THE FREEMAN

IDEAS ON LIBERTY

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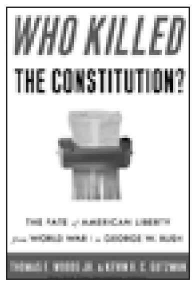

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THE FREEMAN
IDEAS ON LIBERTY

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Perspective

Bad Regulation Drives Out Good

In 1969 economist Harold Demsetz identified a flaw in much public policy analysis, the "Nirvana Fallacy":

"The view that now pervades much public policy economics implicitly presents the relevant choice as between an ideal norm and an existing 'imperfect' institutional arrangement. This *nirvana* approach differs considerably from a *comparative institution* approach in which the relevant choice is between alternative real institutional arrangements."

A common form of the fallacy is rejection of the imperfect free (or freer) market in favor of (presumably) omniscient, omnipotent, and omnibenevolent government regulation. A "flawed" but achievable arrangement is set against an (alleged) ideal, though it is left unestablished whether the ideal can in fact exist. The problem here should be obvious. If the ideal is *not* available, then the comparison is worthless. If the rejected option were compared to other *achievable*—also imperfect—alternatives, it might well be judged superior.

A recent example of the Nirvana Fallacy comes from Sen. Charles Schumer of New York. Asked how the Obama administration will prevent another financial crisis, Schumer said:

"You're gonna find a different system of regulation. . . . So like when Bear Stearns *began to run into trouble*, they're gonna call the heads of Bear Stearns in and say, 'All right fellas, you're getting rid of those two hedge funds; you're gonna raise more capital—even if it means you have lower profitability. . . . [Y]ou do it or we're gonna take sanctions against you.' . . . You need a tough, strong regulator, unified—no holes in the system— . . . who . . . *sees the problem ahead of time*, so they have *complete transparency*, they *know exactly what's going on*. . . ." (emphasis added)

We see at once that Schumer assumes what he must demonstrate: namely, that the regulator can overcome the Hayekian "knowledge problem," the limits posed by the fact that the most critical economic information is not readily obtainable statistical data but rather is diffused and often unarticulated knowledge, including know-how.

Look at what I've highlighted in his statement, and ask yourself what Schumer apparently has not asked himself: How will the regulators "know exactly what's going on"? Spotting Bear Stearns's specific hedge-fund problems "ahead of time" would have required insights and hunches that only entrepreneurs with money at risk could be expected to have—and even those might not have been enough. Fortune-telling is not a widely distributed skill. It's not a matter of toughness or access to Bear's books but, at the very least, of entrepreneurship (not to mention luck), which is profit driven. Bureaucratic regulators bring no such talent to their jobs. More likely, they'd be enforcing formal (possibly outdated and irrelevant) rules, looking for a repeat of the last problem, while missing the next one entirely. As Nassim Nicholas Taleb might say, it's the *next* black swan, not the last one, that bites you.

Schumer's fallacy is actually worse than the standard Nirvana Fallacy. He doesn't compare his unrealizable regulatory vision to the *free* market but rather to our corporatist economy replete with government bailouts, moral hazard, easy credit, and all the other ways of disabling market forces.

The closest we can get to what Schumer says he wants is through the discipline—that is, the regulation—imposed by the unfettered market. That includes bankruptcy's Sword of Damocles and the freedom of traders to sell short—that is, to profit by betting that a company's stock is overvalued and communicating that information to the market early. Predictably, the government is planning to restrict short selling. Bad regulation drives out good.

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Advocates of big government claim they learned lots of lessons from the New Deal. But here's something they missed: The post-1929 economy began to rebound before FDR's programs could have taken effect and even before he took office. Jim Powell explains.

Government spending is said to be indispensable to recovery from a recession thanks to the magic of the "multiplier." Is there really more bang from the government-directed buck? James Ahiakpor debunks the myth.

But surely the government is good at creating productive jobs when it spends money, no? Larissa Price, applying Bastiat's lesson, throws cold water on that hope.

By now you may have bought some of those funny-looking spirally light bulbs after hearing they use less energy and save you money—only to find that they can't hold a candle to the old incandescent bulbs. Thanks to Congress and former President George W. Bush, though, soon you won't have a choice. Michael Heberling has the unfortunate details.

Last spring's G-20 economic meeting called for a crusade against tax havens, places where people can protect their wealth from greedy politicians. Daniel Mitchell comes to their defense.

Can there be freedom when the state sees itself as Robin Hood? Carlos Rodríguez Braun shoots an arrow into the heart of that belief.

Land has been at the center of conflict from time immemorial. Even so-called capitalist countries have been blemished by land monopolies, government-sponsored speculation, and feudal-style interventions, such as property taxes. Joseph Stromberg conducts a tour of the great land question.

Our columnists again serve up an intellectual feast. Lawrence Reed writes about perseverance in the face of adversity. Thomas Szasz further documents psychiatric slavery. Burton Folsom takes a critical look at an economic interpretation of the Constitution. John Stossel examines the "fatal conceit" of interventionists. Walter Williams defends school choice. And Robert Murphy, encountering a free-market advocate's case for government monitoring of derivatives, responds, "It Just Ain't So!"

Our reviewers render verdicts on books about World War II, libertarianism, early globalization, and the Constitution.

—*Sheldon Richman*
srichman@fee.org

Give Up? Are You Kidding?

BY LAWRENCE W. REED

"These are the times that try men's souls. The summer soldier and the sunshine patriot will, in this crisis, shrink from the service of their country; but he that stands by it now, deserves the love and thanks of man and woman. Tyranny, like hell, is not easily conquered; yet we have this consolation with us, that the harder the conflict, the more glorious the triumph. What we obtain too cheap, we esteem too lightly: it is dearness only that gives everything its value. Heaven knows how to put a proper price upon its goods; and it would be strange indeed if so celestial an article as freedom should not be highly rated."

So began the first of 16 pamphlets under the title "The American Crisis," by patriot Thomas Paine. These very words were read aloud to General George Washington's forlorn and bedraggled men on Christmas 1776, the night before the Battle of Trenton.

Consider the backdrop: For the six months since the Declaration of Independence, Americans had been in almost constant retreat. To a disinterested observer, the American cause must have seemed hopelessly quixotic. To many patriots as well, it appeared all but lost. But Paine's stirring words helped give the troops the morale boost they needed. The next day they accomplished the impossible, capturing nearly the entire force arrayed against them. Desertions plummeted and reenlistments soared.

Lovers of liberty need a little Paine today in the face of all the pain around us. It seems at times that the world has gone mad. Companies that lose billions are being bailed out by a government that loses trillions. The same federal Leviathan that outlaws competition in first-class mail delivery but still can't deliver letters at a profit now supposedly knows how to run auto companies, banks, and insurance firms. Debt, deficits, bureaucracy, regulation, government spending—the depressing stuff already in frightful superabundance pre-financial crisis—now threaten our diminishing liberties more than ever before. The cover of the March 15 issue of *Newsweek* proclaimed, "We Are All Socialists Now."

No Sunshine Soldiers

Maybe we have good reason to feel like those dispirited troops on Christmas Day in 1776, but we should learn from what they did just a day later. We can either be summer soldiers and sunshine patriots, or we can let the very principles we profess be our rallying cry for the battles ahead.

We can either be summer soldiers and sunshine patriots, or we can let the very principles we profess be our rallying cry for the battles ahead.

Eternal optimist though I am, I admit that pessimism really tugs at me when I read the morning papers. At every speech I give these days, there's a sizable portion of the crowd that seems ready to crawl under a rock and let the world go to a statist hell in a hand basket.

But then I ask myself, what good purpose could a defeatist attitude possibly promote? Will it make me work harder for the causes I know are right? Is there anything about liberty that an election or events in Congress disproves? If I exude a pessimistic demeanor, will it help attract newcomers to the ideas I believe in? Is this the first time in history that believers in liberty have lost some battles? If we simply throw in the towel, will that enhance the prospects for future victories? Is our cause so menial as to justify deserting it because of some bad news or some new challenges? Do we turn back just because the hill we have to climb got a little steeper?

Lawrence Reed (lreed@fee.org) is the president of FEE.

Readers of this magazine should know the answers to those questions.

This is not the time to abandon time-honored principles. I can't speak for you but someday I want to go to my reward and be able to look back and say, "I never gave up. I never became part of the problem I tried to solve. I never gave the other side the luxury of winning anything without a rigorous, intellectual contest. I never missed an opportunity to do my best for what I believed in, and it never mattered what the odds or the obstacles were."

A Tradition of Courage

Remember that we stand on the shoulders of many people who came before us and who persevered through far darker times. The American patriots who shed their blood and suffered through unspeakable hardships as they took on the world's most powerful nation in 1776 are certainly among them. But I am also thinking of the brave men and women behind the Iron Curtain who resisted the greatest tyranny of the modern age, and won. I think of those like Hayek and Mises who kept the flame of liberty flickering in the 1930s and '40s. I think of the heroes like Wilberforce and Clarkson who fought to end slavery and literally changed the conscience and character of a nation in the face of the most daunting of disadvantages. And I think of the Scots who, 456 years before the Declaration of Independence, put their lives on the line to repel English invaders with these thrilling words: "It is not for honor or glory or wealth that we fight, but for freedom alone, which no good man gives up except with his life."

> We should not squander a second feeling bad for ourselves. This is a moment when our true character will show itself.

As I think about what some of those great men and women faced, the obstacles before us today seem rather puny. We just need to gird our loins. We have to get a lot smarter and better at reaching more fellow citizens with a compelling alternative to the dead hand of the corrupt and incompetent State. We need to put confident smiles on our faces and sally forth.

Time to Rally

We should not squander a second feeling bad for ourselves. This is a moment when our true character, the stuff we're really made of, will show itself. If we retreat, that would tell me we were never really worthy of the battle in the first place. But if we resolve to let these tough times build character and rally our dispirited friends to new levels of dedication, we will look back on this occasion someday with pride at how we handled it. Have you called a friend yet today to explain to him or her why liberty should be a top priority?

Nobody ever promised that liberty would be easy to attain or easy to keep. The world has always been full of greedy thieves and thugs, narcissistic power seekers, snake-oil charlatans, unprincipled ne'er-do-wells, and arrogant busybodies. Sometimes they're nattily dressed in custom-tailored, pin-stripe suits and give good speeches; sometimes they're bedecked in jewel-studded robes and give lousy speeches; on yet other occasions they wear well-worn street clothes and don't bother with a speech at all as they hold you up. It doesn't matter how they're dressed or what they say. No true friend of liberty should just roll over and play dead for any of them.

Wipe that frown off your face and get to work. Liberty's future depends on you.

Government Must Keep Track of Derivatives? It Just Ain't So!

BY ROBERT P. MURPHY

In a surprising *Wall Street Journal* op-ed (www.tinyurl.com/cj6jge), property-rights advocate Hernando de Soto writes that our current financial woes resulted from government's failure to keep tabs on the derivatives market. De Soto has been a hero of free marketeers since publication of *The Mystery of Capital*, which shows that nations are poor where people lack formal, secure, and easily transferable property titles. In the current crisis, he says, trust among participants in the financial sector evaporated because the value of mortgage-backed securities, credit default swaps, and other derivatives couldn't be verified. And that was because of what government did not do.

Economist Hernando de Soto.
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"Unlike all other property paper," de Soto writes, "derivatives are not required by law to be recorded, continually tracked and tied to the assets they represent. Nobody knows precisely how many there are, where they are, and who is finally accountable for them."

Hence: "Government's main duty now is to bring the whole toxic environment under the rule of law where it will be subject to enforcement."

I largely agree with de Soto's diagnosis of the problem, but not his solution. When I worked in the financial sector in early 2007, my boss said his associates in New York were getting nervous because nobody knew how much leverage their trading partners had. It was thus pointless to run the standard "value at risk" and other calculations they teach finance grads, because no individual participant—even a large hedge fund or investment bank—could see the big picture in deals involving complex derivatives. Indeed, after everything blew up, I talked to one credit analyst at an insurance company who said, "Have you ever actually tried to *read* one of these credit default swap contracts? Nobody really knew what they did."

Free Markets Don't Mean Omniscient Entrepreneurs

I bring up these anecdotes to bolster my view that the market critics are probably (at least partially) correct to blame the financial bust on overextended firms that horribly miscalculated the risks they were assuming. I would be willing to go even further and say that innovative financial products that appeared to mitigate risk at the individual level might have paradoxically made the entire system more vulnerable.

But the market critics and de Soto go wrong in concluding that only *governments* can fix the problem. These advocates of increased regulation fail to realize that the case for the free market does *not* rely on omniscient entrepreneurs. Fans of the market should not be embarrassed to admit that sometimes even well-established companies screw up royally and lose billions of dollars.

Robert Murphy (rpm@ConsultingByRPM.com), an adjunct scholar of the Mises Institute and a faculty member of Mises University, runs the blog Free Advice, and is the author of The Politically Incorrect Guide to the Great Depression and the New Deal *(2009).*

Or at least, that's what *would* happen in a true profit-and-loss system. The self-regulation of the market only works when profits *and losses* are allowed. When trying to make sense of why so many large firms were so careless with their investments, we can't ignore the perverse incentives the government had created in a multitude of ways.

For example, the ratings agencies didn't need to worry that they would be ruined if their AAA ratings on mortgage-backed securities turned out to be absurd. If any private-sector actors can be directly blamed for the financial debacle, it would be S&P, Moody's, and Fitch. Yet these rating agencies are still in business because government regulations require banks and other institutional investors to hold bonds and other securities with a certain rating, and (of course) the regulations cartelize the rating industry. Specifically, SEC regulations require that institutions receive their (legally mandated) ratings from a "nationally recognized statistical rating organization" (NRSRO). But lo and behold, it is very difficult for any outsiders to attain this exalted NRSRO status. Since the big three agencies have a guaranteed demand for their services, is it any wonder that they were careless in granting the desired ratings to the complex securities being pushed by their big clients during the boom years? And let's not forget the government-induced shaky mortgages at the foundation of those derivatives.

It is absurd to ask politicians to promote financial integrity and sound accounting.

The fundamental problem with de Soto's analysis is that he thinks politicians and bureaucrats can be trusted to improve financial transparency. This is the height of naiveté. Has de Soto flipped through the U.S. tax code recently? Doesn't he realize that seemingly every week Treasury Secretary Geithner announces another convoluted plan to use tax dollars to encourage leveraged investment in precisely these "toxic" assets?

Apparently, de Soto thinks the virtue of Western governments over the centuries has been to *create* an orderly body of laws within which the free market can flourish. I would argue that it was the relative impotence of Western governments that allowed a market-driven law to emerge, which these governments then codified.

Economists such as Bruce Benson, David Friedman, and Edward Stringham have thoroughly documented the spontaneous development of legal customs and financial rules without any enforcement from the state. The entire body of English common law, too, was not centrally designed by legislatures, but instead emerged out of myriad individual rulings given by judges, as did the Law Merchant, the early modern global commercial law.

Had the government minded its own business, the private financial sector would have learned from its mistakes during the housing boom. There is no reason to suppose that Geithner or anyone else employed by the government can come up with a solution that private analysts couldn't discover. Quite the contrary. In fact, every move the government has taken during the crisis has expanded its power over the private sector and its ability to shower literally trillions of dollars on powerful beneficiaries. Doesn't de Soto see the immense scope for corruption if the government gains more discretionary power over financial transactions?

Ironically, it is the government's *response* to the initial crisis that has led to less transparency not more. Had the troubled firms been allowed to fail, bankruptcy proceedings would have ascertained which companies were holding which assets and how they should be valued. But at least since December 2007, the Federal Reserve has artificially propped up insolvent firms by accepting their "toxic" assets as collateral on short-term loans. In this environment, of course the most leveraged firms will string their investors along and carry derivatives on their books at inflated values.

Regardless of what caused the crisis, government efforts to regulate derivatives will only lock in undesirable aspects of the current market and ensure that politically connected players reap artificial gains. It is absurd to ask politicians to promote financial integrity and sound accounting. They are the worst violators of these principles on the planet. FEE

FDR's Lucky Timing

BY JIM POWELL

On his *New York Times* blog page, Paul Krugman displayed a graph showing that the post-1929 U.S. economy began to expand before Franklin Roosevelt took office. Certainly the economy was recovering before any of FDR's policies had time to play out through the large and complex U.S. economy.

During 1933, Roosevelt's first year in office, GDP increased about 17 percent. What would have accounted for that?

