THE FREEMAN
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President	Lawrence W. Reed
Editor	Sheldon Richman
Managing Editor	Michael Nolan
Book Review Editor	George C. Leef

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Donald J. Boudreaux
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Cover: Detail from portrait of Ludwig von Mises by George V. Augusta, 1971.

Perspective

Human Action as a Work of Art

What can one say *briefly* about *Human Action*? When it was being written and people would ask what it was to be about, the answer given among Mises's students was: Everything.

Indeed.

From the setting forth of praxeology as the a priori science of human action, to the description of the market's operation, to the explanation of the business cycle, to the proof that rational central planning is impossible, Mises's work is nothing less than a work of art. It faithfully captures the elegant orderliness of social reality that grows out of the logic of human action. I could go on, but instead I will reprint here, slightly edited, what I wrote in these pages nine years ago. I can't improve on it.

If I had to pick my favorite sentence in all of Mises's *Human Action* (a daunting task in a 900-page book), it would be this one: "The fact that my fellow man wants shoes as I do does not make it harder for me to get shoes, but easier" (p. 673 of the Third Revised Edition). That sentence may seem rather pedestrian compared to all the sentences Mises used to establish the science of praxeology (human action) and to spin out its countless implications for economics. But it's a perfect example of how Mises showed that untutored intuitions about social interaction are often wide of the mark.

There is an old school of thought, widely identified with the Reverend Thomas Malthus, but actually quite older, that held the opposite of Mises's position. Beginning with the undeniable assumption of scarcity, that school believed the human race was doomed to misery. Population would grow until it strained the carrying capacity of the environment; then starvation, disease, and conflict would set in and scale back the numbers. This process was assumed to be more or less the permanent fate of mankind.

How could it not be? Growing numbers of people would be vying for limited resources. Life had to be poor, nasty, brutish, and short—though not, as Hobbes had it, solitary.

Mises was surely not the first to see it otherwise, but he was second to none in spelling out why the pessimists are wrong. He first seemed to concede their point, then zeroed in on what they missed. "The characteristic mark of the 'state of nature,'" Mises wrote, "is irreconcilable conflict. The means of subsistence are scarce and do not grant survival to all . . . . The source of conflict is always the fact that each man's portion curtails the portions of other men."

What saves man from the dismal existence of wild animals? The division of labor, the first topic taken up by Adam Smith in *The Wealth of Nations.* As Mises put it, "What makes friendly relations between human beings possible is the higher productivity of the division of labor. It removes the natural conflict of interests. For where there is division of labor, there is no longer question of the distribution of a supply not capable of enlargement." Mises drives home the point: "Because many people or even all people want bread, clothes, shoes, and cars, large-scale production of these goods becomes feasible and reduces the costs of production to such an extent that they are accessible at low prices."

The upshot is that because of the productivity specialization makes possible, the rest of the animal kingdom holds few lessons for mankind. Anyone who believes government's role is to temper the market with cooperation needs to learn *that* lesson. The market *is* cooperation.

⋆ ⋆ ⋆

To celebrate the 60th anniversary of the publication of Mises's *Human Action*, we've brought together several high-powered contributors, spanning several generations, all with a special connection to the man and the groundbreaking book: Israel Kirzner, who earned his Ph.D. under Mises at New York University and who is regarded as the dean of Austrian economics; Bettina Bien Greaves, a retired FEE staff member who was Mises's close friend, attended his NYU seminar, and compiled a bibliography of his work; Peter Boettke, a leading member of the "third generation" of American Austrian economists and professor of economics at George Mason University, which has the most Austrian-oriented economics department in the United States; and Peter Leeson, visiting professor at the University of Chicago and one of the rising stars of Austrian economics. Finally, the *Human Action* tribute winds up with Henry Hazlitt's 1949 *Newsweek* column about the treatise. Hazlitt had much to do with introducing Mises to American readers.

I hope you enjoy the photo spread of Mises reflecting his close association with FEE.

Also in this issue, Sanford Ikeda registers his discontent with economics reporting in the newspapers, especially the way the definitions squeeze out any place for Austrian economics.

Barack Obama would have us believe he is ushering in a post-ideological age, where preconceived notions are equated with dogmatism. Mario Rizzo cautions that to throw out ideology is to throw out something important.

The last year of Fed expansion, bank nationalizations, "stimulus" spending, and bailouts has put the American economy even deeper into the arms of the State. In fact, Randall Holcombe says, these measures and precedents have fundamentally changed the U.S. economy.

Congress has decreed that tobacco will no longer go unregulated. Unregulated? Are those folks in Washington joking? Bruce Yandle relates the long history of tobacco regulation.

Here's what our columnists have whipped up: Lawrence Reed wants to know who bailed out whom over the last year. Robert Higgs looks at big business's role in the emergence of American statism. John Stossel imagines what would result from a truly competitive healthcare system. Charles Baird looks at the Employee Free Choice Act. And Steven Horwitz, reading claims that saving is keeping the economy in recession, responds, "It Just Ain't So!"

This issue's reviewers scrutinize books on the New Deal, ownership, global economics, and debt.

Readers react to past articles in Capital Letters.

—*Sheldon Richman*
srichman@fee.org

In the Grip of Madness

BY LAWRENCE W. REED

"Thank God we had the federal government last week to bail out the private sector!"

That's what a rather statist friend of mine declared a year ago as the economy tanked, almost gleeful that the financial crisis seemed to be proving how much we all need a massive federal establishment to both regulate and rescue us.

Never mind the federal government's own indispensable role as an enabler in the crisis, from its reckless monetary policy to its jawboning banks into making dubious mortgage loans. Never mind the long-term danger of its assumption of colossal new obligations and the moral hazard in the message its intervention sends. My response to my friend was of a more narrow focus. "Thank God we have the private sector to bail out the federal government not just last week, but *every* week!" I exclaimed.

Think about it. Taxes on the private sector pay a majority of the federal government's bills. For most of the rest, the government borrows by selling its debt obligations, mostly to private-sector entities—including banks, insurance companies, and individuals.

On and on it goes. The private sector has an awful lot of bailing out to do in the coming decades.

The federal government is the world's biggest taxer and the world's biggest debtor. If those of us in the private sector didn't pay our taxes or didn't buy Washington's paper, the feds would have gone belly-up decades ago. We've rescued Washington to the tune of tens of trillions of dollars over the years. A big difference between Washington's bailing out the private sector and the private sector's bailing out Washington is that the private sector has to work, invest, employ people, and produce goods to come up with the cash. It can't create it out of thin air like Ben Bernanke can.

Our friends in Washington have blessed us with future burdens almost too astronomical to comprehend. In the name of taking care of us in our old age, we are saddled with no less than $6 trillion in Social Security payouts over the next 75 years—*for which there are no presently earmarked funding streams*. According to Brian Riedl of the Heritage Foundation, the unfunded obligations for the new federal prescription drug program, enacted under President Bush, total another $8 trillion.

On and on it goes.The private sector has an awful lot of bailing out to do in the coming decades. I shudder to think how deeply we taxpayers will have to dig in the not-too-distant future to pay the bills of our benevolent, compassionate, and forward-thinking government.

Since Barack Obama took office in January 2009, the federal government has spent a full billion dollars every single hour. Before his term is half over, federal spending will have doubled in just a decade. The deficit in one year's budget is now as large as the entire budget in George W. Bush's first year as president, 2001—and I thought not very long ago that the spending spree he and the Republicans gave us would be tough to beat! The flood of red ink is now adding to the national debt to the tune of about $4 billion every day. At well over $11 trillion, that debt amounts to $37,000 for every living American.

Too Big to Succeed?

We're told by the wise planners in Washington that certain private firms are "too big to fail." So we're handing big chunks of them over to the government.

The question we all should be asking ourselves is this: Are we trusting our economy and our lives to a government that is too big to succeed?

Once upon a time in America, most citizens expected government to keep the peace and otherwise

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

leave them alone. We built a vibrant, self-reliant, entrepreneurial culture with strong families and solid values. We respected property and largely kept the spirit of the Eighth and Tenth Commandments against coveting and stealing. We understood that government didn't have anything to give anybody except what it first took from somebody and that a government big enough to give us everything we want would be big enough to take away everything we've got. We practiced fiscal discipline in our personal lives and expected nothing less from the people in the government we elected, or we threw them out.

But somewhere along the way we lost our moral compass. And just like the Roman Republic that rose on integrity and collapsed in turpitude, we thought the "bread and circuses" the government could provide us would buy us comfort and security.

We gave the government the responsibility to educate our children, though government can never be counted on to teach well the main ingredients of a free society—liberty and character—or just about anything else, for that matter. We asked the government to give us health care, welfare, pensions, college education, and farm subsidies, and now our politicians are bankrupting the country to pay the bills. This welfare state of ours has become one big circle of 305 million people, each with his hand in the next fellow's pocket.

The federal government is not God. It can't even be a good Santa Claus. It's no Mother Teresa either. The fact is, the bigger government gets, the more it starts to look like Moe, Larry, and Curly.

This is a government whose reach even before the financial crisis scarcely left an aspect of American life untouched, from the cradle to the grave and the volume of our toilet-bowl water in between. As a portion of our personal income, its tax and regulatory burden consumes at least five times what it did just a century ago. But to the majority on the Potomac, government is nowhere yet big enough. This is madness writ large.

Stick to the Knitting

Remember *In Search of Excellence*, the 1982 best-selling management book by Tom Peters and Robert Waterman? One of its salient points is that an organization gets off track when it no longer "sticks to the knitting." When it allows its mission to blur and stretch far beyond its founding design, when it becomes distracted by endless and dubious new responsibilities, its core competency evaporates. It will fail to do what it is supposed to do, because it's doing too much of what it's not supposed to do.

It may come as a surprise to those who see aspirin made in Washington as the cure for every ailment, but the federal government is not God. It can't even be a good Santa Claus. It's no Mother Teresa either, because on those occasions when it does some good it usually costs an arm and a leg and sends a big part of the bill to generations yet unborn. The fact is, the bigger government gets, the more it starts to look like Moe, Larry, and Curly.

Accentuating the madness of the present day, the cover of *Newsweek* declared last March, "We are all socialists now."

Pardon me, but I'm not about to sign on to a proven flop. FEE

Saving Is Killing the Economy? It Just Ain't So!

BY STEVEN HORWITZ

In the midst of the current recession, many of the oldest fallacies in economics are making a comeback. In a column titled "Why Saving is Killing the Economy" (CNNMoney.com, February 12), senior writer Chris Isidore repeats one of the oldest: that the key to economic recovery or growth is consumption and that saving retards that process. Isidore states that the increases in savings that accompanied the onset of the recession might make sense to each individual household but are collectively problematic "when what the economy needs most is for consumers to be spending more freely."

But the view that consumption is "stimulative" while saving is harmful is almost the exact opposite of the truth if the goal is to generate sustainable economic growth. Savings is what makes long-term growth possible. It just ain't so that more consumption is what is needed in a recession.

Many of the oldest fallacies in economics are making a comeback.

An Incomplete View

This particular fallacy is essentially a version of the more general fallacy identified by Frédéric Bastiat in the nineteenth century: an inability or refusal to "see the unseen." Consumption has easily observable effects on the economy. We see people spending on new cars or televisions, and we understand how that means larger profits for firms and more opportunities for employment. So it comes as no surprise that people would think that an increase in saving, defined as the portion of our income we do not devote to consumption, would be bad for the economy. If we are increasing our saving, we are presumably reducing our consumption, which means lower profits and fewer job opportunities in the places where we used to be spending those consumption dollars.

So far, the analysis is not necessarily wrong, just incomplete. A full analysis would then ask, "What happens to the portion of people's income no longer being devoted to consumption?" What exactly do we mean by "saving?" If people are "saving" by simply increasing their holdings of currency (say under the storied mattress), then the critics have a point. Those resources *are* being withdrawn from the larger economy, and to that degree they will reduce conventional measures of economic well-being. Of course, those increased currency holdings will improve the well-being of their owner, as he or she is now holding wealth in the preferred form of currency.

This isn't how it usually goes, though. Most saving takes the form of financial instruments, including everything from basic checking accounts to the fanciest investment tools. If people are keeping higher checking account balances or putting more in savings accounts or money market mutual funds, then that wealth is not withdrawn from the economy. It is simply channeled elsewhere than into consumer goods. Financial institutions that accept such deposits lend them to customers who invest in their businesses. This is the process of creating the capital that is the *sine qua non* of sustainable, long-term economic growth.

Steven Horwitz (sghorwitz@stlawu.edu) is the Charles A. Dana Professor of Economics at St. Lawrence University.

In Bastiat's terms, we see the lost expenditures at the retail store, but we mostly don't see the "backdoor" way the savings are channeled to other businesses. More precisely, an increase in the savings rate represents a change in consumers' time preferences: They are saying they are less interested in current consumption and more interested in future consumption. The beauty of financial markets is that they translate that change in preferences into a change in the flow of resources. Those investments will take time to become consumption goods, but that's what consumers want.

Saving Creates Growth

So contrary to Isidore's arguments, restricting consumption does not hamper economic growth. In the long run, economic growth requires saving and the creation of new capital goods.

For savings to contribute to growth this way, financial intermediaries must function properly. The fallacy that increases in saving will frustrate growth finds its most recent theoretical statement in Keynes, particularly in his assumption that the financial system cannot translate savings into investment. In contrast to the classical and Austrian economists, who believed that interest rates would coordinate the supply of savings and the demand for investible funds, Keynes argued that saving was a function of income, and investment was driven by the "animal spirits"—that is, people's psychology and expectations. As a result, there was no reason to think that increases in saving would make their way back into the economy as investment. Indeed, savings was a "leakage" from the expenditure stream made up of consumption, investment, and government spending.

An increase in the savings rate represents a change in consumers' time preferences.

But Keynes was wrong about how markets, especially financial markets, work—at least when they are left to themselves. As Isidore's article points out, if banks are reluctant to lend out the funds that savers are supplying, increases in saving will not get translated into investment spending. He argues that is precisely what is happening right now.

If true, the fault lies not with the saving habits of the public, but with whatever is causing the banks to hesitate. Blaming the public for "saving too much" is wrong, as Isidore himself notes in claiming that "a high savings rate is not a bad thing for the economy." The problem, he argues, is people doing it now when banks won't lend. Why then are banks reluctant to lend?

One answer is that at the onset of the crisis the Federal Reserve System decided to pay interest on the reserves banks hold in their accounts at the Fed. Combined with very low rates of return on other assets, this made sitting on both the public's increased savings and the Fed's newly injected reserves a better choice than lending.

Moreover, the combination of bailouts, quasi-nationalizations, and policy zig-zagging might be making lenders more uncertain about the future and less likely to lend. What economic historian Robert Higgs has termed "regime uncertainty" was responsible for the length of the Great Depression and might be a key reason why banks might lend less than in the recent past. Isidore and others never consider that, in the words of economist Roger Koppl, "Keynesian policies can create a Keynesian world"—that is, bad policy can break the link between savings and investment. In any case, blaming the savers misses the real problem.

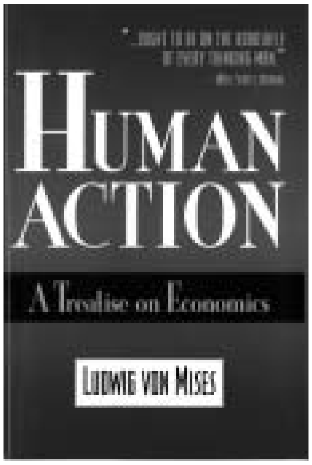
And there might not be a problem anyway: A number of economists have disputed the claim that banks have stopped lending. Even at the height of the crisis in October, economists at the Minnesota Fed found no evidence that banks had stopped lending to individuals or nonbank entities. More recent data from the winter show that while the rate of lending *growth* had slowed, the total quantity of loans to individuals and firms was steady, if not growing slightly. So theory aside, the empirical reality since September does not support the claim that savings is counterproductive. FEE

Human Action, 1949: A Dramatic Episode in Intellectual History

BY ISRAEL M. KIRZNER

A great book, it has been remarked, is like a great castle. It can be viewed from many different angles, each offering a unique perspective. Viewing Ludwig von Mises's monumental work from the vantage of 2009 permits one to see with great clarity one fascinating aspect of the book—the sheer *drama* of its emergence at the time that it appeared. This is a theme on which I have touched more than once over the years. I am grateful for the present opportunity to articulate this theme in somewhat greater detail.

Some 13 years ago (in the May 1996 *Freeman*, which celebrated the first 50 years of public service splendidly contributed by the Foundation for Economic Education), I dwelt on the pivotal role played by FEE in upholding the flag of Austrian economics. I dwelt especially on the role it played (most importantly by providing Mises with a congenial "base") in nurturing the Austrian economics tradition during decades in which the professional reputation of the school was at its very lowest. That paper focused, in part, on the contribution of the Foundation to the subsequent revival of Austrian economics in this country. The present note complements that earlier piece by focusing on the altogether dramatic character of the long-run impact of this magnum opus of Mises, a work that anchored everything which Mises was to write under FEE auspices, and to which the Austrian economics revival is, unquestionably, to be attributed.



The Intellectual Drama of *Human Action*

The term "drama" may seem out of place in regard to a serious tome on the foundations of a serious discipline. But *Human Action* is no ordinary work. It is a work which, at the time, was seen as written in starkly uncompromising fashion, articulating a particular worldview and a particular understanding of economics—at a time when that worldview and that understanding were thought to have been decisively nudged off the professional stage. The book came to be summarily dismissed, and subsequently ignored, as the last gasp of a dying intellectual tradition. But this judgment was grievously mistaken.

