers missing more than 12 questions are eligible for Rhodes Scholarship assistance. □

THE FREEMAN
IDEAS ON LIBERTY

Hail to Prices!

by Jeffery G. Lee

Recently in South Korea I had an experience that bodes poorly for proponents of price controls. During my stay, a Korean friend, D.J., took me to a bar to soak up a bit of local flavor. After a good time, my friend and I left the bar just before midnight in search of a cab. As we were going in separate directions, I said goodbye and prepared to flag down a taxi. D.J., however, knew something I didn't and stayed with me despite my assurances that I could handle myself. I'm thankful he stayed.

I was completely unprepared for what happened. Crowds of people began creeping dangerously far out into the street. D.J. joined the fray, facing the oncoming taxis

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like a modern-day matador. Cabs slowed just enough for D.J. and others to yell their desired destinations into the open window (*Pangbae* Station in our case). Without fail, after hearing the places we and others were intent on going, cab after cab sped off leaving us in clouds of exhaust and bewilderment.

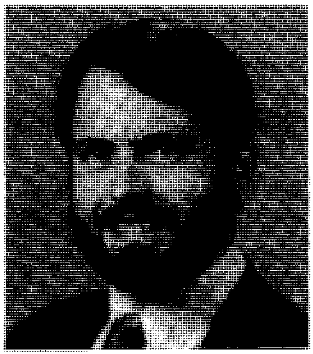
After about 20 minutes, it was apparent that it might take a while to actually get picked up. Interestingly, D.J. "upped the ante" for the ungracious drivers. "Pangbae!"—in endless repetition—had been all that I had heard for nearly a half-hour when my friend began yelling "Pangbae DOUBLE!" He even yelled "Pangbae TRIPLE!" at a driver who stopped only long enough to flash four fingers hoping for four times the normal fare. Later, we stopped a taxi with a "triple." We got in, only to be told to get out when the driver reconfirmed our destination. He said he had misunderstood us and wouldn't go to Pangbae Station.

Later I discovered the reason for this black market in transport. Taxi rates are set by the government. Ostensibly to protect the consumer, the government limits the price taxi companies can charge. The consequence of such myopic legislation should be obvious to any first-year economics student. The artificially low fare not only reduces the supply of taxis, but decreases the incentive of remaining drivers to provide good services to passengers. Full of good but misdirected intentions, government officials have taken it upon themselves to protect the consumer. Ironically, the result is just the opposite. As with all examples of price control throughout history, demand exceeds supply when an artificially low price is mandated, resulting in various degrees of chaos.

After an hour and a half we flagged down a willing driver and made it home. Because our quest was limited to cross-town transportation, the most we suffered was the indignity of standing in the middle of the road, in addition to a few lost hours of sleep. Raise the stakes from the taxi scenario and consequences are more devastating. Instead of commuters, picture physically ill folks clamoring for health-care professionals. "*Pangbae* double!" might suffice as a potential solution when negotiating for something as simple as a ride. I don't imagine, however, an equally likely "*heart attack* double!" would be a very amenable strategy.

Low prices might appear to the uninitiated as desirable. But prices are no culprit. Prices provide ready information on the availability of goods and services, and on the values of goods and services to competing would-be users. Attempts to artificially alter prices are tantamount to removing signs from dangerous roads. Prices fairly balance the amounts of a good available and the amounts demanded. Of course, prices are also the most visible and easily targeted feature of a market economy. Unfortunately, politicians, eager to placate their benefactors, have more influence than economic truths on the formation of public policy.

I do not mean to insinuate any backwardness on the part of Korea (which would upset my Korean wife immeasurably). It just so happened that this experience reminded me of the endless gas lines of the 1970s and of the recent debate over health care in the United States. As economically enlightened as we are in America, we are not immune to a "calculated reversion" to the illogic of price controls. Symptomatic cures for what some may see as the pestilence of prices are misdirected. Hopefully, people can now see through quick-fix solutions to economic problems. If not, maybe something as simple as a taxi ride in Korea would be sufficient to cure their economic myopia. □



Freedom from Taxes?

WASHINGTON—Income tax day may be behind us, but the pain is not over. We are still working for government, and we won't be finished until the middle of this month.

According to the Tax Foundation, the average American had to labor 126 days—to May 6—to pay his or her taxes this year. Looked at another way, people devote two hours and 46 minutes of every workday to government. This is the latest Tax Freedom Day ever, as a result of the 1993 tax hikes. And May 6 is just the national average. If you live in Connecticut or New York, you labor for government till May 28. Residents of Washington, D.C., and New Jersey start working for themselves only on May 18. Residents of Hawaii are indentured servants until May 17. The *least* taxed citizens of America work three and one-half months for the government. Far more people labor four to five months for politicians before earning a penny for themselves.

Even these horrible numbers understate the impact of government on taxpayers. The Tax Foundation only looks at tax collections. The federal government, however, relies on deficits to expand its outlays and regulations to control even more private activities. Thus, the Washington-based Americans for Tax Reform estimates that while Americans may have finished with their taxes on May 6, Spending Freedom Day didn't occur until May 16, when people stopped paying for government outlays. And Cost of Government Day, when citizens were finally free of the total expense of government, including regulation, is still to come, on July 9.

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In short, the average American spends more than *half* of every year working for government. Did you feel liberated after April 15? You shouldn't have—you had nearly *three more months* to go before the money you earned was truly your own.

This is unconscionable—feudal serfs were treated better than taxpayers today. People have a moral right to more of their incomes.

But you wouldn't know it from the debate in Washington. A few legislators freely admit that they want to keep on spending, so they prefer tax hikes to cuts. The more subtle—seen as "responsible" politicians by the opinion-making elite—say that deficit reduction must take first priority. Of course, many of them are convenient converts to budget responsibility, having never before found a federal program they didn't like.

Even many of the defenders of tax reduction seem half-hearted. Rather than simply returning money to people, letting them decide how to use it, they promote supply-side engineering: proposals for specific credits and the like. Moreover, even some tax-cutters fear being perceived as, horrors!, favoring the rich. Thus, they advocate denying any benefits to high earners.

Alas, no one in the nation's capital is making the basic moral case: government is taking far too much of everyone's income and Congress should just cut overall tax rates. Such an approach would also help serious tax-cutters confront their opponents' shameless attempts at class war. The 1980s have been attacked as the decade of greed, but it appears that the 1990s will end up as the decade of envy. People don't so much want more money for themselves as they want to take it away from those with more. Greed is bad enough, eating away at a person's soul. Envy is far worse because it destroys not only individuals, but also communities, poisoning relations as everyone attempts to use the state to live off of everyone else.

Even today, the much maligned "rich" are paying a huge proportion of their incomes in taxes. Many people face a marginal rate of roughly 50 percent in federal taxes alone—income, Social Security, and Medicare. Added to that are state and local income taxes, real estate taxes, sales taxes, county business fees, and a host of other levies. By what right should transient majorities and influential minorities be able to divest people of two-thirds or more of every extra dollar they earn?

Not just the rich are subject to such extraordinary levies. The National Taxpayers Union reports that a family with an average median income of $52,895 pays an extraordinary $26,689 in taxes, more than half. Is that fair?

Particularly scandalous have been attempts to treat the 1981 across-the-board income tax rate reductions as unfairly skewed to the rich. That 25 percent cut provided more in tax cuts to the rich because *the rich were paying so much more in taxes.* It was simple fairness to give someone who paid, say, ten times as much in taxes more tax relief. Given the half dozen major tax hikes passed by Congress over the past decade, a new round of rate cuts would be the fairest reduction of all by offering benefits proportional to what people are already paying.

How to sell sizable tax cuts to a deficit-wary public? Tax reductions would help starve government, forcing it to be more responsible fiscally. Every tax hike in the 1980s was followed by higher, not lower, spending, irrespective of the promises made by successive Congresses and presidents. Ultimately, the only way to stop the special interest looting that occurs daily in Washington is to cut off the money.

Consider the conventional wisdom that irresponsible tax cuts caused the massive deficits of the 1980s. Good try, but no cigar: federal revenues rose (in inflation-adjusted 1987 dollars) from $766.6 billion in 1981 to $894.7 billion in 1991, a hefty 16.7 percent increase. Unfortunately, spending rose more—from $867.7 billion to $1,123.2 billion over the same period, a jump of 29.4 percent (after inflation). Every extra dollar in taxes is an extra dollar for legislators to spend. Taxes are unlikely ever to catch up with outlays because politicians simply can't be trusted with someone else's credit card.

Of course, advocates of tax cuts also need to propose serious budget cuts, killing agencies and subsidies for Republican and Democratic allies alike. There's little gain in taking nicks out of programs: interest groups will still resist and the public won't care enough to voice its support. Instead, legislators need to take great whacks at spending, and let the public know that serious tax relief depends upon voters backing those great whacks.

Finally, if people want everyone to be better off, they should support policies to expand the nation's economic pie rather than steal more from those who are economically successful. Yet the sort of class warfare represented by attempts to "soak the rich" actually reduces employment. Higher marginal rates discourage people from working and investing; confiscatory taxation reduces the availability of private investment capital. Indeed, it is the wealthy who provide much of the capital that business uses to employ people and expand operations. While large, investment-based incomes may seem scandalous to the envious, they help create the jobs that employ low- and middle-income Americans.

How to tell if last November's electoral earthquake makes a real difference? The simplest test next year will be whether Tax Freedom Day and Cost of Government Day have shifted backward. Then we will know the truth of legislators' claims to have the taxpayers' best interests at heart. □

THE FREEMAN
IDEAS ON LIBERTY

Don't Believe the Hysterical Preservationists

by James D. Saltzman

Should it be illegal to hang shutters on your old house without your city's permission? Or to add vinyl siding to your home without first checking with a local panel of political appointees? Or to adorn your own land with a fence made of wood instead of a more costly fence made of stone?

Believe it or not, approximately 2,000 city and county governments across America have acquired this much clout over changes to private property by adopting historic-preservation ordinances.[1] These statutes allow a local government to regulate the appearance or possible demolition of a property by declaring it a historic landmark or by mapping it into a historic conservation district, all without the permission of the owner.

Instead, the owner cannot alter the look of his property without the permission of his local government. For Dennis Foley that meant being told by the Arlington County, Virginia, Historic Review Board in 1993 that he could not hang wood-grain vinyl shutters on his home. Because he lives in an historically protected community, only the more expensive kind made from genuine wood will do.[2]

Even with this much say-so over changes to private property at the local level, preservationists want even more control. In 1993, the National Trust for Historic Preservation placed the entire state of Vermont on the Trust's annual list of the 11 most endangered places in America and followed in 1994 by putting Cape Cod on the same list. In some cases, state and federal agencies can already direct changes to "historic" buildings and sites.