Not FDR's 1933 decision to seize privately owned gold and devalue the dollar from $20 per ounce of gold to $35. This increased the value of gold held by the U.S. Treasury and entitled it to print an additional $3 billion of greenbacks. The Thomas Amendment to the Agricultural Adjustment Act (AAA) authorized the Treasury to print $3 billion more. Nonetheless, the total amount of currency held by the public didn't increase until 1934. The Fed wasn't very active during this period.

The most sweeping pieces of legislation passed in 1933—the climax of the Hundred Days—were the National Industrial Recovery Act (NIRA) and the Agricultural Adjustment Act, but both promoted *contraction*, not expansion. The NIRA authorized FDR to establish cartels fixing wages, prices, and output. The AAA aimed to *reduce* agricultural acreage.

Recovery Preceded Policy

It's not clear how any of FDR's 1933 policies could have accounted for a 17 percent increase in GDP, even if they promoted expansion, because they wouldn't have had time to ripple through the economy. It seems more likely that FDR had the good fortune to come into office near the bottom of the Depression, and enough adjustments in wages, prices, and other factors had occurred that the economy was ready to recover. The economy had recovered from previous panics, crashes, and depressions without a big-government program. Undoubtedly FDR's sunny personality and formidable communications skills helped give people confidence they could achieve a turnaround.

> FDR had the good fortune to come into office near the bottom of the Depression. The economy was ready to recover.

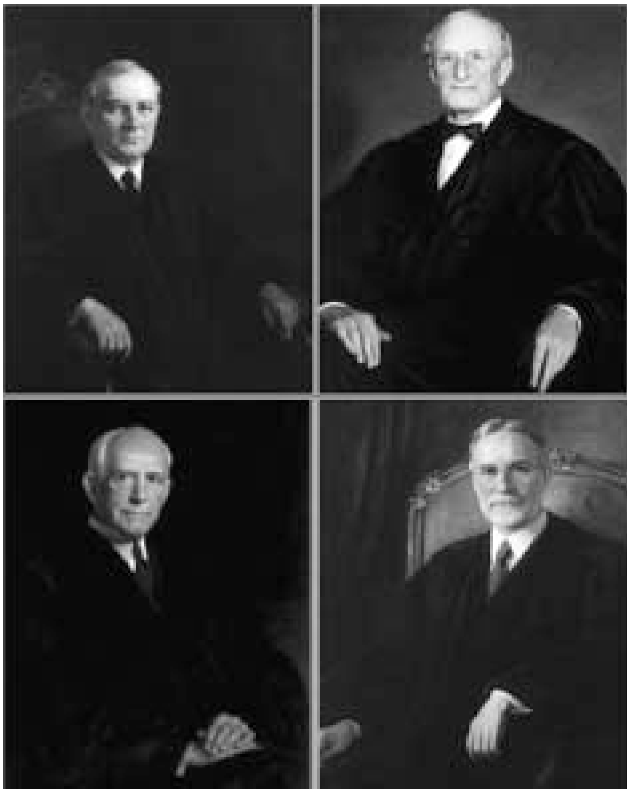
From 1933 to 1937 GDP increased about 60 percent. This was the biggest GDP expansion of the New Deal—and it occurred without federal spending and deficits that would qualify as Keynesian stimulus. Krugman wrote, "[T]he New Deal didn't pursue Keynesian policies. . . . [F]iscal policy was only modestly expansionary." Other economists, such as Price V. Fishback, agree that New Deal budget deficits probably didn't contribute to recovery—Fishback calls FDR's deficits "tiny."

Since the NIRA and AAA promoted contraction, the Supreme Court gave the economy a boost in 1935 by striking them down. Ironically, FDR viewed the anti–New Deal justices as the "Four Horsemen of Reaction."

Jim Powell (powellj@optonline.net), a senior fellow at the Cato Institute, is the author of FDR's Folly, Wilson's War, Bully Boy, Greatest Emancipations, The Triumph of Liberty, *and other books.*

Raising Labor Costs

It has often been said that the depression-within-a-depression of 1938 happened because FDR foolishly cut federal budget deficits, but that couldn't have been the case since the dramatic 1933–1937 expansion occurred without meaningful deficit stimulus. Other factors help explain that depression, starting with the newly centralized Federal Reserve Board's decision in July 1936 to increase minimum required bank reserves 50 percent and its decision in January 1937 to increase bank reserves another 33.3 percent. Suddenly, less money was available for lending, and interest rates went up—a double whammy for employers. The Social Security excise tax on payroll began to be collected in 1937, making it more expensive for employers to hire people. The undistributed profits tax became a big issue in 1937. The Supreme Court upheld the Wagner Act in 1937, setting off the rapid unionization of mass-production industries, which led to an 11 percent increase in wage costs during that *depression* year—and a resulting surge in unemployment.



FDR's "Four Horsemen of Reaction" struck down New Deal programs that threatened economic recovery.
www.supremecourthistory.org

The problem with the New Deal wasn't expansion. The problem was the persistence of high unemployment despite expansion. Many economists point to New Deal laws such as the NIRA, the Wagner Act, and the Social Security payroll tax (there weren't yet any Social Security benefits), which made it more expensive for employers to hire people. Whenever anything becomes more expensive, there's likely to be less demand for it.

Uncertain Tax Environment

In addition, the succession of New Deal tax increases—1933, 1934, 1935, and 1936—reduced private funds available for hiring. And the constant tax changes made it hard for investors to estimate their potential risks and returns, so they remained on the sidelines. Investors, like everybody else, need predictable rules. No wonder investment was at historic lows during the 1930s. Without investment it was very difficult to create new jobs.

When FDR came into office he had Congress and the nation at his feet. He was hailed as a conquering hero. With his rhetorical acumen and political genius, he might have begun by forming coalitions to undo his predecessor Herbert Hoover's biggest disasters: the 1930 Smoot-Hawley Tariff that throttled trade and the 1932 revenue act that doubled many taxes. Ending rather than embracing Hoover's disasters would have been change that people could believe in! If, furthermore, FDR had avoided his own misguided policies, the expansion probably would have been more robust, and without the blunders of 1937, it might have lasted longer—and most important, it would have enabled the private sector to create millions more jobs. FEE

Keynes's Ghost

BY JAMES C.W. AHIAKPOR

Underlying the belief that increased government spending can stimulate the economy is the "expenditure multiplier" theory formalized by Richard Kahn in 1931 and later enshrined in modern macroeconomic analysis through John Maynard Keynes's 1936 book, *The General Theory of Employment, Interest and Money*.

That the Obama administration based its policy on the assumption that every dollar of government expenditure has $1.50 worth of impact is a remarkable testimony to Keynes's observation in that book: "The ideas of economists and political philosophers, both when they are right and when they are wrong, are more powerful than is commonly understood. Indeed the world is ruled by little else. Practical men, who believe themselves to be quite exempt from any intellectual influences, are usually the slaves of some defunct economist."

So it is that Keynes's false expenditure-multiplier argument, severely criticized by his contemporaries, can now be invoked in support of massive spending.

Stimulus proponents confuse saving with hoarding.

The argument is founded on two key assumptions that turn out to be false. First is the notion that savings are not spent but rather are withdrawn from the expenditure stream. That assumption prompts stimulus proponents to believe that taxation or government borrowing expands total spending, while leaving the money in the private sector retards it. The flaw is the equation of saving with hoarding. People save their unconsumed income in bank deposits and mutual funds, purchase bonds (private or government) and stocks, or some combination of all of these. Thus savings are the sources of funds spent by borrowers. And as the classical economist most admired by Keynes declared: "No political economist of the present can by saving mean mere hoarding."

That was Malthus, who was reaffirming Adam Smith's explanation in *The Wealth of Nations* that "What is annually saved is as regularly consumed as what is annually spent, and nearly in the same time too; but it is consumed by a different set of people." Note that "to consume" does not only mean "to eat." It also means to "use up." Thus John Stuart Mill elaborates Smith's explanation: "The word saving does not imply that what is saved is not consumed, nor even necessarily that its consumption is deferred; but only that, if consumed immediately, it is not consumed by the person who saves it. If merely laid by for future use, it is said to be hoarded; and while hoarded, is not consumed at all." And when savings are borrowed by businesspeople, they are "all consumed; though not by the capitalist.

James Ahiakpor (james.ahiakpor@csueastbay.edu) is a professor of economics at California State University, East Bay.

Part is exchanged for tools or machinery, which are worn out by use; part for seed or materials, which are destroyed as such by being sown or wrought up, and destroyed altogether by the consumption of the ultimate product. The remainder is paid in wages to productive laborers, who consume it for their daily wants; or if they in their turn save any part, this also is not, generally speaking, hoarded, but (through savings banks, benefit clubs, or some channel) re-employed as capital, and consumed."

Keynes's lack of formal training in economics, besides his eight weeks of tutorials from Alfred Marshall, may explain his failure to interpret correctly Marshall's own restatement of the meaning of saving, which Keynes himself quoted: A man "is said to spend when he seeks to obtain present enjoyment from the services and commodities which he purchases. He is said to save when he causes the labor and the commodities which he purchases to be devoted to the production of wealth from which he expects to derive the means of enjoyment in the future."

Increased government spending simply shuffles around currently earned incomes and savings without adding anything to total spending.

The Government Spending Shuffle

The multiplier's second incorrect premise is that government expenditures are "autonomous"; that is, government spending does not depend on current income. It may be true that politicians pay hardly any attention to the level of income in the economy when they choose how much government should spend. That it planned to spend $787 billion when the economy was in a recession is ample testimony to such an inclination. But the amount the government spends comes primarily from taxes paid out of the public's current income. Furthermore, government expenditures above tax receipts have to be paid for through the sale of bonds, purchased out of the public's savings. Thus increased government spending simply shuffles around currently earned incomes and savings without adding anything to total spending. And when government shifts more of current income toward its favored expenditures, the economy's future functioning is impaired because such spending yields less than would have resulted had the income earners spent the money themselves.

Borrowing from the rest of the world may add to total spending in the United States at the expense of spending in some other countries. But it is hard to conceive of foreign savers eager to send their unspent incomes to the United States when their own economies are experiencing recessions. Besides, the Keynesian multiplier idea is supposed to hold in every country. Thus it is unrealistic to expect that all governments would be able to increase their borrowing from "the rest of the world" in order to increase total world spending.

Borrowing from a central bank (inflation) may increase total spending beyond currently generated incomes. However, the stimulative effect can only be temporary, until nominal wages adjust to the resulting rise of prices and participants in the capital markets have taken measures to hedge against future capital losses. This is the classical forced-saving doctrine that Keynes read but failed to interpret correctly, thinking it applies only to an economy operating at full employment.

Indeed, David Ricardo described as an "absurdity" the belief in the ability of a central bank to promote lasting economic prosperity by issuing paper money. The belief, he said, attributes "a power to the circulating medium which it can never possess." Keynes encountered a similar warning about the futility of a central bank's money creation to promote prosperity in Ricardo's *Principles* but unwisely dismissed it as having relied on the assumption of full employment. The Federal Reserve evidently has been attempting to prove Ricardo wrong with its reckless money creation, especially since the third quarter of 2008. It has lost so far.

Production Drives Economies

A fundamental flaw of the Keynesian multiplier argument, besides the two faulty premises, is its failure to recognize that consumption spending follows production and the earning of income. It is incorrect to think of spending as one consumer handing over a fraction of her income to another to spend. Rather, individuals engage in production from which they earn incomes by selling what they do not consume. From the incomes thus earned, individuals purchase goods and services they themselves do not produce. The remaining income may be held in cash (hoarding) or turned over to others through purchasing interest- or dividend-earning assets (saving). That is why the classical economists emphasized that production, rather than consumption, drives an economy, another explanation Keynes encountered from Mill but could not interpret correctly:

> What constitutes the means of payment for commodities is simply commodities. Each person's means of paying for the productions of other people consist of those which he himself possesses. All sellers are inevitably, and by the meaning of the word, buyers. Could we suddenly double the productive powers of the country, we should double the supply of commodities in every market; but we should, by the same stroke, double the purchasing power. Everybody would bring a double demand as well as supply; everybody would be able to buy twice as much, because everybody would have twice as much to offer in exchange.

Before Keynes borrowed Richard Kahn's formulation of the expenditure multiplier, founded on consumption expenditures, other analysts had argued the "multiplying effect" of production, as Mill explains above. The argument is that increased productivity or a surge in production within one sector of an economy stimulates increased production in others as a result of the additional demand or income generated by that sector. Thus the discovery of high-yielding varieties in agriculture or the introduction of more advanced information-processing technologies into computers may have multiplying effects on production in other sectors of an economy. That explanation is a far cry from the Keynesian belief that by taking some of the public's income to subsidize the arts, pay the unemployed over an extended period, or cover children's health care, government will stimulate increased production in the rest of the economy. Even necessary expenditures on infrastructure entail forgone production. For a correct analysis, one always has to keep in mind the displacement effect of government spending.

Among Keynes's contemporaries who criticized his multiplier argument most consistently was R. G. Hawtrey, who declared it variously as "practically untenable, . . . nonsense, . . . [and] fallacious," and said that it does not represent "a correct account of the sequence of events." (See more of such criticisms in my "On the Mythology of the Keynesian Multiplier," *American Journal of Economics and Sociology*, October 2001.) Evidently, those who recommend massive government spending have paid little heed to previous criticisms of the multiplier argument. They presumably were impressed by its expression in algebra and geometry in modern macroeconomics textbooks. They also have not learned from the failure of former President Bush's tax cuts of 2008, which were meant to stimulate consumer spending and spare the economy from a downturn. Cutting taxes, only to borrow from the public to fund the increased deficit, could not have increased production. Perhaps the failure of the so-called stimulus to bring economic recovery will finally teach the right lesson on the impotence of increased government spending.

Massive, diversionary spending by government does not help the recovery process.

Economic recessions typically are the result of a mismatching of production with consumer demand. Given the incentives of producers to correct their own mistakes to recover profitability, economies sooner or later recover from recessions on their own. But recovery can be forestalled when governments undertake expenditure or regulatory measures that frustrate the corrective actions of private producers and consumers. Massive, diversionary spending by government does not help the recovery process. FEE

What the Drug Warriors Have Given Us

BY SHELDON RICHMAN

Violence among Mexico's drug cartels and government has spilled over the U.S. border and beyond. The *New York Times* reports, "In the past few years, the cartels and other drug trafficking organizations have extended their reach across the United States and into Canada. Law enforcement authorities say they believe traffickers distributing the cartels' marijuana, cocaine, heroin, methamphetamine and other drugs are responsible for a rash of shootings in Vancouver, British Columbia, kidnappings in Phoenix, brutal assaults in Birmingham, Ala., and much more. United States law enforcement officials have identified 230 cities . . . where Mexican cartels and their affiliates 'maintain drug distribution networks or supply drugs to distributors,' as a Justice Department report put it in December."

Does anyone still think the "war on drugs" is a good idea?

That may strike some people as an odd question under the circumstances, so let's take it from another direction. Have you seen the news stories about the violence on the border being perpetrated by the Mexican whiskey and cigarette cartels?

No? That's probably because there was no such violence and are no such cartels.

So why are there violent cartels in marijuana, cocaine, and heroin but not in whiskey and cigarettes?

All together now: *prohibition*.

"Our" Fault?

Of course the politicians blame everything and everyone but themselves for this spreading violence. "Our insatiable demand for illegal drugs fuels the drug trade," Secretary of State Hillary Clinton said. "Our demand"? Including hers? "Our inability to prevent weapons from being illegally smuggled across the border to arm these criminals causes the deaths of police officers, soldiers and civilians." Her answer, in addition to sending the Mexican government taxpayer money, is to go after consumers of drugs and manufacturers and dealers of guns she doesn't like.

Drug users and gun dealers are to blame for drug-cartel violence? That makes no sense. If it did, then drinkers and smokers would be creating violence, too. What's missing?

> Why are there violent cartels in marijuana, cocaine, and heroin but not in whiskey and cigarettes? All together now: prohibition.

Once again in unison: *prohibition*. Who brought us prohibition? Politicians. Every politician, bureaucrat, and agent who facilitates or enforces prohibition is an accomplice in the violence because he or she helps to create the conditions in which thugs have a comparative advantage in dealing drugs.