Human Action was *not* a work merely presenting, once again, the ideas of an earlier tradition. The book in fact represented, we must point out, a dramatic *revision*, a dramatic *deepening* of the insights of the Austrian school. Precisely when the Austrian economics tradition was widely seen as virtually dead, as material only for treatises on the history of economic thought—precisely at that time that very tradition brilliantly produced a sparkling, fresh, fundamentally new interpretation of its central tenets. Six decades later we can see how Mises's revision and rein-

Israel Kirzner is professor emeritus of economics at New York University and did his doctoral work under Ludwig von Mises. Professor Kirzner is the author of many books in the Austrian tradition of economics, among them Competition and Entrepreneurship; Perception, Opportunity, and Profit; *and* The Meaning of Market Process.

terpretation inspired a revival of serious academic and scholarly interest in Austrian economics. Seen from this perspective, the 1949 publication of *Human Action* must surely be recognized as a dramatic episode in the history of economics.

The Decline of Austrian Economics, 1932–1945

At the outset of the 1930s the Austrian school of economics was recognized on the continent, in the United Kingdom, and in the United States as an important component of contemporary academic economics. For young scholars from America visiting the European academies at that time, an invitation to present their work at a seminar at the University of Vienna was a highly valued professional achievement. In Britain, Lionel Robbins, the most prominent economist at the University of London, published his 1932 classic, *An Essay on the Nature and Significance of Economic Science*, replete with insights and citations the author had culled from the Austrian literature and from his visits to Vienna. In that same year Robbins invited the brilliant young Friedrich Hayek (a close associate and protégé of Mises) to join the London faculty in a prestigious professorship. And Hayek's appearance on the British academic scene had an almost dramatic impact on British economics discussion, especially in regard to capital and monetary theory.

Precisely when the Austrian economics tradition was widely seen as virtually dead, it brilliantly produced a sparkling, fresh, fundamentally new interpretation of its central tenets.

Yet just a few short years later, it seemed, this success had evaporated. The advance of economic theory in the '30s (advances related in particular to the work of Piero Sraffa and John Maynard Keynes, to theories of imperfect and monopolistic competition, to the theories of socialist economics, and to sophisticated advances in mathematical economics) seemed to have left the Austrians far behind. They were seen to have been defeated by Keynes (in regard to macroeconomic issues), by Frank Knight (in regard to capital theory), and by Oskar Lange and by Abba Lerner (on the possibility of efficient socialist economic planning), and to have failed to keep pace with the exciting developments in welfare theory, econometrics, and mathematical economics. The physical dispersal of the circle of Vienna economists who had attended Mises's famed *privatseminar* as a result of the political turmoil of the times certainly contributed to the impression that the Vienna tradition was no longer a live component of modern economic thought. (Mises himself had left Vienna for Geneva in 1934.) Although Mises published *Nationalökonomie* in Geneva in 1940 and Hayek published *The Pure Theory of Capital* in 1941, the economics profession paid virtually no attention to these works. By the end of World War II, with Mises a refugee in New York and without a regular academic position, the outlook for the future of the Menger-Böhm-Bawerk tradition seemed bleak indeed.

Moreover, it can be argued, certain aspects of the developments in mainstream economic theory during the '30s—despite their overall thrust *away* from the path of Austrian theory—may well have seemed to *erode* the case for a distinctive Austrian presence. In its early years the Austrian school had gained its distinctiveness from its pioneering challenge to the dominance of the German Historical School. But by the 1930s, *that* war (on behalf of the legitimacy of abstract economic theory) had been decisively won; all the major schools of European economic thought were on the side of the Austrians in regard to the role of pure theory. And in 1932 Mises himself had written to the effect that all "modern" schools of economic thought subscribe to the same set of economic principles, albeit in different languages and with different modes of exposition. Mises himself, it seems clear, had (in 1932) not recognized the *gulf* that (as would later become amply clear!) separated the dominant Anglo-American mainstream from the economics that Mises himself identified with the Austrian tradition. So a number of Mises's disciples (including, perhaps, Fritz Machlup, Gottfried Haberler, and Paul Rosenstein-Rodan) might be excused for thinking that what was important to the

Austrian tradition was by now (the '30s) well-accepted in mainstream economics. There was no intellectual profit, such Austrians came to believe, to be gained by insisting on the distinctiveness of the Austrian label.

The Socialist Calculation Debate and the Mises-Hayek Revolution

Yet if the immediate post-World War II scene appeared so wholly inhospitable to a distinctive Austrian economics, both Mises and Hayek were in fact working, independently but along parallel paths, toward a revolutionary reinterpretation of their intellectual heritage. (This note is, of course, focusing on Mises's classic work of 1949. But it would be a serious mistake to fail to note that the "drama" we have seen in the appearance of Mises's book had its parallel in the appearance of Hayek's 1948–49 volume of essays, *Individualism and Economic Order*. I have elsewhere discussed the complementarity between those two contributions in "Ludwig von Mises and Friedrich von Hayek: The Modern Extension of Austrian Subjectivism," republished as chapter 7 in my *The Meaning of Market Process: Essays in the Development of Modern Austrian Economics*.)

Human Action was a defiant declaration of theoretic independence.

The "socialist economic calculation debate" that raged in the prewar decade had, it seems reasonable to believe, induced the revolutionary revisions in their understanding of markets. The uncritical acceptance by the economics profession of the Lange-Lerner thesis—that socialists can plan efficiently by modeling their plan after general equilibrium conditions (postulated by mainstream theorists as governing competitive market systems)—taught Mises and Hayek that their own understanding of how markets work differed *fundamentally* from that of their neoclassical colleagues. Mises, in particular, now realized that mainstream neoclassical theorists do *not* subscribe to the same understanding of the economic principles governing markets to which Austrian economists (or, at any rate, he) subscribe. Mises wrote *Human Action* to articulate with utmost conviction his *refusal* to accept that mainstream neoclassical interpretation of how markets work. *Human Action* was a defiant declaration of theoretic independence—a declaration spelling out explicitly what had hitherto (at least in Mises's view) been implicit in *earlier* neoclassical (and particularly in Austrian) market theory. (See Frank M. Machovec's *Perfect Competition and the Transformation of Economics*.)

This explicit articulation constituted a dramatic, revolutionary deepening and extension of existing Austrian theory. That it came to inspire the late-twentieth-century revival of Austrian economics, although ignored and overlooked when it was first published, is in large part what made the publication of *Human Action* an episode of intellectual drama.

Market Process Versus Market Equilibrium

What the socialist economic-calculation debate taught Mises, I believe, is that it is necessary, in order to promote economic understanding of what the market system achieves, to replace expository emphasis on attainable market equilibrium patterns with an emphasis on the character of the *processes* of equilibration. (For an exhaustive exploration tending to support this assertion, see Don Lavoie's *Rivalry and Central Planning: The Socialist Calculation Debate Reconsidered*.)

This latter emphasis reveals the essentially *entrepreneurial* character of the market process and underscores the role of *dynamic competition* (as against the state of so-called "perfect competition") in this entrepreneurial process. (In Hayek's work a parallel shift of emphasis was being articulated: namely, a replacement of a world of imagined perfect mutual knowledge by a world in which the market "learning" process tends continually to expand the scope of mutual knowledge—subject, of course, to the continual disruptions generated by exogenous changes in demand patterns, resource availabilities, and so on.) The writers who believed that central planners *could* emulate market efficiency had overlooked, in Mises's view, the subtle processes of entrepreneurial *discovery*, through which alone one could postulate any systematic tendencies toward market equilibrium.

By focusing on the entrepreneurial process at work in markets unhampered by governmental obstacles to competitive entry, Mises offered much more than a reinterpretation of traditional price theory. His insights offered a brilliant new understanding of the meaning of market competition and thus also a revolutionary perspective on the theory of monopoly. Mises's understanding of the market process implied not only the rejection of mainstream orthodoxy in the theory of socialism, but also far-reaching implications for the theory of antitrust policy and, more generally, for the theory of government regulatory policy.

For many years this new emphasis in Misesian-Austrian economics was completely ignored. In the immediate post-World War II decade the focus of professional attention was not on the precise formulation of the foundations of microeconomics, but on the extent to which microeconomics must, in the real world, be superseded, as a practical matter, by Keynesian macroeconomic considerations. Moreover, the increasing sophistication of mathematical economics, and its applications in the elaboration of the ambitious Walrasian general-equilibrium theoretic enterprise, combined to make Mises's ideas seem old-fashioned, elementary, and even primitive. As is now well-known, these were decades (stretching from after the 1921 publication of Knight's *Risk, Uncertainty and Profit* until William Baumol's pioneering work almost half a century later in the resurrection of the entrepreneurial role) in which mainstream economic theory almost completely lost sight of the entrepreneur.

By the 1960s and '70s younger students and scholars were beginning to discover Mises's work and to recognize the sparkling freshness of his ideas.

The Drama of the Austrian Revival

But Mises's great work was *not* destined to be buried forever under this deafening silence. By the 1960s and '70s younger students and scholars were beginning to discover Mises's work and to recognize the sparkling *freshness* of his ideas. The economics profession—or at least some of its more daring and independent-minded graduate students—were at the same time beginning to take note of and to acknowledge the stultifying irrelevance of much of what was being taught in mainstream graduate departments. The downfall of Keynesian economics during the latter decades of the century focused renewed attention on the foundation of microeconomics. In *Human Action* more and more young scholars rediscovered ideas that enabled them to make sense of the complex world that economic science is supposed to help us understand. The downfall of the Soviet Union focused attention on the profound truths about socialism to be extracted from the Misesian foundations. That downfall taught many that the mainstream of the profession, which had for decades defended the possibility of socialist economic efficiency and had contemptuously dismissed those who had challenged that possibility, was simply and ingloriously wrong.

The modest revival of interest in the Austrian economics tradition over the past four decades has highlighted, in my opinion, the drama inherent in the first appearance of *Human Action*. This work was the courageous manifesto of a scholar of incorruptible integrity who, close to the seventh decade of his life, contributed a brilliantly fresh articulation of economics truths. That this work was ignored for decades and only subsequently won recognition (albeit modest), adds to the intellectual drama of this episode in the twentieth-century development of economic thought. Speculation concerning the *future* influence that may yet be exerted by this towering work only enhances the excitement sparked by this drama. FEE

Human Action: The 60th Anniversary

BY BETTINA BIEN GREAVES

We are celebrating the 60th anniversary of a great book, *Human Action: A Treatise on Economics,* by a learned man and a clear thinker: the Austrian economist Ludwig von Mises. It presents Mises's understanding—after long years of study and thought—of how the market economy functions. It is a major contribution to human knowledge.

Interventionist ideas dominated Europe when Mises was a young man. He wrote later that when he entered the university in 1900, he was "a thorough statist [interventionist]." Unlike most of Mises's fellow students, he was not a Marxist; he had studied the works of Marx, Engels, and Lassalle, found them incomprehensible and so was "consciously anti-Marxian."

At that time the teachings of Gustav Schmoller's Historical school of economic state science prevailed in the German universities. According to Schmoller, the only scientific method for the sciences of human action was history, the study of the past from which economic theory was to be abstracted. Moreover, Schmoller's school did not really deal with scientific problems but was dedicated instead to the glorification and justification of Prussian policies and Prussian authoritarian government. Thanks to Mises's intense interest in historical knowledge, he never accepted historicism, having rejected this view of economics even as a high school student.

During his Christmas vacation in 1903, Mises's senior year at the university, he read Carl Menger's *Grundsätze der Volkswirtschaftslehre* (*Principles of Economics*). The book opened his mind to a new way of thinking, a completely different approach to economics from that of either Marxism or historicism. As he wrote later, it "made an 'economist' of me."

As Menger presented it, economics is a science of reason and logic, the study of the actions of men, their ideas, and the means they use to accomplish their chosen ends. Menger's book dealt with the *economizing individual* as a universal phenomenon —that is, his principles apply to everyone at any time. We all act on the basis of our own subjective values in the effort to acquire things we consider important for "our continued existence and development (life and well-being)." We try to use what we have to get what we want as expeditiously and economically as possible, given the time and circumstances. Once Mises realized that economics was a science and that subjective value and marginal utility were the bases for all economic theory, his interest turned from history to economics.

> Once Mises realized that economics was a science and that subjective value and marginal utility were the bases for all economic theory, his interest turned from history to economics.

Subjective value theory explained that voluntary exchanges improved the situation of both parties to a trade. One man's gain was not another man's loss; rather, both parties expected to benefit. In the absence of force, fraud, or human error, they did. Then *ipso facto*

Contributing editor Bettina Bien Greaves (Bbgreaves@aol.com) was a longtime FEE staff member, resident scholar, and trustee. She attended Ludwig von Mises's New York University seminar for many years and is a translator, editor, and bibliographer of his works.

in a free-market world, conditions would continually improve and people would become better off, richer, more peaceful, and more prosperous. But the market then was by no means free. Almost all European governments forcefully interfered with it, regulating and controlling their economies to a considerable extent. The Austrian government controlled rents, restricted imports, and inflated the money supply to subsidize the railroads and food producers. Germany's socialistic policy would culminate in an almost completely controlled economy in World War I and later in Hitler's National Socialism. In the Soviet Union the communists destroyed the market and private property.

Mises reasoned that if in a free-market society, where peaceful social cooperation prevailed, the voluntary actions and choices of individuals tend to coordinate the actions of all market participants, improve production, and contribute to peace and prosperity, then interference through force or threat of force hampered and disrupted that process. Mises was a serious and conscientious student. The more he studied and thought, the more he realized that future peace and prosperity depended on promoting an understanding of good free-market ideas and opposing bad government-interventionist ideas. As a high school student he had adopted as his motto a phrase from the Latin poet Virgil: "Do not yield to the bad, but always oppose it with courage." Hence he determined not only to improve his own understanding of economics but also to fight interventionist ideas by explaining their harmful consequences and by teaching sound economic ideas in the classroom, lectures, seminars, books, and articles.

Mises felt the need to integrate all the teachings of the Austrian school into a comprehensive treatise on economics.

Early Development

In his 1922 book, *Socialism*, Mises followed Menger in explaining how money developed out of barter as a trading commodity and became society's medium of exchange. Without such a common denominator, traders would be unable to calculate consumer demand, production costs, and selling prices. Mises pointed out that in a socialist society without private property, there could be no market prices and without market prices, the task of the government's central planners would be like trying to steer a ship without a rudder—chaos!

In Mises's earlier book, *The Theory of Money and Credit (*1912), he pointed out that by lowering the interest rate asked of borrowers, banks could expand credit, create more "money" to lend, make borrowing easier, and thus stimulate businesses artificially. He explained later that the German government itself had been responsible for its runaway inflation in 1923 by printing money to spend and to lend. Only much later did Mises realize that unexplained economic crises were due not to market failure, but to the artificial reduction of interest rates—by banks and by governments—that caused a "boom" by inducing businesses to borrow more than they would have otherwise and then later a "bust," when their projects, which turned out to be *malinvestments*, made losses.

A Comprehensive Treatise

Mises had written books on money, inflation, the trade cycle, and socialism, as well as articles on practically every aspect of economics. Yet he felt the need to integrate all the teachings of the Austrian school—subjectivism, the division of labor, monetary theory, international trade, pricing, competition, monopoly, savings, investment, and more—into a comprehensive treatise on economics. Mises's activities with the Austrian Chamber of Commerce in Vienna occupied him almost full-time. However, anticipating the rise of socialism in Austria and of Hitler in Germany, Mises accepted a teaching position at the Graduate Institute of International Studies in Geneva, Switzerland, in 1934. His teaching schedule in Switzerland was not strenuous, and he finally had time to devote to the book on economic theory he had been contemplating for some time. He began shortly after he arrived in Geneva, and he kept on writing in between his other obligations—teaching, getting married (his wife-to-be had managed to get out of Vienna shortly after the Nazis arrived in 1938), and lecturing at international meetings. He wrote in longhand, submitting his manuscript page by page to be typed. Finally, in the spring of 1940, thanks to Mises's determination and persistence, the manuscript for *Nationalökonomie,* an all-encompassing 756-page book on economics, was in the hands of the publisher.

By then, World War II had begun. Germany had overrun and occupied Austria, Poland, Holland, Belgium, Norway, and France, and attacked Russia. Mises's situation in Switzerland, as a "stateless citizen" after the Nazis occupied Austria, had become uncomfortable. Friends of Mises arranged for him to be issued a non-quota U.S. visa, and he made plans to leave Switzerland. The publication of *Nationalökonomie* was announced in the *Tribune de Genève* on June 16–17, 1940. With the Nazis in control of most of Europe, 1940 was an unpropitious time for launching on the European market a new German-language free-market-oriented book. Though depressed by the war and sorry to leave Switzerland, Mises was undoubtedly proud and pleased to be carrying with him in his luggage, when he left for the United States on July 4, a copy of his newly published treatise on economics.

Mises and his new wife arrived in New York on a hot and muggy August 2, 1940. It took some time for Mises to feel settled in the United States. But by 1944 he had written and had published two English-language books (*Omnipotent Government* and *Bureaucracy*). In 1946 he became economic adviser to FEE.

Hazlitt's Suggestion

Around this time, FEE trustee Henry Hazlitt, economic journalist, author of the popular *Economics in One Lesson*, and a close friend and supporter of Mises, suggested that *Nationalökonomie* be translated into English. Mises disagreed, saying it should be rewritten in English for an American audience. So Mises set to work. FEE founder and president Leonard E. Read was supportive of the effort. A FEE secretary helped type the final manuscript, and Read committed FEE to purchasing 500 copies to assure its publication by Yale University Press.

Human Action (1949) is organized along similar lines to *Nationalökonomie.* But it is a very different book, longer than the German original (889 pages) with fewer references to European history. Instead *Human Action* is illustrated with incidents of interest to American readers. For instance, it cites Margaret Mitchell's *Gone with the Wind*, the U.S. experiment with Prohibition in the 1920s and 1930s, and General Billy Mitchell, ardent advocate of air power in the 1930s, who was demoted and court-martialed for criticizing the military, then posthumously rehabilitated and honored.

In *Human Action* Mises starts at the very beginning. Human beings act. Why? Because they are dissatisfied in some respects and have an idea about how to improve their situation.