And preservationists have no qualms about annihilating owners' freedom of choice when it conflicts with preservationists' wishes for the appearance of properties. For example, a recently proposed historical preservation ordinance for Houston called for fines of up to $500 per day for violating any article of the ordinance, a penalty the local Preservation Alliance criticized as too weak to "provide an effective deterrent"[3] against unacceptable changes to "historic" buildings. Meanwhile, the National Trust for Historic Preservation advises: "The stiffness of the penalty varies with each community depending on the likelihood of non-compliance."[4]

According to this thinking, local police powers are needed to protect a "historic" property from the whims of its owner. As the Houston Preservation Alliance claims, "historic landmarks are landmarks no matter what an owner might think and should be designated and protected accordingly."[5] In other words, successful preservation cannot occur unless the owner of a "historic" building or site can be forced to let others manage changes to the appearance of his property.

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Preservation Without Coercion

But the coercive preservationists are wrong. Successful preservation *does* occur voluntarily. In Great Britain, for example, private and voluntary conservation societies—including the National Trust and National Trust for Scotland, the Historic Houses Association, and the Landmark Trust—use private donations and some government grants to acquire, restore, and maintain over 1,800 historic properties, almost all in the British Isles.[6] Recently, the Landmark Trust has purchased sites in Italy and the United States.[7] And the Trust gets one third of its annual budget from leasing its properties for holidays or vacations.

Uncoerced preservation is also common in America. For example, Kykuit, the Rockefeller family estate near Tarrytown, New York, was given over in 1992 to the (American) National Trust for Historic Preservation, so that the Trust could display the estate's house, gardens, and art collection to the public.[8] Just last February, the Heritage Society of Houston received the circa-1870 house of the Reverend Jack Yates, a nineteenth-century African-American civic leader. The Society will spend $300,000 renovating the building, turning it into a museum.[9] In 1989, the National Trust for Historic Preservation and *Successful Farming* magazine teamed up in a project called "Barn Again!" to advise farmers on how to restore old barns and gave prizes of up to $1,000 for the best results.[10]

Offering prizes can encourage preservation, but even better urging comes from market incentives. According to *Time*, "Barn Again!" prizewinners "spent an average of $11,000 on their projects, compared with a $25,000-to-$35,000 cost for a new metal building."[11] In general, rehabilitating an old structure is cheaper than building a comparable new one, especially when the cost of tearing down the existing building is included.[12]

Thus, common sense leads investors to restore old buildings conveniently located in or near a downtown. A comprehensive review of modern economic research on historic preservation appeared in the Summer 1991 issue of the *Journal of the American Planning Association* and concluded that "gentrification rarely proceeds by central direction, but rather, through the individual investment decisions of hundreds of thousands of people."[13] Preservation rules usually arrive only after an area has achieved fashionability and stirred investor interest.

For example, renewal preceded local district rules in the Woodland in Waverly neighborhood of Nashville. This locale was first developed between the 1890s and the 1930s. After declining through the 1950s and 1960s, the area revived in the 1970s.[14] Local historic district controls on demolitions and design arrived in 1985 once a petition was signed by 80 percent of neighborhood property owners. So before the controls, Woodland in Waverly had already become a magnet for buyers serious about fixing up old buildings.

Restoration has also preceded regulation in Houston, which adopted its first preservation ordinance in 1995.[15] Prior to that, some of the city's oldest neighborhoods have enjoyed a spontaneous revival since the 1970s. Perhaps the best example is the Houston Heights, a neighborhood of four square miles first developed before the turn of the century.

Formerly one of Houston's most desirable locations, the Heights deteriorated in the early sixties. Crime soared. Nevertheless, a surplus of Victorian homes and quaint bungalows, available at bargain prices, began attracting buyers in the early 1970s who sought to settle only minutes from downtown and from the city's other major employment centers.

What began as a trickle of new investment in the Heights soon became a deluge. Between 1970 and 1980, the price per square foot of single family homes in the Heights increased 17.5 percent, equal to or better than the increases in the more fashionable Houston neighborhoods of Bellaire and West University Place.[16] Between 1990 and 1994, average prices rose 25 percent in the Heights while dropping slightly in Bellaire and moving up slowly in West University.[17]

Preservationists argue that controls are necessary to draw investors by offering them assurance that a neighbor won't do something distasteful with his property. But investment has flooded the Heights even while the area has lacked the "protection" of preservation mandates. Most good homes are restored, not torn down for gaudy replacements, and much of the new construction is architecturally compatible with the old, all without a nudge from the heavy hand of government.

The Real Enemy of Preservation

In fact, when the hand of government gets involved with old buildings, it usually pushes them down or blocks their recovery. For example, in his 1966 report, "The Federal Bulldozer,"[18] Martin Anderson decried federal urban-renewal schemes of the 1950s and 1960s for leveling tens of thousands of sturdy inner-city homes. No doubt, this scheme destroyed many structures that would now be cherished as "historic" buildings.

Today government interference in preservation continues. Stringent building codes discourage the restoration of older properties.[19] In addition, zoning laws requiring excessive parking and setbacks while restricting mixed uses complicate efforts to revive older areas.[20] Transportation policies favoring street and highway construction in the suburbs subsidize the flight of people and their money from inner-cities.[21] Furthermore, when taxes in the central city are higher than those in surrounding jurisdictions, people move from the former to the latter,[22] reducing investment in older buildings at the urban core.

And don't forget obstacles created by the preservation rules themselves. As a 1991 federal report found:

> Regulations governing the preservation of buildings can also block rehabilitation of older structures. A project may be slowed while a determination is made as to whether an old elementary school or hotel is of historic significance. If the building is labeled as historic, then the planned rehabilitation is sometimes subject to lengthy and costly approval processes to ensure authenticity of appearance. In other cases, where a building is in a historic district or has been individually designated as historic, energy-efficient enhancements such as replacement of windows and doors or drilling of holes into side walls for the injection of insulation may be blocked on the basis of strict adherence to preservation standards.[23]

As one developer testified in the report, a dispute between local and state landmark groups over his plans to renovate three older homes in Louisville "consumed about $20,000 more than I originally planned, in increased carrying costs and lost time, and added considerably to the price of the finished product."[24] Not surprisingly, the 1991 report in the *Journal of the American Planning Association* offers the speculation that preservation rules shift small-scale investment to areas with comparable properties not covered by the rules.[25]

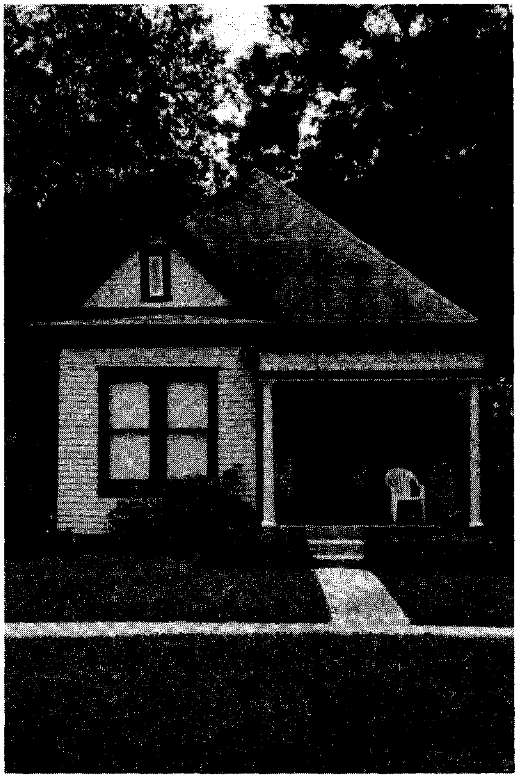
Correlation Is Not Causation

But coercive preservationists maintain that their rules encourage investment. For proof, they point to thriving conservation districts. A favorite example is the Lower Downtown (Lo-Do) area of Denver.[26] There, say the preservationists, restrictions enacted in 1988 on demolitions and design in Lo-Do transformed the 20-block area in little more than five years from a run-down warehouse district into a trendy locale for restaurants, bars, shops, small offices, and condos. Historic rules, boast the preservationists, are good for business.

But correlation should not be confused with causation. Investment picked up after the installation of preservation controls but not because of them. Yes, the Lower Downtown Business Support Program attracted more than $15 million in new investments and 500 new jobs between 1987 and 1991.[27] Yet these changes occurred, according to reports written in 1990 and 1992 for Denver's planning department, as the city was speeding the regeneration of the area with $114 million in street and sewer improvements between 1988 and 1993.[28] As developers know, private investment dollars tend to flow in the direction of such large public outlays for infrastructure.

Lo-Do's surplus of sturdy old buildings, available for low prices just as Denver crept out of a local recession,[29] also made the area ripe for investment, regardless of preservation controls. In fact, the 1990 report says that the renovation of Lo-Do buildings was 25 to 30 percent cheaper than new construction.[30] And a new major-league baseball stadium just outside Lo-Do has strengthened the area as a location for bars and restaurants. Thus, public subsidies and market opportunities, not preservation rules, accelerated Lo-Do's redevelopment.

Lo-Do isn't unique. Scratch a preservation district "success story" and you're likely to find public subsidies, tax breaks, or zoning bonuses,[31] with one or more of these channeling investment toward areas favored by the preservationists. Thus, preservation awards may profit some targeted businesses or apartments by giving them an unfair advantage over their local competitors outside the district. If preservation rules were beneficial in themselves, tax breaks and other public assistance would not be needed to funnel investors into historic districts.



Preservation by choice, not by edict, in the Houston Heights.

Property Values

Preservationists also argue that their rules serve the public by raising the value of designated properties. How? "Properties with such designation tend to receive a higher degree of maintenance due to pride of ownership and thus maintain or increase in value better than those of comparable actual age without a designation of historical significance,"[32] explains the National Trust for Historic Preservation.