For years advocates of free trade in drugs—that is, basic rights to life, liberty, and property for drug consumers, producers, and merchants—have pointed out that prohibition, besides being an immoral invasion of liberty by the state, sets in motion a variety of concrete evils that harm innocent people. (No one has been more consistent and rigorous in this than Thomas Szasz). These evils include the corruption of law enforcement, violent crime, and the expansion of intrusive government. Besides these domestic evils, the U.S. government has alienated farmers in foreign lands by helping to destroy their crops and livelihoods. If that's not terrorism, nothing is. Crop destruction has been a recruiting tool for guerilla organizations, while

Sheldon Richman (srichman@fee.org) is the editor of The Freeman.

black-market profits finance them and others with malign intent.

Few listened to these Cassandras against the anti-drug crusade. Maybe people will listen now.

Government Impotence

While violent gangs that make their money selling drugs in the black market are murdering and kidnapping people, invading homes, and committing other atrocities, the politicians have nothing to say but the same bromides they've been repeating for years. Thinking we're either simpletons or amnesiacs, they expect us to be comforted by their words. (Will they be right?) They promise to defeat the cartels, crack down on drug use, and disrupt the gun trade. It won't work. It's never worked. It can't work. Black-market operators are always steps ahead of the plodding bureaucrats. Break up one gang and another emerges. The drugs keep flowing (there's plenty of bribe money), and consumers will have what they want when they want it. The profits made possible by the black market are powerful incentives to keep the industry going. Government is impotent. (They can't even keep drugs out of prisons!)

> The rest of us have no reason to support the complex of government and "private" tax-financed agencies that grow fat prosecuting the drug war.

Yet the gangs could be put out of business overnight. How? By removing the criminal penalties for the production, trade, and consumption of all drugs; by bringing the black market into the open, so disagreements can be resolved through civil channels and a talent for violence is no longer an advantage; by dissolving the extraordinary profits that illegal industries always reap.

Yes, it is that easy.

People will recoil. We can't do that! No? Then accept as normal the unspeakable violence that is starting to spread from city to city, because that is the alternative to the stubborn refusal to end the "war on drugs," which is really a war on people. Even full police-state tactics will not be able to control it, though that won't stop demagogic politicians from giving them a try.

The Drug War Finances Government Careers

I don't expect the multitude of officials who depend on the drug war for their livelihoods and power to endorse an end to prohibition. They have shown themselves more than willing to accept the violence (against others) as the price of their ambition. The new threat to us is an opportunity for them to amass more power, bigger budgets, and higher salaries.

But the rest of us have no reason to support the complex of government and "private" tax-financed agencies that grow fat prosecuting this war. The worn-out rationalizations can't stand examination. Prohibition keeps no one from getting any drug he wants at an affordable price. On the contrary, it encourages the creation of cheaper, more potent drugs, just as alcohol prohibition replaced wine and beer with hard liquor. (More bang in a more compact form.) Prohibition doesn't keep our children safe. It makes drugs into enticing forbidden fruits and pushes the trade into less-visible channels. Drugs aren't "dangerous," though people are capable of doing harmful things with them—and many other things. (Jacob Sullum's *Saying Yes* is an eye-opening book that I highly recommend.) Addiction is not a disease; it's a choice.

Everything the drug warriors have said is wrong—and often a conscious lie.

Drugs are to our society what Eurasia and East Asia were to Oceania in Orwell's *1984*: a convenient conjured-up demon to justify expansion of power and the usurping of liberty—in the name of keeping us safe.

What will it take, if not the current violence from Mexico, to make people see through the scam?

Look around. It's our self-proclaimed protectors from whom need we protection most. FEE

What is Seen and What is Unseen: Government "Job Creation"

BY LARISSA PRICE

Barack Obama says his roughly $800 billion American Recovery and Reinvestment Plan could save or create between three and four million American jobs by 2010. Many of these proposed jobs—building or repairing roads, bridges, and buildings—recall the New Deal. There is a modern twist, of course, with the promise to develop "alternative energy sources" such as wind farms, solar panels, fuel-efficient cars, and the like. "The jobs we create will be in businesses large and small across a wide range of industries," Obama promised, "and they'll be the kind of jobs that don't just put people to work in the short term, but *position our economy to lead the world in the long term*." (emphasis added)

First, one may ask: how can Obama and his economic advisers know what kinds of jobs will position our economy to "lead the world" in the long term? Indeed, how can we expect *anyone* to know what kinds of jobs will be able to offer such a guarantee of wealth and security, considering the enormous complexity of our world? Billions of individuals are constantly making decisions based on their own expectations about the future. Potential ideological shifts and their inevitable changes to policy funding and support complicate matters further. This is without considering technological advancements that can turn the best-laid central plans into white elephants. There is little an individual or group can possibly know or predict for the future, particularly on such a large scale as three to four million jobs.

There is little an individual or group can possibly know or predict for the future, particularly on such a large scale as three to four million jobs.

However, assuming Obama and his advisers are right—that his plan will indeed save or create that many jobs—what proof do we have that it will leave us better off than if it's not implemented at all?

In his essay "What Is Seen and What Is Not Seen," the French classical-liberal economist Frédéric Bastiat explained that there is a tendency to recognize only the intended consequences of an action (what is seen). However, there are often other, subsequent effects that are not perceived as connected to the action (what is not seen). Furthermore, the short-term effects of an action can sometimes be quite different from the longer-term, unseen consequences.

In the case of public works, Bastiat explained that government produces nothing independent from the resources and labor it diverts from private uses. When government borrows money to create jobs, what is readily seen are people employed and the fruits of their labor. However, what is generally not considered are the many things that could have been produced if the capital had not been removed from the private sector to fund the government programs in the first place. Such policies necessarily benefit some (the favored workers) at the expense of others (those who would have had the jobs that were not created) and eventually the taxpayers, who have to repay the debt.

Larissa Price (larissa.price@gmail.com) is a former FEE staff member.

What is Seen

New Deal public-works projects provided plenty of evidence for Bastiat's theory. They not only failed to help lift the economy out of the Great Depression but also served to make it "great."

First, many jobs created under FDR benefitted few besides those employed—in things like studying the history of the safety pin, collecting campaign contributions for Democratic Party candidates, chasing tumbleweeds, and cataloging 350 different ways to cook spinach. (See Lawrence Reed's *Great Myths of the Great Depression*, www.tinyurl.com/7eecje.)

In addition, much of the "job creation" was directed according to political preferences, rather than where jobs were arguably needed most. For instance, a disproportionate amount of public relief went to western "swing states" expected to help Roosevelt win votes in future elections, rather than to the poorest states, such as those in the South, which were already solidly Democratic during this period. Relief and public-works spending also seemed eerily to increase during election years, and it has been shown that votes for FDR correlated closely with jobs and other special government benefits given. (See Burton Folsom's *New Deal or Raw Deal? How FDR's Economic Legacy Has Damaged America*.)

When government controls wealth it inevitably tends to serve political ends rather than consumers.

What is Unseen

New Deal job-creation projects also impeded productivity by discouraging private firms from adopting new technologies. A prime example is a government farm in Arizona where a dairy crew discovered that it could turn a profit only by using milking machines, rather than milking by hand, and eliminating some jobs. But that would have violated the terms of a government loan. So the machines were not brought in, and the staff members who made the suggestion were fired. (Amity Shlaes tells the story in "The New Deal Jobs Myth," www.tinyurl.com/d3xda6.)

Roosevelt is still celebrated for his job-creating measures because the people who gained employment were easily seen. However, what wasn't (and isn't) so easily recognized is that to pay for his public-works experiments, the government sucked up much of the available capital by selling bonds and collecting taxes, including a 5 percent withholding tax on corporate dividends and ever-rising income taxes. The top income tax rate hit a staggering 90 percent. Thus the New Deal had the unintended consequence of prolonging the Great Depression by diverting resources that could have been used to create wealth.

Barack Obama and his advisers should take a lesson from history. The New Deal and its public-works projects were a disaster, and it would be remiss to think they should be given another try. As Bastiat explained, government doesn't create wealth; it only diverts it. When government controls wealth it inevitably tends to serve political ends rather than consumers. FDR's New Deal policies are a testament to that, and if they are repeated in response to our current economic crisis, it will only hinder the recovery. FEE

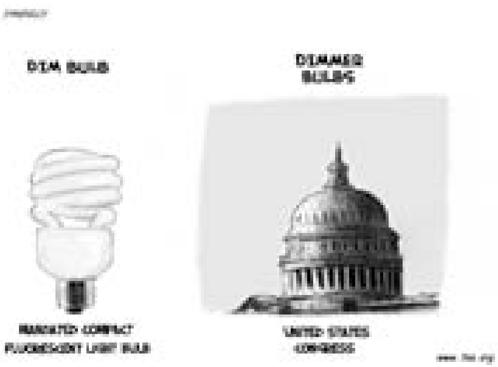
Dim Bulbs

BY MICHAEL HEBERLING

"Hell, there are no rules here—we're trying to accomplish something."

—Thomas A. Edison

Edison's words may have been true in the 1800s. Today, however, we have plenty of rules, thanks to the U.S. Congress. Some are so bizarre that you have to question the judgment of those who come up with them. One rule in particular is probably causing Edison to spin in his grave. His most famous invention, the incandescent light bulb, a mainstay in every American household for over a hundred years, has been banned by an act of Congress and will be replaced with the government-approved compact fluorescent light (CFL) bulb.



U.S. Rep. Jane Harman announced in a 2007 news release that her provision "bans Thomas Edison's favorite oldie, the 100-Watt incandescent, by 2012, and will phase out inefficient light bulbs by 2014. By 2020, it requires that all light bulbs be 300 percent more efficient than today's incandescents."

Unfortunately, the federal government's ban on products that happen to work just fine is nothing new. In writing about government-mandated products, I have noticed remarkable similarities in each case. They proceed through four phases and the light-bulb mandate is no exception.

Phase 1: Bureaucrats, "consumer advocates," and environmentalists trumpet how wonderful the new product is. The extensive hoopla surrounding it can be boiled down to just two claims: big savings for the consumer and benefits to the environment.

The Department of Energy (DOE) and the Environmental Protection Agency (EPA) began to promote CFLs in 1999 with their "Change a Light, Change the World" program. The DOE's and EPA's promotional (lobbying?) efforts were directed at members of Congress and governors, plus state and local officials, to encourage their constituents to participate. In 2006 then-Secretary of Energy Samuel Bodman said: "Here's a simple step we can take to preserve energy resources, save money and help the environment." This is the typical approach that the government uses to influence the marketplace. The government never states that its chosen product is better.

The "big savings" never refers to the retail price. This is because the government-endorsed products are always more expensive than the consumer-endorsed alternatives. A 75-watt incandescent bulb at my local Kroger store costs 22 cents. The 20-watt CFL (advertized as equivalent to the 75-watt bulb) costs $5.49–25 times more expensive. A three-way incandescent bulb (50-100-150 watts) costs $1.25. A three-way CFL (12-23-32 watts) costs $13.12. That's ten-and-a-half times more expensive. So when the government, environmentalists, and con-

Michael Heberling (mheber01@baker.edu) is president of the Baker College Center for Graduate Studies in Flint, Michigan.

sumer advocates talk about big savings, they are obviously not talking about the upfront cost. They mean the operating cost over the life of the product. CFLs are advertised to last up to ten times longer than the incandescent bulb and use 75 percent less energy.

In the not-too-distant past, patriotism was exploited by the government to elicit a desired response from its citizens. Today, it is environmentalism. This has become our de facto state religion. When the government says that we need to do something because it is good for the environment, we are expected to take it on faith. We are not to question the government's motives or logic for taking away our freedom of choice, but are expected to feel good about forgoing our selfish consumer desires because there is no higher calling in this country than saving the environment.

Rejected by Consumers

Phase 2: Consumers weigh the advantages and disadvantages of this wonderful product and decide that it is not really that wonderful after all.

CFLs have been on the market for some time, but so far consumers have not been impressed. Besides being expensive and strange looking, the light quality doesn't seem to please people. They are not as good for reading as incandescent bulbs are, for example. Many also complain that the bulbs flicker and buzz. Dimming the intensity of CFLs also poses a problem. It would appear that consumers have a very clear choice: They can pay more for the new inferior government bulb or pay far less for a superior existing product. This might help to explain why CFLs made up only 5 percent of the light-bulb market last year, according to H. Sterling Burnett of the National Center for Policy Analysis.

I have been trying one of these bulbs above the sink in our kitchen. When I get up in the morning to make coffee, I flip the switch—but the light doesn't really turn on. It starts off with a faint glow that gradually brightens for two to three minutes until fully illuminated. To get the lighting I want I must also turn on the light over the stove (one of those bad incandescent bulbs) because it brightens immediately. So now I am using two lights instead of one. Because turning the CFL on and off is so annoying, it is the one light in the house that we tend to leave on all the time. Why not? It's so cheap! This situation is analogous to what happened when the government imposed CAFE fuel-efficiency standards: People drove more.

Mandated by Government

Phase 3: Hating to have their recommendations ignored by the ignoramus class, the miffed elitist class takes steps to mandate their beloved product.

Here is a question that never gets a direct or honest answer: If these economical and environment-friendly products are so wonderful, why is it necessary to outlaw competing products? The unsaid answer appears to be: The government, consumer advocates, and environmentalists know what's best for the consumer.

In the not-too-distant past, patriotism was exploited by the government to elicit a desired response from its citizens. Today, it is environmentalism.

As Ed Feulner, president of the Heritage Foundation, put it, "It's only inferior or unnecessary products that require congressional intervention to survive. Useful or innovative products thrive on their own."

When Rep. Harman introduced the bipartisan ban on the Edison light bulb, she said, "Only 10 percent of the power used by today's incandescent bulbs is emitted as light, while the other 90 percent is released as heat." Let me see if I have this right. Here in Michigan, where we have long, cold winters, the incandescent light bulbs in our family room actually help keep my wife, daughter, and me warm while we watch TV and read. Since the lights in the rest of the house (except for the light over the sink) are all off, why is this considered a problem? In the summer, when it gets dark later, we hardly use the lights. So I fail to see why this issue demands heavy-handed congressional intervention.

The Energy Independence and Security Act, signed by President Bush in 2007, contained the incandescent ban, but it also included a Consumer Awareness Program, authorizing $40 million to help consumers make energy-efficient lighting "choices." Thus as the government takes away our freedom of choice, it also spends our money to convince us that we really have a choice.

Bad Product

Phase 4: It becomes clear that the consumer's reluctance was justified. The product is in fact bad. But it doesn't matter because the old product that worked has been outlawed.

The DOE guidelines for CFLs suggest that they be left on for at least 15 minutes after they are turned on, prompting Andrew Ferguson of the *Weekly Standard* to comment, "Odd, isn't it—an energy-saving device that you're not supposed to turn off?" It turns out that the lifespan of a CFL depends on how many times you turn it on and off. Failure to keep the light on causes the bulbs to burn out just as fast as the Edison bulbs. There go those big savings. So try to get in the habit of *not* turning off the lights after using the bathroom, a closet, or the laundry room. However, plan to come back 15 minutes later to turn off the light.

And while CFLs that are left on may last ten times longer than incandescent lights, no one is saying that they will fully perform for that long. A Department of Energy study found that after 40 percent of the advertised service life, a quarter of the CFLs started to become dim bulbs. If you don't mind having dim bulbs for 60 percent of the service life, then CFLs should make you happy.

A Department of Energy study found that after 40 percent of the advertised service life, a quarter of the CFLs started to become "dim bulbs."

While these mandated lights may be great for the environment, they are not so great for humans. In some people they trigger headaches or even migraines because of the nearly imperceptible flickering. The BBC reported that the bulbs can also increase the risk of seizures in people with epilepsy. According to the *Winnipeg Free Press*, the United Kingdom's Health Protection Agency recommends that people be no closer than about a foot from these lights for more than an hour a day. The ultraviolet radiation emitted by CFLs is like direct sunlight on bare skin. Thus the government is mandating that we all have miniature sun lamps throughout our homes.

But maybe the government light bulb is not really good for the environment after all. It turns out that the each CFL contains five to ten milligrams of mercury. Mercury is one of the most toxic substances on earth; it can cause serious health problems, including nerve and kidney damage. The mandate will result in millions or billions of CFLs ending up in landfills where the mercury will leach out to contaminate the soil and groundwater.