Beginning at the Beginning

In *Human Action* Mises starts at the very beginning. Human beings act. Why? Because they are not neutral with respect to their situation; they are dissatisfied, uneasy in some respects, and have an idea about how to improve their condition. All actions are, by definition, purposive—that is, aimed at ends. This is the subject of economics. Economics is not a study of the physical production of material things; that is physical science, mechanics, or technology. Economics is not a study of what men did in the past; that is history. It is not a study of *why* men act; that is psychology or, Mises's term, thymology. It is not the study of unconscious bodily functions (digestion, breathing, the beating of the heart, the involuntary reflexive responses of the human body to stimuli); that is physiology.

Humans act based on subjective evaluations, so subjective value theory is crucial for understanding all economic phenomena. Men have values, wants, and preferences. Some things are more important to them than others. They seek to trade things they have that they value less for things they value more. They are uneasy, dissatisfied, so they strive to exchange their present situation for another. Mises explained that prices are ratios reflecting the relative subjective values of buyer and seller expressed in money terms at the instant of exchange. Thus economics is not a study of material things or monetary statistics, but of decisions, ideas, choices, values, and the purposive actions of human beings.

From this point of view, Mises described the workings of the market. Production, the division of labor, exchanges, wages, money, savings, and trades all stem from the decisions, choices, purposive actions, ideas, and personal subjective values of economizing individuals as they bid and compete with one another to improve their respective situations. Similarly, Mises explained supply, demand, competition, unemployment, monopoly, domestic and international trade, and more as outcomes of the actions and interactions of valuing individuals, each doing their best under the circumstances to seek their ends.

In *Human Action* Mises also analyzed government interventions into the market—taxes, price controls, price supports, inflation and credit expansion, special privileges and subsidies to some and special costs to others, trade restrictions, monetary expansion and contraction, war, and so on. Such government interventions inevitably have unintended consequences, such as increased costs, distorted production, higher prices, idle resources and unemployment.

By describing in *Human Action* the workings of a society based on social cooperation, the division of labor, and private property, Mises believed he presented the guideline for maintaining a free-market economy.

Human Action: An Economic Treatise represents the culmination of Mises's life-long effort to present a comprehensive economic theory of the operations of an unhampered market plus a description of how government interferes with and obstructs social cooperation and market activities. It is a sober, scientific book, not a diatribe.

It is our relatively free market that has produced the cornucopia of goods and services we enjoy today; it has increased our knowledge of the world, improved living standards, and supported an ever-increasing population. By describing in *Human Action* the workings of a society based on social cooperation, the division of labor, and private property, Mises believed he presented the guideline for maintaining a free-market economy. He also believed he explained how this trend toward plenty, peace, and prosperity can be disrupted by government interventions. He concluded:

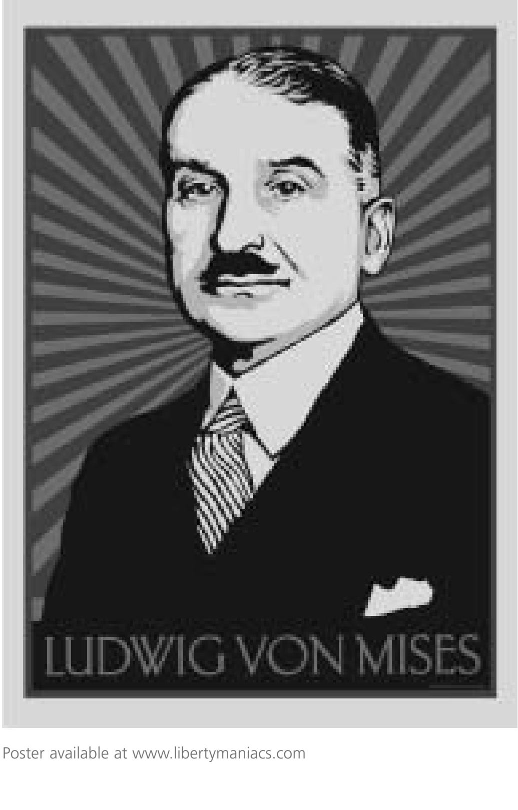
"The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological, and therapeutical achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race." FEE

Human Action: The Treatise in Economics

BY PETER BOETTKE

"Next week we will discuss the master's work." So stated Dr. Hans Sennholz to close his graduate seminar during my junior year at Grove City College. I had owned a copy of *Human Action* since my freshman year, but the book was too daunting for me to really study it. I preferred to read Henry Hazlitt's *Economics in One Lesson* or Ludwig von Mises's *Planning for Freedom*, or Sennholz's own *The Age of Inflation*. But I had read those works thoroughly. And by this time I had already taken a year-long history-of-thought course at Grove City, in which I read classics such as Adam Smith's *The Wealth of Nations*, J. B. Say's *Treatise in Political Economy*, and John Stuart Mill's *Principles of Political Economy*. I also had read Mises's *Socialism* and F. A. Hayek's *The Road to Serfdom*.

Because I was a serious student of free-market economics, Sennholz invited me to join his "graduate seminar," which met on Wednesday nights and read the classics. That year we read Carl Menger's *Principles* and *Investigations* and Eugen von Böhm-Bawerk's *Capital and Interest*. So on Sennholz's orders I picked up my copy of *Human Action* and went to the library every night until I had read the book cover to cover. Thanks to my undergraduate mind and the speed with which I tried to absorb the material, I missed much more than I comprehended.



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But what I did comprehend changed my life.

It was that experience more than any other that made me realize I wanted to be an economist—not just an advocate for the free market. A year later I applied, and was accepted, to law school, but decided to defer that and attend graduate school in economics instead. Studying economics in the way Mises described the discipline in *Human Action* seemed the appropriate path.

Over the next year I worked to clear up my misunderstandings of Mises by reading Murray Rothbard's *Man, Economy, and State* and Percy Greaves's *Mises Made Easier*. Then in the second semester of my senior year I reread *Human Action* for a senior project for Sennholz on the *methodenstreit* (the Austrians' battle with the German Historical school over the legitimacy of economic theory) and the relationship between Mises and Max Weber.

A year later, when I started graduate school at George Mason University, Professor Don Lavoie

Contributing editor Peter Boettke (pboettke@gmu.edu) is a professor in the economics department at George Mason University, the deputy director of the James M. Buchanan Center for Political Economy, and a senior research fellow at the Mercatus Center.

impressed me when, in an undergraduate course, he held up *Human Action* and said to the students, "This is the greatest book ever written in economics. I love this book." I understand what Lavoie meant. For the past 20 years I have had the good fortune to be able to use *Human Action* in at least one Ph.D. course every year.

No Substitute

To the American student of economics, Rothbard's presentation in *Man, Economy and State* might be more straightforward than *Human Action*, and Israel Kirzner's discussion in *Competition and Entrepreneurship* picks up more naturally than *Human Action* from where intermediate price theory leaves off. But to the serious student of Austrian economics, there is no substitute for a thorough reading of *Human Action*. Even Hayek's *Individualism and Economic Order* is best read as a complement to Mises's great work, certainly not as a substitute if you hope to understand not only Hayek's thought and argument, but also how markets actually work and why government cannot effectively regulate, let alone plan, a modern economy.

Mises wrote economics not as a series of specialized topics, but as an integrated whole grounded in the consistent and persistent study of the logic of purposive human action.

Since it was first published, Mises's great work has been misunderstood. It is not primarily a work in methodology; it simply lays out the methodological foundations at the beginning. It is not primarily a work about the failures of government and the superiority of the market economy, though that is a logical conclusion to draw from the work's analysis of interventionism and socialism. It is not primarily a work in market theory and the price system, though it does place a priority on entrepreneurship and the quest for profit and the discipline of loss. It is not primarily a work dealing with money, capital, and interest, but it does devote considerable time to the coordination of economic activities through time and devotes considerable space to the nature of money and capital and the role played by interest. Finally, *Human Action* is not focused on the wages of workers or the pattern of international trade, but it does lay out the economic theory of factor pricing, the principle of comparative advantage in the allocation of labor, and the international division of labor and the gains from specialization and exchange.

Human Action is not exclusively any *one* of these things precisely because it is *all* of these and more. Mises wrote economics not as a series of specialized topics, but as an integrated whole grounded in the consistent and persistent study of the logic of purposive human action.

In my view there have been two great defining characteristics of economics since its birth as a discipline in the eighteenth century: the market economy's self-regulating capacity (the invisible hand) and self-interest (rational choice). Self-regulation was the great discovery of the Schoolmen of Salamanca, the French Physiocrats, and the Scottish Enlightenment philosophers. The Austrian school of economics represents the modern refinement of this classical theory of spontaneous order. Mises inherited it from Smith, Say, Menger, and Böhm-Bawerk and developed the argument further. The unhampered market economy corrects itself through price adjustments; losses, which weed out imprudent decision makers; and profits for prudent decision makers. In the process the market directs scarce resources into wealth-creating activities and general prosperity. Through relative prices and profit-and-loss accounting, individuals' exchanges and innovations align technology and resource availability with consumer preferences.

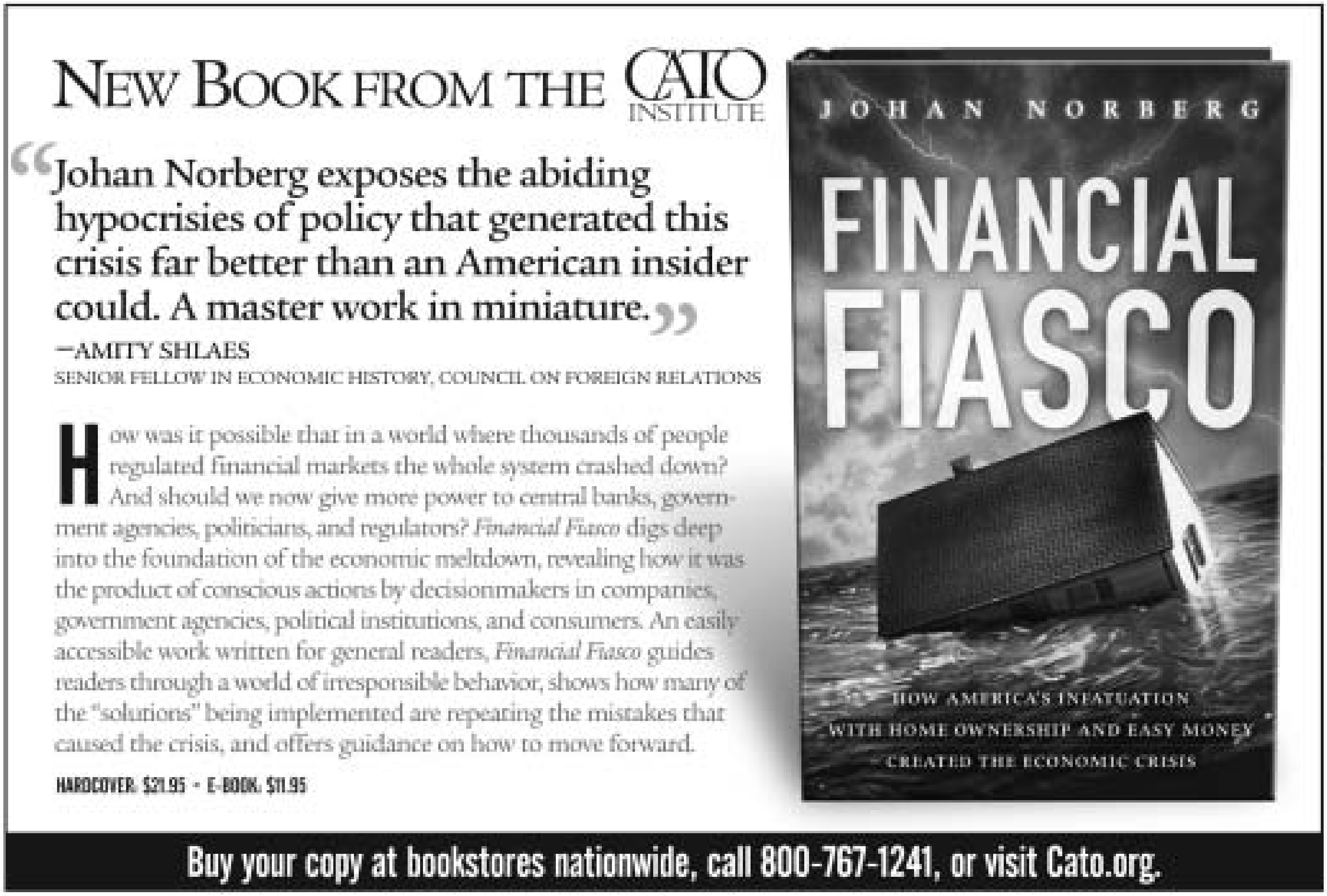
Coordination of Consumption and Production

One sign of Mises's genius is that his demonstration of this harmonization was more thorough than any before him. He showed how purposive action within the institution of private property coordinates consumption desires and production plans according to the least-cost methods of production. The private-property market economy mobilizes individual initiative and enables people to rationally calculate the alternative uses of scarce resources. Consumers, buying and abstaining from buying, create profits and losses that guide business decisions and coordinate economic plans through time.

Mises's work on rational economic calculation provided the decisive argument against socialism, but it also explains the foundation of the market order. The free market enables calculation, socialism makes it impossible, and interventionism distorts it. Without private property, freedom of contract, monetary stability, and fiscal responsibility, the process of rational economic calculation is thwarted.

Adam Smith articulated the idea of the invisible hand, but it was Mises who explained how the market economy actually works. *Human Action* is Mises's fullest and finest statement of that explanation.

To put it bluntly, *Human Action* is the *greatest* work in economics in the twentieth century. It is *the* treatise in economics. FEE



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What *Human Action* Has Meant to Me: Reflections of a Young Economist

BY PETER T. LEESON

I remember well when I discovered *Human Action*. I remember because it has had the profoundest influence on my development as an economist not only up to that point, but also since then.

I first read *Human Action* when I was in high school. At the time I was very much interested in, and influenced by, supply-side economics. One of the supply-siders I was reading (maybe it was George Gilder or Paul Craig Roberts?) referenced Ludwig von Mises's treatise, which I subsequently picked up.

My first days with the book were tough going, to say the least. I needed a dictionary and an encyclopedia of philosophy by my side to make sense of the first few chapters, which discuss Mises's method. I made it through the methodological discussion but understood little of it. Fortunately, I didn't let that stop me from continuing with the book, the rest of which I found somewhat easier to digest.

The author with his *Human Action* collection.

In the days and weeks that followed I read *Human Action* with a dedication I'd never applied to a book before. I kept careful notes in the margins and faithfully followed the footnotes. I felt enlightened with every sentence and could hardly wait for the next one to enlighten me further. The sense of intellectual excitement I felt the first time I read the book is a feeling I hope every person experiences in his or her life.

I encountered a few passages I found extremely difficult to understand and more than a few I didn't understand at all. But what I was picking up struck me as so important and penetrating that I did something I rarely did in those days when I completed a book: I opened up to page one and began reading it again.

Over the next year I read *Human Action* many times—exactly how many times, I don't remember. But it got to the point where I could, in a matter of seconds, flip to most any decent-sized passage I sought in the book without looking at the table of contents or index. In the years that followed I read *Human Action* some more, and then again. As I learned more economics—from Mises's other works and those of other economists—and learned more in general, I came to better understand those parts of *Human Action* that I formerly found impenetrable and developed a better grasp of those parts of the book I had understood only weakly before.

As is probably clear from my description, I found, and still find, *Human Action* an endlessly rewarding and illuminating book. In my opinion it is the most important book on economics of the twentieth century and quite possibly the most important book in economics, period. For this reason I've studied it more closely than I've studied any other book; and I believe that who I am as an economist and how I approach economics has been shaped more by *Human Action* than by any other book.

If the number of copies of *Human Action* in my library is any indication, this is certainly true. My first

Peter Leeson (pleeson@gmu.edu) is a visiting professor of economics at the Becker Center on Chicago Price Theory at the University of Chicago and author of The Invisible Hook.

copy was the blue, soft-cover, third edition. Since then I've acquired over a dozen other copies of the book—enough for multiple copies of every edition—including my prized possession: a first edition signed by Mises himself, which was given to me by my mentor, Peter Boettke, when I completed my Ph.D. Perhaps unusually, *Human Action* was my "gateway book" to Mises's other works. After *Human Action* I read *Socialism*, *The Theory of Money and Credit*, *Liberalism*, and then others. I loved and learned much from them all, but none more than Mises's magnum opus.

Charting an Educational Course

I became so enamored with Mises's ideas through *Human Action* that I chose where I would pursue my undergraduate education on the basis of which school would allow me to be closest to these ideas and learn more about them. In this sense *Human Action* charted my formal educational course.

Hillsdale College, my alma mater, is home to Mises's personal library. (I spent unhealthy amounts of time sitting at Mises's desk in the Mises Room in Hillsdale's library in a failed effort to absorb some of his brilliance.) At the time I was choosing a college, Hillsdale was also home to one of the world's foremost Mises and *Human Action* experts, former FEE president Richard Ebeling, who occupied the Ludwig von Mises Chair. Between Mises's personal library and Professor Ebeling I was sold on Hillsdale. And I was not disappointed. The opportunity to learn more about Mises, Austrian economics, and *Human Action* in particular, under the mentorship of Richard Ebeling, proved every bit as outstanding as I could have imagined.

In the same way that Hillsdale was the only college that made sense for me, given my passion for Mises and *Human Action*, so George Mason University's doctoral program was the only one that made sense for me. George Mason was (and is) home to the man who, together with Israel Kirzner, defines modern Austrian economics and is the leading Austrian economist in the world: Peter Boettke. The chance to further my study of *Human Action* and Mises's work more generally under Pete's tutelage made George Mason's draw irresistible. And, similar to my experience studying *Human Action* under Professor Ebeling, my experience studying the book under Pete not only met my wildly optimistic expectations but in fact surpassed them.

I have had the great fortune of teaching Austrian economics at the undergraduate and Ph.D. levels at George Mason. (This academic year I'm visiting at the University of Chicago.) In my undergraduate course *Human Action* is the only text. Each semester I hope some student will "discover" Mises's treatise as I did years ago, and that *Human Action* will have the same life-altering effect for him or her as it has had for me.