But the facts say otherwise. The study in the Summer 1991 issue of the *Journal of the American Planning Association* reviewed the impact of local historic designation on property values around the country in the 1970s and 1980s. In the Park Slope neighborhood of Brooklyn, "the greatest property value increases occurred prior to designation."[33] Meanwhile, several "blocks in Galveston's Strand historic district . . . experienced an annual growth rate of only about 11 percent from 1974 to 1977, although city values overall rose by 28 percent per year."[34] In five Washington, D.C., neighborhoods, the rate of increase in property values actually *slowed* after the imposition of local historic controls.[35]

Despite the preservationists' beliefs, assets do not become more valuable because the government has gained more control over them. A study in the May 1994 issue of the *Journal of Real Estate Finance and Economics*, explains how stringent preservation rules in Philadelphia weakened the value of small apartment buildings by 24 percent relative to comparable apartments without the rules.[36] And according to the 1992 report written for the Denver planning department, preservation controls on demolition and design in Lower Downtown created a "cap on expectations"[37] for financial returns to investors in the district by prohibiting high rises and new parking facilities. Only the preservationists would equate progress with scaling back the future value of property.

Censoring Our Choices

The economic arguments for historic preservation rules—that they foster community benefits like urban renewal, local business growth, and rising property values—falsely presume that a political elite knows better how to manage property than do the individuals who actually own the properties. And supplanting the aesthetic choices of the property owner with the edicts of the historical commission isn't just bad economics; it's censorship. The government has no more business imposing aesthetic controls on our buildings than it does on our clothes or our cars. □

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2. "Property owner dramatically demonstrates absurdity of 'historic' preservation rules," *Land Rights Letter*, April 1994, p. 1.
3. The Greater Houston Preservation Alliance, "Policy Statement Regarding Proposed Historic Preservation Ordinance and Motions to Amend, Placed Before City Council, September 28, 1994," p. 3.
4. Constance Epton Beaumont, "A Citizen's Guide to Protecting Historic Places: Local Preservation Ordinances," *The National Trust for Historic Preservation*, May 1992, p. 8.
5. Greater Houston Preservation Alliance, *op. cit.*, p. 2.
6. Francis Golding, "Keeping Britain's Past Alive," a publication of the British Foreign and Commonwealth Office, 1993, pp. 5–6.
7. Leslie Geddes-Brown, "Checking in to an English landmark," in *House Beautiful*, June 1992, p. 50.
8. Susan Mary Alsop, "Legend of Kykuit," *Architectural Digest*, May 1992, pp. 136–147.
9. Norma Martin, "Yates historic home dedicated downtown," *The Houston Chronicle*, February 21, 1995, p. 41A.
10. J. D. Reed, "On the Farm: Barn Again!" *Time*, February 20, 1989, pp. 88–89.
11. *Ibid.*, p. 88.
12. Donovan D. Rypkema, "Preservation Under (Development) Pressure; We Have Consumed Enough of Somebody Else's Assets," in *Vital Speeches*, February 15, 1990, p. 269.
13. Dennis E. Gale, "The Impacts of Historic District Designation; Planning and Policy Implications," *Journal of the American Planning Association*, Summer 1991, p. 327.
14. "Districts Make the Difference," *op. cit.*
15. On February 22, Houston adopted a limited ordinance, allowing the city to designate properties as historic without the owner's permission but also providing some opportunities for the owner to alter or demolish his "historic" property as he sees fit after a 90-day waiting period.
16. Meredith H. James, "The Effect of Zoning on Residential Values," privately published, 1991.
17. "Tracking Houston's Home Prices," *The Houston Post*, June 12, 1994, p. D-6.
18. Martin Anderson, *"The Federal Bulldozer," Urban Renewal, The Record and Controversy*, 1966, pp. 491–508.
19. "Not in My Back Yard; Removing Barriers to Affordable Housing," Advisory Commission on Regulatory Barriers to Affordable Housing, The Department of Housing and Urban Development, 1991, p. 3–3.
20. Richard Moe, in "All Adding Up to Noplace; How Transportation Polices Affect Communities," (*Vital Speeches*, May, 15, 1994, p. 468) explains how such zoning rules complicate efforts to proceed with new development patterned after older downtown areas.
21. Bennet Roth, "Inner city could be big loser in roads improvement funding," *The Houston Chronicle*, January 15, 1991, p. 1A.
22. "Most Cities Surveyed Have Raised Revenues," *Insight*, February 25, 1991.
23. "Not in My Back Yard," *op. cit.*, 3–2 to 3–3.
24. *Ibid.*, 3–3.
25. Dennis E. Gale, *op. cit.*, p. 333.
26. Nora Richter Greer, "Preserving Preservation," *Architectural Digest*, March 1991, p. 88.
27. Karen Weintraub, "Downtown Houston ripe for dramatic turnaround; Denver's success a model for Market Square District," *The Houston Post*, July, 24, 1994, p. A-26.
28. Thomas M. Roelke, "Impact of Historic District Designation, Lower Downtown, Denver, Colorado, Second Analysis, April 1, 1990- March 31, 1992," Denver Office of Planning and Community Development, p. 25.
29. William Hathaway, in "Rocky Mountain High, Lessons from a real estate market that climbed out of a slump" (*The Hartford Courant*, August 8, 1993, p. J-1), says that the Denver economy ended its slump and "improved slowly between 1987 and 1989."
30. "Lower Downtown: Economic Impact of Historic District Designation," Hammer, Silber, George Associates, July 1990, p. 9.
31. See "Zoning Strengthens Character," *Southern Living*, November 1990, pp. 104–105. Developers following preservation and other guidelines in Coral Gables, Florida were "eligible for square footage beyond what normally would be allowed under standard zoning."
32. Bridget Hartman, "Public Benefits," The National Trust for Historic Preservation, p. 36.
33. Dennis E. Gale, *op. cit.*, p. 327.
34. *Ibid.*, p. 326.
35. *Ibid.*, pp. 328–332. This slowing coincided with slowing property values at this time for the entire city.
36. Paul K. Asabere, *et al.*, "The Adverse Impacts of Local Historic Designation: The Case of Small Apartment Buildings in Philadelphia," *Journal of Real Estate Finance and Economics*, May 1994, pp. 225–234.
37. Roelke, *op. cit.*, p. 5.

THE FREEMAN
IDEAS ON LIBERTY

Free Banking and Economic Development

by David Glasner

About five years ago I published a book, *Free Banking and Monetary Reform,* that proposed a radical reform of our monetary system. Competing banks, I argued, should be free to supply any monetary instrument, including currency or banknotes, while the government would perform the limited but vital function of establishing a currency unit (e.g., the dollar) in terms of which privately supplied monetary instruments could be defined. And to ensure optimal stability of the purchasing power of the currency unit, I proposed a mechanism of indirect convertibility tied to a price (or, preferably, a wage) index.

I have been disappointed but not surprised to detect no groundswell of popular support either for free banking or for any of my specific proposals. I do not believe that this lack of enthusiasm betrays any shortcomings with free banking or my proposals. What the indifference to free banking reflects is rather a salutary, "if it ain't broke, don't fix it" sort of conservatism. As long as inflation remains low and the banking system is not collapsing, practical people will not undertake the effort required to effect a reform of this magnitude. The potential benefit from such a reform is not big enough to outweigh the perceived risk in trading the monetary system we know for one we don't.[1] I have therefore concluded that my proposals for free banking are less relevant for the United States and other developed countries with stable monetary systems than for less developed and former Eastern Bloc countries now lacking the monetary stability necessary for economic development. Without secure monetary institutions, these countries have far less to lose than do advanced countries by experimenting with free banking. Nor, for reasons that will become apparent, can less developed countries simply copy the monetary systems of the advanced ones. Free banking is, therefore, ideally suited for overcoming the systemic problems that now frustrate the attempts of less developed countries to achieve monetary stability.

To understand why free banking is so well suited to the circumstances of less developed and former Eastern Bloc countries, we must first consider how money and banking can contribute to economic development. The role of money is familiar and obvious—it is a medium of exchange. Money facilitates exchange by allowing us to trade without having to identify, as we do in barter transactions, a double coincidence of wants. Reducing barriers to trade promotes economic progress by allowing resources to be shifted from less to more valued uses. Such

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shifts create new opportunities and new demands for resources, triggering an upward spiral of output and wealth.

It is worth observing that the capacity of money to perform this extraordinarily valuable social function poses something of a puzzle. The existence of an instrument that serves only as a medium of exchange, providing no real services, seems to contradict the usual assumption of economists that self-interest motivates economic decisions. Why do people accept money, which (despite its social utility) has no direct use for them individually, in exchange for real commodities or services that do have direct use for them? The acceptability of money is sometimes attributed to an implicit understanding among people to act in the common good rather than pursue selfish goals or to a command by the sovereign imposed through legal-tender laws. But neither recognition of the common interest in having a medium of exchange nor laws commanding that an instrument be accepted as legal tender could make people use as money an instrument that they would not have otherwise, in their narrow self-interest, chosen so to use.

Self-Interest and Exchange

How then does self-interest cause anyone to accept a money that has no use except to be exchanged for something else? Whether it is in my self-interest to accept money in exchange for real goods and services depends critically on whether I expect other people to accept money in exchange for real goods and services. If I expect other people to refuse money that I offer in exchange for their goods and services, then my self-interest is to refuse money in exchange, too. But if I expect other people to accept money that I offer in exchange for their goods and services, then my self-interest may dictate accepting money in exchange for the goods and services that I supply, because doing so may allow me more easily to sell what I want to sell and more easily to buy what I want to buy than if I try to barter. The less confident I am that it will retain its value, the less willing I shall be to accept it in exchange. So whether money is acceptable is a matter of degree, not a simple yes or no question.[2]

It is, at any rate, clear that money cannot function well as a medium of exchange unless people are confident that it will be acceptable at roughly its current value in the future. Whatever undermines people's confidence or trust in the future value of money threatens its capacity to serve as a medium of exchange. The delicate web of mutually supporting expectations that allows a medium of exchange to function can easily unravel or collapse if the trust underlying those expectations is eroded—or betrayed.

In primitive conditions, the medium-of-exchange role of money can be performed without the aid of banks. Money could circulate hand-to-hand, either in the form of precious metals, coins, or currency (convertible or fiat) issued by the state. However, the transfer of deposits within or between banks through checks (and now electronically) is an exceptionally efficient way to convey money in trade. To engage in monetary exchange through banks, people must hold deposits with them. By holding bank deposits instead of some other form of money or wealth, people lend banks capital which the banks then lend to borrowers (who typically borrow to finance investment, not consumption). Thus, by providing a convenient way for the public to hold money and execute transactions, banks channel the savings represented by the public's deposits to investors. As intermediaries between ultimate savers and ultimate borrowers, banks increase the return to savers from savings and reduce the cost to borrowers of borrowing, promoting economic development within the areas they serve.