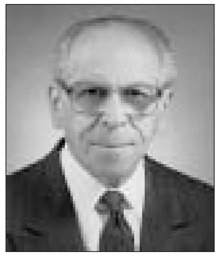
So how do CFLs fit with the EPA's recommendation that we purchase mercury-free products? It explains that the amount of mercury in the bulbs is much smaller than the amount in old-fashioned thermometers (which are disappearing from households) and watch batteries. Both statements may be true; however, I have never had a thermometer or watch battery explode, shatter, or break the way a light bulb does. It was also my choice to have, or not to have, a mercury-filled thermometer or watch battery. The EPA's final defense is that the health and environmental risks of CFLs are insignificant compared to the risk presented by the mercury put out by coal-burning power plants.

So what happens if a CFL next to my daughter's bed breaks? According to the EPA guidelines, I am to: 1) open the windows and evacuate the room for 15 minutes; 2) shut off the heating or air-conditioning system; 3) carefully scoop up the glass using stiff paper and place it in a glass jar or sealable plastic bag; 4) after vacuuming, wipe the canister and put the bag or debris in a sealed plastic bag; and 5) throw away clothing or bedding that comes in contact with the broken glass or the mercury-containing powder. I must not wash contaminated clothing or bedding because mercury fragments may also contaminate the washing machine or pollute the sewage.

Has this convinced you that the health and environmental risks of CFLs are minor?

As a result of the Energy Independence and Security Act, we will be forced to buy new light bulbs for every room in the house that are more expensive, of lower quality, dangerous to our health, and bad for the environment. Given this government mandate, the consumer has three options. The first is to go out and buy up all the old-fashioned Edison bulbs before they become illegal. The second option is to try to get a family discount on hazmat suits. The final option is to just say no to dim bulbs. U.S. Rep. Michele Bachmann has proposed the Light Bulb Freedom of Choice Act. She is facing extensive opposition from the green lobby, big government, and consumer groups. Sadly, fighting for freedom in this country has become an uphill battle. FEE

The Shame of Medicine: The Depravity of Psychiatry



BY THOMAS SZASZ

Responding to my May 2009 column (www.tinyurl.com/ddl5p6), George Mason University economics professor Bryan Caplan commented: "In the last couple of decades, a lot of people have apologized for the past crimes of the groups with which they identify: the U.S. for Japanese internment, the Church for Galileo, Swiss bankers for Nazi money laundering, even the Japanese (kind of) for their war crimes. I'd like to see psychiatrists do the same—to admit that unusual preferences are not 'disease,' affirm that it is wrong to treat people against their will, and turn their backs on the 'greats' of their profession who believed in and practiced coercive therapy."

I am grateful to Caplan for calling attention to a problem most people prefer to ignore. His expectation will, however, not be fulfilled, and it is important to understand why. Claiming competence in astronomy and incarcerating heretics are not integral to the identity of the Catholic Church. In contrast, claiming competence in predicting "dangerousness" and incarcerating persons alleged to be so because of "mental illness" are integral to the psychiatric enterprise. Wikipedia defines civil commitment as "the practice of using legal means or forms as part of a mental health law to commit a person to a mental hospital, insane asylum or psychiatric ward against their will and/or over their protests. . . . A common reason given for involuntary commitment is to prevent danger to the individual or society."

Psychiatrists alternately deny and delight in possessing special professional skill at detecting future "dangerousness" that entitles them to the special power to incarcerate individuals they so stigmatize in prisons that masquerade as hospitals. The American legal system makes heavy use of psychiatric determinations of dangerousness, as a result of which vast numbers of Americans are deprived of liberty and, at the same time, of opportunity to demonstrate the injustice of their detention. Examples abound.

> The American legal system makes heavy use of psychiatry, as a result of which vast numbers of Americans are deprived of liberty.

Kafka in Court

In March 2004 Susan Lindauer was arrested in Maryland and charged with "acting as an unregistered agent of a foreign government." She faced up to 25 years in prison. Instead of trying Lindauer, government psychiatrists declared her mentally incompetent to stand trial and incarcerated her at the Carswell Federal Medical Center in Texas, a facility described as providing "medical and mental health services to female offenders." But Lindauer was *not* an offender. She was an innocent American.

After "hospitalizing" Lindauer for 18 months, her "medical" torturers concluded that, although she was still mentally ill and incompetent to stand trial, she no longer needed psychiatric "care." Released from detention, she returned to Maryland where federal court services referred her to a private agency for counseling. According to a motion filed by her attorney, her counselor, Dr. Bruke Tadessah, said, "That evaluation showed a diagnosis of post traumatic stress disorder due to her experiences at Carswell." Last January the federal government dropped

Thomas Szasz (tszasz@aol.com) is professor of psychiatry emeritus at SUNY Upstate Medical University in Syracuse. His latest books, both from Syracuse University Press, are The Medicalization of Everyday Life: Selected Essays *and* Psychiatry: The Science of Lies.

its case against Lindauer as "no longer in the interest of justice," implying that her psychiatric persecution had been in the interest of justice.

Consider the contrast. Inmates of American mental-health facilities are stigmatized as "mental patients"; their torture is called "treatment"; and they are regarded as the beneficiaries of a caring government's therapeutic services. The inmates at the Abu Ghraib prison in Iraq were not stigmatized as "mental patients"; their torture was not called "treatment"; and they were regarded as the victims of government-sponsored "detainee abuse."

Indefinite Incarceration

When Donald Schmidt was 16, he molested and drowned a 3-year-old girl. Under California law juvenile offenders who commit serious crimes can be kept in the system only until they are 25. But Schmidt's detention has been extended under the state code that allows "continued detention if a jury finds the inmate has a mental disorder, defect or abnormality that causes the person to have serious difficulty controlling his or her dangerous behavior."

What is Schmidt expected to do to get a divorce from his "doctors" and regain his liberty? Every two years he can petition for release and hope that a judge will order a "trial," letting jurors decide whether he remains a "danger to society." Anticipating another such contingency, a Santa Cruz County district attorney Bob Lee declared, "We believe he's a psychopath." Richard A. Starrett, a clinical psychologist, agreed that Schmidt was still a danger, though "not a psychopath." Barry Krisberg, president of the National Council on Crime and Delinquency in Oakland, California, called Schmidt's situation "one in a million."

The claim that Schmidt's indefinite psychiatric sentence is unusual is typical of the deceit and depravity intrinsic to forensic psychiatry. John Hinckley, Jr., never convicted of a crime, is serving his 28th year of psychiatric imprisonment. Evidently the government's greatest psychiatrists need more time to cure him of dangerousness.

Psychiatry *is* the political legitimation of the incarceration of innocent individuals under psychiatric auspices, a practice that appears to enjoy near-universal approval by people in modern societies. Recognition of the fact that noncoercive psychiatry is an oxymoron is obscured by the concurrent practice of seemingly consensual "therapy." I say "seemingly" because the mental-health professional retains the privilege and obligation to deprive his patient of liberty if he "poses a danger to himself or others." As a result, psychiatrists and the press regularly tout psychiatric "reforms," while the "doctors" engage in ever-increasingly refined forms of psychiatric depravity, supported by the unquestioned and unquestionable premise that "dangerousness" justifies imprisonment called "hospitalization."

In the published report of a 1981 workshop titled *Behavioral Science and the Secret Service,* sponsored by the prestigious Institute of Medicine, Robert Michels, University Professor of Medicine and of Psychiatry at Weill Cornell Medical College in New York, asserted that "most mental health professionals believe that there is no major ethical dilemma if it is in the patient's interest to violate his confidentiality, and that it is generally in the patient's (as well as society's) interest to prevent a major violence." The assertion that "most mental health professionals believe" that violating a defendant's Sixth Amendment right to trial serves his interest is evidence of psychiatric depravity, not morality.

To make matters worse, a few pages later the workshop reporter informs us that "Some conferees, including psychiatrists Robert Michels and Loren Roth [a prominent forensic psychiatrist and professor at the University of Pittsburgh], questioned the utility of making dangerousness determinations at all, because such decisions at any one time are likely to be highly unreliable and invalid. . . . Mental health professionals in general have not been shown to be better than anyone else in making predictions about behavior which might occur in the distant future under changing conditions."

None of this evidence impairs the professional standing of psychiatry as an ethical and scientific medical discipline. The psychiatric enterprise is so deeply rooted in social control and so strongly supported by pseudoscientific magic and prejudice that psychiatrists must either cling to and justify the coercive services they render or repudiate and abolish their profession as they and we know it. FEE

In Praise of Tax Havens

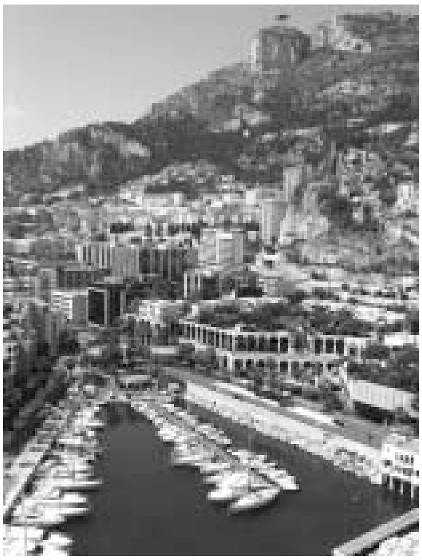
BY DANIEL J. MITCHELL

"The proprietor of stock is properly a citizen of the world, and is not necessarily attached to any particular country. He would be apt to abandon the country in which he was exposed to a vexatious inquisition, in order to be assessed to a burdensome tax. . . . A tax which tended to drive away stock from any particular country would so far tend to dry up every source of revenue both to the sovereign and to the society."

—Adam Smith, *The Wealth of Nations*, 1776

In May, President Obama declared war on Americans who shelter their money in low-tax jurisdictions overseas.

Meanwhile, at the behest of politicians from high-tax nations, international bureaucracies are persecuting these tax havens. The Paris-based Organization for Economic Cooperation and Development (OECD), for instance, blacklisted 41 such jurisdictions as part of its "harmful tax competition" project earlier this decade and is now trying to bully them into changing their attractive policies. The European Commission has several anti-tax-competition schemes, including a "saving tax directive" that seeks to coerce low-tax jurisdictions into helping Europe's welfare states track—and tax—flight capital. And the United Nations has a Committee of Experts on International Tax Matters whose objective is to impose global rules to hinder the flow of jobs and capital from high-tax nations to low-tax nations. As though this weren't enough, the G-20 communiqué last spring singled out tax havens for a crackdown.



Monaco has long been a tax haven for rich Europeans.
Photo courtesy Zoltan Gyenge

The common theme of all these efforts is that politicians want to replace tax competition with tax harmonization. Tax competition exists when politicians feel pressure to improve tax policy so the geese that lay the golden eggs will not fly away. Ever since the Reagan and Thatcher tax-rate reductions began the process of tax competition, nations have been racing to lower rates in hopes of attracting—or retaining—jobs and investment. Since 1980 average top personal income tax rates in the developed world have dropped about 26 percentage points and corporate tax rates more than 21 points. And there are now 27 jurisdictions with flat taxes, an amazing development. No wonder the global economy—notwithstanding current turmoil—is so much stronger today than it was in the 1970s.

According to stereotypes, tax havens are little islands in the Caribbean, and indeed that's true of some of the world's premiere offshore centers. But to be more accurate, a tax haven is any jurisdiction that satisfies two criteria: First, its tax laws are attractive to global investors and entrepreneurs, and second, it protects its fiscal sovereignty by choosing not to enforce the bad tax laws of other

Daniel Mitchell (dmitchell@cato.org) is a senior fellow at the Cato Institute.

nations, at least when they are trying to tax economic activity outside their borders. This means, of course, that individuals and businesses from high-tax nations have the option of using those jurisdictions as havens against excessive taxation.

Havens Are in The Nationality of The Beholder

So what are the tax havens? Places such as Liechtenstein and the Cayman Islands belong on the list, but so do many "onshore" nations. One of the world's leading experts on offshore issues, Marshall Langer, wrote in *Tax Notes International* that "the most important tax haven in the world is . . . Manhattan. . . . [T]he second most important tax haven in the world is London." The United States and United Kingdom are havens because the law enables foreigners to invest money and not report the income to their tax police. That's good for the U.S. and U.K. economies, and for foreign taxpayers.

By some counts there are more than 70 tax havens in the world, ranging from big nations like the United States to obscure, tiny jurisdictions such as Melilla, an autonomous part of Spain on the coast of Morocco, and Sark, a tiny British-controlled island off the coast of France. In some cases, such as the United States, the tax-haven policies are designed to attract global capital and are only available to foreigners. In other cases, such as the Bahamas, the beneficial tax rules are open to both residents and nonresidents.

Tax havens are valuable precisely because politicians are less likely to be greedy when they know taxpayers have escape options.

Tax havens are good for the global economy primarily for four reasons. First, they promote good policy around the world by pressuring politicians in high-tax nations to lower tax rates. The pro-growth changes noted earlier have been happening mostly because of tax competition, and tax havens are valuable precisely because politicians are less likely to be greedy when they know taxpayers have escape options. Remarkably, even OECD economists understand that tax competition is a pro-growth force in the world economy. They have admitted that "the ability to choose the location of economic activity offsets shortcomings in government budgeting processes, limiting a tendency to spend and tax excessively."

Tax havens have been especially helpful in convincing politicians to reduce the double taxation of income that is saved and invested. Many nations have lowered or eliminated death taxes and wealth taxes because the politicians have finally figured out that oppressive tax laws simply lead taxpayers to move their money to havens such as Luxembourg or Panama. Likewise, nations have reduced double taxation of dividends, interest, and capital gains. The politicians figure it's better to have a low rate and collect some money rather than to have a high rate and drive investment to Switzerland or Singapore.

From an economic perspective, these lower tax rates are critical because they reduce the tax bias against saving and investment. This encourages people to set aside more of today's income to finance tomorrow's growth—and even socialist economists agree that capital formation is the key to long-run prosperity and rising living standards.

Second, tax havens generate high living standards. According to World Bank data, nine of the world's 13 richest jurisdictions are tax havens. Not surprisingly, academic researchers have confirmed that tax havens grow faster and create more prosperity for people than higher-tax areas. This is especially important in the developing world, where poor nations that become tax havens enjoy big reductions in poverty.

Third, tax havens promote better governance. One of the problems plaguing the developing world is the lack of sound institutions. Property rights, the rule of law, and sound money are the indispensable building blocks for wealth creation and economic growth. Two academics, James Hines and Dhammika Dharmapala, found that the desire to become a tax haven leads nations to improve their institutions for the simple reason that global investors don't want to place their money in poorly governed jurisdictions. And the World Bank's governance indicators find that tax havens rank very high. This is something that should be applauded not assaulted.

Fourth, tax havens promote economic activity in high-tax nations. This seems paradoxical, but most countries, even high-tax nations, generally have more favorable tax rules for inbound investment than for their citizens' economic activities. Politicians figure their own citizens are captive customers who can be overtaxed, but they understand that they have to compete for global investment. Moreover, academic experts have found that citizens in high-tax nations often take advantage of this preference and use a neighboring tax haven as a platform to invest in their own country. This additional investment, which otherwise would not have taken place, increases the prosperity of the high-tax nation.

The case for tax competition also is bolstered by Nobel laureates who recognize that competition between nations is a critical force for better policy. To cite just three examples, James Buchanan wrote that "tax competition among separate units . . . is an objective to be sought in its own right," and Milton Friedman noted that "Competition among national governments in the public services they provide and in the taxes they impose is every bit as productive as competition among individuals or enterprises in the goods and services they offer for sale and the prices at which they offer them." Gary Becker, meanwhile, wrote that "competition among nations tends to produce a race to the top rather than to the bottom by limiting the ability of powerful and voracious groups and politicians in each nation to impose their will at the expense of the interests of the vast majority of their populations."

Tax havens protect people from venal and incompetent governments by providing a secure place to invest their assets.

Shelter From Persecution

Low-tax jurisdictions also offer a safe haven for people subject to persecution. The vast majority of the world's population lives in nations where governments fail to provide the basic protections of civilized society. Indeed, in many cases governments are the problem since ruling elites use their power to exploit people. Corruption often is rampant, expropriation common, and crime endemic. There is also widespread persecution. Not surprisingly, people with money are common targets of oppression—particularly if they are members of religious, political, ethnic, racial, or sexual minorities.

Tax havens protect people from venal and incompetent governments by providing a secure place to invest their assets. A Jewish entrepreneur, for instance, would be foolish to keep his money in a local bank when the government is controlled by anti-Semites. Indeed, Switzerland's admirable, centuries-old human-rights policy of protecting financial privacy was strengthened in the 1930s to protect German Jews who wanted to guard their assets from the Nazis.