My graduate Austrian course focuses on journal articles outside the Austrian literature, but also includes *Human Action*. Even where the book doesn't figure explicitly in a given lecture, it looms large indirectly through the influence it has had over my thinking about whatever the discussion may be.

> The way I got here was through Mises's *Human Action*. Every year I read *Human Action* again, and every year I learn something new.

Constant Influence

My career as an economist has only just begun. But it's no exaggeration to say that the way I got here was through Mises's *Human Action*. Every year I read *Human Action* again, and every year I learn something new. Some of my research explicitly draws on and relates to this book. (See, for instance, "Was Mises Right?" with Pete Boettke in the *Review of Social Economy*, 2006.) Most of it does not. But this doesn't mean *Human Action* isn't actively influencing this work. Its influence is alive and well in all of my writing in at least two ways.

First, since *Human Action* permeates my thinking as an economist, in one sense, every paper I write is the result of this book. Second, the particular themes I focus on, most notably private institutions of governance and self-enforcing exchange, are, in my mind, attempts to build on and extend the Austrian research program Mises identifies and elaborates in *Human*

Action. As I've written elsewhere, I take the twin themes of spontaneous order and social cooperation under the division of labor as central to Mises's project in *Human Action*, and these themes motivate my work.

In *Human Action*, Mises highlights what he calls the "Ricardian Law of Association," which is at the core of this motivation. As Mises describes it (Chapter 8, Part 4):

> The law of association makes us comprehend the tendencies which resulted in the progressive intensification of human cooperation. We conceive what incentive induced people not to consider themselves simply as rivals in a struggle for the appropriation of the limited supply of means of subsistence made available by nature. We realize what has impelled them and permanently impels them to consort with one another for the sake of cooperation. Every step forward on the way to a more developed mode of the division of labor serves the interests of all participants. In order to comprehend why man did not remain solitary, searching like the animals for food and shelter for himself only and at most also for his consort and his helpless infants, we do not need to have recourse to a miraculous interference of the Deity or to the empty hypostasis of an innate urge toward association. Neither are we forced to assume that the isolated individuals or primitive hordes one day pledged themselves by a contract to establish social bonds. The factor that brought about primitive society and daily works toward its progressive intensification is human action that is animated by the insight into the higher productivity of labor achieved under the division of labor.

Taking its inspiration from this central insight, my work investigates the institutional mechanisms that make social cooperation under the division of labor, per the Ricardian Law of Association, a reality. Confronted with obstacles to their realization of mutual benefits of exchange—most notably the absence of exogenously given and enforced rules of social order—what do individuals, whose reason shows them the potential for immense gains from social cooperation, do to make it possible for them to exploit this potential in practice? If we can answer this question posed by Mises's insight in *Human Action*, we can advance our understanding not only of how individuals actually achieve social cooperation under the division of labor, but also how they do so without command.

Human Action offers me a kind of guiding light for pursuing economic research.

Guiding Light

Human Action thus offers me a kind of guiding light for pursuing economic research. It lays out a pure logic of choice and deploys this logic in the context of alternative institutional arrangements to illuminate the economic consequences of those arrangements and shed light on their emergence. To me, this is what economics is about.

As I look forward to the future I see *Human Action* figuring as prominently in my life and thinking as it did when I was a teenager. Certainly my passion for it remains undiminished. I have no doubt it will take my mind to new and exciting places, as it has since I discovered it years ago. I eagerly anticipate the new intellectual experiences I'll have, areas of study I'll enjoy, thinkers I'll interact with and learn from, and academic relationships I'll form. And I'll owe it all to Ludwig von Mises's *Human Action*. FEE

The Case for Capitalism

BY HENRY HAZLITT

There has just been published by the Yale University Press a book that is destined to become a landmark in the progress of economies. Its title is *Human Action*, and its author is Ludwig von Mises. It is the consummation of half a century of experience, study, and rigorous thought.

No living writer has a more thorough knowledge of the history and literature of economies than Mises, and yet no living writer has been to more pains to take no solution of any problem on faith, but to think out each solution, step by verified step, for himself. The result is a work of great originality written in a great tradition. Although it builds on what was sound in the classical economists and on the revolutionary revision of Menger, Böhm-Bawerk, Jevons, Clark, and Wicksteed, it extends beyond any previous work the logical unity and precision of modern economic analysis.

I know of no other work, in fact, which conveys to the reader so clear an insight into the intimate interconnectedness of all economic phenomena.

I know of no other work, in fact, which conveys to the reader so clear an insight into the intimate interconnectedness of all economic phenomena. It makes us recognize why it is impossible to study or understand "collective bargaining" or "labor problems" in isolation; or to understand wages apart from prices or from interest rates or from profits and losses, or to understand any of these apart from all the rest, or the price of any one thing apart from the prices of other things.

It makes us see why those who specialize merely in "monetary economies" or "agricultural economies" or "labor economies" or "business forecasting" so often go astray.

So far is Mises's approach from that of the specialist that he treats economics itself as merely part (though the hitherto best-elaborated part) of a more universal science, "praxeology," or "the science of every kind of human action." This is the key to his title and to his 889 comprehensive pages.

Mises is so concerned to lay foundations of his work with unassailable solidity that he devotes the first 142 pages to a discussion of "epistemological" problems alone. This is apt to discourage all but the most serious students of the subject. Yet there is nothing pretentious or pedantic in Mises's writing. His sentences and vocabulary are as simple and clear as his profundity and closely woven logic will permit. Once his more abstract theoretical foundations have been laid his chapters are models of lucidity and vigor.

Outstanding among his many original contributions are his "circulation credit" theory of business cycles, which emphasizes the harm of cheap-money policies, and his demonstration that partial socialism is parasitic

Henry Hazlitt (1894–1993), founding vice president of FEE and Freeman *contributor, was a popular economics writer who worked for the* Wall Street Journal *and* New York Times*, and then, from 1946 to 1966, wrote a column for* Newsweek. *He was the author of* Economics in One Lesson, The Failure of the "New Economics," *and many other books. This article is from his September 19, 1949* Newsweek *column.*

on capitalism and that a complete socialism would not even know how to solve the problem of economic calculation.

This book is in fact, as the publishers declare, the counterweight of Marx's *Das Kapital*, of Lord Keynes's *General Theory*, and of countless other books recommending socialization, collectivist planning, credit expansion, and similar panaceas. Mises recognizes inflationism under its most sophisticated disguises. He demonstrates repeatedly how statist interventions in the market economy bring about consequences which, even from the standpoint of those who originally advocated the interventions, are worse than the state of affairs they were designed to improve.

Human Action is, in short, at once the most uncompromising and the most rigorously reasoned statement of the case for capitalism that has yet appeared. If any single book can turn the ideological tide that has been running in recent years so heavily toward statism, socialism, and totalitarianism, *Human Action* is that book. It should become the leading text of everyone who believes in freedom, in individualism, and in the ability of a free-market economy not only to outdistance any government planned system in the production of goods and services for the masses, but to promote and safeguard, as no collectivist tyranny can ever do, those intellectual, cultural, and moral values upon which all civilization ultimately rests. FEE

Giants of Liberty

Human Action
Mises presents economics—not as a study of material goods, services, and products—but as a study of human actions. He sees the science of human action as a science of reason and logic, which recognizes a regularity in the sequence and interrelationships among market phenomena. Mises defends the methodology of praxeology against the criticisms of Marxists, socialists, positivists, and mathematical statisticians. Cloth, 4 vols., slipcase edition, $72.00; paperback, 4 vols., slipcase edition, $42.00. Paperback edition in one volume, $34.95 (limited supply).

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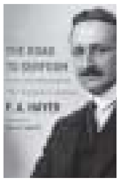

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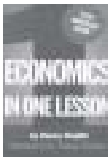

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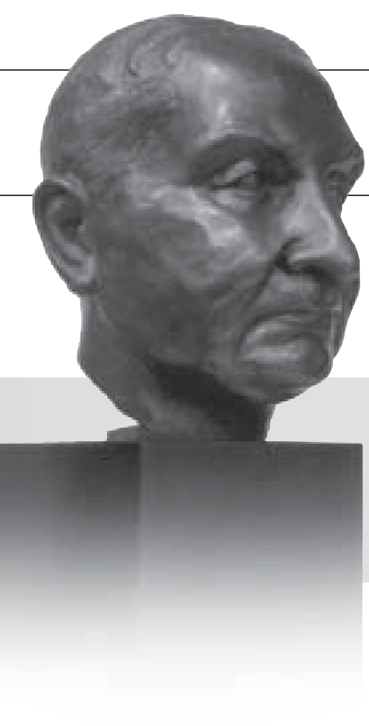
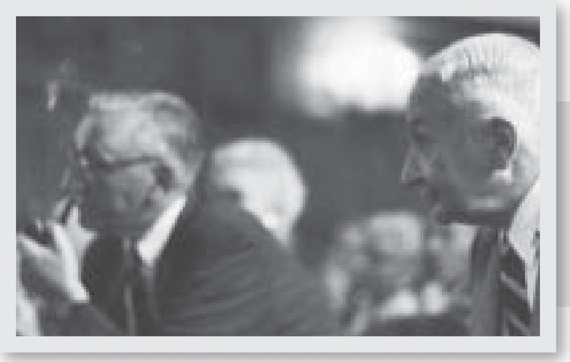


Ludwig von Mises at FEE

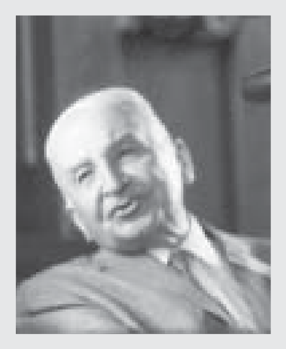
Mises, Eduardo Lasteo, and Enrique Lancer, visiting Argentinian scholars, at FEE, 1960

Percy L. Greaves and Mises, 1959, waiting for Mises' plane to Argentina for the lectures that would become *Economic Policy: Thoughts for Today and Tomorrow*.



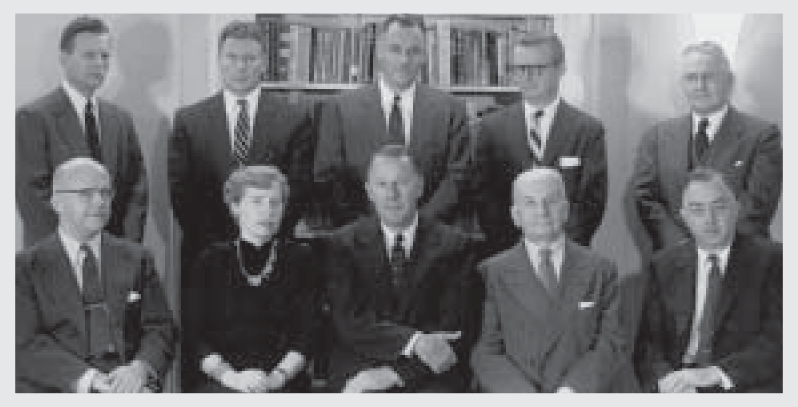
F. A. Hayek and Mises at Mont Pelerin meetings, Princeton, NJ, 1958

Wife Margit and Mises, Manchester, VT, Aug 1963



Mises at Mont Pelerin, 1958

Henry Hazlitt and Mises, date unknown



Front row, left to right: W.M. "Charlie" Curtis, Bettina Bien Greaves, Leonard E. Read, Ludwig von Mises, Floyd A. (Baldy) Harper. Back row, left to right: Paul L. Poirot, Edmund A. Opitz, Ivan Bierly, Charles Hull Wolfe, Thomas Shelley, Oct 1955 at FEE

As one of the most influential modern free-market thinkers, it was only natural that Ludwig von Mises would exert a formative influence on FEE, the first comprehensive free-market educational organization in America. The relationship, begun when Leonard Read was still developing his ideas for FEE, continued over many years. Mises was a regular presence at FEE events and wrote articles for *The Freeman*. His students—from Bettina Bien Greaves to Hans Sennholz, Israel Kirzner, Murray Rothbard, and countless others—have often gone on to work with or for FEE. Particularly in its early years, when free-market advocates were so few and far between, FEE played a crucial role in both supporting Mises himself and bringing his ideas to new generations of supporters of liberty.

FEE Seminars, July 1963. Mises is seated in the second row, middle

Margit and Mises, Buckhill Falls, PA 1955

Murray Rothbard, Hazlitt, and Mises

Mises and Hayek at the Mises *Dinner Circle*, NYC, 1959

Mises and Margit, Plano, TX, 1970 (photo by Nicky Naumovich)

Ludwig von Mises, photographed by Margit in the Austrian Alps, shortly before his death in 1973

Mises, Bettina and Percy L. Greaves, and Margit in Manchester, VT, Summer 1971

These photos come from the FEE archives; special thanks to Bettina Bien Greaves, who donated the overwhelming majority of them.

Mises portrait, 1936, Geneva (photo by Georgi Halm)

Our Economic Past

The Rise of Big Business and the Growth of Government

BY ROBERT HIGGS

Most people learn about the relation between the rise of big business and the growth of government in the form of what amounts to a morality play. In the most widely disseminated version, presented in nearly every American history textbook, the emergence of big business (playing the role of the devil) is said to have given rise to a variety of evils and abuses—monopoly power, pollution, exploitation of workers, and so forth. Matthew Josephson tells this story in rousing (if not scrupulously factual) style in his 1934 classic, *The Robber Barons*. The masses are said to have cried out for relief and to have pressed their political representatives to enact protective legislation. Thus emerged, most markedly during the Progressive, New Deal, and Great Society periods, a profusion of government programs, regulatory agencies, and direct government participation in economic life (divine intervention, as it were), which served to shield the public from the otherwise crushing weight of brutal laissez-faire capitalism.

Big business is a lot less uniform than it initially appears.

A competing tale, popular among many libertarians and some left-radicals, presents the rise of big business as leading directly to satanic endeavors. This version maintains that the big businessmen, however virtuous they might have been at the outset, ran into trouble because of rampant competition among the emergent big firms. To suppress this irksome, profit-sapping market phenomenon, they used their wealth diabolically to influence or bribe lawmakers to create government programs, regulatory agencies, and so forth that, in effect, allowed them to wield the government's coercive power in the service of propping up their cartels, suppressing competition, and maintaining excessive profits. The classic exposition of this interpretation is Gabriel Kolko's *The Triumph of Conservatism* (1963).

Unfortunately, although these morality tales contains grains, or even big chunks, of truth, each leaves out a great deal of important, relevant evidence. In short, reality was much messier than either interpretation suggests. It is difficult to read deeply researched books such as Robert H. Wiebe's *Businessmen and Reform* (1962), Morton Keller's *Affairs of State* (1977), and Martin J. Sklar's *The Corporate Reconstruction of American Capitalism, 1890–1916* (1988) and cling to *any* simple interpretation of the relationship between the rise of big business and the growth of government.

Part of the difficulty arises from the vastness and complexity of the U.S. economy. A multitude of organized interest groups emerged to lobby the various levels of government. Although the federal government became increasingly weighty in the overall mix of interventions, the states and the large cities continued to play important roles—for example, such outright socialism as appeared in the United States arose primarily at the municipal

Robert Higgs (rhiggs@independent.org) is senior fellow at the Independent Institute (www.independent.org), editor of The Independent Review, *and author of* Neither Liberty nor Safety: Fear, Ideology, and the Growth of Government *(Independent Institute).*

level, especially for so-called public utilities, such as electricity and gas production, and local mass transit, such as streetcar service.

No serious scholar denies that businessmen played important parts in creating the interventionist state. "But who," Wiebe asks, "are the businessmen? Sometimes they appear to be a handful of particularly successful and powerful men [Murray Rothbard emphasized especially the kingpins in the "Morgan ambit"]. At other times the community presumably includes everyone from the chairman of U.S. Steel to the corner grocer, without information on how, if at all, their thoughts and actions differ." Wiebe is more impressed by the businessmen's differences and rivalries than by their agreements. For example, the big New York bankers, notwithstanding their obvious clout, often had to contend with dissident bankers in major financial centers such as Chicago, Boston, Philadelphia, St. Louis, and San Francisco, who did not relish being overshadowed by the Wall Street titans—which is one reason (among several) why the Federal Reserve Act of 1913 created not a single central bank but twelve regional banks.

Wiebe concludes: "Among those prominent in the movements for a regulated economy were businessmen and farmers after greater profits, politicians in need of an issue, journalists in search of a story, a new class of economic and administrative specialists looking for ways to utilize their knowledge, and clergymen hoping to re-establish morality in industrial America."

In substantial part, what made the big business ("trust") question so politically salient in the late nineteenth and early twentieth centuries was not so much the increasing size of the leading firms as it was the emergence of a national (that is, interstate) market fostered by the development of new technologies of transportation and communication, especially the railroads (themselves described as "the first big business") and the telegraph. When the scope of business had been local or at least predominantly intrastate for nearly all firms, government action in relation to business took place primarily on the local or state scene. As the national market came to characterize more and more businesses activities, established business-government relations became unstable and began to break down.

The giant corporations, which in many cases had become large in order to exploit new technologies and organizational structures that offered economies of scale and scope, entered increasingly into competition with the multitude of smaller firms serving previously fragmented local or regional markets. Firms threatened by the big interstate sellers sought protection by appealing to their local and state governments. For this reason, among others, local and state intrusions into market relations grew markedly in the late nineteenth century. The potential and actual mobility of firms, however, helped to contain these interventions, because companies pressed too hard simply left the jurisdiction.

At the same time, the big firms' owners, harassed by dozens of state governments and their rapacious politicos, began to see the wisdom of federal regulation. Perhaps, they reasoned, they might stand a better chance of escaping from meddlesome, costly, and fluctuating state and local regulations if instead they dealt with a single, national, regulatory body. Such an agency might also be used to keep the big firms' own interstate competition in check, thereby maintaining their returns.