Creating and Maintaining Confidence

Having considered how money and banking promote economic development, we can now ask which institutions will support a stable system of money and banking. Since money cannot function well as a medium of exchange unless people have confidence in its future value, the fundamental task of monetary institutions is to create and maintain that confidence. How can such confidence be created and maintained? The answer for a private supplier of money, i.e., a competitive bank, is very different from the answer for a state that supplies money. And it is on that difference that I am going to rest the case for free banking as the solution for chronic monetary instability in less developed and former Eastern Bloc countries.

Why does it matter whether money is supplied privately or by the state? When a private bank creates money, it does so by issuing a special type of IOU against itself. The IOU allows the owner of the IOU or anyone he assigns to demand its instant redemption in terms of a fixed amount of a specified asset. For example, when Citibank creates a demand deposit, it is promising to redeem that deposit in terms of an equivalent amount of U.S. currency to the depositor or to anyone to whom the depositor writes a check up to the amount of the deposit.[3]

A bank's contractual obligation to redeem its IOUs on demand does not automatically create the confidence in their future value required for them to function as money. If the bank is widely expected to default on its IOUs, those IOUs, regardless of the bank's net worth or financial soundness, will not function as money, because IOUs that people do not expect to be honored will be unacceptable in exchange. For a bank to create confidence that it will continue redeeming its IOUs, it must convince people that it would lose more by defaulting than it would gain. Whether people will trust banks with a substantial net worth to honor their contractual obligations depends in large part on the legal consequences of default for the bank. If the legal system under which banks operate strictly enforces contractual obligations and penalizes default, default will appear unlikely.

One might question whether, if they were not legally required to make their moneys convertible into an asset whose supply or value they could not control (e.g., currency or gold), private banks would voluntarily obligate themselves to redeem their IOUs on demand in terms of such an asset. But no private bank has ever issued irredeemable money without a state edict declaring the money legal tender and acceptable for discharging tax liabilities. Moreover, the theoretical argument denying that a private bank can issue irredeemable money is compelling. The magic a bank performs by creating money is to impart a value to something whose only use consists in being valuable. The bank performs this conjurer's trick by legally committing itself to redeem instantly its IOUs in terms of another asset whose value it cannot control. That credible promise allows the bank's IOU to take on a value identical to that of the redemption asset. But without the promise, people, recognizing the potential profit from issuing valuable IOUs and redeeming them for nothing, would never place a value on such IOUs any higher than their expected final redemption value, namely, zero. Inconvertible bank IOUs must be worthless.[4]

Inside and Outside Money

It may be helpful to distinguish here between inside and outside money. The money private banks supply is called inside money because it represents a debt the bank creates against itself. Outside money can be a physical commodity (e.g., gold) that has become acceptable as a medium of exchange, or a fiat currency issued by the state that has become acceptable as a medium of exchange. Like gold, outside money is an asset without being anyone's liability. Private banks cannot create outside money; they can only create inside money which, to make acceptable, they promise to convert on demand into some outside money.

A sovereign may choose to issue inside money by committing itself, like a private bank, to convert its money on demand into some asset whose supply and value are beyond its control, or to issue outside money in the form of fiat currency. Should it do the former, its IOUs are apt to be less acceptable than those of a private issuer for one very powerful reason: while the default by a private bank on its obligation to redeem its IOUs triggers immediate insolvency, allowing creditors to seize its assets, a sovereign is immune from such sanctions when it defaults. Indeed, a sovereign's default, isn't even called a default, but a devaluation. People would therefore have much better reason to expect a sovereign to default on its obligations than to expect a private bank to do so.

Should the sovereign seek to issue an inconvertible fiat currency, it faces credibility problems of a different sort. Sovereigns have, indeed, successfully issued fiat currencies in numerous instances, so fiat currencies can maintain their value for long periods of time. However, there have been more unsuccessful than successful fiat currencies. So it certainly is not the case that a sovereign, just by declaring a fiat currency legal tender, can ensure its acceptability in exchange.

A sovereign wishing to issue a fiat currency must overcome two problems. First, how can it create a demand to hold the currency it is issuing? Why should anyone sacrifice any real goods or services just to hold pieces of paper that have no use other than to be exchanged for something else? For the pieces of paper to be used as money, people must want them enough to sacrifice something else of value for them. To assume that such pieces of paper have value because they are money begs the question why people accept them as money in the first place.

Second, a positive demand to hold an asset clearly does not ensure its acceptance as money. As I explained above, for an asset to be accepted as money, people must share expectations about the stability of its future value. So even if the sovereign can create a demand for fiat currency, how does it create sufficient consensus among the public about the currency's future value for people to use it as money?

Creating Demand for Fiat Money

Let us consider first how the State can make its currency more valuable than the paper it's written on. A legal-tender law that requires fiat currency to be accepted in the discharge of debts doesn't, by itself, impart any value to the fiat currency. It simply provides a way for some people to discharge debts that they previously incurred but does not compel anyone to accept legal tender in exchange for real goods and services. So why would anyone prospectively supply something of value in exchange for fiat currency? If what the State declares legal tender is not acceptable, people can avoid accepting debt instruments that could be discharged by the proffer of legal tender.

A more powerful way to create a demand to hold fiat money is for the sovereign to require its currency to be used in discharging tax liabilities. If the public owes the sovereign enough at certain times of the year (e.g., April 15), then the demand to hold currency may be sufficient (even during periods of zero or negative net tax liability) to give the currency positive value throughout the year.

But though feasible, such a strategy may still be impractical, which raises our second problem. Even if government tax certificates have a positive value, what would create a sufficient consensus about the expected future value of these tax certificates for them to serve as money? Without such consensus, a positive value will not enable them to serve as money. Indeed, there are few if any historical instances in which a fiat currency was successfully introduced without its first having been made convertible into another money. Thus, although requiring taxes to be paid using a fiat currency seems to be necessary to prop up its value after convertibility has been suspended, acceptability as payment for taxes may not suffice to enable a sovereign to create a new fiat currency.[5]

To sum up: A private issuer of inside money has more credibility than a sovereign issuer of inside money, because people generally understand that a sovereign has less to lose than a private bank by reneging on a convertibility commitment. A defaulting bank forfeits its assets to its creditors while a devaluing sovereign forfeits only its reputation. On the other hand, a private bank cannot issue outside money, while a sovereign can. But a sovereign's capacity to issue a fiat currency without first making it convertible into some other money or asset may be quite limited. Even if requiring its currency to be used in paying taxes gives the currency a positive value, the currency may still not be an acceptable money. Unless the currency, upon introduction, is made convertible into an accepted medium of exchange, the consensus about its future value required for a fiat currency to serve as money may be lacking.

My argument thus far has two basic implications for less developed and former Eastern Bloc countries. First, such countries cannot create stable monetary systems based on inconvertible fiat currencies, because their political regimes lack the credibility to impose stable monetary institutions by fiat. Lacking a widely accepted money about whose future value expectations are secure, such regimes cannot create an acceptable money out of thin air, because they cannot impose a consensus about the future value of a fiat currency.

Creating a new fiat currency inevitably creates a hyperinflationary environment, because with no public confidence in the future value of the currency, the public will be willing to hold very little of it. This does not mean that the demand for money of any kind is small. The demand for a stable money in which people had confidence would be much greater than the demand for a new fiat money. An attempt to force more than this small amount into circulation, say, to finance the government deficit, causes rapid inflation. And the inevitable attempt to overreach the limits of that revenue source by printing even more money triggers a vicious inflationary cycle that causes a complete monetary breakdown.

All Moneys Are Not Equal

Conventional monetary models make two unwarranted assumptions that lead to disastrously misguided policies for developing countries. First, they assume that all money is alike, so that there is a given demand for money, which any instrument so designated can satisfy. Second, they assume that total output is independent of the amount of money. But not all moneys are equal and an inferior money in which people have no confidence cannot perform the services that a superior money could. Moreover, money serves as working capital for households and businesses adding to their productivity, while monetary stability provides a kind of intangible infrastructural capital that adds to the productivity of all economic agents independent of the amount of money they hold individually. Policies aimed at achieving monetary stability in developing countries by restricting the quantity of the available fiat money treat a minor symptom but ignore the fundamental problem, which is that distrust of the available money makes it useless and deprives the economy of desperately needed monetary services.

Thus, the second implication is that in such circumstances the only feasible way to create a consensus about the future value of a currency is to make it convertible into another money, e.g., the dollar, about whose future value expectations are secure. But governmental commitments to establish and maintain convertibility, as the recent Mexican fiasco has shown yet again, are obviously not credible, because a sovereign that defaults on such a commitment faces no effective sanction. Devaluations are a dime a dozen.

Nevertheless, given sufficient reserves, and given some institutional constraints on money creation and on government borrowing, governments can maintain a fixed exchange rate for a period of time. With sufficient resolve, they may do so indefinitely. However, such pegs are extremely fragile. Once an economic or political shock occurs, the expectation of a future devaluation becomes almost irresistible even for a developed country.

One way a government could increase confidence in its commitment to maintain convertibility is to create a currency board whose sole function would be to issue domestic currency in exchange for an equivalent amount of some foreign currency in terms of which the domestic currency would be defined. Such a system, if maintained, converts the domestic currency into a denomination of the foreign currency in terms of which it is defined. However, even a currency board cannot prevent a government from devaluing if that is what the government decides to do.

It is now clear why free banking is so well suited for less-developed and former Eastern Bloc countries. By making the commitment to maintain convertibility one which holders of money can enforce through legal means against private banks instead of one that can be abrogated by the sovereign at will, free banking avoids the barrier that sovereign irresponsibility places in the way of creating monetary confidence.[6]

Under free banking, private banks would be allowed to issue currency (banknotes) and create deposits denominated in units of their own choosing. Thus, if the public wished to use dollars, free banks would be willing to create money denominated in dollars. However, since there would be legal problems in issuing banknotes denominated in dollars, free banks would instead define new denominations (say, the crown) in terms of dollars (one crown equals one dollar), so that prices could be quoted interchangeably in either dollars or crowns. Because it would allow private banks to supply the hand-to-hand currency needs of the public, free banking would be preferable to simple dollarization which would require a country to import the dollars required for hand-to-hand circulation by means of a costly export surplus.

By setting an appropriate tax rate on bank profits, governments would, in the end, derive more tax revenue from the profits of the competitive banks than they could have by issuing fiat currencies and seeking to exploit their monopolistic control over those currencies. But even this gain would be dwarfed by the general increase in tax revenue that would result from an economic boom triggered by the provision of sound and stable money by a system of free competitive banking. □

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1. Yet, as I pointed out in my book, continuing financial innovation and technological progress toward a cashless economy will, like it or not, gradually lead us over the long term at least part of the way toward free banking even with no deliberate redesign of our basic monetary institutions. The same point has been emphasized by Sir Samuel Britten in two recent columns in the *Financial Times*, June 9, 1994 and June 16, 1994.