Many groups in the world face discrimination and hostility, often from government. The ethnic Chinese in nations such as Indonesia and the Philippines frequently are resented by the local population. The same is true for people of Indian descent in East Africa. When people belong to groups that are unpopular and susceptible to being targeted by the government, it makes sense for them to protect their families' interests by putting money someplace like Hong Kong, where the politicians from their country have no feasible way to find out about it. The same financial-privacy laws that make tax havens so attractive to French families and Swedish entrepreneurs who want to escape oppressive taxation also protect other people from different forms of persecution.

Tax Hypocrisy, Not Harmonization

It is worth noting that even the international bureaucracies acknowledge the valuable role of tax havens and financial privacy. The UN, for instance, admitted in a 1998 report that "For much of the twentieth century, Governments around the world spied on their citizens to maintain political control. Political freedom can depend on the ability to hide purely personal information from a Government." The leader of the OECD's anti-tax-competition campaign, Jeffrey Owens, admitted to the U.K.-based *Observer* that "tax havens are essential for individuals who live in unstable regimes."

The campaign against tax havens interferes with the right of jurisdictions to pursue pro-growth policies, which is especially discriminatory against poor nations. Having "no or low taxes" is the main criterion for being listed as a tax haven by the OECD. Yet most OECD nations did not have income taxes during the 1700s and 1800s, when they climbed from agricultural poverty to middle-class prosperity. We should all be offended that such nations now want to deny that same opportunity to poor nations. It is rather unseemly for powerful white-governed nations in Europe, which control the OECD and European Commission, to target less powerful nonwhite jurisdictions in places such as the Caribbean.

Another issue is the OECD's hypocritical treatment of capital compared to labor. The Paris-based bureaucracy is upset that investment funds are flowing to low-tax jurisdictions, many of which are in the developing world. But OECD nations are big beneficiaries of a "brain drain" from developing nations. This flow of talent is beneficial to "labor-inflow" nations, just as global financial flows are beneficial to "capital-inflow" nations. Yet the OECD is not suggesting that developing nations have the right to tax emigrant income earned in OECD nations. So why should OECD nations be allowed to tax flight capital in non-OECD nations?

Another example of hypocrisy is that the United States, United Kingdom, Austria, Belgium, Switzerland, and Luxembourg are all OECD members and yet were not on the original OECD blacklist even though they are tax havens for foreign investors. (The list was later revised.) Only smaller less-powerful nations were subject to this form of discrimination. And of course the ultimate hypocrisy of all is that the bureaucrats who work at the OECD and UN all get tax-free salaries, yet they run around the world demanding that other nations raise taxes.

The bureaucrats who work at the OECD and UN all get tax-free salaries, yet they run around the world demanding that other nations raise taxes.

Politicians from high-tax nations and their agents at the international bureaucracies often admit that the moral issues are pertinent. But then they say that they are worried that havens enable some of their residents to avoid the tax net. But why is that the fault of jurisdictions with better tax policy? If high-tax nations want better compliance, shouldn't they fix their tax systems instead of trying to bully other nations into surrendering their fiscal sovereignty and becoming vassal tax collectors? In any event, the notion that there are huge amounts of unpaid tax is just one of several myths disseminated by opponents of tax competition. Let's have a look at these myths.

Myths of Anti-Competition

Myth 1: Tax havens result in $100 billion of unpaid taxes. President Obama wants to dramatically increase the power of the Internal Revenue Service, claiming that this is the only way to collect the money that supposedly is hiding in low-tax jurisdictions. The number is phony. The IRS—which certainly cannot be considered a fan of tax havens—estimates that the overwhelming share of the so-called tax gap is the result of what happens in the United States. Part of the make-believe $100 billion apparently comes from a former John Kerry staffer, who concocted an estimate of $70 billion in unpaid individual income tax. But when the Congressional Research Service (CRS) asked for the method used to generate the number, the staffer confessed, for all intents and purposes, that he made it up. According to the CRS memo, he "was not able to send us a written discussion of his estimating procedure" and he "indicated that the estimate was an uncertain one." That's the understatement of the century.

Myth 2: Cracking down on tax havens is the best way to improve compliance. Politicians from high-tax nations and bureaucrats at the OECD claim that "offshore" jurisdictions deprive politicians of much-needed tax revenue. This assertion is rather strange since tax receipts were at record levels in OECD nations until the current downturn. But how best to improve tax compliance? Academic research strongly indicates that the biggest factor in tax compliance is tax rates. When tax rates are excessive, people are less likely to obey the law. And if they can't protect their income using tax havens, they'll use the domestic underground economy. Or they'll be less productive. The world's leading expert on the issue, Friedrich Schneider at the Johannes Kepler University in Austria, explains that income and payroll taxes are "the main causes for the existence of the shadow economy" and higher tax rates increase "the incentive . . . to work in the shadow economy."

Myth 3: Tax Havens Lead to Higher Taxes for ordinary people. One of the worst myths is that low-tax jurisdictions reduce taxes on sneaky people and this causes politicians to raise taxes on others to make up the difference. But if this were true, increasing amounts of money flowing to tax havens should be accompanied by higher tax rates in the outflow countries. Yet, as noted, the opposite has occurred. Politicians are lowering tax rates because of the competition from tax havens. This means that all taxpayers benefit because of the risks taken by those who invest in low-tax jurisdictions.

Politicians are lowering tax rates because of the competition from tax havens. This means that all taxpayers benefit because of the risks taken by those who invest in low-tax jurisdictions.

Myth 4: Tax havens are money-laundering centers. Contrary to this routine smear, all the objective evidence shows that they have the toughest rules against dirty money. Not a single tax haven is on the blacklist of the Financial Action Task Force. A few tax havens are considered money-laundering centers by the CIA, but there are far more non-havens on its list. The State Department says the same thing. It's also worth noting that every major tax haven has been cleared by the IRS for having good know-your-customer laws to hinder dirty money, and all of the major havens also are members of the Egmont Group, which is open only to jurisdictions that have effective financial intelligence units to fight dirty money. No wonder an Australian academic found it was much easier to launder money in onshore nations than in offshore jurisdictions.

When he was a senator President Obama sponsored legislation designed to persecute tax havens, and his chairman of the National Economic Council, Larry Summers, is a harshly ideological opponent of low-tax jurisdictions. Now Obama has made good on his word. That places the U.S. on the side of countries like France and Germany, giving the OECD's previously stymied tax-harmonization efforts new life.

Advocates of economic liberty need to resist these efforts. The Center for Freedom and Prosperity, which was founded in 2000 to help protect tax competition, has done an excellent job (I'm a board member, so perhaps I am biased). But preserving tax competition in the new political environment is going to be a major challenge. FEE

From Good Samaritan to Robin Hood

BY CARLOS RODRÍGUEZ BRAUN

Unjust forms of accumulating wealth have always been open to, and practiced by, human beings, but progress depends on the restraints placed on this type of money-making. If six billion people can be fed today, it is because the normal way of becoming rich is not stealing or plundering or pirating, but something more beneficial: production in the market.

The market is a complex order. A thief needs only violence to get rich; a cattle trader needs more things, such as order and justice; in other words, an environment where transactions can be safely completed. The market does not obey "the law of the jungle"—just the opposite: The law of the jungle prevails where there are no markets. Peaceful exchange with secure property rights is more productive than widespread robbery, but many criticize the rich regardless of the path they followed to opulence, as if they all had achieved their wealth illicitly. Apparently, George Bernard Shaw's fallacious quotation still rules the day: "I am a gentleman: I live by robbing the poor."

The most common way to make a fortune in a free market is organizing a successful company. How can this company succeed and pay handsome salaries? In a free market there is only one answer: by making something consumers appreciate. Under such circumstances, the businessman's wealth is linked to the social utility of his labor, a utility proved by consumers who buy because they too benefit from the deal.

Of course, one can always make money breaking the law, as thieves and swindlers do. And there is also another method that, while unjust, does not always appear that way: to become rich by avoiding competition or gaining other privileges that only the state can grant.

Monopolies and protectionism exemplify these strategies. Both became the enemies of classical liberals, who argued in favor of the free market and against the privileged groups that injured the majority of the population by imposing high prices and limiting the ability to choose.

Alongside the state's expansion during the past century, opportunities to profit from using the state to avoid competition have proliferated.

Alongside the state's expansion during the past century, opportunities to profit from using the state to avoid competition have proliferated. Through the apparatus of government, lobbying groups have obtained power over their markets, subsidies, and every other kind of anticompetitive protection.

Blocking market activity breaks the connection between social needs and the supply of goods and services aimed at satisfying them. But it may turn out to be profitable: Fortunes have originated in anti-competitive privileges bestowed by political power or made possible by its regulations. In such cases it is fair to distrust the wealthy.

Often, however, no distinction is made when it comes to criticizing rich people. They all appear

Carlos Rodríguez Braun (crb@ccee.ucm.es) is professor of the history of economic thought at Universidad Complutense in Madrid, Spain.

reproachable, and few dispute the need to impose on them specific burdens and progressive tax scales aimed at dealing with the "problem" of inequality. The state must force-fit all of us into a Procrustean bed.

Internal Robin Hood Service

Many thus would have the state play Robin Hood, robbing from the rich (no matter how they got the money) and giving to the poor. I do not dispute that this legend is open to several interpretations, including a plausible libertarian one. Robin Hood can be seen as an enemy of tyranny and the abuse of law, a friend of the people, a man who robbed tax collectors and privileged aristocrats, returning the money to the victimized peasants. This is a very appealing version of the story. My objection, however, is directed exclusively at the danger of casting the modern state in the powerful image of a hero seeking redress and justice. It uses this image to legitimize its vast distribution operations and to show its supposed liberality.

The notion of the state playing Robin Hood has two weaknesses. First, there is no way to prove that if the authorities take a dollar by force from a rich person and give it to a poor person, the collective happiness increases. As Anthony de Jasay says, the only way to solve the problem of comparisons between individuals is for the state to impose *its* preferences on the community. The outcome of these operations, in the words of Bertrand de Jouvenel, is not a redistribution of income from rich to poor but from everyone to the state.

When the state plays Robin Hood, it takes from everyone.
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The second weakness in the state-as-Robin-Hood argument is that it only works if the treasury is small. The state in the days of Robin of Locksley was limited, but when it takes on modern proportions, no matter what Barack Obama may say, it can no longer finance itself only by taking money from the very rich, who are by definition a minority. The state might pretend to do this, but in practice its only financing option is to take money from everyone.

One of the main arguments for the growth of the modern state is the fight against inequality. Some claim that without the state's intervention, human beings would abandon the poor to their own devices and charity would prove both insufficient and insulting.

The allegation that, without the state's helping hand, people would ignore their fellow human beings in poverty can't stand even a cursory analysis. From the dawn of civilization, examples to the contrary abound. Voracious tax increases have not managed to extinguish the humanitarian impulse.

Charity is a noble and deep human feeling. Why is it dismissed and devalued? Why is it deemed humiliating, while state aid is viewed as a display of compassion?

Virtue Requires Liberty

Helping our fellow man and political distribution are very different actions. Let us take as an example the noble conduct of the Good Samaritan, a beautiful portrait of humanitarianism. A basic assumption—in truth, an essential element—of the parable is liberty. The Good Samaritan's virtue stems from the fact that he acts voluntarily; if a centurion forced him to help the poor Jew, beaten and abandoned in the road, the parable would have made no sense. Virtue, in effect, demands liberty.

In this example, we see the demoralizing effect of state expansion. Many nongovernmental organizations, particularly in Europe, do not ask citizens to freely and voluntarily hand over a fraction of their income. Instead, they ask the state to extract sums from taxpayers' pockets. Amazingly, the sacrifice of liberty and responsibility on the altar of political power is praised, while providing free and voluntary aid to one's fellow man is dismissed as humiliating charity.

The fact is that where markets are permitted to work, fewer people need economic assistance of any kind. The centuries since Adam Smith wrote *The Wealth* *of Nations* have provided ample evidence to support his message: Free trade and security in one's rights are the pillars on which individuals can improve their condition. Despite this, many people criticize the market economy and allege that it encourages marginalization. It is common to read statistics showing great poverty and accusations that market-oriented countries like the United States are infernos of inequality.

Not Condemned to Poverty

The problem with such statistics is that they are based on surveys that fail to track the same people through time. Thus they cannot provide the most important piece of information: Are the poor condemned to poverty or are they able to rise out of it? The statistics, in short, rarely measure social mobility. But when they do, they show that the poor have large possibilities of escaping the lowest percentile of income distribution. It is in fact more probable that a very poor person in America will climb to the highest income rung than that he will remain in poverty. One could argue that the data indicate mobility but not improvement, given that there is always a poorest 20 percent. Incomes in an advancing society like the United States, however, are not constant but rather are increasing—despite pervasive government interference—and this, not welfare, offers everyone the opportunity and the incentive to progress.

When the state compels humanitarian action, it precludes virtue.
abcgallery.com

State-Sanctioned Inequality

Socialists and interventionists of all parties have reluctantly ended up accepting the market, but they claim government intervention is necessary to tackle inequality. However, inequality is only objectionable if there is a lack of competition and freedom. The modern state's onerous and inefficient distributive structures, ostensibly built to wipe out inequality, have had perverse effects and a demoralizing impact on society, pushing different groups to fight over public favors. It is an out-of-control process in which, as the German liberal Ludwig Erhard said, everyone puts his hand in the pocket of everyone else.

The clamor from interventionists against inequality morphs into a clamor for a larger and larger state. This path leads to the loss of liberty and a distortion of both democracy and justice. It distorts democracy because, by attempting to solve inequality, it removes limits to power and expands the field of state action. It distorts justice because the only way to solve inequality politically is for the state to have the power to treat individuals unequally. Thus the struggle to eliminate inequality ends up destroying the most important form of equality for an open society: equality before the law. FEE

The Founders, the Constitution, and the Historians

BY BURTON FOLSOM, JR.

The first step in getting Americans to disregard the Constitution is to get them to distrust the men who wrote it. This assault on the Founders, subtle at first, began in earnest almost 100 years ago. The first historian to challenge the motives of the Founders was Charles Beard in *An Economic Interpretation of the Constitution of the United States* (1913).

In this landmark book, Beard, a professor of history at Columbia University, argued that the Constitution was "an economic document drawn with superb skill by men whose property interests were immediately at stake." The Founders, then, rather than being patriots, wise lawmakers, or thoughtful students of government, were primarily in the Constitution-writing business to protect their "property interests."

Historian Charles Beard said the Constitution was meant to serve the Founders' economic interests.
wikipedia.org

The Founders' economic motives, according to Beard, were straightforward—they were owed money from their support of the Revolution, and those "public securities" (receipts for loans made to support American independence) were not being repaid under the weak Articles of Confederation. A stronger governing document was needed to ease the transfer of tax dollars from ordinary citizens into the pockets of the more affluent Founders.

Thus, according to Beard, the constitutional convention in Philadelphia in 1787 was promoted by "a small and active group of men immediately interested through their personal possessions in the outcome of their labors. . . . The propertyless masses were . . . excluded at the outset from participation. . . ."

Beard, who was among the first generation of professionally trained historians, gathered evidence on the Founders: "Many leaders in the movement for ratification were large [public] security holders," he argued. Those who opposed the Constitution owned fewer public securities.

Each state had to vote on ratifying the Constitution, and Beard offered evidence that "the leaders who supported the Constitution in the ratifying conventions represented the same economic groups as the members of the Philadelphia convention." The Founders, Beard conceded, did not write the Constitution merely to make money, but nonetheless, "The Constitution was essentially an economic document."

Beard's thesis, seemingly well researched, was presented in a tentative way, but it soon swept the historical profession and became gospel in college classrooms by the 1920s. The Constitution, professors suggested to their students, was not a document worthy of special respect. It was a product of self-interest that should be interpreted loosely and changed as the Progressives saw fit.

The constitutional separation of powers, for example, according to Woodrow Wilson—a friend of Beard's and a fellow Ph.D. in history—was a "grievous mistake" by the Founders. More centralization of power was needed—especially in the executive branch—to change society through needed reforms, such as the progressive income tax.

Beard made his reputation with his book and went on to an illustrious career: He authored or coauthored 49 books that had sold more than 11 million copies by 1952.