As both small and big businessmen organized and pressed for favorable government interventions, other groups increasingly entered the fray, defensively if not offensively: Farm, labor, professional, and academic associations formed and sought expanded government measures. The nineteenth century's dominant ideology, a distinctly American version of laissez faire, seemed increasingly unable to restrain this grasping for economic advantage via enlarged government power.

Because ideology and political movements develop reciprocally, the pervasive reactions to the rise of big business around the turn of the twentieth century gave rise not simply to a proliferation of newly organized interest groups seeking government protection of threatened positions; it also prompted intellectuals, both independents and "hired guns," to develop new rationales for more active government. Thus Progressivism as ideology developed concurrently with Progressivism as politico-economic practice, each aspect reflecting the changing socioeconomic opportunities and hazards created by the rise of big business and its repercussions throughout the economy. FEE

A Triple Whammy for Austrian Economics

BY SANFORD IKEDA

They say that when economic times are good businesses can get away with sloppy practices. In the intellectual world, however, it seems that sloppy thinking prevails in desperate times and important distinctions get thrown out the window.

A good example of this appeared recently in a March 4 *New York Times* article titled "Ivory Tower Unswayed by Crashing Economy" (www.tinyurl.com/bnesly). Reporter Patricia Cohen suggests that in spite of the apparent failure of the free market in housing and finance in 2008, supporters of the free market have been surprisingly slow to change their minds. "Free market theory, mathematical models and hostility to government regulation still reign in most economics departments at colleges and universities around the country," the story said.

To begin with, this reveals a naïve view of how intellectual paradigms shift in the academy. Does the reporter expect that professors would so quickly abandon long-cherished beliefs or that in a few short months they would be summarily replaced by professors with "better" ideas? (It may be too much to expect of someone evidently unfamiliar with university tenure to be familiar with the concepts of Thomas Kuhn.)

That aside, there were three other things that bothered me about this article because they reflect serious untruths that have been spreading into the larger public discussion in the wake of the Panic of 2008.

In the intellectual world, sloppy thinking prevails in desperate times and important distinctions get thrown out the window.

Blaming the Free Market: Orthogonal Mindsets

First is the all-too-common bromide that the free market is wholly or at least primarily responsible for the current economic mess. There is no need to attack this notion here, owing to the numerous articles that have already been published within the last year, including in *The Freeman*, thoroughly refuting this fallacy.

As I've debated the issue in various public forums over the past few months, I've realized that there are two widely held and mutually exclusive views on how the situation came about and therefore on the best way to fix the problem.

One is that to get the economy out of slump, it's necessary to understand how and why we got to where we are. Identifying the causes of the widespread poor judgment that produced this mess requires that we look for changes in the "rules of the game" that gave investors the incentive to create it. Then, having understood that, we must change the incentive structure so as not only to revive the economy in a way consistent with sound economic principles but also to ensure that we don't wind up back here ever again. (Since this has been addressed elsewhere, it is not my concern here.) Although consistent with several schools of thought, one might call this the "Austrian view."

Sanford Ikeda (sanford.ikeda@purchase.edu) is an associate professor of economics at Purchase College, SUNY, and the author of The Dynamics of the Mixed Economy: Toward a Theory of Interventionism.

The other perspective sees markets as dominated by the irrational drives and psychological proclivities of private investors. It's therefore a waste of valuable time during a crisis to search for the causes of perverse incentives because *all* incentives are in a sense perverse or at least potentially so.

One popular version of this blames the housing and financial bubbles of the recent past on an epidemic of "greed." It argues that a psychological shift occurred under the apparently more market-friendly regimes of the 1980s and 1990s that intensified investor avarice and prompted irresponsible lending and borrowing. Since private investment is the source of the problem, the solution lies in massive government spending to stimulate confidence and restart the economy. (It is not my intent to critique this view here.) I will call this the "animal spirits" view, after John Maynard Keynes, who made the expression popular.

The interesting thing is that, because each side approaches the present situation from such divergent perspectives, neither really understands the other. The approaches aren't "opposed" but "orthogonal"—the debate is really never joined, and each side simply doesn't "get" the other.

The Austrian and Keynesian approaches aren't "opposed"—each side simply doesn't "get" the other.

"Free-Market Economics" = Mathematical Economics?

Second, and what I find just as disturbing and even more puzzling as an Austrian economist, is the way the reporter tacitly equates what she calls "free-market economics" with mathematical economics, and in particular the mathematical economics of equilibrium-obsessed neoclassical economics. This is something I've encountered a lot lately. It surprises me because, of course, the truth is in most ways just the opposite.

Standard economics bristles with mathematics. I routinely tell my undergraduates who express an interest in getting a Ph.D. in economics to double-major in mathematics, or at least take as many electives as they can in calculus, statistics and probability, and linear algebra.

Austrian economics, which most people who have heard the term associate with "free-market economics," does not reject mathematical methods when appropriate, such as doing economic history or illustrating economic principles of supply and demand. But mathematics is most applicable in describing situations in which all plans are coordinated and no discoveries are left to be made—that is, in an "equilibrium."

Now economic regularities, such as prices, do emerge, and we can say some valuable things about the context—the rules of the game, if you will—in which we can expect them to do so and why. But the highly complex processes in which this happens are not usefully described as an equilibrium.

Real markets are, somewhat paradoxically, both orderly and unpredictable: orderly because entrepreneurial alertness to profit opportunities within a given market tends to reconcile inconsistencies among the plans of individual buyers and sellers; and unpredictable because there is no perfect guarantee that any profit opportunity will be discovered.

The bottom line is that Austrian economists in general are highly skeptical of attempts to mathematically model real markets, especially for the purposes of prediction. The high-powered mathematics used by financial analysts to evaluate complex derivatives and assets built on securitized mortgages, for example, are now seen as fundamentally flawed precisely because of the oversimplifications (relative to the reality to which they are applied) they had to incorporate to make them mathematically tractable. (The work of Nassim Nicholas Taleb brings this out.).

Lumping Austrian economics with other "free market" approaches (leaving aside the appropriateness of this term) that use these dubious mathematical techniques thus strikes me as bizarre.

Reasoning from a False Premise

Finally, because for Cohen free-market economics equals neoclassical mathematical economics, the only alternatives she mentions in the article naturally are those that are anti-market. That is, if free-market economics is mathematical economics and if mathematical economics failed, then we must abandon free-market theory. "There are a handful of departments that have welcomed alternative theorists, like the University of Massachusetts, Amherst; the University of Massachusetts, Boston; the University of Utah; and the University of Missouri, Kansas City (where the Heterodox Economics Newsletter is published)," Cohen states.

The prevailing heterodoxy at these departments places them in opposition to free markets.

Is there an economics that doesn't proclaim the virtues of mathematical virtuosity? Does that economics appreciate the ability of the entrepreneurial-competitive process to generate social order and cooperation? Does that economics therefore search for the causes to the present situation, not in animal spirits, but in the rules of the game that gave rise to perverse incentives? Unfortunately, Cohen never asks these questions, but the answer is in the affirmative: Austrian economics.

Fighting the public conflation of Austrian economics with the mainstream is one thing Austrians can do to help turn the intellectual battle around.

Economists during an economic crisis are as popular as weathermen during a hurricane. And so, like many of my colleagues, I've been doing more speaking before public audiences in the past several months, trying my best to clarify the situation. I've found, however, that there's much hostility not only to the idea of free markets, but also to economists in general, and even much skepticism about whether economics is a science.

Fighting the public conflation of Austrian economics with the mainstream whenever the opportunity arises is one thing Austrians can do to help turn the intellectual battle around. This is an instance in which methodological issues need to take center stage. FEE

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In Defense of Ideology

BY MARIO J. RIZZO

There have been many statements recently to the effect that we should not let "ideology" or "philosophy" stand in the way of solving our economic problems. Indeed, the Obama administration (like the previous Bush administration) is keen to persuade us to drop all this prejudice and to go after each problem—banking, stimulus, and so forth—on its own terms. We should examine each solution on its own merits.

The Obama administration is keen to persuade us to drop all this prejudice and to go after each problem—banking, stimulus, and so forth—on its own terms.

President Obama's inaugural address includes an apparent attack on ideology:

> What the cynics fail to understand is that the ground has shifted beneath them—that the stale political arguments that have consumed us for so long no longer apply. The question we ask today is not whether our government is too big or too small, but whether it works. . . .

Furthermore, Christina Romer, the chairperson of Obama's Council of Economic Advisers, is often described as a *non-doctrinaire* economist who simply follows the data wherever they may lead.

What appears to be a sensible idea to turn our problems into purely technical ones is, on the contrary, profoundly unscientific and, more generally, anti-intellectual.

This is a big subject and deserves comprehensive treatment. Let it suffice here to make a few crucial observations.

In the first place, this point of view is not new. I cannot trace here the full extent of its intellectual roots—they are deep and wide—but we can find it in such essays, relevant to our current concerns, as "The End of Laissez Faire," (1926) by John Maynard Keynes.

Keynes believed that one of the most important functions of economics is to determine what belongs to the State's agenda and what does not. "The important thing for Government is not to do things which individuals are doing already, and to do them a little better or a little worse; but to do things which at present are not done at all." Keynes was referring to decisions that fall outside of the sphere of the individual, "to those decisions which are made by *no one* if the State does not make them."

Actually, the sphere to which Keynes referred is the aggregate outcomes of individual decisions. He did not have much confidence in the spontaneous order of the market. He rejected what he thought were the "metaphysical or general principles upon which, from time to time, *laissez-faire* has been founded." So, "[w]e cannot settle on abstract grounds, but must handle on its merits in detail . . . to determine what the State ought to take upon itself to direct by public wisdom. . . ."

Mario Rizzo (mario.rizzo@nyu.edu) is an associate professor of economics and co-director of the Austrian Economics Program at New York University.

1. Ideology as a Presumption

Keynes is rejecting any *presumption* that the "results of human action but not of human design" (F. A. Hayek citing Adam Ferguson) are beneficial. He seems to be saying that we can operate without any presumptions at all; we can simply look at each "problem" on its own merits and make an individualized decision in each case. But a presumption is not an arbitrary belief; it is not "metaphysical" in the sense that it is completely impervious to new evidence. A presumption is a belief we accept until *sufficient* evidence to the contrary is forthcoming.

However, evidence is rarely definitive or overwhelming. We need to begin from somewhere. The Bayesian statisticians say that we begin with prior probabilities and then update them with new evidence. Prior probabilities are only slightly modified with incremental evidence. These priors function in a manner similar to a presumption. So, for example, a person may think that a large urn contains 95 percent red balls and 5 percent blue ones—say, because someone he thought reliable told him so. But if he starts drawing balls from the urn and keeps getting blue ones, he will soon revise downward his estimate of the proportion of red balls, although drawing only *one* blue ball will not affect his estimate very much.

A presumption is not an arbitrary belief. A presumption is a belief we accept until sufficient evidence to the contrary is forthcoming.

2. Ideology as Scientific Framework or Research Program

In the realm of scientific hypotheses, even the "falsificationist" Karl Popper accepted a *principle of tenacity*, which had it that hypotheses are not to be dropped in face of just any conflicting evidence. No hypothesis will have 100 percent of the evidence in its favor. (A falsificationist is a scientist or philosopher who believes that data can count against a theory and enough such data can refute it. However, he is careful never to say that data can definitively prove a theory.)

Is this rational? It depends, in part, on the nature of the prior probabilities or the prior hypothesis. Suppose someone says: "By and large the free market is best, among all the feasible alternatives, at promoting human welfare." Is this ideology? I think most people would say it is. What is it based on? Well, for some people it may be a religion or faith of sorts. *But then its negation can be as well.* However, it need not be a faith.

I think that for almost all economists who subscribe to the statement, it is a generalization based on evidence. The evidence is in the form of a general way of looking at the world—a framework or research program that is supported in many specific cases. *Note that the statement itself goes beyond the individual specific cases.* It must go beyond them to deal with new problems and new events. It must function, in a specific application, as a conjecture about novel situations.

Looked at in this way, "ideology" is useful in scientific discourse. In fact, I suggest it is indispensable. How else can we approach new problems when the likely outcome of our search for specific evidence is inconclusive?

3. Ideology as a Window on Indirect or Long-Run Consequences

One of the difficulties attendant upon looking at each problem and each solution individually is the tendency to ignore indirect or long-run effects. For example, we were told, "Consider the 'problem' of insufficient homeownership, and just solve it." So this was done. A solution of subsidized homeownership and very low interest rates was put into effect. Should we not have cared about the longer-run effects of such policies? It would have been impossible to predict when and to what extent problems would have occurred. So many thought it was foolish to worry. Those who did worry were dismissed as dogmatically anti-Fannie/Freddie and anti-flexible Fed policy. And here we are.

Ideologies stress the interconnections among policies and problems. They may point us in the direction of the general principle implied by a policy and hence the implicit rationalization of further policies. They may make us alert to unintended changes in incentives in related problem areas, especially when this worsening of other problems has happened time and again. They show us that when the State intervenes there is more than just some pinpointed technology involved.

4. Ideology as Shortcut for Rationally Ignorant People (Most of Us)

Most people are not scientists, economists, or intellectuals. They are not testing hypotheses. They have other things to do. They are often rationally ignorant. How can they make up their minds about public policy? Many, though not all, are ideological. They choose a set or complex of beliefs that comports best with their observations and experience. For them, too, it is not rational to give up the worldview because some (few) observations seem to conflict. Forgive some of them who are not willing to throw away long-held beliefs on the say-so of a president whom most never heard of two years ago.

> Ideologies stress the interconnections among policies and problems.

5. Ideology as an Ethical Framework

Public-policy questions are not simply technical questions. They involve ethical issues. The economist John Neville Keynes (the father of John Maynard Keynes) divided economics into science, ethics and art. (See J.N. Keynes's *The Scope and Method of Political Economy,* Chapter II). The *science* is the technical aspect: causes and effects. The *ethics* involves the standards that are applied to determine whether a state of affairs is good or just. And the *art* involves the sometimes intuitive judgments of how to apply the science to get (or allow) the outcomes policymakers want.

An ideology can serve as a rough guide to ethical considerations. For example, some people believe that it is immoral to "reward" people for irresponsible economic behavior. Maybe a policy wonk disagrees because he thinks that systemic effects are all that matter. Is the citizen to be faulted for acting or evaluating on the basis of her belief, regardless of the wonk's opinion? In general, the belief makes good sense. As a long-run rule of behavior, the idea that economic actors should bear *both* upside and downside risk would have saved us, for example, from the Fannie/Freddie overexpansion in the first place as shareholders would not have believed in implicit guarantees. Is this an idea we want people to give up without resistance? I do not think so.

Ideology is okay. It is fine to be ideological. It is indispensible to effective analysis of the world. Just make sure that the ideology makes real sense. FEE

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Transforming America: The Bush-Obama Stimulus Programs

BY RANDALL G. HOLCOMBE

George W. Bush's and Barack Obama's "stimulus" programs will permanently transform the American economy. The market-based system that has produced unprecedented prosperity relies on profit and loss, which rewards individuals and firms that add value to the economy and penalizes those that detract value. The various stimulus programs undermine that system.

My discussion will focus on four distinct components of the 2008-09 stimulus: Federal Reserve policy, the Troubled Asset Relief Program (TARP), the Obama stimulus spending package, and the bailouts of automobile and financial firms. Because there is a temptation to stereotype political parties, labeling the Democrats the party of big government and the Republicans the party of limited government and fiscal conservatism, it is worth emphasizing that these policies were bipartisan. The Federal Reserve policies came during the Bush administration and under Fed Chairman Ben Bernanke, a Bush appointee. TARP was implemented by Bush and his Treasury Secretary Henry Paulson, and the bailouts of automobile and financial firms were initiated in the Bush administration.

My message is one of hope and change. The change is the four stimulus programs. The hope is this: I hope I am wrong about the permanent negative effects these programs will have on America.

Federal Reserve Policy

Two fundamental elements of Federal Reserve policy changed in 2008: The Fed began making loans to nonbank financial institutions and buying financial assets other than securities issued by the U.S. Treasury.

The Fed was established in 1913 primarily to lend money to member banks based on their assets that could be used to pay off the loans. Until 2008 the only firms the Fed would lend to were member commercial banks. Then the Fed began making loans to nonbank financial institutions. It did so to provide those firms with liquidity, but in doing so it broke with precedent in two ways. First, it made loans to firms that were not members of the Federal Reserve System, and second, it made loans based on questionable assets, running the risk that the borrowers might not be able to repay the loans.

In 2008 the Fed began making loans to nonbank financial institutions and buying financial assets other than securities issued by the U.S. Treasury.

The second major change was that the Fed bought financial assets not issued by the Treasury—so-called toxic assets held by private banks and other firms. The true value of the assets was questionable, so the Fed risked losses. The Fed can afford to take those losses, however. The biggest problem with this change in policy is that by buying some assets rather than others, the Fed was supporting some firms over others.

Randall Holcombe (holcombe@fsu.edu) is the DeVoe Moore Professor of Economics at Florida State University.

For example, it bought assets from AIG, an insurance company, to keep it from failing and ultimately has taken over ownership of AIG with an 80 percent equity interest. The Fed also purchased assets of questionable value from investment bank Bear Sterns to facilitate its acquisition by JPMorgan Chase. Meanwhile, investment bank Lehman Brothers went into bankruptcy and failed. Why save Bear Sterns but not Lehman Brothers? The Fed also initiated the Term Asset-Backed Securities Loan Facility (TALF) to make loans to holders of various types of securities. TALF borrowers do not have to be banks.

These two new policies are problematic because they constitute an "industrial policy." I am not questioning the effects of these policies. Hindsight will provide a better answer. Rather, I am questioning the precedent that the policies create for future Fed involvement in the economy.

The Fed has now established the precedent of making loans to firms that, at its discretion, it deems worth supporting, based on assets of questionable value. That puts the Fed in the position of picking winners and losers in the economy. Similarly, by choosing to buy "toxic assets" only from some sellers it is supporting some investors while letting others fend for themselves. Again, the Fed is picking winners and losers.

Market discipline is far superior to government regulation because firms that choose losing strategies will and should be allowed to fail.