2. A money can survive even if there is some expected depreciation in its value, but the more depreciation is expected the less useful and the less acceptable money becomes. Because of the positive feedback effects between your willingness to accept money and my willingness to accept money (now referred to as a network externality), monetary collapse can come very suddenly in response to a seemingly small change in expected depreciation.

3. The legal restrictions requiring U.S. banks to hold reserves of currency or otherwise restricting their behavior are, for purposes of this discussion, irrelevant. What matters is that in creating deposits, banks are offering an IOU that they are contractually obligated to redeem in terms of an asset (U.S. currency) whose supply or value they cannot control. If banks were legally allowed, as they once were and as they would be under free banking, to create banknotes circulating from hand to hand as currency, the legal status of banknotes could be similarly characterized, except that the bank's obligation to redeem would be to the bearer of the banknote not to the original holder of the deposit.

4. I have explained this point more fully in my article, "The Real Bills Doctrine in the Light of the Law of Reflux," *History of Political Economy*, Winter 1992, pp. 885–86.

5. On the role of prior convertibility in establishing a fiat currency, see G. Selgin, "On Ensuring the Acceptability of a New Fiat Money," *Journal of Money, Credit and Banking*, November 1994, pp. 808–26.

6. The government might still profit from devaluation by reducing the real value of debt denominated in terms of the domestic currency, but it is not clear that the government so circumstanced would have anything to gain by denominating debt in terms of its domestic currency rather than the foreign standard currency since denominating in terms of the foreign standard currency would enable it to borrow at a reduced interest rate.

THE FREEMAN
IDEAS ON LIBERTY

Thomas Jefferson's Sophisticated, Radical Vision of Liberty

by Jim Powell

When Virginians reflect on the American Revolution, they often like to describe George Washington as its sword, Patrick Henry as its tongue, and Thomas Jefferson as its pen.

Jefferson expressed a sophisticated, radical vision of liberty with awesome grace and eloquence. He affirmed that all people are entitled to liberty, regardless what laws might say. If laws don't protect liberty, he declared, then the laws are illegitimate, and people may rebel. While Jefferson didn't originate this idea, he put it in a way that set afire the imagination of people around the world. Moreover, he developed a doctrine for strictly limiting the power of government, the most dangerous threat to liberty everywhere.

Jefferson was among the most learned men of his time. He understood historic struggles for liberty. He drew on his practical experience serving as a representative in the Virginia House of Burgesses, the Virginia Convention, Continental Congress and Confederation Congress, and as Governor of Virginia, Minister to France, Secretary of State, Vice President and President of the United States.

With his gifted pen and meticulous script, Jefferson drafted more reports, resolutions, legislation, and related official documents than any other Founding Father. Above all, Jefferson wrote letters, probably more than his illustrious contemporaries, and a larger number of these letters survive—some 18,000. He corresponded with many leading lights of liberty, including Thomas Paine, John Adams, Benjamin Franklin, Patrick Henry, Marquis de Lafayette, James Madison, George Mason, Jean-Baptiste Say, Madame de Stael, and George Washington.

He had a reserved manner, even with his children, but he was a steadfast friend. His friendship with James Madison endured for a half-century. Jefferson's tact enabled him to maintain relationships with prickly-pear patriots like Thomas Paine and John Adams. In an affectionate letter, Adams commended him for "friendly warmth that is natural and habitual to you."

Jefferson was an instantly recognizable Founding Father. He stood about six feet two inches tall, was thin, had reddish hair, hazel eyes, and a freckled complexion. As a young man, he was a snappy dresser, but in later years he neglected his appearance. His hair turned gray and flopped around his

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head. When President, he reportedly greeted morning visitors in worn slippers and a worn coat.

Jefferson's intellectual legacy has been hotly contested. For four decades after he left the White House, his ideas dominated U.S. government policy, and he was revered as the "Sage of Monticello." Then the Civil War changed everything. Some 620,000 people died amidst that struggle to preserve the Union, turning public opinion against Jefferson who had defended the right of secession and independence. He fell even further out of favor during the "Progressive Era" when reformers imagined that every problem could be fixed by giving the federal government more power. President Theodore Roosevelt scorned Jefferson as a "scholarly, timid, and shifting doctrinaire." Hamilton, apostle of government power, became the most revered Founder.

The bicentennial of Jefferson's birth, 1943, prompted many Americans to think about his life, and his reputation experienced a comeback. It was marked by construction of the Jefferson Memorial in Washington, D.C., emblazoned with his stirring oath: "I have sworn upon the altar of God eternal hostility against every form of tyranny over the mind of man." As historian Merrill D. Peterson explained the comeback: "The man glorified in the monument had transcended politics to become the hero of civilization. He had come to stand for ideals of beauty, science, learning, and conduct, for a way of life enriched by the heritage of the ages yet distinctly American in outline. The range of his appeal, if not its intensity, increased with the disclosure of his varied and ubiquitous genius."

Since about 1960, Jefferson has again come under attack. Constitutional historian Leonard Levy, for instance, cited episodes when Jefferson suppressed civil liberties, especially during his terms as Virginia Governor and U.S. President. Historian J.G.A. Pocock portrayed Jefferson as a backward-looking country aristocrat who feared cities and commerce, out of touch with the modern world. Historian Bernard Bailyn called Jefferson an unthinking "stereotype." Some historians revived Federalist charges that Jefferson fathered children with his attractive young slave Sally Hemings. And of course, many historians expressed disgust that Jefferson owned slaves, bred slaves, gave away slaves as wedding presents and never liberated any slaves—he reportedly owned 180 slaves when he wrote the Declaration of Independence and had 260 slaves when he died. Historian Page Smith claimed that because Jefferson didn't always live up to his expressed ideals, he was a fraud, and his ideals were no good.

Though Jefferson had personal failings—in the case of slavery, a monstrous one—they don't invalidate the philosophy of liberty he championed, any more than Einstein's personal failings are evidence against his theory of relativity. Moreover, every one of Jefferson's adversaries, past and present, had personal failings, which means that if ideas are to be dismissed because of an author's failings, Jefferson and his adversaries would cancel each other out. When historians finish dumping on Jefferson, they still won't have cleared the way for Karl Marx or whomever they admire. Jefferson's accomplishments and philosophy of liberty must be recognized for their monumental importance.

Early Life

Thomas Jefferson was born April 13, 1743, at a plantation named Shadwell, along the Rivanna River. He was the third child of Peter Jefferson, who seems to have been a self-educated, enterprising man—surveyor, plantation operator, judge, and representative in the Virginia House of Burgesses. His mother, Jane Randolph, brought aristocratic blood from a prosperous Virginia family. While Thomas expressed admiration for his father, he hardly ever talked about his mother.

Jefferson was tutored by Anglican ministers in Latin, Greek, science, and natural history. For two years, he attended William and Mary, America's second-oldest college (after Harvard), located in Williamsburg. Then he began studying English common law and opened a successful law practice.

Jefferson loved books. Among the titles that would influence his understanding of liberty: John Locke's *Two Treatises on Government*, Adam Ferguson's *An Essay on the History of Civil Society*, and Baron de Montesquieu's complete works. His library would eventually exceed 6,000 volumes.

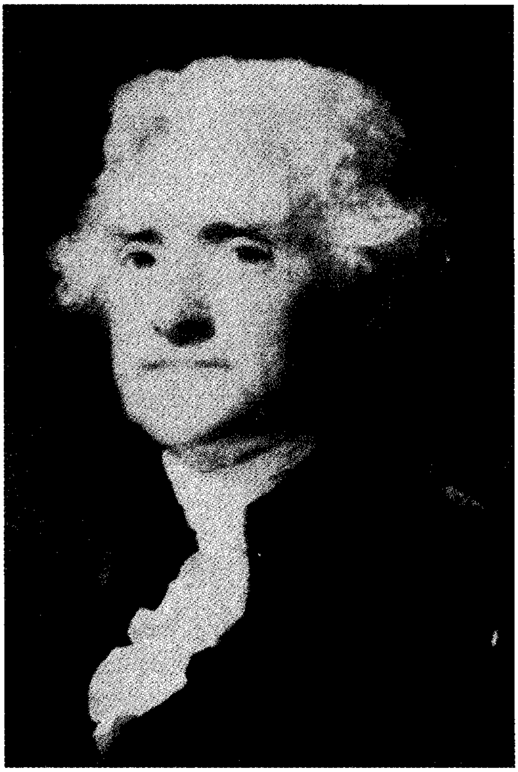
Jefferson was in the thick of things politically because Williamsburg was the capital of Virginia, the largest and richest colony. His political career began in December 1768 when he was elected to the Virginia House of Burgesses. The hot issue was Britain's persistent effort to defray its war debts by taxing colonists. Jefferson helped form a committee of correspondence for coordinating tax resistance.

In 1774, Jefferson wrote his first published work, a 23-page pamphlet called *A Summary View of the Rights of British America.* It was a legal brief which boldly declared that Parliament didn't have the right to rule the colonies. The work established Jefferson as a man who had a way with words.

By March 1775, Jefferson was named a delegate to the Second Continental Congress in Philadelphia. He met people he had heard much about, especially John Adams, Samuel Adams, and Benjamin Franklin. After meeting the Virginian, John Adams remarked: "Writings of his were handed about, remarkable for their peculiar felicity of expression. . . . [Jefferson] was so prompt, frank, explicit and decisive upon committees and in conversation . . . that he soon seized upon my heart."

On June 7, 1776, Richard Henry Lee urged the Continental Congress to adopt his resolution for independence. Debate was scheduled for July 1st, while Jefferson, Franklin, John Adams, Roger Sherman, and Robert R. Livingston were assigned to prepare a statement announcing and justifying independence.

Thirty-three-year-old Jefferson drafted the Declaration of Independence on the second floor of a Philadelphia home belonging to bricklayer Jacob Graff, where he rented several rooms. They were at Market and Seventh streets. Jefferson wrote in an armchair pulled up to a dining table. He



Thomas Jefferson
(1743–1826)

probably scratched away with a goose quill pen, a writing implement which is quite difficult to use. By habit, he did most of his writing between about 6:00 PM and midnight. The Declaration took him 17 days.