During the 1950s, historian Forrest McDonald did a more thorough study of the Founders and discovered what can most generously be described as errors in research and, less generously, as fraudulent research. McDonald traveled to archives throughout the original

Burton Folsom, Jr. (Burt.Folsom@Hillsdale.edu) is professor of history at Hillsdale College, author of New Deal or Raw Deal?, *and FEE's senior historian.*

13 states and meticulously compiled data on thousands of men involved in the debate over the Constitution. After systematically studying the lives of the Founders and the state convention delegates, McDonald wrote *We the People*, which debunked Beard completely. "No correlation" exists, McDonald discovered, "between their economic interests and their votes on issues in general [or] on key economic issues." In fact, McDonald emphasized that in Pennsylvania, South Carolina, and New York "most [public] security holders opposed ratification."

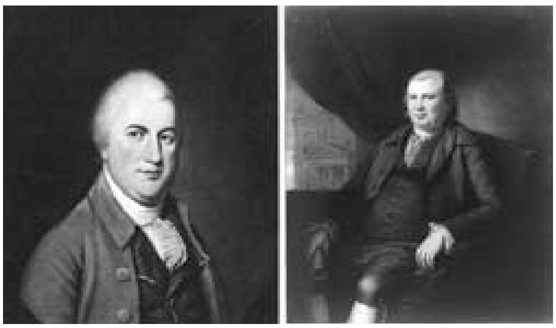
How could Beard have erred so badly? In part Beard missed the mark because he was trying to hit something else—a Progressive agenda for reform, the excuse to transfer wealth from the haves to the have-nots. If the Founders were merely protecting their economic interests, Beard and his progressive friends were justified in supporting the redistribution of wealth.

How can we be sure that Beard was blinded by his ideology? One indication is that he seems to have willfully distorted his evidence to suggest that certain signers of the Constitution owned more public securities (and other forms of wealth) than they actually did. For example, Daniel Jenifer of Maryland, who signed the Constitution in Philadelphia, held no public securities—a point against Beard's view that the signers were self-interested. But Beard classified Jenifer among the large security holders because his son Daniel Jenifer, Jr., held several thousand dollars' worth of them.

But alas, as McDonald shows, "Jenifer had no children—at least no legitimate ones—for in both of the sources Beard used to gather data on Jenifer, it is expressly stated that Jenifer was a bachelor." Beard also classified Gunning Bedford, Jr., a delegate from Delaware, as a security holder, but, as Beard admits, there were two Gunning Bedfords in Delaware, and the one who didn't sign the Constitution was the one who owned the public securities. Furthermore, Beard places delegates Nicholas Gilman, William Samuel Johnson, Charles Pinckney, and others as holders of public securities, but they did not acquire these securities until long after they signed the Constitution.

Some of Beard's mistakes are more subtle. He classifies delegate William Few as a security holder because Few funded a "certificate of 1779" with a "nominal" value of $2,170. True, but what Beard neglects to say is that Few's "nominal" value was scaled down to a mere $114.80, a sum hardly worth motivating Few to sign the Constitution to redeem.

No doubt all the Founders were concerned about their own finances as well as those of the nation. But in writing the Constitution, they were above all trying to apply principles of natural rights and limited government to create a durable nation that would be a bastion of freedom in an unfree world. James Madison and other Founders diligently studied ancient and modern republics to learn from their mistakes what safeguards to employ to protect liberty while allowing elected politicians enough authority to effectively lead the nation.



Nathaniel Gorham and Robert Morris signed the Constitution; it would ultimately cost them their fortunes.
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What Beard omits from his history is the wisdom and dedication of the Founders in overcoming narrow self-interest to produce a masterful guiding document for the country. The actions of Robert Morris of Pennsylvania and Nathaniel Gorham of Massachusetts, for example, are remarkable. Both men signed the Constitution and supported it vigorously even though they ultimately lost money doing so.

Both men had committed to buy land with public securities—which were trading at only about 15 percent of par value before the Constitution was ratified. When the Constitution was ratified and the public securities were redeemed, both Morris and Gorham had to buy the securities at par value, so they both lost fortunes. Morris, in fact, went from being the wealthiest merchant in the United States in 1787 to being tossed into debtors' prison in the 1790s. Contrary to Beard, Morris had voted against his own economic self-interest, and for his country's financial integrity. FEE

The American Land Question

BY JOSEPH R. STROMBERG

In 1934 in the depths of the Great Depression, Southern agrarian (and historian) Frank Owsley called for an *American* land reform. He suggested that "unemployed or underemployed families be staked to a homestead, even subsidized, to remain on the land and produce."

This proposal was not really all that shocking: Such a program would have been consistent enough with the advertised purpose of certain phases of American land policy from 1776 on. American governments handed out land (however acquired) for over a century to veterans, settlers, land speculators, railroads, timber corporations, mining companies, and other parties. (I'll give you three guesses which groups made out the best). Governments did so as a source of revenue, for geostrategic reasons, to win favor with voters, or to reward a small class of typically American operators who flat-out *deserved* to be rich.

The Homestead Act was an exception to the usual process for handing out land.
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In a new, revolutionary, and republican society, there was of course much talk about widespread property as the bulwark of republican freedom. But the talk was so general that Federalists and Republicans could share it, while leaving themselves plenty of room in which to create a small class of owners of a disproportionate amount of the public domain. Overall—from the founding land speculators down to 1893, when the frontier allegedly ran out—American land policy resembled in both theory and practice the kind of "privatization" we see under mercantilist Republican administrations. One landmark in the process was *Johnson and Graham's Lessee v. William M'Intosh* (1823). Here, Chief Justice John Marshall undertook to write a long essay on the received theory of how property previously stolen by European kings or their agents is best conveyed. As was his wont, Marshall proved entirely too much, in as clear a case of Albert Jay Nock's "copper riveting" of narrowly focused property rights as we could want. (See my "Albert Jay Nock and Alternative History," *The Freeman*, November 2008, www.tinyurl.com/c67q7j.)

Southern agrarian Andrew Lytle noted that from the settler's point of view the whole frontier process represented an attempt to get away from would-be aristocrats and other aspiring land monopolists. Consistent republican ideologists like Thomas Skidmore and George H. Evans agitated from the 1820s into the 1840s in favor of giving homesteaders first claim on the territories. Generally speaking, other claimants prevailed, while the politics of slavery and antislavery further complicated the matter. In the bigger picture, the Homestead Act of 1862 was the exception rather than the rule, as Paul W. Gates showed in a noteworthy 1936 paper ("The Homestead Law in an Incongruous Land System," *American Historical Review*).

I cannot discuss here what an ideal policy based on "mixing one's labor" with resources might have looked like. Suffice it to say that sales of thousands and tens of thousands of acres to individuals, land companies, and corporations were not especially consistent with any

Joseph Stromberg (jrstromberg@charter.net) is a historian and freelance writer.

genuine republican ideal. The disappearance of most of the best land in California into the hands of a half-dozen individuals in a few decades comes to mind. But large-scale buyers had mixed their money with federal land officers, and that no doubt counts for something.

Meanwhile, the judiciary—state and federal—busily remodeled the common law and shifted the burdens of industrialization onto third parties, extensively modifying the older law of nuisance. Harry Scheiber finds that "law was often, if not to say usually, mobilized to provide effective subsidies and immunities to heavily-capitalized special interests [under] either 'instrumentalist' or 'formalist' doctrine." Even existing doctrines of "public rights" and eminent domain came to serve business interests. Finally, federal judges' discovery in the 1880s of corporate "personhood" in the Fourteenth Amendment perfected the Federalist Party's original mercantilist program. All these changes importantly influenced just who would benefit from the American State-system of land tenure (to use Nock's phrase) and its attendant modes of preemption and exploitation.

If independence is illusory in our time, it is at least partly because the political activities of well-connected elites long since removed the preconditions of independence deliberately and systematically.

Land and Independence

Many writers have seen a special relationship between landownership and personal independence. And here we hit on what is perhaps the truest insight of republican theory—one taken up by many classical liberals. Briefly, this holds that a broad "middle class" of property owners is essential to the maintenance of free societies. The point is as old as Aristotle. On the negative side, in decrying the social effects of England's fabled land monopoly, radical liberals like Percy Bysshe Shelley, Thomas Paine, Thomas Hodgskin, and John Bright implicitly affirmed the republican axiom.

A typical nineteenth-century American "self-help" book aimed at young men did not say, "Get a job working for wages within an increasingly intricate division of labor so as to enjoy a greater variety of consumer goods." Instead, it said, "Get yourself a competency"—a vision fraught with republican implications suitably modernized. Working for wages, if one did it at all, was a temporary stage—to be endured while learning a skill or trade and abandoned later in favor of real or potential independence. This independence, derided in our time as "illusory," left one free (within limits) not just from state interference but also from nineteenth-century employers. And if independence *is* illusory in our time, it is at least partly because the political activities of well-connected elites long since removed the preconditions of independence deliberately and systematically.

One key (but not the only one) to this much-sought-after independence was access to land, a theme taken up by Catholic writers Hilaire Belloc and G. K. Chesterton in early twentieth-century England. Sociologist Robert Nisbet commented that never, after reading Belloc, did he "imagine that there could be genuine individual liberty apart from individual ownership of property." In any case, as historian Christopher Lasch put it, "Americans took it as axiomatic that freedom had to rest on the broad distribution of property ownership." Perhaps Americans were wrong to believe such a thing. But let us examine the matter a bit more.

This American axiom receives support from those political economists who believed that the land/labor ratio importantly determines social structure. Edward Gibbon Wakefield somewhat gave the game away in the 1830s by opposing easy access to land in Australia, lest potential wage-earners try for self-sufficiency before spending "enough" years working for others. Marx chided Wakefield for letting this "bourgeois secret" out and was in turn chided by Franz Oppenheimer, Achille Loria, and Nock for not learning the right lesson from Wakefield's recommendations on rigging the market.

H. J. Nieboer argued (1900) that where resources are "open," few will work for big enterprises, and the latter will (if they can) institute some form of slavery. Evsey Domar writes (1970) that one never finds "free land, free peasants, and non-working owners" together. Why? Because where political leverage allows, aspiring lords and (literal) rent-seekers will eliminate the free land, the free peasants, or both.

Colonial Policies

With this theorem in view, let us survey some colonial evidence. Enterprisers in colonies have always wanted regular supplies of cheap labor for their projects. Although there is no evidence in favor of a "right" to such a thing, these prospective employers were never discouraged. Aided by colonial administrators with the same assumptions, they gradually overcame native economic independence. Land was the key, and neither the colonizers nor the natives doubted it. No matter how hard natives worked on their holdings, colonialists decried their "idleness"—and their uncivilized failure to work for wages.

The Japanese government saw Okinawans' land ownership as an impediment to modernization.
Okinawa Soba [flickr.com]

We may therefore give the overworked English Enclosures time off (for now) and look at some other cases. Consider the Japanese colonial administrator in Okinawa who complained in 1899 that the typical Okinawan held land and therefore had low expenses and few wants. For these reasons, the native saw "no need to undertake any other business, nor to save money." Since native lands were held informally, they could not be capitalized. Such people and properties did little for the great cause of development and, shortly, the Japanese government (!) denounced Okinawans' customary arrangements as "feudal" and set out to modernize the island. American occupation later perfected this anti-agrarian revolution. Doubtless, however, much "employment" was created in the post-World War II Okinawan service economy dominated by the U.S. military.

Turning to English colonies in the Caribbean and Africa, we find comparable phenomena. England abolished slavery in the colonies in the 1830s. (Never mind that, as historian Eric Foner comments, "Through a regressive tax system, the British working classes paid the bill for abolition.") By this time, English policymakers had embraced Adam Smith's view that positive incentives motivated labor better than fear of starvation or draconian punishments did. But an ocean made all the difference, Foner observes, and new peasantries made up of former slaves were "seen in London, as in the Caribbean, as a threat not simply to the economic well-being of the islands, but to civilization itself." John Stuart Mill's famous defense of peasant proprietors "did not extend to the blacks of the Caribbean; their desire to escape plantation labor and acquire land was perceived as incorrigible idleness."

And so Britain's former slave colonies put vagrancy and other laws to work and crafted taxes aimed at restricting "the freedmen's access to land." As Foner puts it, "Taxation has always been the state's weapon of last resort in the effort to promote market relations within peasant societies"—that is, to force people *into* markets in which they were not eager to participate. In Kenya the problem was one of "dispossessing a peasantry with a preexisting stake in the soil," but colonial legislation proved up to the task. Foner concludes that in "the Caribbean and southern and eastern Africa . . . the free market [was] conspicuous by its absence"—its workings restricted "as far as possible" in the interest of the well-off and powerful.

Historian Colin Bundy has studied the economic rise and political-economic fall of a class of independent African farmers in the Eastern Cape Colony and other parts of South Africa. Various Cape Location Acts (1869, 1876, and 1884) sought to lessen "the numbers of 'idle squatters' (i.e., rent-paying tenants economically active on their own behalf) on white-owned lands." Such peasant farming "conferred . . . a degree of economic 'independence': an ability to withhold, if he so preferred, his labour from white landowners or other employers." Further: "Both the farmer and the mineowner perceived . . . the need to apply extra-economic pressures . . . to break down the peasant's 'independence,' increase his wants, and to induce him to part more abundantly with his labour, but at no increased price." In their view, "Africans had no right to continue as self-sufficient and independent farmers if this conflicted with white interests."

Bundy observes that "Social engineering on this scale took time and effort, but the incentives were powerful." By way of a "one man one lot" rule under the Glenn Grey Act of 1894, legislators sought to keep African farming within "certain acceptable bounds." (Here, finally, was a use for John Locke's famous "proviso" about leaving enough resources for others!) Evictions increased after the Anglo-Boer War (1899-1903). Rents rose (Enclosure defenders, take note), and former tenants stayed on as laborers. Tax pressure on African farmers increased. This "employers' offensive" from 1890 to 1913 ended successfully in the South African Natives Land Act of 1913, which effectively outlawed the practices under which a particular African peasantry had shown much success.

> Colonial policies in Africa aimed to proletarianize independent peasants by leaving them no option but to work for Boers and Brits.

One supposes, in standard libertarian fashion, that agricultural *employment* increased thereafter along with land values. But that was the whole point: to *proletarianize* independent peasants by leaving them no option but to work for wages for Boers and Brits on farms, in mines, and elsewhere. Whether more "employment" was good in itself seems unclear. We can, at least, impute the outcome back to specific political intentions and levers. So much for the colonies, then—and all this without even mentioning the two greatest monuments to England's defense of free markets: Ireland and India.

Telescopic Land Reform

Colonial bureaucrats and employers saw a definite connection between small-scale landownership and independence, and resolved to cut that independence short. By now we begin to see that "the subsidy of history"—to use Kevin Carson's useful term—has been very large indeed (*The Freeman*, June 2008, www.tinyurl.com/d3yyqu). A number of libertarians have understood the problem at hand in pretty much these terms. They have tended, however, to dwell on instances *far away* from our own shores, writing about land reform in Latin America, South Africa, Asia, and other places. In the mid-1970s Murray Rothbard, Roy Childs, and others addressed the matter.

Rothbard wrote that "free-market economists . . . go to Asia and Latin America and urge the people to adopt the free market and private property rights" while ignoring "the suppression of the genuine private property of the peasants by the exactions of quasi-feudal landlords. . . ." In this vacuum, only the local communists appeared to support "the peasants' struggle for their property. . . ." And so libertarians "allowed themselves to become supporters of feudal landlords and land monopolists in the name of 'private property.'"

Decades earlier, that very conservative German liberal economist Wilhelm Röpke wrote that German history would have gone better had Prussia undergone "a radical agrarian reform breaking up the great estates and putting peasant farms in their place." He adds: "Influential Social Democratic leaders opposed the transformation of the great estates in Prussia into peasant holdings . . . as a 'retrograde step.'" Röpke called for freeing Germany from "agrarian and industrial feudalism" and the ills "of proletarization, of concentration and overorganization, of the agglomeration of industrial power and the destruction of the individuality of labor. . . ." In his view, the typical proletarianized worker or clerk wanted "a small house of his own with a garden and a goat shed, an undisturbed family life without training courses, mass meetings, processions, and political flag days; dignity and pleasure in his work, an independent if modest existence. . . .”

Why Go Abroad?

For Enclosure-like pressures on small-holders closer to home, we need look no farther than states like Kentucky, where courts vigorously enforced the full feudal rigor of the “broad form deed,” thereby ensuring the strip mining of many a mountaineer out of productive existence down to the early 1990s. With the system so long stacked in favor of big landholders and bankers, well subsidized by history, one begins to understand the popularity of those New Deal programs that promoted individual home ownership.