Its conduct is much like what the Japanese government has done for decades. In the 1980s that government, coupled with Japanese banks, directed assets to the firms they viewed as most important to the economy. This industrial policy was hailed by many observers as giving the Japanese economy a growth advantage. In the early 1990s the booming Japanese real-estate market collapsed, much as the U.S. market did in 2006-08, and many Japanese banks were left holding assets of questionable value, collateralized with mortgages with higher face values than the mortgaged property. Rather than allow insolvent banks to fail, the Japanese propped them up, maintaining their precarious positions, and the Japanese economy has stagnated ever since.

Japanese industrial policy is no longer held in such high regard, but the Federal Reserve's recent actions have it engaging in the same type of industrial policy. Having set that precedent, the long-run effects are likely to be pernicious. Unless the Fed firmly repudiates its industrial policy, clearly saying it made a mistake that won't be repeated, financial firms will take the same risks, believing the Fed will step in to help if the market turns against them.

Many think that to avoid a repeat of the 2008 meltdown, the government should more tightly regulate the financial markets. President Obama has proposed a major overhaul of the regulatory apparatus. Yet financial firms are already among the most highly regulated firms in the nation, and it is implausible to think that the problems were the result of too little regulation. If anything, they were the effect of too much government involvement in those markets.

Market discipline is far superior to government regulation because firms that choose losing strategies will and should be allowed to fail. This would give every firm an incentive to choose profitable strategies and would weed out those that do not. The Fed's industrial policy moves in the opposite direction, so more regulation would change nothing.

TARP

In September 2008 Bush Treasury Secretary Henry Paulson announced that the financial markets had frozen. Lending had ground to a halt, he said, and banks would not even lend to each other because their "toxic assets" called into question their solvency. Paulson asked Congress to pass emergency legislation providing him $700 billion to buy up those assets, creating liquidity in the financial sector so that normal lending activities could resume. TARP, approved on October 3, 2008, provided the money and gave the secretary the discretion to spend it as he saw fit.

Paulson claimed the money was needed immediately to prevent a collapse of the financial system. However, none of the TARP money went toward buying toxic assets. Instead the Treasury used the money to purchase equity interest in banks—that is, to partially nationalize many banks.

Paulson also pressured the nine largest banks to take the TARP money whether they needed it or not because if only some took the money, they would be stigmatized as weak, which could further undermine their financial positions. So now the federal government is the owner of a substantial share of the American banking industry.

Some of the strings attached to that money did not appear until after the government already bought into those banks. Obama and Treasury Secretary Timothy Geithner wanted to regulate the pay of bank executives, claiming that the federal government, as part-owner of those banks, should limit excessive pay. As a result, many recipients of TARP money are anxious to repay it and to buy back the stock the federal government now owns. But the federal government has put roadblocks in the way of banks that want to get out from under the burdens that come with TARP. The government likes that control. One fear that Geithner expressed is that if some banks escape the strings attached to TARP, they might raise executive pay, leading the better bank execs to leave the TARP-encumbered institutions for the higher pay at those banks that are free of TARP. (Some banks have started to pay the money back.)

It is difficult to identify the features that make it a stimulus bill rather than just a big spending bill. In fact, the spending is largely for items Obama campaigned on.

The Obama Stimulus Package

Immediately after his election, Obama pushed hard to get Congress to pass a nearly $800 billion spending bill to stimulate the economy, which some claimed was mired in the worst recession since the Great Depression. While history will judge whether the recession was that severe, the rhetoric served to pass the bill. However, it is difficult to identify the features that make it a stimulus bill rather than just a big spending bill. In fact, the spending is largely for items Obama campaigned on. Much of it will occur after 2009 and so does not qualify as a stimulus for a depressed economy.

A lot of the alleged stimulus money was directed toward sectors that were holding up relatively well during the recession, such as healthcare and state and local governments. Government employment was steadier than private-sector employment when the bill was passed and can be expected to do even better with the money. Directing money toward relatively strong sectors is hardly the best way to stimulate the economy, even though it does further the goals that Obama campaigned on when he was running for president.

Even the economic analysis underlying the stimulus program can be called into question. The Keynesian idea is that by running budget deficits and increasing government spending, aggregate demand will be increased, pushing the economy toward prosperity. Of course, to spend that money, the government must first borrow it from elsewhere in the economy. There's no free lunch. Moreover, if increasing government spending and running large budget deficits really lead to prosperity, the economy would have been in nirvana by 2008. When Bush was elected in 2000 the federal budget was in surplus, and for Bush's eight years government spending and the budget deficit continually increased, which by Keynesian logic should have produced a robust and maybe overheated economy, not an economy mired in recession. The Obama stimulus package was simply a continuation, on a much grander scale, of the eight years of Bush fiscal policy, a policy of continually increasing government spending and continually increasing budget deficits.

The Obama stimulus package was really just a big spending bill that did not offer much stimulus, but that will saddle the economy with bigger government from now on, hindering economic growth, slowing the recovery, and reducing prosperity.

Bailouts

In addition to bailing out many failing banks and other financial firms, Bush and Obama also used taxpayer money to bail out Chrysler and General Motors. Bear in mind that when Obama campaigned for office and gasoline prices spiked above $4 a gallon, he advocated a windfall profits tax on oil companies. That idea fell by the wayside as prices fell in 2009, but these two policies provide a chilling example of how to undermine the very foundation of the market: When companies are successful and profitable—like oil companies in 2008—single them out for extra taxes, and when companies are unsuccessful and unprofitable—like auto companies in 2009—single them out for government subsidies.

One need understand only the most basic of economic principles to see how pernicious these policies are. If firms in an economy can take resources and combine them into products that are more valuable than the resources they started with, they are adding value to the economy and should be rewarded. In a market economy they are—through profits. If firms take resources and combine them into products that are less valuable than the resources they started with, they are harming the economy and they should be penalized. In a market economy they are—through losses. Profit and loss are essential to the operation of a market economy and provide the signals and incentives that have led to the remarkable economic progress that has characterized America (hampered as the economy is by government).

> If firms take resources and combine them into products that are less valuable than the resources they started with, they are harming the economy and they should be penalized. In a market economy they are—through losses.

The bailouts began as loans to Chrysler and General Motors, which the firms had no chance of being able to pay back. The administration's way of addressing this has been to negotiate to convert those loans into an equity interest in the firms, thus nationalizing the automobile companies in a manner similar to how TARP has nationalized banks. The federal government carries a big stick and is in a position to use that stick to its advantage. Under Obama's bankruptcy plan for General Motors, the government will control 60.8 percent of the company, with 17.5 percent for a United Auto Workers trust fund. Bondholders could wind up with a 10 percent equity interest in the company.

On the surface this appears quite unfair to bondholders, whose bonds had a face value of $27 billion. Some bondholders objected, rightly saying that the claims of holders of secured debt should come before the claims of the firm's employees in any bankruptcy proceeding. But while some bondholders objected, many did not—because they were recipients of TARP money and therefore effectively under government control. TARP recipients JPMorgan Chase, Citigroup, Morgan Stanley, and Goldman Sachs owned about 70 percent of Chrysler's debt. The government supported them with bailout money and then bullied them to give up their assets to the UAW.

The pernicious consequences go well beyond these transactions. How will this affect other union-heavy companies when they try to raise money in the bond market? The precedent is set for employees to move ahead of secured-debt holders in bankruptcy proceedings. Debt finance will become much more difficult for firms with unionized labor forces. One critic argued that the favoring of the UAW over bondholders amounted to shaking down lenders for the benefit of Obama's political supporters, which is corruption and abuse of power. We would have done better to let the market and the bankruptcy court determine the fate of Chrysler and GM.

Fundamental Transformation

When we step back and look at the bipartisan efforts to rescue the economy from recession, those changes represent a fundamental transformation in the nature of the American economy. In the longer run Obama wants to substantially increase government's role in health care, which is already largely in government's hands with Medicare, Medicaid, SCHIP (health insurance for children), and the regulations that govern healthcare providers and pharmaceutical companies. Obama has also stated his intention to further regulate the energy industry to limit emissions and to shift production toward renewable energy sources. His cap-and-trade initiative would impose billions in costs on the economy and would effectively dictate the technologies by which energy is produced.

Now we stand on the brink of the most significant erosion of the market economy since the New Deal, with few dissenters.

Few commentators are looking at the long-run implications of these changes, focusing instead on how much the proposed Obama deficits will increase the national debt or on how the Federal Reserve's increases in the monetary base will impact inflation in coming years.

Déjà Vu All Over Again

I have described the changes. My hope is that I am overestimating their long-run impact. Indeed, the nation has found itself in similar situations before. In the 1970s we faced economic stagnation, rising unemployment, and rising inflation, which soared into the double digits. There were government-mandated price controls and frequent lines at the gas pumps as a result of shortages caused by those price controls. There was every reason to be pessimistic, but in the 1980s the Reagan administration turned many of those things around. Tax rates were slashed; the price controls were abandoned; and a more deregulated economy led to two decades of growth and prosperity. At least some of the credit for this, as well as much of what happened in Margaret Thatcher's England, must be attributed to the power of ideas emanating from Milton Friedman and other free-market thinkers.

Similarly, in the 1940s socialism seemed such an attractive alternative to American capitalism that F. A. Hayek wrote *The Road to Serfdom*, arguing that socialism was that road, and Joseph Schumpeter, in *Capitalism, Socialism, and Democracy*, lamented that in democracies people could vote away their freedoms and that the people who benefited the most from a free economy were unwilling to defend it. Yet America prospered. When the Berlin Wall collapsed in 1989, followed by the demise of the Soviet Union in 1991, there was every indication that everyone would recognize that market allocation of resources is better for everyone than government planning.

Now we stand, two decades later, on the brink of the most significant erosion of the market economy since the New Deal, with relatively few dissenters. In a few short centuries markets have taken much of the world's population from subsistence to remarkable prosperity and continuing economic progress. Are we really ready to abandon that system and replace it with something similar to what resulted in the collapse of the Soviet Union? FEE

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The Myth of Unregulated Tobacco

BY BRUCE YANDLE

On June 22, President Obama signed the Family Smoking Prevention and Tobacco Control Act (FSPTCA), a law that gives the U.S. Food and Drug Administration (FDA) regulatory authority over tobacco products. The law requires the FDA to develop a new tobacco-regulation center with all related costs to be covered by fees paid by the industry. Among other things, the FDA will regulate nicotine content, which cannot be increased, ban flavored cigarette sales (except for menthol-flavored products), and regulate marketing practices, eliminating the use of such words as "light" or "low tar" unless it can be shown empirically that the words are associated with products that provide health benefits.

Empowered to regulate industry marketing practices, the FDA must develop warning labels that must cover 50 percent of the side space on cigarette packages. The labels must draw from a catalogue of congressionally sanctioned phrases that include:

> WARNING: Cigarettes are addictive. WARNING: Tobacco smoke can harm your children. WARNING: Cigarettes cause fatal lung disease. WARNING: Cigarettes cause cancer. WARNING: Cigarettes cause strokes and heart disease. WARNING: Smoking during pregnancy can harm your baby. WARNING: Smoking can kill you. WARNING: Tobacco smoke causes fatal lung disease in nonsmokers. WARNING: Quitting smoking now greatly reduces serious risks to your health.

As dramatic as this all seems, this extension of FDA powers received a somewhat mixed response from the medical and health-advocate communities.

John Cohn, a lung-disease specialist at Thomas Jefferson University Hospital in Philadelphia said, "It's sort of like asking the police commissioner to regulate prostitution." Perhaps Cohn anticipates agency capture of the sort typically seen in Washington.

Matthew Myers, president of the Campaign for Smoke-Free Kids, a leading lobbyist for the law, took a more optimistic but still somewhat guarded position. "You can stay with the status quo, with industry controlling the level of nicotine in products and companies deciding what health claims to make. Or you can give control to an agency with a history of scientific expertise in regulating products. This fills an important gap."

All Bark

This somewhat tepid celebration was prompted by uncertainty about how the FDA would really manage its new authority. There is also the feeling that this statute, like many others, had a title that sounded more powerful than the content justified. The word "prevention" in the title sounds rather dramatic, but the teeth in the law itself are more like baby teeth than fully mature incisors. (Consider, for example, the exception made for menthol-flavored cigarettes.)

The politicians' commentary that followed the law's passage was much more boastful and self-congratulatory. Senator Edward Kennedy, long an advocate for more government control of the industry and sponsor of the Senate version of the law, exclaimed, "Miracles still happen. The United States Senate has finally said 'no' to Big Tobacco."

Bruce Yandle (yandle@bellsouth.net) is Alumni Distinguished Professor of Economics Emeritus, Clemson University, and Distinguished Adjunct Professor of Economics, Mercatus Center, George Mason University.

Had Congress really said no?

In a way, Kennedy misstated what had actually happened. The Senate had not entirely said no. Indeed, the biggest of big tobacco, Altria Group, the producer of market-leader Marlboro, had lobbied long and hard for the bill's passage. Altria's two major competitors, Lorillard and Reynolds Tobacco, saw the law as giving Marlboro, with its market share locked and a lead in developing no-nicotine products, an unfair advantage. As is often the case, the Senate picked a winning horse and rode it. The Senate said yes to one and no to two others.

With Kennedy unable to lead the battle for his bill due to illness, Senator Christopher Dodd assumed leadership. Not quite as dramatic in his comment as Kennedy, but in a way equally inaccurate, Dodd said, "For more years than anyone can count, we've had an industry that's gone basically unregulated."

Unregulated Tobacco?

It is true that tobacco products have not been regulated by the FDA, though the agency has attempted to do so almost since its 1906 founding. But after decades of regulation by the Federal Trade Commission (FTC), the Federal Communication Commission (FCC), and Congress itself, hardly anyone who has followed the industry would say it has gone "basically unregulated."

The biggest of big tobacco, Altria Group, lobbied long and hard for the bill.

Instead, some would argue that it was regulation that defined the industry's trade practices and, by doing so, maintained the industry's high profits and expanded the sale of products in just those markets Tobacco-Free Kids and others worry about. (See John Calfee's "The Ghost of Cigarette Advertising Past," *Regulation*, Nov.–Dec. 1986.)

How could this be? Consider the following capsules that come from a long tobacco saga (these and more can be found in Bruce Yandle, et al., "Bootleggers, Baptists and Televangelists: Regulating Tobacco by Litigation," *University of Illinois Law Review*, 2008):

Almost from the start, tobacco products were regulated. The first government efforts to control tobacco consumption date at least to 1629, when the colonial authorities in Massachusetts Bay prohibited settlers from planting tobacco except in small quantities used for medicinal purposes. (Kennedy's position follows an historic Massachusetts tradition.) Health interest groups have a long history of activism as well. The focus was on cigarettes. There were several hundred anti-cigarette leagues in the United States with more than 300,000 total members by the turn of the nineteenth century.

Twenty-six states banned the sale of cigarettes to minors by 1890, and 16 states totally prohibited cigarette sales by the end of 1909. World War I is said to have been a stimulus for cigarette consumption. As a result of extensive lobbying by tobacco producers, by 1927 all of the state bans on sales to minors were repealed. As bans declined, state taxes appeared, beginning in 1921 in Iowa and spreading to nearly all states by 1960. Politicians learned that tobacco products were a mother lode for tax revenues. There were no more total bans.

The FDA was explicitly denied authority to regulate tobacco when Congress passed the Pure Food and Drug Act of 1906, which created the agency. Just before passing the act, nicotine, then listed as a drug, was removed from the U.S. pharmacopeia. This assured the FDA could not regulate nicotine as a drug. Since 1906, when amending the FDA act and related legislation, Congress has consistently rejected proposed amendments to grant FDA regulatory powers. Congress regulated the industry itself.

While scientific data may have been lacking, popular recognition of the harms from smoking showed up in expressions that developed for cigarettes and related ailments: coffin nails, smoker's cough, gasper, wheezer, lung duster. Yet a 1938 *Consumer Reports* article on smoking and health indicated no scientific evidence of harm from smoking. Nevertheless, marketplace recognition of health problems led the tobacco companies to go on the attack: "Not a cough in a carload" and "Remember Juleps, forget your cough" (Chesterfield); "Not a single case of throat irritation due to smoking" (Camels); and "Why risk sore throats?" (Old Gold).

In 1950 the FTC issued cease-and-desist orders against major cigarette companies on all health-effect advertising. The commission found that all popular cigarettes were harmless for healthy smokers. On these grounds, comparative health claims—"less smoker's cough," for example—were prohibited. Later, when cigarette producers introduced filters and began to advertise levels of tar and nicotine, the FTC struck again. In February 1960 the FTC announced that it had negotiated a voluntary agreement with the tobacco companies to cut all tar and nicotine claims from cigarette advertising. The agency heralded the "industry-government cooperation." The FTC action brought to an end health-effect advertising that had led to a sharp decline in tar-weighted cigarette sales and the demise of some of the stronger cigarette brands.

In 1964 the Surgeon General reported a causal connection between smoking and lung cancer, chronic bronchitis, and coronary disease. It also stated that "cigarette smoking is a health hazard of sufficient importance in the United States to warrant appropriate remedial action." Immediately, the FTC initiated proceedings to regulate cigarette advertising. In a final proposed rule, the FTC called for all cigarette packages to carry this warning: "Cigarette Smoking is Dangerous to Health and May Cause Death from Cancer and Other Diseases." Congress intervened, sharply rebuked the FTC, and in 1965 passed the Federal Cigarette Labeling and Advertising Act that required a milder warning: "Caution: Cigarette Smoking May Be Hazardous to Your Health." The FTC was banned from further meddling for at least four years.

Cigarette Regulation May Be Fatal to New Entrants

In May 1969 the FTC attempted to require all cigarette advertising to warn that "Cigarette Smoking is Dangerous to Health and May Cause Death from Cancer, Coronary Heart Disease, Chronic Bronchitis, Pulmonary Emphysema, and Other Diseases." Once again, Congress countered and passed the Public Health Cigarette Smoking Act of 1969, which banned all cigarette advertising on electronic media after January 1, 1971, and mandated that all cigarette packages bear a milder statement: "Warning: The Surgeon General Has Determined that Cigarette Smoking Is Dangerous to Your Health." The ban on radio and TV advertising ended the public-health messages required by the FCC, which had been shown to cut cigarette consumption, and reduced most of the $200 million annual advertising cost for existing tobacco products. The ban also made it more costly for new entrants to gain market share.