Like *A Summary View of the Rights of British America*, the Declaration was mostly a legal brief listing a succession of complaints against England—revolution wasn't to be undertaken lightly. In the Declaration, however, Jefferson directed his case against George III rather than Parliament, and he provided more of a philosophical justification for the Revolution.

With just 111 words, he expressed ideas which would inspire people everywhere: "We hold these truths to be self-evident: that all men are created equal; that they are endowed by their Creator with certain inalienable rights; that among these are life, liberty and the pursuit of happiness; that to secure these rights, governments are instituted among men, deriving their just powers from the consent of the governed; that whenever any form of government becomes destructive of these ends, it is the right of the people to alter or abolish it, and to institute new government, laying its foundation on such principles, and organizing its powers in such form, as to them shall seem most likely to effect their safety and happiness."

This was radical stuff. It was radical for Jefferson's day, as subsequent struggles with Federalists made clear. It was too radical for Abraham Lincoln who forcibly resisted the secession of Southern states. Today, it remains a radical creed, since few Americans talk much about the right of armed rebellion against government.

As Jefferson later explained his aims: "to place before mankind the common sense of the subject, in terms so plain and firm as to command their assent, and to justify ourselves in the independent stand we are compelled to take. Neither aiming at originality of principle or sentiment, nor yet copied from any particular and previous writing, it was intended to be an expression of the American mind, and to give to that expression the proper tone and spirit called for by the occasion."

All colonial delegates except those from New York, who initially abstained, voted for Lee's independence resolution on July 2nd. Then came a three-day debate on Jefferson's draft of the Declaration. Congress voted to cut about a quarter of the text and insisted on many minor changes. Deferring to delegates from Georgia and South Carolina, and perhaps delegates from some Northern colonies that had engaged in the slave trade, Congress cut Jefferson's extended attack on George III for not outlawing the slave trade.

Congress approved the Declaration of Independence on July 4th. On July 19th, 56 men officially signed what was to become the most important document in American history.

Jefferson served as Revolutionary War Governor of Virginia, raising money and cobbling together defenses against the British. Moreover, thanks to his efforts, Virginia became the first state to achieve complete separation of church and state.

Amidst these public crises, Jefferson endured shocks at home. He and his wife Martha had three children die in infancy. On September 6, 1782, Martha died at 33—complications from childbirth. They had been married 10 years. Deeply depressed, he stayed in his room for three weeks. Then, for several more weeks, he spent nearly every day alone, riding his horse through the woods around Monticello. It was fellow Virginian James Madison who coaxed Jefferson back into public life.

Jefferson went on to do much more for liberty during his phenomenal career. He represented American interests in Paris while the Constitutional Convention conducted its epic debates, but through correspondence he helped convince James Madison, architect of the Constitution, to support adoption of a bill of rights. As Secretary of State in George Washington's cabinet, Jefferson was horrified at Alexander Hamilton's scheming to subvert the Constitution and expand federal power. This convinced Jefferson that he must seek the Presidency. He won in 1800, cut taxes, cut spending, and paid off a third of the national debt. When Spain blocked access to the Mississippi and ceded it to Napoleon, then conquering Europe, Jefferson moved to purchase the Louisiana territory, even though he couldn't defend the policy on constitutional grounds. Unfortunately, his presidency closed on a sour note—frustrated by British seizures of American sailors and goods, he declared a trade embargo that backfired.

After his second term, Jefferson retired to Monticello, his beloved mountaintop mansion near Charlottesville, Virginia. Here he planned the University of Virginia, played with his 13 grandchildren, struggled with his money-losing properties, and wrote many luminous letters.

Jefferson explained his exhilarating vision of liberty, perhaps his most precious legacy to the world. He insisted that liberty is impossible without secure private property: "a right to property is founded in our natural wants, in the means with which we are endowed to satisfy these wants, and the right to what we acquire by those means without violating the similiar rights of other sensible beings. . . ."

How gracefully he rejected envious appeals to seize wealth: "To take from one, because it is thought his own industry and that of his fathers had acquired too much in order to spare to others who, or whose fathers have not exercised equal industry and skill, is to violate arbitrarily the principle of association, the guarantee to everyone a free exercise of his industry and the fruits acquired by it."

Jefferson urged Americans to pursue peace through free trade. "It should be our endeavor," he wrote, "to cultivate the peace and friendship of every nation . . . Our interest will be to throw open the doors of commerce, and to knock off all its shackles. . . ."

Personally, the most heartening experience of Jefferson's last years was the reconciliation with John Adams. It was the idea of Benjamin Rush, a Philadelphia physician and fellow signer of the Declaration of Independence. In January 1811, Dr. Rush wrote Jefferson, reminiscing about Revolutionary days and Adams' contributions. Although Jefferson and Adams became bitter rivals for the presidency, Adams had later defended Jefferson against attacks from fanatical Federalists. Jefferson, almost 69, told Dr. Rush that while he was wary of the suspicious and envious Adams, then 76, he recognized what Adams had done for American liberty. Not long afterwards, a couple of Jefferson's Virginia friends visited Adams and heard him declare: "I always loved Jefferson and still love him." Word got back to Jefferson who was thrilled.

Adams ended up writing the first letter on January 1, 1812, and Jefferson replied: "I now salute you with unchanged affections and respect." Soon correspondence was flowing between Quincy and Monticello. The two men talked about their health, books, history, and current affairs. They touched on past political disagreements, Adams' persistent pessimism and Jefferson's enduring optimism. Above all, they talked about the American Revolution which both men were immensely proud of. "Crippled wrists and fingers make writing slow and laborious," Jefferson confided in October 1823. "But, while writing to you, I lose the sense of these things, in the recollection of ancient times, when youth and health made happiness out of every thing."

Before Jefferson slipped into a coma on July 3, 1826, he asked: "Is it the Fourth?" He died on the Fourth, about 12:20 PM, a half-century after the glorious Declaration. Meanwhile, in Quincy, Massachusetts, some 500 miles away, John Adams was fading, too. Around noon on the Fourth, some six hours before he died, he managed a few words: "Thomas Jefferson survives." Indeed he does, in the hearts and minds of millions everywhere who cherish liberty. □

THE FREEMAN
IDEAS ON LIBERTY

Forrest Gump: A Subversive Movie

by Aeon J. Skoble

A Hollywood movie is like a box of chocolates: it tastes good, but it's really bad for you. Of course, it isn't bad to eat a small amount of chocolates; likewise, not all Hollywood movies are bad for you. But after seeing *Forrest Gump*, the charming aphorism that was central to the film ("My momma says that life is like a box of chocolates") metamorphosed in my mind in this fashion. I caught myself enjoying the film while realizing that I was enjoying something unhealthy. As time passes since the film's release, it not only grows in popularity, but the associated merchandising increases. One can buy collections of Gump sayings, tins of "BubbaGump Shrimp," Gump t-shirts, and so on. As the film's appeal grows, so does the need to examine its message. The movie won six Academy Awards (including Best Picture and Best Actor for Tom Hanks)—so the film is clearly an influential social and cultural item.

Before criticizing the film's vices, I first praise its virtues. It is very well executed. The by-now-well-known special effects that make Tom Hanks appear in old newsreel footage and play championship ping-pong, and that make Gary Sinise's legs disappear, are outstanding. Hanks adds another finely crafted performance to his résumé. The film's narrative structure is tight, and strikes the right balance between serious drama and light comedy. Indeed it is truly an excellent film, in the sense that it tells a story well and conveys a message. But the values portrayed, like a box of chocolates, are too sweet and not entirely healthy.

This film is subversive. It doesn't subvert the Constitution of the United States, but rather it is subversive of the human spirit. This claim will come as a spoilsport voice-in-the-wilderness to the many who are trumpeting the film as a triumph of the human spirit. *Forrest Gump* is unambiguously anti-intellectual, and subversive in its power to make one enjoy it anyway.

The naive innocent who prospers in a wicked world is an old standard, and a very seductive device. Even Wagner, after announcing the coming of the superman, found refuge in this archetype in *Parsifal*. Here Hanks portrays a man with an I.Q. of 75 who becomes a national hero and a millionaire through. . . what? The purity of his spirit and the grace of God, or something like that. The message is that intelligence, indeed ability generally, are unimportant. Providence will watch out for those without gifts, therefore everyone is gifted. Some of Gump's achievements are due to his being a nice guy. He wins the Medal of Honor for rescuing his company because he is unwilling to abandon his friend. But he becomes a great runner by divine fiat. His shrimp boat survives a hurricane. He becomes a champion ping-pong player simply by not taking his eye off the ball. It's not quite like *Being There*, to which this film is frequently compared. The character Chance in *Being There* receives his fortunes through the misinterpretations of his idiocy by a sick society, hence the satire. *Gump* is satire-free. But the film makes us ask, what's the point of having talents if talent is unimportant?

The film not only portrays talent as unimportant, but literally as an impediment to the good life. Consider the intelligent and intellectually curious Jenny. She is an independent thinker who questions authority

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and social standards, and who is experimental and adventuresome. Jenny is punished with a series of abusive relationships; she finally dies of AIDS. I've rarely seen a characterization so hostile to inquiry. It is revealed that the roots of her eagerness to question authority and think independently are having a dysfunctional family. So an evil force drives her to independence of thought, and the results of the consequent life are drugs, abusive boyfriends, and AIDS.

The contrast with Gump is clear enough. His mother loves him. He always does as he's told, and prospers as a result. In response to the command, "just run," he is able to score touchdowns. This trait also makes him a natural for military service. To be sure that we do not interpret all this as anti-Christian, Jenny, despite her sins, is forgiven and rewarded in the afterlife in the form of a perfect child conceived with Forrest. When Lieutenant Dan loses his legs, he rails against God, but when he makes his peace with God, he walks again.

Gump's mother, played well by Sally Field, keeps admonishing him that he's no different from everyone else. The film insistently advances the idea that there is "nothing wrong with being stupid." Honestly, could there be a more dangerous message to promulgate? It should go without saying that people should not be cruel to those with less ability, and we may indeed wish to care for those incapable of taking care of themselves. But is there really *nothing wrong* with being less able, less smart? This is not about self-esteem for the disabled, it is actually about radical leveling, a devaluation of ability. How is Gump no different from anyone else? This claim seems innocent enough, and might follow from the idea that those of less ability are still humans deserving respect and dignity. But of course he is different—he is a great runner, a football star, a war hero, a millionaire. Most of us are none of those things. And he has a 75 I.Q., which most of don't have either. So he is different from most people. By downplaying that, the critique of ability is made more subtle.