With the system so long stacked in favor of big landholders and bankers, well subsidized by history, one begins to understand the popularity of those New Deal programs that promoted individual home ownership.

Economist Michael Perelman has confirmed a direct relationship between rural labor without independent means of support and the applied politics of English classical economists. The latter preached a great gospel of “work,” mainly for others, who *ought to be* doing this work. Except for a narrow class of Dissenting Protestant factory owners, those most vigorously espousing this gospel were not themselves noted for doing a lot of work. Together, however, owners and economists said in effect, “Work *for us*, join the armed forces, or emigrate, ye doughty Angles, Saxons, Jutes, and Scots.” And emigrate they did, leaving us with an American folk wisdom in which old times in England, Scotland, and Ireland were not that great. (This folk memory may have at least as much heuristic value as latter-day econometric claims that *everyone* became better off in the new division of labor.)

And so we return to Henry George’s problem: How did Americans manage as a society to seize so much land, incur whatever moral guilt goes with the seizures, and then not bloody have any of it? The chief mechanism was precisely the political means to wealth that Oppenheimer and Nock analyzed. The reason *Brisco County Jr.*’s “Robber Barons” struck the right note is that there were such individuals. California was a laboratory case, as George well knew, of the successful primitive accumulation of land by a microscopically small class of state-made men. As with ontogeny and phylogeny, Western accumulation recapitulated Eastern accumulation. From such causes arose the famous “end” of the frontier circa 1893. But open land did not so much disappear naturally as succumb to preemption. And then, with perfect timing, the conservation movement put enormous quantities of land beyond the reach of actual settlers.

As for those Americans who currently own property, they typically own it after 20 or more years of bank payments. Is land so genuinely scarce that a bank must always be in the middle? This remains our central question. Certainly, nineteenth-century allocations played a lasting role, and later political interventions added to concentrated property ownership.

And what of the promotion of “easy” home ownership in recent years? It is a product of 1) the widespread delusion, in the wake of Lyndon Johnson’s and Richard Nixon’s inflationary financing of the Vietnam War, that real estate constitutes the ultimate inflation hedge, and 2) the specific dynamics of the expansionist fractional-reserve banking under new rules (“deregulation”) increasing moral hazards for bankers.

There is also the unhappy fact of property taxes—our chief surviving feudal due. Fail to pay those, and the state enrolls a new owner on your former property. This reduces somewhat the fact of private property in land.

Independence, Republicanism, and Liberty

Some classical liberals and libertarians downgrade personal independence. Better to participate in the going order and enjoy a wider array of comforts, they say. But socialists and corporate liberals can play the same game—and have for over a century. It seems to me that those libertarians who join in this refrain rather willfully misconstrue a very simple point: They hail the joys of the division of labor, the higher degree of civilization (that is, more stuff) to be gained from dependence, interdependence, and sundry trickles of income and utility down and up. But already in 1936, Southern agrarian John Crowe Ransom noticed a flaw in this reasoning, writing, "[I]ncome is not enough, and the distribution of income is not enough. If those blessings sufficed, we might as well come to collectivism at once; for that is probably the quickest way to get them." If greater choice among consumer goods makes up for lost independence, then the case for socialism (or X) would be clinched, provided socialism (or X) *could* deliver the economic goods (where "X" stands for any political ideology offering us the same stuff/independence tradeoff.)

I doubt we are necessarily "better off" merely because of *employment*. We need to know more, including why particular sets of choices exist in the first place. Back in the '60s, Selective Service used to "channel" us into the "right" occupations by threatening to draft us. Given the parameters, our choices were "free." If it's that easy, then we are always free, no matter the historical and institutional constraints. Similarly, "To Hell or Connaught" was a choice, and never mind that Oliver Cromwell and his army arbitrarily created this particular prisoner's dilemma. But perhaps I have leapt from choices among goods to choices between ways of life. Why? Let us look into this.

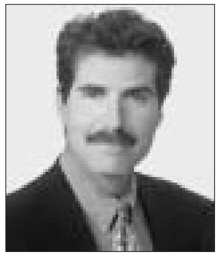
What if proletarianization is not the ideal form of human life? What if a complex division of labor is merely useful or convenient, but not a moral imperative? What if most of us are hirelings, well paid or otherwise, and then we learn what that status amounts to? The post-Marxist socialist André Gorz writes, "Capitalism owes its political stability to the fact that, in return for the dispossession and growing constraints experienced at work, individuals enjoy the possibility of building an *apparently* growing sphere of individual autonomy outside of work." Our interest here is the "autonomy" mentioned, which sounds like a near cousin of "independence." The sentiment seems sound enough, and the partial convergence of Röpke and Gorz is eye-opening.

Now in the view of Quentin Skinner (a modern republican theorist of note), unfreedom arises both from direct, forcible coercion *and* from institutional arrangements that make people dependent, since the latter always contain the possibility (realized or not) of arbitrary interference and coercion. Such discussions usually center on the form of state. Utilitarian liberals like Henry Sidgwick did not care about forms. If the Sublime Porte, Tsar, or King of England leaves us substantially alone, we are "free," and that is that. In Skinner's view, if those worthies *can* on their own motion change their policy of leaving us alone, we are *not* free, no matter what they are doing right now. Freedom requires that we not be menaced by latent unknown powers.

What if proletarianization is not the ideal form of human life? What if a complex division of labor is merely useful or convenient, but not a moral imperative?

Freedom in this sense is liberty—a shared civic or public good. Like many real public goods it is not provided by the state, indeed the state may be its chief enemy. Law and settled custom may provide this public good, and consumer goods—the people's pottage—do not compensate for abandoning such an order, where it exists. Today, people often work long hours to *buy* some independence. In another time, they *began* with some independence, and then chose how hard to work. Now we see, perhaps, the difference between choices among economic goods and past choices between systems structuring our choices.

Widespread landownership long supported a kind of liberal-republican independence. Perhaps we should reexamine the nexus and ask ourselves how, in Donald Davidson's words, we "let the freehold pass," and whether that was really for the best. FEE



The Fatal Conceit

BY JOHN STOSSEL

We've been rolled again.

Sure, the economy is in bad shape—though the late '70s and early '80s were worse in many ways. But is it true that every economist agrees that massive "stimulus" is the solution?

"A failure to act, and act now, will turn a crisis into a catastrophe," President Obama said.

If someone expresses skepticism, Obama and other political leaders suggest that economists are unanimous in believing that government spending is the only answer.

"We have a consensus that we need a big stimulus package that will jolt the economy back into shape," Obama said.

House Majority Leader Steny Hoyer agreed: "Every economist from right to left, Republican, Democrat, advises that it has to be a very substantial package."

What Consensus?

It's a lie. There was no consensus. (Anyway, a consensus doesn't mean something is true.) Finding an economist who opposed government spending as a way to fix the economy was easy. More than 350 signed a petition opposing the bill.

"How is it the government is going to be able to spend a dollar in such a way that it generates a dollar or more in value?" asked George Mason University economist Peter Leeson. "A more likely possibility is that a dollar that government takes out of the private sector is a dollar the private sector doesn't have to spend."

Leeson is referring to the "broken-window" fallacy, which comes from Frédéric Bastiat's story about a boy who throws a rock through a shop window. Since the shopkeeper has to buy a new window, some believe the mischief will actually stimulate the local economy. The fallacy lies in overlooking that the shopkeeper would have spent the money some other way if he didn't have to replace the window.

Every penny the government spends will first have to be borrowed from someone in the economy—that is, someone already struggling with the recession's effects on their income, assets, and future planning. So where's the stimulus?

Every penny the government spends will first have to be borrowed from someone in the economy—that is, someone already struggling with the recession's effects. So where's the stimulus?

It's also quite a conceit to believe that a few men in power are smart enough to know precisely how to spend trillions of your dollars.

"They're exploiting a minor correction in the economy. . . . Markets go through corrections all the time," Lydia Ortega of San Jose State University told me.

I pointed out that people say this correction is worse—maybe like the Depression.

"But markets need to go through this correction," she said. "What's happening now, what's making it worse, is that people don't know what's going to happen. There's so much uncertainty generated by the government spending."

The more the government does, the more private investors wait.

"Part of the reason that people aren't spending is they don't know what these characters in Washington are going to do," says Howard Baetjer of Towson University.

John Stossel is co-anchor of ABC News' "20/20" and the author of Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong, *now in paperback.*

"Japan tried six spending packages in the early 1990s. The result? A decade of lost growth," points out Ben Powell of Suffolk University. "It's the government's own policies that contributed to the bubble. The government's not the answer to it."

One Finger in the Dike, Two Crossed

I wanted to ask the bailout's big boosters about that. Two agreed to talk: Maxine Waters of the House Finance Committee and Majority Leader Hoyer.

Hoyer conceded that he "overstated the case" when he said every economist endorsed government action.

Wasn't the bubble caused by too much debt?

"No doubt about it."

So the answer is more debt?

"Most economists believe that's the case."

This stimulus spending, is it going to work?

"I hope so."

Might it cause hyperinflation?

"We hope it doesn't."

Well, that's comforting.

"Government can't sit and just twiddle its fingers," Rep. Waters told me. "We have got to interject money into these banks and these systems that help this economy work."

> The arrogance of the political class is stunning.

How are you going to pay for it?

"We have borrowed money before. We continue to borrow money, but we pay it back."

She left a few things out. Debt means interest payments and higher taxes in the future. It also means inflation when the Fed prints money to reduce the real value of the debt.

But the politicians are confident that they can wisely spend trillions of your dollars. The arrogance of the political class is stunning. FEE

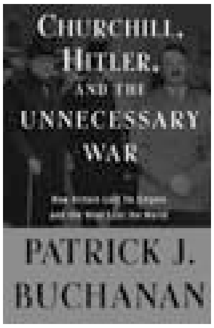
Book Reviews

Churchill, Hitler, and "The Unnecessary War": How Britain Lost Its Empire and the West Lost the World

by Patrick J. Buchanan

Crown Books • 2008 • 544 pages • $29.95 hardcover and e-book; $20 paperback

Reviewed by Robert Higgs



As a soldier, politician, and writer, Winston Leonard Spencer Churchill (1874–1965) made a deep imprint on world history for more than half a century. He is best known for rallying his countrymen during the fateful Battle of Britain when he was prime minister—thereby, many people believe, stemming the flood that was sweeping Adolf Hitler to world conquest. Small wonder that *Time* magazine named him its Man of the Century, a designation that many other admirers have embraced.

Churchill, however, never waited idly for the world to construct his legend. From the 1890s onward, he strove to put himself in the places, especially the wars, where he would be best situated to advance his fame and realize his ambitions, and as he made his way through a series of adventures, he promptly wrote articles and books about each of them, thus shaping in large degree how others would view his actions. Moreover, he was an excellent writer; his articles and books sold very well, and in 1953 he was awarded the Nobel Prize in Literature. His sharp wit and dazzling rhetoric enhanced his reputation.

In *Churchill, Hitler, and "The Unnecessary War,"* Patrick J. Buchanan seeks to demolish the Churchill myth, along with several related ones, which he does with surprising success. I say "surprising," not because the myth itself was ever unassailable—excellent historians, including Ralph Raico, long ago pounded Churchill's feet of clay into dust—but because Buchanan is known primarily as an ideological polemicist. Yet in this book he presents respectably balanced and well-documented arguments for his theses. If he is not himself a professional historian, he has absorbed the works of scores of well-reputed historians, and he carefully assesses a number of counterarguments against his position. Although Buchanan presents no previously unreported facts, he offers abundant evidence expressed in clear, forceful prose. All in all, he makes a persuasive case.

Buchanan correctly views the two world wars as "two phases of a Thirty Years' War." He argues that both phases were unnecessary and that Great Britain "turned both European wars into world wars."

For World War I, he maintains: "Had Britain not declared war on Germany in 1914, Canada, Australia, South Africa, New Zealand, and India would not have followed the Mother Country in. Nor would Britain's ally Japan. Nor would Italy, which London lured in with secret bribes of territory from the Habsburg and Ottoman empires. Nor would America have gone to war had Britain stayed out. Germany would have been victorious, perhaps in months. There would have been no Lenin, no Stalin, no Versailles, no Hitler, no Holocaust."

For World War II, he maintains: "Had Britain not given a war guarantee to Poland in March 1939, then declared war on September 3, bringing in South Africa, Canada, Australia, India, New Zealand, and the United States, a German-Polish war might never have become a six-year war in which fifty million would perish."

He argues that the decisive event in the run-up to World War II was not the infamous 1938 appeasement at Munich—because the Germans had good reason to reabsorb the Sudetenland from Czechoslovakia—but the 1939 guarantee, which was foolish of the British to make and foolish of the Poles to rely on. It was foolish because Britain had no means of defending Poland. When Hitler attacked in 1939, after Polish leaders refused to return Danzig to Germany, the British could only watch helplessly.

Buchanan begins his narrative at the end of the nineteenth century and ends it at the conclusion of World War II. Churchill occupies center stage in this extended drama because he "was the most bellicose champion of British entry into the European war of

1914 and the German-Polish war of 1939." Along the way, Buchanan adduces evidence that Kaiser Wilhelm II, a grandson of Queen Victoria and nephew of King Edward VII, did not seek war with Great Britain (in 1910, he "marched in Edward's funeral—in the uniform of a British field marshal"). Likewise, 30 years later, Hitler wished to avoid war with Great Britain, whose people and empire he admired: "His dream was of an alliance with the British Empire, not its ruin." The *Lebensraum* he sought lay to the east of Germany, not to the west. The Germans did not seek to "conquer the world," despite frequent claims to that effect, and in any event, they lacked the means to achieve such a conquest.

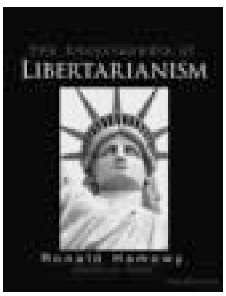
No short review can depict the breadth, the depth, and the many fascinating details of Buchanan's book. Read it and see for yourself. It may well challenge your most cherished beliefs about Winston Churchill and the world-shattering Thirty Years' War of 1914–45.

Robert Higgs (RHiggs2377@aol.com) is a senior fellow at the Independent Institute and author of Depression, War, and Cold War.

The Encyclopedia of Libertarianism

Edited by Ronald Hamowy
Cato Institute/Sage Publications • 2008 • 664 pages • $125.00

Reviewed by Martin Morse Wooster



There have been all sorts of books about libertarianism, from introductory treatises to memoirs and biographies of important figures in the field to histories such as Brian Doherty's significant *Radicals for Capitalism*. But until now there has been no encyclopedia of libertarianism, no one-volume reference work that college students or intellectually adventurous adults could use as a handy guide to libertarian ideas and personalities. The Cato Institute's *Encyclopedia of Libertarianism* fills that gap. It's a significant book that ought to be acquired by anyone with a serious commitment to fair and open debate.

Ronald Hamowy, a professor emeritus at the University of Alberta, has assembled articles from 163 scholars, ranging from *New York Times* economics columnist Tyler Cowen to decentralist historian Bill Kauffman. The contributors also include one Nobel Laureate, Chapman University economist Vernon L. Smith, as well as some uncredentialed freelancers.

The encyclopedia has several quirks. There are no entries for libertarian thinkers younger than Charles Murray, who was born in 1943. Anyone interested in learning about libertarian scholars who are now in their 40s and 50s will have to look elsewhere.

Nor are there any entries on libertarian institutions. The older libertarian organizations are covered by biographical entries on their founders.

Entries are divided into three classes: short biographies of important libertarian figures, longer entries on public-policy topics such as eminent domain, globalization, and health care, and still-longer entries on ideas, including four on economics (Austrian, Chicago, experimental, and Keynesian), two on liberalism (classical and German), and two on individualism (methodological and political/ethical).

The authors of these idea-based entries are generally fair, but also occasionally make claims unsupported by evidence. It is not true, as Jackson Kuhl argues, that "Hoover and the Republicans sealed their doom" in 1932 by supporting Prohibition; as historian Michael Lerner has shown, Prohibition was a minor rather than a major cause of Herbert Hoover's defeat, and Franklin Roosevelt's opposition to Prohibition was equivocal. Nor is it true, as Wesleyan University scholar Richard Adelstein contends in his entry on the early twentieth-century Progressive movement, that "for many, progressivism also entailed a commitment to racial purity"; the leading thinkers among the Progressives—Herbert Croly, Walter Lippmann, and Walter Weyl—were generally free of racial prejudice. Adelstein's case would have been stronger if he had tied the Progressives to eugenics rather than to racism.