In 1998, 46 state attorneys general negotiated a settlement with tobacco producers after several successful state suits against tobacco companies based on recovering the cost of Medicaid payments for tobacco-related illnesses. The settlement yielded payments to the states that totaled $200 billion, which converted to an average annual payment to each state of $180 million in perpetuity. To generate the revenue the tobacco producers were allowed to collude and raise prices, doubling the wholesale price of cigarettes. Total sales volume went down. Profits went up. In effect the tobacco firms became well-paid tax collectors for the states. The settlement also contained a rich set of regulations that affected the marketing of tobacco products to youthful consumers.

Industry-Serving Regulation

No, there is no evidence to suggest that tobacco has until now been "an industry that has gone basically unregulated." But there is ample evidence that tobacco regulation has served the interests of the industry and the politicians that broker favors to the industry. Meanwhile, consumers of tobacco products, who are generally a lower-income population, have been denied the benefits of competitively determined product information; they also have unwittingly become major sources of revenue for state politicians, who generally provide more benefits to higher-income than lower-income consumers.

One can only speculate about what might have happened had the FTC not outlawed health-effects advertising and had the industry not become one of the more regulated industries in America. FEE

Competition Would Save Medicine, Too

BY JOHN STOSSEL

Competition so regularly brings us better stuff—cars, phones, shoes, medicine—that we've come to expect it. We complain on the rare occasion the supermarket doesn't carry a particular ice-cream flavor. We just assume the store will have 30,000 items, that it will be open 24/7, and that the food will be fresh and cheap.

I take it for granted that I can go to a foreign country, hand a piece of plastic to a total stranger who doesn't speak English . . . and he'll rent me a car for a week. Later, Visa or MasterCard will have the accounting correct to the penny.

Compare: Governments can't even count votes accurately—or deliver the mail efficiently.

Yet now, somehow, government will run auto companies and guarantee us health care better than private firms? And the public seems eager for that!

If you think it's mainly the political class and mainstream media that are clueless, listen to the doctors. Dr. Atul Gawande, in an otherwise interesting *New Yorker* article on health-care costs, disparages medical savings accounts and high-deductible insurance. First, he explains the theory behind this proposal to cardiologist Lester Dyke:

"[People would] have more of their own money on the line, and that'd drive them to bargain with you and other surgeons, right?"

Gawande comments, "He gave me a quizzical look."

The doctors then dismiss the idea with a sneer.

"We tried to imagine the scenario. A cardiologist tells an elderly woman that she needs bypass surgery and has Dr. Dyke see her. They discuss the blockages in her heart, the operation, the risks. And now they're supposed to haggle over the price as if he were selling a rug in a souk? 'I'll do three vessels for $30,000, but if you take four, I'll throw in an extra night in the ICU'—that sort of thing? Dyke shook his head. 'Who comes up with this stuff?' he asked."

I do. Adam Smith did. Market competition is what's brought us most of what's made life better and longer.

The Free-Rider Benefit

But the doctors have mastered the anti-free-market sneer: Markets are good for crass consumer goods like washing machines and computers, but health care is too complicated for people to understand.

That's nonsense. When you buy a car, must you be an expert on automotive engineering? No. And yet the worst you can buy in America is much better than the best that the Soviet bloc's central planners could produce. Remember the Trabant? The Yugo? They disappeared along with the Berlin Wall because governments never serve consumers as well as market competitors do.

Maybe 2 percent of customers understand complex products like cars, but they guide the market—and the rest of us free-ride on their

Central planning produced the Trabant. What kind of healthcare is it likely to produce?
German Federal Archive

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. Copyright 2009 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

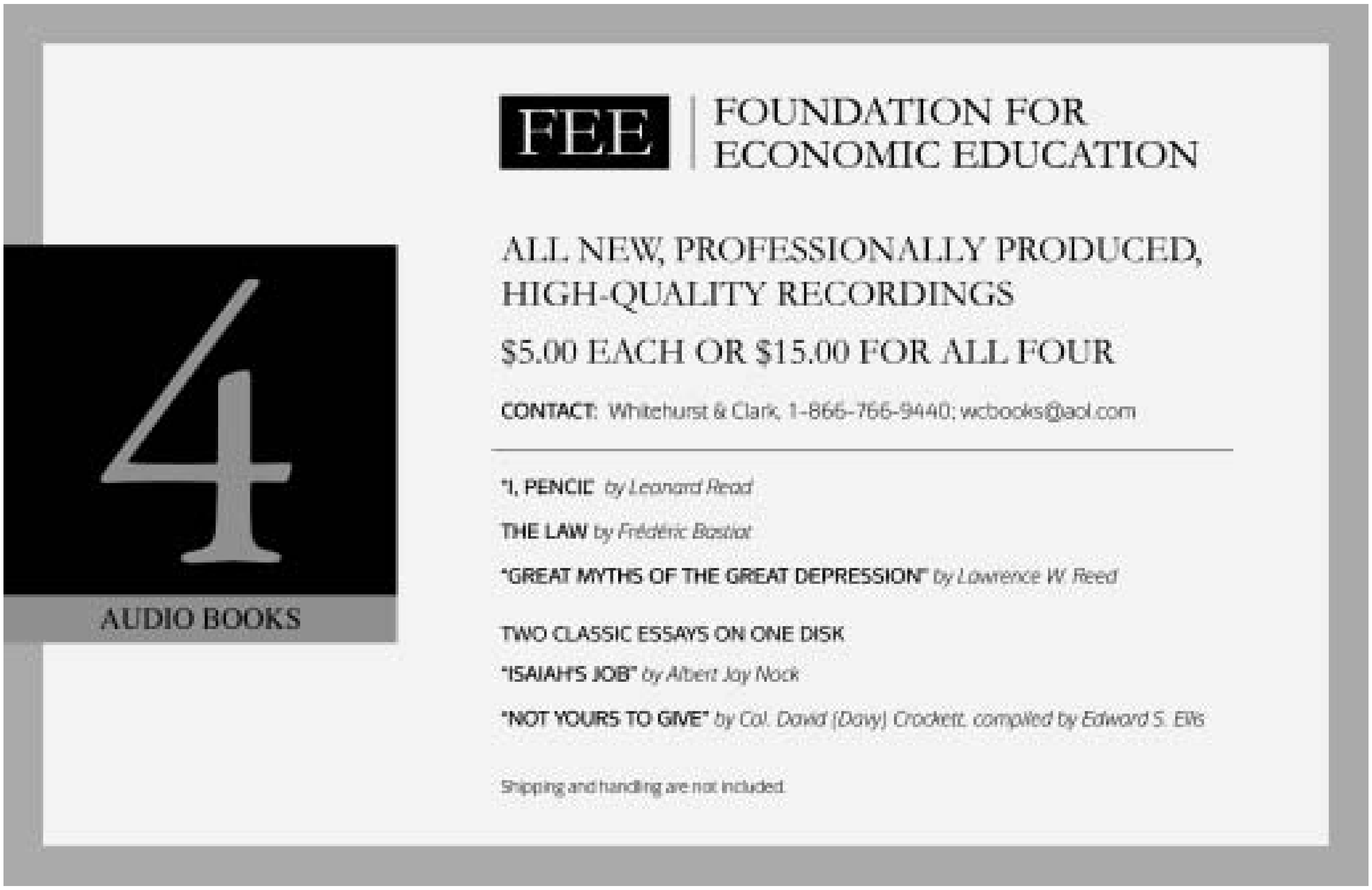
effort. When government stays out, good companies grow. Bad ones atrophy. Competition and cost-conscious buyers who spend their own money assure that all the popular cars, computers, etc. are pretty good.

The same would go for medicine—if only more of us were spending our own money for health care. We see quality rise and prices fall in the few areas where consumers are in control, like cosmetic and Lasik eye surgery. Doctors constantly make improvements because they must please their customers. They even give out their cell numbers.

Drs. Dyer and Gawande don't understand markets. Dyer's elderly woman wouldn't have to haggle over price before surgery. The decisions would be made by thousands of 60-, 40-, and 20-year-olds, the minority who pay closest attention.

Word about where the best values were would quickly get around. Even in nursing homes, it would soon be common knowledge that hospital X is a ripoff and that Y and Z give better treatment for less.

People assume someone needs to be "in charge" for a medical-care market to work. But no one needs to be in charge. What philosopher F.A. Hayek called "spontaneous order" and Adam Smith called "the invisible hand" would make it happen, just as they make it happen with food and clothing—if only we got over the foolish belief that health care is something that must be paid for by someone else. FEE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Capital Letters

Did World War II Help End the Great Depression?

Much as I admire Robert Higgs's work, I suggest clarifying two points he makes in the October 2008 *Freeman*. Higgs says that World War II did not end the Great Depression; genuine prosperity did not return until after the war. But the Depression *did* give way to wartime full employment. Saying so does not deny that war is hell, as General Sherman said, and a hell of a way to end a depression.

Higgs downplays how money and other liquid assets created during the war contributed to postwar prosperity. He notes that holdings of them "did not decline at all after the war." But they did not need to decline to have their effect. Their continuing in circulation, lubricating transactions in goods and services, helped restore production and employment.

Higgs's understanding of why the "Great Duration" dragged on through the 1930s, while not the whole story, deserves to be widely shared.

—LELAND B. YEAGER
Auburn University (Emeritus)

Robert Higgs replies:

I do not dispute Professor Yeager's point that "full employment" returned during the war. I insist, however, that this employment be kept in proper perspective. The government's withdrawal, mainly by conscription, of almost 20 percent of the labor force into the military and its acquisition of war-related goods and services, which occupied another 20 percent of the labor force, had everything to do with the disappearance of unemployment. This employment situation was extraordinary in many ways and could not have been sustained for long without wrecking the economy.

My point about the liquid assets that "did not decline at all after the war" was intended only to explode the simplistic, but oft-embraced, myth that postwar prosperity reflected the "release" or "liquidation" of such assets accumulated during the war. The assets that one party sold, another party acquired, and in nearly all cases both parties to the transaction were Americans, so no assets were "released" from the overall U.S. economy.

Professor Yeager's claim that the war-spawned liquid financial assets, by "continuing in circulation," "lubricat[ed] transactions in goods and services" and thereby "helped restore production and employment" requires more space for discussion than I have here. Whatever my skepticism, however, I would think twice about debating this question with a monetary theorist of Professor Yeager's eminence.

Did the Framers Have Economic Motives?

In his essay in the July-August *Freeman*, Professor Burton Folsom, Jr., undertakes to demolish Charles A. Beard, "[t]he first historian to challenge the motives of the Founders" as men "primarily in the Constitution-writing business to protect their 'property interests.'" Beard allegedly did this in aid of making a partially "discredited" Constitution into something to be "changed as the Progressives saw fit." Further, Forrest McDonald is supposed to have decisively refuted Beard, when in fact he demonstrated the complexity of the issues and the limitations of Beard's categories.

But if Beard stressed fund-holders excessively, he also described a coalition that also included merchants, manufactures, and land speculators. If he went wrong on a few individuals and made the relation between interests and ideas seem rather mechanical (a boon to his critics), his broad reading can be sustained. Indeed, much of Beard's case was first made by former Antifederalists like John Taylor. Beard might have done better to follow their lead more rigorously.

Broadly speaking, Federalists had in mind protecting their present and securing their *future* interests by establishing a mercantilist state that could help them make money. If this involved "the transfer of tax dollars from ordinary citizens," well that is the nature of public debt. The key was the expectation that the new government could forcibly jack outstanding continental notes up toward their nominal value. This mattered to many actors of the day, whatever the plight of Gorham, Morris, and Few. The beneficiaries might not correlate exactly with Federalists in conventions or elsewhere, but there would be a nice overlap.

In addition, the question remains whether Americans were in any great need of a miraculous "founding" in 1787. Professor Folsom assumes that the Constitution cannot possibly be controversial. Yet conservative, property-owning interests frequently have their reasons for supporting bigger government. And broad powers, once granted, find new uses.

Beard's hurried approach and simplifications hurt his case, but there are many later quasi-Beardians who have corrected Beard on various details while sustaining much of his reading, for example: E. James Ferguson, *The Power of the Purse* (1961); Jackson Turner Main, *The Antifederalists* (1961); Robert Maguire and Robert Ohsfeldt, "Economic Interests and the Constitution: A Quantitative Rehabilitation of Charles A. Beard," *Journal of Economic History* (1984), and "Self-Interest, Agency Theory, and Political Voting Behavior: The Ratification of the United States Constitution," *American Economic Review* (1989); Thomas Ferguson, *Golden Rule* (1995); and Jac C. Heckelman and Keith L. Dougherty, "Personalty and Interests at the Constitutional Convention: New Tests of the Beard Thesis" [online].

—JOSEPH R. STROMBERG
by e-mail

Burton Folsom replies:

Mr. Stromberg and I are not in strong disagreement. I do think that Forrest McDonald "decisively refuted Beard" and that Beard's research errors on Gorham, Morris, and Few support that view. But I also agree with Stromberg that in refuting Beard, McDonald often "demonstrated the complexity of the issues and the limitations of Beard's categories." That part indeed constitutes much of McDonald's argument. Stromberg cites authorities sympathetic to Beard, but many other historians (for example, Robert Brown, Lee Benson, and even Beard's student Phillip Crowl) are critical of Beard.

Stromberg correctly focuses on the public securities as a key focus of debate. Would the new government, with its new constitution, repay the debts incurred during the Revolutionary War or not? Naturally, Robert Morris and others (McDonald estimates 20,000 holders of public securities) wanted their money back with interest. That was what the agreement was. Thus writing the new constitution was indeed controversial. Those who did not hold public securities had no incentive to foist a new system on the nation that made it easier to write into law new tax bills. Some of those holders of securities ended up at the Constitutional Convention and supported the signing of the Constitution. McDonald's research is a breath of fresh air because he shows that some of the holders of public securities opposed the Constitution, and others, like Morris, ultimately lost a fortune by supporting repayment of the American debts. The Founders cannot be reduced merely to a self-interested group of wealth holders promoting a new constitution to protect their economic interests. Beard and the Progressives, when they push the discussion in that direction, have oversimplified the issue.

Does Utilitarianism Deserve Bashing?

In an otherwise meritorious article ("The 'Risk' of Liberty: Criminal Law in the Welfare State," September 2008), Michael N. Giuliano parrots the tiresome old bashing of utilitarian ethics. (He sometimes says "consequentialism," but since versions of utilitarianism make up almost the entire set of consequentialist doctrines, the distinction is unnecessary here.) "The main component of utilitarianism," Giuliano writes, "holds that the rightness or wrongness of an action is determined purely by its consequences. . . . The law's reach under the utilitarian mentality is predicated on the belief that the ends justify the means." Unlike English and American tradition, which recognized personal liberties either preexisting or superseding government power, "The 'greatest happiness of the greatest number' rule . . . declar[es] that the ends justify the means. . . . The trek toward greater utilitarianism was in avowed opposition to the natural rights that . . . once 'morally' exonerated the humblest citizen in defiance of the highest authority."

Where does Giuliano get his notions about utilitarianism? Clearly not from the writings of such great philosophers and economists as David Hume, John Stuart Mill, Henry Hazlitt, Ludwig von Mises, R.M. Hare (and F.A. Hayek, who was a utilitarian despite evidently disliking that label). Nor from Aristotle, whose eudemonism foreshadows the soundest strands of utilitarianism. No, Giuliano seems to be thinking, at n-th hand, of an extreme "act-utilitarianism" or "situation ethics," which would disregard principle and treat each case on its own supposed merits. This caricature version, if ever actually advocated, has nowadays become no more than a straw man for critics to blow down while claiming victory for their own favorite doctrines.

A sounder version, "rules" or "indirect" utilitarianism, recognizes powerful reasons for respecting principles, including those of natural or personal rights; and it distinguishes between good and bad personal characters, thus incorporating "virtue ethics." This version quite rejects recommending any specific behavior or policy just because its intended good consequences are thought likely to outweigh any bad ones. Instead, it endorses enduring principles like those of Giuliano himself, and precisely on grounds of utility, on the grounds that they are essential to "social cooperation," as Mises said, the kind of society affording free individuals the best prospects of achieving their various goals in life—in a word, happiness.

Like many of the critics whom he parrots, Giuliano takes Jeremy Bentham as his whipping boy. Not all but much that John Stuart Mill wrote deserves applause, including his essay on "Bentham" (1838). Mill understood Bentham's distinctive personality. Bentham was good at probing for the exact meanings, if any, of noble-sounding but possibly empty words and slogans. He was good at probing for the rationale of inherited institutions and legal technicalities. But Mill did not think much of Bentham as an original philosopher and regretted the publication of his *Deontology*. Bentham's offhand remark about the greatest good for the greatest number, uncharitably interpreted, is indeed nonsense. His faith in the great benefits that suitably instructed legislators could achieve is, as we now see, gravely misplaced. Bentham was far from being the soundest of utilitarians, and it is just wrong to take him as defining what utilitarianism is all about.

Public policy is largely ethics, applied or misapplied. What, then, does Giuliano conceive of as the soundest basis for ethics? Principles of honesty, property, freedom, and rights, as well as the distinction between good and evil, are decisive for a good society and human happiness; but they are not irreducibly intuited ultimates: they can be explained and argued for. Would Giuliano not argue for them? What grounds for them could he find, other than ultimately utilitarian grounds? Conceivably the authors of the policies that Giuliano rightly condemns had the parrot-like misinterpretation of utilitarianism at the back of their minds. That is no excuse, however, for giving the misinterpretation further currency.