There's no secret to excelling, the film tells us, just do what you're supposed to do. In real life, people must earn their achievements. Of course, some steal and some inherit, but in general, people have to achieve through their efforts. At any rate, that would be a better lesson to teach, I submit, than that if you just blunder about, God or fate will take care of everything. No ability is necessary to make a fortune in the shrimp business—just make sure that your shrimp boat is the only one left intact after a hurricane. No ability is necessary to be a football hero—just run until they tell you to stop running.

Of course, all these bits in the film are funny and charming. I laughed and smiled on cue with everyone else. Hanks is always likable, and Gump especially so, being the sweet innocent that he is. But I am disturbed that a film could attain such popularity and appeal by advancing the view that ability is not an important component of business success and that critical thinking is not essential to achieve prosperity. Despite Gump being a successful businessman, the film thereby conveys a tacit anti-commerce message.

The anti-commerce message derives from the more general anti-ability theme. If intelligence and analytic ability are not portrayed in the most popular film of the year as important components of the good life, an intellectually lazy generation will tacitly take this as support for their disengaged condition. The majority of teens cannot locate the Pacific Ocean on a world map, or the Civil War by half-century. The fastest growing trend in criminal defense is diminished responsibility. Books are out, MTV is in. Critical reasoning is on the decline not only as a skill but as a desideratum. And now comes *Forrest Gump* to reinforce the idea that we are not responsible for our destinies, that intelligence is not important, that independent thought will be punished. That's dangerous.

Forrest Gump is not a bad film, but it is subversive. The film is subversive because it *is* so well made and enjoyable. I enjoyed it even as I was aware of the unhealthiness of its message. If anyone tells me that it was a good film, or that he or she enjoyed it, I won't disagree. But if anyone tells me that it was profound or that it changed his life, I shall weep. □

Sorry, Charley, But That's Not Capitalism!

"All economic transactions involve a win-lose proposition. Every gain involves a loss."

—Charley Reese, *Orlando Sentinel*
May 22, 1994

Lord Acton once said, "There is no error so monstrous that it fails to find defenders among the ablest men." That was my reaction to a series of articles recently written by national columnist Charley Reese. Over the years, Reese has made a reputation as a strong defender of individual rights against a growing Leviathan, the federal government. So it was all the more perplexing when I read some of his claims about free-market capitalism:

"Two people can't eat the same bean. That's the essence of economics."

"All economic transactions involve a win-lose proposition."

"The historically visible trend [in capitalist societies] is always for the rich to get richer and the poor to get poorer."

"Only the youngest, the strongest can put stock in pure capitalism."

Statements like these were demolished years ago in Leonard Read's classic little book, *Clichés of Socialism,* which was recently updated by Mark Spangler under the new title, *Clichés of Politics* (Foundation for Economic Education, 1994). Unfortunately, some clichés die slowly.

Let me respond to each one of these commonly held criticisms of the free market.

Voluntary Exchange Is Win-Win

First, is the free market similar to a sporting event, where one team wins and the other loses? Not at all. In every voluntary transaction, both the buyer and seller gain. Here's a simple proof: Suppose I sell an apple to a student for $1. The student buys the apple because he would rather have the apple than the dollar bill. Thus, by purchasing the apple, he improves his situation. On the other hand, I sell the apple because I'd rather have the dollar bill than the apple. I too am better off.

In *Das Capital,* Karl Marx popularized the view that all exchanges under free-enterprise capitalism involved an equality of values and therefore one person's gain must be another person's loss. But now we see that just the opposite is true: All transactions in a voluntary exchange involve an inequality of values. In fact, without an inequality of values, no voluntary exchange would ever occur.

Because of an inequality of values, both the buyer and seller gain in every transaction. The only exception to this law is when fraud or deception is involved. When that happens, one party gains at the other's

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expense. But in a voluntary exchange, where full and honest information is revealed, everyone benefits.

The Essence of Capitalism

Reese says that the essence of capitalism is contained in the statement, "Two people can't eat the same bean." Not so fast, Charley. A free market is not just an "either-or" proposition. Capitalism is also a highly cooperative system. If there are two people and only one bean, the free market provides a better alternative: plant the bean and harvest enough beans to feed both people! That's the true essence of capitalism.

Granted, natural resources are limited. But the beauty of free enterprise is its ability to *multiply* these resources into goods and services that people can use to increase their standard of living. What really matters is not so much the amount of resources in their natural state but the supply of *economically useable* natural resources, which are limited only to the extent of our know-how and physical ability to transform these inputs into useable wealth. In that sense, there is virtually no limit to further advances in our standard of living. In reality, nature isn't scarce, only the productive capacity of labor to change nature into real wealth is.

Capitalism Can Improve Everyone's Standard of Living

Finally, Charley Reese is wrong in suggesting that capitalism breeds inequality, that the rich get richer and the poor get poorer. Under the free market, the rich get richer and the poor get richer too. Historically, citizens of capitalistic nations have enjoyed higher real wages and steady advances in the quantity, quality and variety of goods and services. Only government, the politics of coercion, causes a decline in the standard of living.

Moreover, the free market does not only benefit the young and the strong, as Charley Reese suggests, but the weak, the poor, and the discriminated. Contrary to popular belief, capitalism is not a dog-eat-dog jungle where only the fittest survive. As the classical economist David Ricardo demonstrated, the market is characterized by comparative advantage, not just absolute advantage in the division of labor. Therefore, opportunities abound for people of all abilities, talents, religions and races. The less fortunate may not earn a high wage, but they can and do benefit from the blessings of a technologically advanced capitalistic society. Today practically everyone, rich and poor, enjoys the benefits of electrical power, the telephone, the automobile, television and radio, books and newspapers, and a myriad other goods and services. Such everyday products were available only to the wealthy less than a century ago.

A free society is by no means perfect. People make mistakes, employers sometimes take advantage of workers, sometimes workers shortchange their employers, and salesmen may deceive the public. But the strength of the market is that bad business, deceptive practices, and shoddy merchandise are constantly being overwhelmed by good business, accurate information, and quality products. On net balance, there is no substitute for the free-enterprise system. □

BOOKS

Clichés of Politics

edited by Mark Spangler

The Foundation for Economic Education • 1994 • 314 pages • $15.95 paperback

Reviewed by Robert Batemarco

There's much truth in the old saying that it's not so much what people don't know that hurts them, as what they know that just isn't so. Indeed, when things we know that aren't so are used to shape public policy, it hurts not only those who harbor the misinformation, but virtually everyone falling under the jurisdiction of such misguided policy. The Foundation for Economic Education counters such superficially plausible but fundamentally wrong-headed ideas in *Clichés of Politics*. Edited by Mark Spangler, it lists and refutes 83 economic fallacies which have proven to be leech-like both in their tenacious hold on the public mind and their proclivity to drain the life-blood of our economic prosperity. While most of the 83 appear here for the first time, 27 "classic clichés" originally appeared in FEE's 1970 volume *Clichés of Socialism*.

Just how much of a stronghold these nuggets of misinformation have attained was evident in President Clinton's 1995 State of the Union Address, which included either explicitly or implicitly no fewer than six of the clichés debunked in these pages. Had the President read, understood, and taken to heart Tibor Machan's exposé of national service as, "a ploy, once again, to extract unpaid work from unsuspecting and gullible folks, another type of involuntary servitude," which is at best, "a wasteful way to give direction to human works" (p. 289), he would not continue to regard it as the accomplishment of which he is most proud. Had he not swallowed hook, line, and sinker the cliché that, "the government must set standards for living and working conditions," he would not have proposed a boost in the employment-killing minimum wage. Only someone enamored of the shopworn assertion that, "government should guarantee freedom from want," could contend that ceasing to subsidize out-of-wedlock births is somehow punishing people, "just because they happen to be poor." Paul Poirot's critique of that cliché in these pages is shaped by the insight that subsidizing failure breeds even more failure.

Characteristic of the FEE approach to economic issues is its willingness to go beyond mere cost-benefit considerations to focus as well on the morality of the actions imposed. Entry after entry in this book serves as evidence of this. Thus, Cecil Bohannon's refutation of the cliché that "food is a right" rests not only on the recognition that government attempts to guarantee a right to food invariably destroy the incentives to produce food, but that they do so at the expense of the rights of food producers. Similarly, Robert Higgs counters the claim that, "in a national emergency, government must control the economy," by alluding to the inevitable distortions created by such control, but he clinches his argument by declaring that, "even if the government were more capable, it would not be justified in using its coercive powers for any and all purposes." This volume leaves no doubt, as if there ever were any, which side FEE is on in what Murray Rothbard calls "the eternal struggle between morality and immorality, between liberty and coercion."

Clichés of Politics challenges the statist conventional wisdom on every front. Whether the false notion under consideration involves the nature of rights or foreign trade, regulatory policy or income inequality, health care or political philosophy, it is handled with dispatch. For the uninitiated, this book is a virtual crash course in FEE's freedom philosophy. For those already well acquainted with these ideas, it provides clear, concise, and quotable articulations of them. Anyone who learns the lessons put forth in this book need never fear entering the battle of ideas unarmed.

Not only was Spangler judicious in his

selection of the most harmful and well-entrenched bromides to attack, but he has assembled a veritable "all star team" of free-market thinkers past and present to assist him in that effort. Among the most prominent are FEE founder Leonard Read, current FEE president Hans Sennholz, Henry Hazlitt, Murray Rothbard, John Hospers, Llewellyn Rockwell, Robert Higgs, and Tibor Machan. I'll take them on my side any day. □

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Death By Government

by R.J. Rummel

Transaction • 1994 • 496 pages • $49.95

Reviewed by Doug Bandow

The line, "I'm from the government and I'm here to help you," takes on new meaning after reading R.J. Rummel's devastating *Death By Government*. This century, estimates the University of Hawaii policial scientist, the State has killed almost 170 million people.

The numbers are so horrifying, so unfathomable, so unbelievable—it is tempting to dismiss them as meaningless statistics. But consider: this century, politicians have killed, for matters of ideology and policy, the equivalent of the entire population of Russia. With the slaughter averaging roughly 1.8 million people a year, in effect every resident of Houston or Philadelphia has been buried year in and year out.

Rummel calls these murders "democide" rather than "genocide," because the latter focuses on the elimination of specific ethnic groups, while the former includes mass killings for any number of other reasons. He readily acknowledges the difficulty in developing an accurate death toll, but no one has done better: Rummel offers 72 pages of references. The basic problem, he explains, is power. Writes Rummel: "Power kills; absolute Power kills absolutely." Of course, this problem is not new. Rummel estimates that some 133 million people were murdered over the first several thousand years of human life. China's emperors were particularly brutal, killing 33.5 million; the Mongols ran a close second at 30 million.