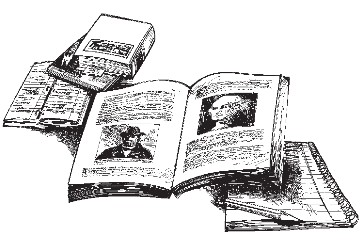
It should be noted that some of the authors of these idea-based entries add fresh libertarian insights to familiar topics. For example, in the entry on the New Deal, Wake Forest scholar Robert Whaples notes that the New Dealers used government spending for political ends, giving more money to swing states than to yellow-dog Democrat ones thought unlikely to vote for Republicans. Nevada, whose three electoral votes were in play at the time, got six times as much welfare spending per capita as more solidly Democratic North Carolina. While New Deal spending did go first to the hardest-hit areas, Whaples writes, "Spending for political advantage in upcoming elections was a significant factor" in determining where Franklin Roosevelt doled out his welfare spending.

Two essays in the encyclopedia are especially important. The General Introduction, by Stephen Davies of Britain's Manchester Metropolitan University, eloquently distills several thousand years of libertarian history into 12 densely written pages. Anyone interested in the history of liberty will learn something from Davies's masterly writing. (For example, did you know that the first Europeans to call themselves "liberals" were Spaniards trying to recover from Napoleon's tyranny? Or that Lord Byron, in 1815, co-edited the freedom-oriented journal *The Liberal*?)

Also important is the essay on the "War on Terror" by Ohio State political scientist John Mueller. Mueller persuasively shows that the Bush administration policy of spending unlimited funds to protect every conceivable target from every conceivable threat flunks any reasonable cost-benefit test. He notes that the Pentagon, for example, is in the process of moving many of its employees to remote locations—without any consideration about how this dispersion will clog the roads or how our national security will be improved by forcing Defense Department employees and contractors to massively increase their fossil-fuel consumption.

The *Encyclopedia of Libertarianism* is an important reference book that shows the depth, range, and lasting significance of libertarian ideas. FEE

Martin Morse Wooster (mmwooster@yahoo.com) is an author and editor living in Silver Spring, Maryland.

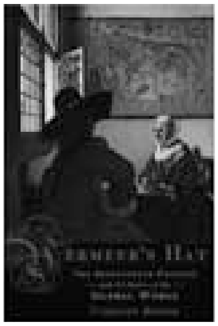


Vermeer's Hat: The Seventeenth Century and the Dawn of the Global World

by Timothy Brook

Bloomsbury Press • 2008 • 288 pages • $27.95 hardcover; $17.00 paperback

Reviewed by George Leef



Timothy Brook has written a fascinating work on the pivotal seventeenth century, one that defies neat categorization. It isn't a history per se, although it is about a crucial period of history. It isn't really about economics, but it conveys a considerable amount of economic understanding. Nor is it a work on philosophy, even though philosophical ideas play an important role. Finally, it isn't a book on art, but great paintings by the Dutch artist Johannes Vermeer (1632–1675) are central to the author's project.

So, just what is *Vermeer's Hat?*

It's a little bit of everything, organized around several Vermeer paintings. Vermeer's canvases, Brook points out, don't merely depict scenes of Dutch life, but also help us understand an era of rapid economic change. There are stories to be teased out of these exquisite paintings, and the author does so brilliantly.

As a young man, Brook was cycling through Holland and had a minor accident in the city of Delft. A woman who had seen his accident took the scraped, muddied cyclist in for a meal and some rest. Thus began Brook's fascination with Delft, which soon came to include the paintings of its most famous artist, Vermeer.

The title comes from a painting of a man in a fancy coat and impressively large hat, seated at a sunlit table speaking with a young woman. (It can be seen in The Frick Collection in New York City.) Brook explores various socioeconomic features of the painting, but devotes most of his pages to the hat. *How had it come to be?* The material was beaver, not an animal native to Holland. Beaver hats had become highly popular due to their durability and fashion, which meant a lot of commerce in beaver pelts. They came through Amsterdam along with a fabulous array of exotic goods that led

French philosopher René Descartes to proclaim it "an inventory of the possible."

At this point, Brook embarks on an extended discussion of the great Dutch trading empire. Before the seventeenth century most commerce was local. Once the Dutch (and a few other seafaring nations) established global trade routes with centers in Asia, Africa, and the Americas, the quantity and variety of goods available increased dramatically. Beaver pelts from North America, spices from tropical islands, porcelain from China, and much, much more became available to consumers at steadily falling prices. Trade enlivened the previously drab existence of most people.

In the seventeenth century, however, trade was beset not only by the frailties of wooden ships and the hazards of weather and navigation but also by violence. Armed ships of the trading nations regularly preyed on cargo vessels of other nations. Naturally, piracy also ate into profits. Officials of the Dutch East India Company, seeking a justification for having seized a Portuguese ship, turned to a young lawyer named Hugo de Groot (now known as Grotius) for a legal brief. What he produced was a document entitled *Freedom of the Seas.* Brook writes that Grotius made several bold arguments: "The boldest of all is one that no one had thus far thought to make: all people have the right to trade." Eventually, it became an accepted canon of international law that no government has the right to prevent nationals of other states from using the sea lanes. This principle's effect on living standards is obvious.

Especially intriguing to *Freeman* readers will be Brook's chapter on money. Global commerce depended on specie payments, chiefly in silver. His discussion of that subject is triggered by a Vermeer painting showing a woman weighing something with scales. Once Brook identifies that something as silver coinage, the chapter takes off on a global tour that includes mining, minting, and the exchange of goods for money. Brook's readers learn some important lessons about money. After he observes that Europe had coinage from different countries in circulation, he writes, "Fortunately for the burgeoning commercial economy, the substitution of one type of coin for another did not interfere with the main purpose of money, which is to calibrate the relative value of objects."

Another illustrative historical lesson concerns the futility of attempting to ban allegedly harmful substances, tobacco in particular. Globalization in the seventeenth century brought tobacco and smoking to the Far East, and some rulers wished to prevent the people under their control from indulging in the pastime. Banning tobacco, however, didn't work any better than banning alcoholic beverages worked in the United States early in the twentieth century.

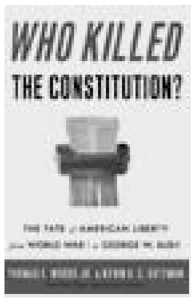
For a stimulating read that digs far into our history and unearths a wealth of information about trade and cultural exchange, I highly recommend this beautifully produced volume. FEE

George Leef (georgeleef@aol.com) is book review editor of The Freeman.

Who Killed the Constitution? The Fate of American Liberty from World War I to George W. Bush

by Thomas E. Woods, Jr. and Kevin R. C. Gutzman
Crown Forum • 2008 • 272 pages • $25.95 hard cover and e-book • $15.00 paperback

Reviewed by J. H. Huebert



There have now been many conservative and libertarian books covering the demise of American liberty under the U.S. Constitution, so if you don't think you need to read another one, I understand.

Still, if that's what you think, you're wrong.

The latest entry in the genre, Thomas Woods and Kevin Gutzman's *Who Killed the Constitution?*, is something different. It's well worth your while.

Unlike some other writers, Woods and Gutzman don't just place the blame for our present situation on a handful of bad Supreme Court decisions. Instead, they show how, in the twentieth century, all three branches of the federal government have spun out of control, completely abandoning any pretense that the Constitution constrains them at all.

Woods and Gutzman demonstrate how the executive branch claims virtually unlimited power. President George W. Bush damaged the constitutional fabric significantly, and the authors demolish the dubious constitutional scholarship of Bush's court intellectual, law professor John Yoo. They point out, too, that presidents never have trouble finding "scholars" like Yoo to rationalize their power grabs.

But the authors also show that Bush did not do much of anything new. All presidents since at least Harry Truman have assumed they could make war without a declaration from Congress. In fact, most presidents since Theodore Roosevelt have assumed, as he did, that they can do anything they want in the absence of a specific constitutional restriction on their power. (Gene Healy's recent book, *The Cult of the Presidency*, reviewed in the March *Freeman,* offers much additional detail on this subject.)

A Litany of Abuses

One chapter in particular illustrates this by exposing one of the worst, but most overlooked, government crimes in U.S. history: Franklin Roosevelt's confiscation of everyone's gold. This discussion also gives the authors an opportunity to offer an important bit of economic education as they explain why gold was used as money in the first place.

You might expect the chapter titled "Roads to Nowhere" to offer a familiar list of pork-barrel projects funded by Congress. Instead, the authors show that the federal government shouldn't be funding roads at all, no matter where those roads go. Early presidents assumed they would need a constitutional amendment to fund "infrastructure" projects. Unfortunately, today they just assume it's within their power and that assumption goes unchallenged.

Other chapters explore topics such as the Commerce Clause, which the courts have used to justify almost anything Congress does; the military draft, which violates the Constitution's prohibition of slavery; presidential "signing statements" (written pronouncements by a president on signing a bill, often with the intent to modify the statute and especially to nullify its application to the executive branch), and President Truman's attempt to nationalize the steel industry.

Two of the boldest chapters deal with what the authors call the "third rail of American jurisprudence"—*Brown v. Board of Education* and its aftermath. The authors show how *Brown* had no basis in the Constitution—and that the Supreme Court justices behind the decision knew it. Yes, the book's authors actually say it: the Fourteenth Amendment's text does not actually prohibit school segregation.

Even if that's so, why attack this sacred cow when most everyone today opposes segregation anyway? Because if the Supreme Court can so utterly disregard the Constitution and the very idea of law in this decision to reach its own policymaking goals, then there really is no Constitution to speak of anymore. And that's the point. As they say in their introduction, "the Constitution is dead."

Beyond Redemption

Refreshingly, they don't argue that the Constitution might be revived by electing the right people or bringing the right lawsuits. Indeed, they even suggest that our sorry result might have been inevitable—not only with this particular Constitution, but with *any* written constitution. After all, what do you expect will happen when you let federal officials determine the limits of the federal government's power? That's true regardless of who's in office, or what they might say before being elected. Woods and Gutzman write: "People in power exercise all the power they can get, even after they have howled in the wilderness against legislating judges, imperial presidents, and the death of states' rights."

The authors also quote Lysander Spooner, who put the problem best when he wrote in the nineteenth century that the Constitution "has either authorized such a government as we have had, or has been powerless to prevent it. In either case, it is unfit to exist." FEE

J. H. Huebert (jhhuebert@jhhuebert.com), an attorney, is an adjunct professor of law at Ohio Northern University College of Law, a former FEE intern, and an adjunct faculty member of the Ludwig von Mises Institute.

School Choice

BY WALTER E. WILLIAMS

The overall quality of primary and secondary education received by white students is nothing to write home about. The very fact that 30 percent of college freshmen require remedial education, at a cost of over $2 billion, is pretty good evidence that there is widespread fraud in the conferring of high-school diplomas. That level of fraud, though, does not compare to the fraudulent education received by blacks—that darn near approaches criminality. According to National Assessment of Educational Progress (NAEP) findings, only in writing do less than 40 percent of black high school students test "below basic." NAEP defines "below basic" as being unable to demonstrate even "partial mastery of prerequisite knowledge and skills that are fundamental for proficient work" at their grade. In math 70 percent and in science 75 percent of black students score below basic. Black high-school graduates perform a little worse than white eighth-graders in both reading and U.S. history and a lot worse in math and geography. The nation has tried almost everything to improve black education: busing, setting up magnet schools, pouring billions of federal, state, and local tax dollars, and all for naught. It seems that the only approach that has not been tried on a large scale is some form of school choice.

The staunchest opponents of school choice want, demand, and can afford school choice for themselves, but for the less affluent it is a different matter.

Most school-choice proposals are in the form of either educational vouchers, which pay all or part of the cost of nonpublic education, or tuition tax credits, which let parents deduct tuition from taxes owed. Some of the support for school choice comes from the expectation that it would introduce more competition into education and produce higher-quality education for all students, particularly minority students. Though school choice has that potential, I support it for another reason: Namely, I think any government-created and -protected monopoly is harmful to the best interests of consumers. Competition always produces a superior and lower-cost product than government monopolies. It is no accident that our supermarkets (stocking over 60,000 different items) are the best in the world. Similarly, it's no accident that we lead the world in communication, computer hardware, software technology, the Internet, and other areas where competition is ruthless.

There is no reason to suspect that it would be any different if there were competition in primary and secondary education. U.S. universities, particularly at the graduate level, are the envy of the world. People from every country salivate at the chance to earn a graduate degree here. However, I would wager that there would be no such excellence if our graduate education were organized like our primary and secondary education.

Most of the criticism of school choice, regardless of method, is wrong and self-serving. My own preference is for tax credits as opposed to vouchers. Tax credits would reduce the risk of government intervention in the form of Departments of Vouchers.

There is considerable hypocrisy among some of the staunchest opponents of school choice. They want, demand, and can afford school choice for themselves, but for the less affluent it is a different matter. President and Mrs. Barack Obama enrolled their two daughters in Washington's prestigious Sidwell Friends School,

Walter Williams is the John M. Olin Distinguished Professor of Economics at George Mason University.

forking over $28,000 a year for each girl. Whilst Obama was senator, the girls attended the University of Chicago's Laboratory School, a private school charging almost $20,000 each. A Heritage Foundation survey found that 37 percent of the members of the House of Representatives and 45 percent of senators in the 110th Congress sent their children to private schools (www.tinyurl.com/d97ooo). Public-school teachers enroll their own children in nonpublic schools to a much greater extent than the general public. In Cincinnati about 41 percent of them send their children to nonpublic schools. In Chicago it is 38 percent, Los Angeles 24 percent, New York 32 percent, and Philadelphia 44 percent (www.tinyurl.com/99d8s). Both congressmen and public-school teachers enroll their children in private schools at rates three, four, and five times the rate of the general public.

Public-school teachers enroll their own children in nonpublic schools to a much greater extent than the general public.

Defenders of the education monopoly have advanced arguments against greater competition in primary and secondary education. These arguments seem plausible; however, a little reflection shows they are simply baseless.

Public schools would be destroyed. This charge amounts to a tragic confession that public schools are so inferior that given choice all parents would opt out. In fact, some public schools are doing a satisfactory job; those schools would survive. Schools doing a poor job would have to either improve or face an exodus of students and perish.

Private schools would skim off the best students. Assume for a moment this might happen. To object to parental choice for that reason is callous arrogance and cruelty. It differs little from saying that parents who want better education prospects and a brighter future for their children should be held hostage until some undetermined time when public schools have improved.

School choice would lead to school racial segregation. Most voucher and tuition-tax proposals prohibit racial discrimination. The major thrust for school choice has come from black parents. Moreover, most large city public schools are already racially homogeneous, but while a smaller percentage of blacks attend private schools, those schools are more racially heterogeneous.

There are not enough private schools. This is an absurd criticism and reflects ignorance of markets. In the 1970s there were no computer software stores and few videotape rental shops. Would anyone have argued back then that the manufacturing and marketing of computers and VCRs should be held up until software and video shops were in place? By purchasing computers and VCRs, consumers created the demand for those shops. We would expect the same with private schools. If parents had vouchers or tax credits worth $3,000 or $4,000, profit-seeking entrepreneurs would meet the demand for private schools.

Parents, particularly those who are low-income, can't make wise choices. This is a demeaning attitude toward the poor, and it also reflects ignorance of how markets operate. People have little direct information about the quality of most goods and services they use. They depend on indirect information, such as word of mouth, consumer reports, and advertisements. The market would generate information about K–12 schools just as markets already provide information about colleges and universities. It is inconceivable that parents, particularly black parents, could choose schools worse than the ones their kids already attend.

Education vouchers and tuition tax credits face another source of opposition: from those fearful of government control of nonpublic schools. I share that concern and urge strong measures to minimize that likelihood. The question I pose to these critics is: Which is the more serious and costly risk, the increased government intervention in nonpublic schools that might accompany school choice or the continued educational destruction of the nation's youngsters, particularly its black and Hispanic youngsters?

Finally, I am thoroughly convinced that all children, including black children, can achieve academic excellence. What's necessary is 1) parental involvement, 2) well-behaved and motivated children, and 3) a competitive educational environment. FEE