While the State long ago demonstrated its democidal nature, the political experiment has, unfortunately, taken a much deadlier turn this century. Indeed, the twentieth century demonstrates the utterly disastrous results of what historian Paul Johnson calls the Age of Politics. Unique to this century has been the marriage of sinful men, all-powerful governments, and technological progress. As a result, 20 death states have killed 170 million human beings.

The greatest system of mass murder belongs to the Soviet Union—the "Soviet Gulag State," as Rummel refers to it. Some 62 million, "Old and young, healthy and sick, men and women, even infants and the infirm, were killed in cold blood." What makes this slaughter particularly mystifying is the fact that most of these victims were, as Rummel puts it, "guilty of . . . nothing."

Anyone who has read Robert Conquest knows the details of Joseph Stalin's persecutions, but even Rummel's much shorter account provides more than enough information to turn anyone's stomach. There was genocide, such as the slaughter of the Don Cossacks, Ukrainian peasants, and Estonians. There were the mass purges of the Communist Party. And there were killings to fulfill quotas. At least the other murders fulfilled a horrific, perverse logic. But these? Explains Rummel:

> [M]urder and arrest quotas did not work well. Where to find the "enemies of the people" they were to shoot was a particularly acute problem for the local NKVD, which had been diligent in uncovering "plots." They had to resort to shooting those arrested for the most minor civil crimes, those previously arrested and released, and even mothers and wives who appeared at NKVD headquarters for information about their arrested loved ones.

Who can doubt that this was, as Ronald Reagan opined, an evil empire?

Then there are the Communist rulers of China, Mao Zedong, Deng Xiaoping, and company, who were long feted in the West. Their victims roll was modest only when compared to that of the Soviet Union: 35 million. Given such a record, Rummel asks, why was anyone surprised at the murder of students and workers in Tiananmen square?

China's history is, in many ways, more tragic than that of Russia. Rummel figures that various emperors killed 33.5 million people. Nearly a million died at the hands of warlords early this century. Chiang Kai-shek's nationalists, backed so enthusiastically by many Westerners, slaughtered ten million, putting Chiang in fourth place behind Adolf Hitler in the pantheon of mega-murderers. And then came the Communists.

As revolutionaries, Mao Zedong's forces killed millions under their control. Once in power throughout China, the new regime liquidated millions more opponents. The "Great Leap Forward" resulted in a famine that left as many as 27 million dead from starvation. Millions more were murdered during the Cultural Revolution. Almost as inconceivable as this endless slaughter was the fact that so many Western leftists could have promoted so vile a system for so long.

Mass murderer number three was Hitler, along with his criminal gang of anti-Semites, misfits, misanthropes, and racists. Rummel numbers the Third Reich's victims at 21 million. Germany's killings were heavily weighted toward genocide—of Jews, Slavs, and Gypsies, for instance, though few people escaped the Nazi jackboot. Hitler also deserves blame for igniting the worst war in history, with generous help from Stalin and others.

Rummel goes on to chronicle more modest killers, like Japan, Cambodia, Turkey, Vietnam, Poland, Yugoslavia, North Korea, and Mexico. What makes his analysis particularly useful is its impartiality. His book forces us to remember mass killing by the supposed good guys in World War II.

Even Great Britain and the U.S. come under criticism for their terror bombings of civilian populations during the same conflict. Rummel goes so far as to list Britain as a "Centi-Kilomurderer," responsible for an estimated 816,000 deaths, primarily from its World War II aerial campaign, which exceeded anything attempted by Nazi Germany.

Death By Government is a depressing, unnerving book. For this very reason, it should be read in history classes not just across America, but around the world. The problem of power, as Rummel terms it, remains with us today—just ask residents of Angola, Bosnia, Chechnya, Georgia, and Rwanda, among many, many other lands. Only if we learn from the past can we ever hope to end state-sanctioned murder. The case for human liberty and limited government has never been made more effectively than by this fearsome book. □

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Beyond Politics

by William C. Mitchell and Randy T. Simmons

The Independent Institute/Westview Press • 1994 • 234 pages • $17.95 paperback, $49.50 cloth

Reviewed by Gregory P. Pavlik

Within the last 30 or so years some advocates of limited government have begun promoting public choice economics. This small but increasingly influential school of thought applies assumptions of neo-classical economics about human behavior to public employees, elected or not. Public choice economists insist that politicians and bureaucrats are motivated by rational self-interest, and the manifestations of that self-interest result in perverse and disastrous consequences for the public. Many of their insights buttress earlier sociological and political analyses of both the State and the political class, echoing the work of such theorists as Franz Oppenheimer, Vilfredo Pareto, and Ludwig von Mises.

William Mitchell and Randy Simmons have written an interesting and informative work on political interventionism in the economy from a public choice perspective. The book, *Beyond Politics*, begins with a discussion of welfare economics, that branch of the dismal science that deals with, among other things, issues of market failure. Market failure refers to the divergence of real markets from the assumptions of perfect competition.

One of the most troubling of market failures in the eyes of the general public is monopoly. On this issue and others, the authors approach the "market failure" from a public choice point of view, showing that the incentives of government officials are structured in such a way as to exacerbate the very problems, real or imagined, that the State is being used to solve.

For example, politicians in a democracy must seek popular re-election. The easiest and most effective means of staying in office is often the use of public power to benefit an electorally powerful interest or constituency. Why then the absurd belief that politicians can be relied upon to eliminate monopolies? For one thing, a genuine monopoly is impossible to maintain against the forces of a competition in a free market economic system. Politics is the only means of creating a sustainable monopoly through artificial barriers to competition. More importantly, it is in the interest of politicians to structure regulatory mechanisms that inhibit competition and lead to consolidation, since this creates a wealthy and grateful backer for the politician.

In a similar fashion, Mitchell and Simmons argue convincingly that market failures are often ill-defined and almost never warrant the degree of criticism they invoke. To drive the point home, the authors show that private solutions are invariably superior to public solutions. In fact, most of the book deals with what the authors call "public failure," the inability of the public sector to live up to the vision of an efficient and benevolent government handling the flaws of the marketplace.

The book ends with a call for a return to a free and unfettered economy, something which the authors have succeeded in demonstrating as superior to the various schemes involving the State. Occasionally lost in the long discussions of the personal interests of politicians and bureaucrats and the economic consequences of interventionism is the fact that the most precious cost of growth of the State can be measured in terms of human liberty. The loss of freedom may be one of the unseen costs for economists, but it is the heaviest of burdens for civilization.

Beyond Politics is flawed by an over-reliance on equilibrium models to illustrate points in the text. A free economy is dynamic and constantly changing. Many of the authors' points could be made using economic laws based on apodictic principles that do not presuppose static conditions in the economy. But this caveat should not preclude an appreciation of the devastating critique of statism, government intervention, and the pretensions of the political classes found in this book's pages. *Beyond Politics* is a cogent defense of the economic system of a free society and a firm rebuttal to some of its most vociferous critics among the economics profession. It deserves the attention of anyone interested in the great economic controversies of our day. □

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Investment Biker

by Jim Rogers

Random House • 1994 • 402 pages • $25.00

Reviewed by Richard A. Cooper

Jim Rogers autographed my copy of *Investment Biker* with the words, "Life is short; Ride hard and far." Rogers closes his highly readable account of the round-the-world motorcycle trip he and girlfriend Tabitha Estabrook accomplished with more words of wisdom: "More important, I've also learned that if you've got a dream, you have to try it; you must get it out of your system. You will never get another chance.

If you want to change your life, do it." Motorcycles, markets, and musings make this book both provocative and entertaining.

Viewers of the CNBC show *Mutual Fund Investor* will recognize his blend of down-home Alabama folksiness, savvy investment insights, and shrewdly biting public policy comments. Those viewers and other readers will marvel at the observations of Jim riding about China, Russia, Africa, South America and elsewhere, as he records his impressions and predictions about economic policies and investment prospects. Often he saw how bad economic policies and wars had squandered great natural endowments and the labor of the inhabitants.

Why does Jim Rogers want to see and know the world? He hails from the small town of Demopolis, Alabama. His family's phone number was 5. Just 5. As he says, if you are from somewhere that small you either stay there your whole life or you want to get out and make your mark in the wider world. Despite the folksiness, Rogers is a well-educated and sophisticated man. From Yale he went to graduate school at Oxford with a summer stop on Wall Street along the way. He was a partner in a hedge fund after going to Wall Street full time. Jim left Wall Street in 1980 with millions of dollars.

Jim and Tabitha's trip—intellectually and geographically—began in Ireland. Let Jim tell this part: "Riding through this part of Ireland was wonderful, great for motorcycles, the roads curvy and small and convoluted, green and beautiful. All my life, from my history courses at Yale to my work at Oxford and later on Wall Street, I've studied geography, politics, economics, and history intensely, believing they are interrelated, and I've used what I've learned to invest in world markets. I was on the lookout for investment opportunities, for some country—and its investment market—about to take off, where I could jump in and make five, ten, fifteen times what I put in."

Unfortunately, Ireland could not meet Jim's tests. He worried over its instability but was most concerned about statist policies. The conflict between statism and entrepreneurial capitalism is one of Jim's key themes. Where statism reigns, decay increases and opportunity decreases. Tied to that conflict is the burden of war frustrating the achievements of peace.

Jim observes that "Ireland is a victim of statism, which my dictionary defines as the concentration of economic controls and planning in the hands of a highly centralized government, and which I further define as the belief that the state is the mechanism best suited for solving most if not all of society's ills, be they health related, natural disasters, poverty, job training, or injured feelings. Statism is *the* great political disease of the twentieth century, with Communist, socialist, and many democratic nations infected to a greater or lesser degree. When the political history of our century is written its greatest story will be how a hundred variants of statism failed." I would say this is the story that should be written, but I expect that the story told will be how the historians' preferred brand of statism was not tried with enough rigor or was mishandled.

Unlike economists, Rogers is not merely interested in economic policy or analysis but in scouting out investment prospects. He is none too optimistic about the United States. Bright spots include Botswana. Botswana? Yes, and he tells a great story about why he is optimistic about this small African country.

Investment Biker shows you a world through a unique pair of eyes—badly maintained roads and sweeping natural vistas, economies wrecked by statist mismanagement, and countries torn by renewed tribalism. All this with a country boy's way with words and a Wall Streeter's eye for investment opportunities. You can enjoy the ride with Jim Rogers, and think of your gasoline savings. □

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