—LELAND B. YEAGER
Auburn University (Emeritus)

Michael Giuliano replies:

Professor Yeager's response to my article suggested that the view of utilitarianism represented therein was a "caricature version" that "has nowadays become no more than a straw man for critics to blow down." The article was referring to a certain species of utilitarianism in order to provide one possible explanation, among several, as to how the welfare state has lowered the threshold of allowable risk such that more and more behavior is elevated toward artificial criminality.

My reason for criticizing this "caricature" version of utilitarianism, this version that is "indeed nonsense" according to Yeager, is that it is the version that legislators and other lawmakers so often adopt if only implicitly and independently of any actual theory. It is rarely sophisticated "rules" utilitarianism that is the force behind legislative crusades. Bentham's "oversimplified test" involving "Pleasure-and-Pain, or the Greatest Happiness," as Hazlitt observed, could conceivably be applied in a blind "manner to all traditional ethical judgments." That much of our legislation follows a similarly sweeping rule was the true object of my criticism.

Bentham was used as the example because these oversimplified tests are, in the most basic way, generally identified with utilitarianism applied in the more common situational and legislative settings. I had no intention of suggesting that this was truly the best of utilitarianism as understood in an academic, philosophical sense. I am compelled to defer to the esteemed Professor Yeager as to the best and most appropriately understood utilitarianism as that concept might be used before an academic background.

My argument was hardly that, emanating from the ink and pen of Bentham, his ideas directly flowed through the strands of history into the conscious minds of lawmakers. Perhaps there might be a certain indirect relationship. The point was simply that much of the *criminal* legislation at issue (though I do not suggest a formalistic distinction between criminal and other enactments) was based on transient public demands and outcries and limited by no particular ethical judgment at all.

As Professor Yeager concluded his response with the observation that the lawmakers might have "had the parrot-like misinterpretation of utilitarianism at the back of their minds," it is apparent that he essentially recognized my point, however clouded it may have been by a semantically sweeping condemnation that had as its purpose a brief point in the essay. The utilitarianism I referred to was not, excepting the point on Bentham, intended to generally diminish scholarly utilitarian thought, but was instead focused toward the garden-variety utilitarianism that often animates the lawmakers creating the legal landscape we live in.

Can the Word "Capitalism" Be Salvaged?

I should like to rescue the word "capitalism" from the Marxians and [the late] Clarence Carson. In spite of Carson's claim in his "Capitalism: Yes and No" (reprinted in May) that it is a value-laden word describing an economic system that leads to "greater and greater concentrations of wealth" in the hands of a few, I maintain that it is a suitable term for describing the free-market private-property economy.

Clarence Carson was primarily an historian. But he was a "classical" economist, not a Misesian or an "Austrian." He did not understand modern, subjective-value, marginal-utility economics.

Along with Adam Smith and Karl Marx, Carson accepted the "classical" separation of the factors of production into three distinct categories—land, labor and capital. Thus he defines capitalism in the Marxian value-laden sense as a system of mass production that uses "capital," that is, tools and machines, together with "the exercise of government power," forcing the "transformation of some greater or lesser portion of the wealth of a people into capital."

It is useless to argue about the definition of any word. A writer, speaker, or economist can use any term as he wishes, so long as he defines it and makes his meaning clear. Mises was wont to say that "An economist is no more willing to use another economist's term than he is to use his toothbrush." However, some definitions of words are more suitable than others.

Capital, as a concept, represents the calculation of the value of all capital goods in monetary terms. Capital goods embrace not only industrial tools and machines but all factors of production—produced and semi-produced factors, nature-given factors (land and natural resources), labor, time, and even techniques, recipes, and ideas used in production. Thus capitalism is a perfectly good word for describing the economic system based on the use in production of "capital," that is, capital goods.

Granted, the term "capitalism" was first actually used by Karl Marx in a pejorative sense. However, I would argue that "capitalism" is a suitable word for describing the voluntary market system, process, or arrangement, of production, exchange and trade of privately owned property, accumulated capital. . . . Defined in this way, it is a neutral, non-value-laden term for describing the cooperative market system in which everyone depends on everyone else. . . .

—BETTINA BIEN GREAVES
by e-mail

Does Deficit Spending Only Shift Costs Forward?

Roy Cordato's June article, "Deficit Spending and Future Generations: Not What You Might Think," is confusing. He writes that "Every dollar the government spends has to come out of some existing person's pocket and therefore preempts the use of that dollar somewhere else in the economy—not in the future, but here and now."

Every dollar government spends does not come out of some existing person's pocket. Dollars not coming from a pocket are those that the Federal Reserve System (FRS) gets off its printing presses. These printing-press dollars dilute the value of existing dollars (money-supply inflation). This is what I have learned by reading *The Freeman.* If I have been misled or misunderstand, I would like to know.

As Cordato says, if government taxes and spends existing dollars, such dollars are unavailable for investment by private individuals. Printing-press dollars cannot be available for use by private individuals unless the dollars are given directly to them by the FRS (does this ever happen?) or through the banking system, or by the Treasury Department.

Cordato states that "The real costs of government spending, no matter how it is financed, are experienced here and now." But this can't be completely correct, else, as he says, we would not in the future have "coercive wealth transfers from future taxpayers to future government bondholders." (Does "future government bondholders" presume debt has not been repudiated directly or through monetary inflation?)

If General Motors or Chrysler gets dollars collected via taxation, that is one thing; if they get dollars borrowed through Treasury bonds or notes, that is another, because repaying borrowed dollars requires payment of interest along with, at some future time, the principal; if they get printing-press dollars, these will be spent as these companies choose (with bankruptcy court permission while in bankruptcy?) to spend them and then will begin circulating elsewhere in the economy, likely making more dollars available for fewer, or no increase, in goods, causing price inflation.

Finally, he states that "Deficit spending creates the occasion for coercive wealth transfers from future taxpayers to future government bondholders. When the bills come due, most of our children and grandchildren will have part of their incomes coercively transferred through higher taxes to those who hold the Treasury notes. Government debt makes our children less free."

Government debts makes all of us less free today and tomorrow. Hence, to modify Cordato's words, the "handwringing . . . about passing on the cost of 'stimulating' our economy onto future generations is [*not*] misplaced." Else why the "coercive wealth transfers from future taxpayers?" The reasoning is confusing.

—EARL ZARBIN
Phoenix, Ariz.

Roy Cordato replies:

Thanks to Mr. Zarbin for his comments. First I want to point out that I was not attempting to address all possible scenarios when it comes to deficit spending. Instead I was addressing a particular argument; by "borrowing now, taxing later—Congress and the President are forcing future generations to pay for our problems. [They] are shifting the costs of this massive spending scheme to our children." I was basically trying to dispel the myth that the current generation is somehow free-riding, through deficit financing, on future generations. I was not trying to suggest that there were no costs to future generations. Indeed, I was pointing to those costs in the last couple paragraphs, where I discuss the loss of freedom that will be experienced by our children and grandchildren. If this was not clear, I apologize.

In keeping my argument narrowly focused I was indeed assuming that the debt was neither monetized nor explicitly repudiated. Of course this is not a realistic assumption, particularly with respect to monetization, which is already occurring. Because of this I did indeed overlook many issues that would arise in a situation where the Fed plays an active role in buying up the debt.

That said, I would like to defend the idea that even when the government spends newly created money it does indeed come from existing persons' pockets. This is why inflation is often referred to as a tax. As the Fed creates new money, the money that I am currently holding, as Mr. Zarbin rightly points out, is diluted—that is, worth less. In this sense new money that is spent is coming out of people's pockets and, in terms of real purchasing power, is preempting the use of existing dollars in the economy. More importantly, government spending, regardless of where the money comes from, preempts the use of real resources by the private sector in the here and now. Real resources—labor, natural resources, capital, and so on—are bid away from those who would direct their use in the absence of the government spending. This is true even if the source of the revenues for that government spending is the printing press. This is why I felt comfortable in pointing out that "all current spending must come from current revenues and can only utilize current resources."

More on the FDIC

My compliments to Jeffrey Miron on the article concerning FDIC in the May *Freeman*. It is a correct explanation of the unintended consequences that develop when government attempts to cure a perceived problem. As he discussed, the unintended consequences may be a greater problem than the original perceived problem. And he also discussed the possibility that the perceived problem might not have been a problem were it not for a preceding government regulation.

I was president of a small bank in a small town for 25 years. I observed the effect FDIC had on the attitude, motivations, and decisions of bankers; and also the effect it had on the public in their choice of banks. FDIC has tended to increase credit expansion and risk taking. Whether that is a good or a bad thing should be left to the free market and not decided by government.

As with any government regulation there is also a tendency to expand the scope of regulation. FDIC, originally . . . a protection for the public in their bank deposits, became a vehicle to enforce what officials deemed to be socially desirable actions. Consider the FDIC enforcement of making loans in certain geographic areas (the [anti-]red-lining concept). Or consider the encouragement of lending to certain racial or social groups. Or the disfavor of lending practices that resulted in loan ratios being below a certain percent considered desirable by the FDIC. And yes, they did keep . . . figures on all three of the above and jawbone the bankers to meet what the FDIC considered our social responsibility. The threat was that should an [uncooperative] bank want to establish a branch or expand its operation . . . the FDIC would . . . consider the bank as not having met the standard of public need. . . .

—RAE C. HEIPLE
Whitefish Bay, Wis.

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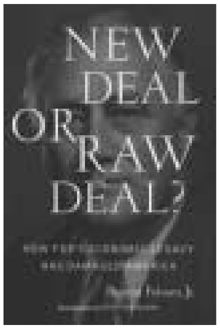
Book Reviews

New Deal or Raw Deal? How FDR's Economic Legacy Has Damaged America

by Burton Folsom, Jr.
Simon & Schuster Threshold Editions • 2008/2009 •
318 pages • $27.00 hardcover; $15.00 paperback

Reviewed by Robert Higgs



Not everyone loved President Franklin D. Roosevelt. Even in 1936, when he enjoyed his most lopsided electoral victory, almost 17 million voters cast their ballots for Alf Landon. During Roosevelt's long presidency, he attracted vigorous literary critics, such as H.L. Mencken, John T. Flynn, and Garet Garrett. But the winners write the history, and for many years, the bulk of the writing about Roosevelt and the New Deal amounted to little more than hagiography.

Gradually, however, as the original Roosevelt idolaters aged and died, more-balanced appraisals began to appear, and several good iconoclastic books have appeared recently, including: Thomas Fleming's *The New Dealers' War*, Gene Smiley's *Rethinking the Great Depression*, Jim Powell's *FDR's Folly*, and Amity Shlaes's *The Forgotten Man*. Now we can add Burton Folsom's new book to the list.

Folsom builds his discussion around what he calls "the Roosevelt legend," the handiwork of historians who idolize FDR, applaud the New Deal, and, if they cavil at all, do so only to lament that the New Deal did not create a socialist paradise. If Folsom does not give this legend a knockout blow, he certainly thrashes it severely, and no honest reader can come away from this well-documented book with a positive view of FDR or his economic nostrums.

Folsom presents a colorful overview of the economic events of the 1930s, drawing on the latest revisionist literature to strengthen his critique of the New Deal, but readers who want a strictly economic appraisal will probably do better by going directly to the new interpretive sources he employs. Where Folsom shines brightest is, first, in his appraisal of Roosevelt as a person and as a politician and, second, in his demonstration of the extent to which the vaunted New Deal was little more than a partisan political endeavor.

Roosevelt has always been renowned for his charm and charisma, and there is no gainsaying that many people were taken in by his ebullient self-confidence. Underneath this appealing surface, however, the real Roosevelt was anything but attractive. Instead, he was callous, self-centered, manipulative, and chronically dishonest. Having been an indifferent student, he was, in Folsom's words, "no intellectual." In particular, he knew little about economics and made scant effort to learn. Nevertheless, he pushed through his hugely unsettling economic policies largely to serve political ends, justifying his actions with the foolish idea that merely "trying something" made sense even though he had no idea of the economic effects this blind flailing would produce.

Folsom presents a valuable discussion of the great extent to which taxes were increased during the 1930s, especially excise taxes—on alcoholic beverages, gasoline, cigarettes, radios, movie tickets, and many other goods—that bore relatively heavily on lower-income people. From 1933 through 1936, federal excise taxes exceeded federal individual and corporate income taxes combined, and during the following four years excises always brought in at least 40 percent of federal revenue. After 1935 Social Security payroll taxes diminished poor people's wages disproportionately.

Especially from 1935 onward, Roosevelt plunged into class warfare. He sought a variety of soak-the-rich taxes and got Congress to approve several of them, including an economically damaging tax on corporate retained earnings, a prime source of funding for new firms. He sent the IRS on punitive expeditions against political opponents Huey Long and Hamilton Fish, newspaper publishers William Randolph Hearst and Moses Annenberg, and former Treasury secretary Andrew Mellon, among others. At the same time, he instructed the IRS to back away from investigations of political favorites. The President also directed the FBI to investigate people he disliked.

Folsom gives an eye-opening account of various ways in which the Roosevelt administration used the billions of dollars of relief funds at its disposal for partisan political purposes. "If we probe deeply into Roosevelt's popularity," he writes, "we almost always discover the presence of patronage—the creating and the manipulating of federal jobs to strengthen his political support." FDR did not invent patronage, but he greatly increased its scale.

After Roosevelt tried to pack the Supreme Court in 1937, the New Deal began to sputter, and new programs and taxes became more difficult to push through Congress. His attempt to "purge" uncooperative legislators in the 1938 elections failed, angering many senators and representatives in the process. "The president became resented more than adored," writes Folsom, "and soon Congress was altering his legislation and overriding his vetoes." The 1937–38 "depression within a depression" cost the president even more support.

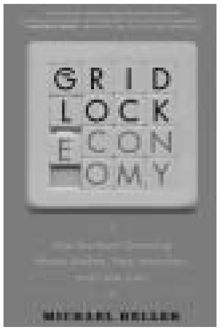
Nonetheless, the bulk of the New Deal persisted. Indeed, much of it remains in effect today. Folsom concludes: "The myth that these programs were once valuable, that they helped end the Great Depression, and that they restored prosperity to the United States has been enough to keep them going." Moreover, once a program has been created, "bureaucrats within the program flock to defend it, [and] those receiving benefits from the program strive to retain it." FEE

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

The Gridlock Economy: How Too Much Ownership Wrecks Markets, Stops Innovation, and Costs Lives

by Michael Heller
Basic Books • 2008 • 259 pages • $26.00

Reviewed by Art Carden



Without private property rights, people have incentives to overuse an asset. Conflicting private property rights, on the other hand, create a "tragedy of the anti-commons" in which resources are underused, according to Michael Heller. In *The Gridlock Economy*, he treats the reader to a compelling array of examples of the tragedy of the anti-commons in practice, from conflicting rights to the electromagnetic spectrum to problems assembling the rights necessary to expand airports to the ways innovation is slowed by the need to assemble bundles of patents.

Heller, who teaches property-law courses at Columbia Law School, summarizes his point this way: "Gridlock is a free market paradox. When too many people own pieces of one thing, cooperation breaks down, wealth disappears, and everybody loses." I'm not convinced that this is really a "free market paradox." If anything, gridlock is a state failure rather than a market failure.

The book's main contribution to the literature on property rights and institutions is to show that private ownership is a necessary but not sufficient condition for the market to work its magic. When many people have private property rights that allow them to exercise veto power over more valuable projects, wealth dissipates because bargaining is dominated by holdup problems. Russian privatizations, for example, split rights across too many parties and erected veto points that created anti-commons resources.

Heller offers a wide-ranging discussion of regulatory pathologies leading to "gridlock," particularly in the ways intellectual property is regulated in the biotechnology industry. He doesn't, however, answer a question I had throughout the book. If it's clear, as he says, that regulation cannot keep up with innovation (as we've seen in technology, medicine, and most recently high finance), why should we trust the state to regulate further? As a Hayekian, I'm skeptical of the notion that regulators can have the information they need to get the market *as it is* to function as it does on the blackboard in economics 101.

Since outside observers can't articulate a theory of rights or a structure of institutions that will "work" a priori, it stands to reason that legal institutions should be flexible so as to allow for innovation across fields. While Heller looks for new ways to design institutions, perhaps we should find better ways to let these institutions evolve.

Heller notes that "judicial and political battles are overtaking the academic research" and that Congress is considering serious overhaul of the patent-law infrastructure. But will that solve the "gridlock" problem? Why should we expect members of Congress to know how intellectual property in biotech should be structured? We shouldn't. I am afraid that Heller is too caught up in what James Buchanan calls "the romance of politics," expecting politicians to solve problems of their own making.

It would be the height of folly for me as an economist in Memphis to presume to know how intricately detailed contracts in biotech firms should be structured, but we can see some of the pathologies of regulation in a dynamic economy emerging in high-tech enterprises. For example, Heller notes that the Federal Trade Commission arbitrarily dissolved the patent pool for laser eye surgery. He also points out a disturbing trend that deserves further investigation: "In telecom, competitors know that often the most profitable approach is not to innovate, but to stop others from investing." He's right. Patent law is often used in a rent-seeking fashion that burdens real innovators, but that has nothing to do with any market failure. Our system of intellectual property is a creature of the government.

Among the causes of gridlock Heller identifies is antitrust law. He writes, "For biotech pooling to have any chance, Congress may need to create special antitrust rules." He seems not to see how such rules will be hard to adapt to further innovations. And again, he is too trusting of politicians to tinker with legislation to solve a problem. Outright repeal of the antitrust laws would be a much better move, solving numerous problems all at once.

There is much in *The Gridlock Economy* that could be explored in greater detail, but these are directions for further research rather than criticisms of the thesis. I expect that the book will find its way onto reading lists across campuses worldwide. It offers much food for thought, but readers should think skeptically about Heller's eagerness to have politicians solve problems that are mostly if not entirely of their own making, not the free market's. FEE

Art Carden (cardena@rhodes.edu) teaches economics at Rhodes College in Memphis, Tennessee.

The Complete Idiot's Guide to Global Economics

by Craig Hovey with Gregory Rehmke

Alpha • 2008 • 272 pages • $18.95 paperback and e-book

Reviewed by George C. Leef

For years the series of *Complete Idiot's Guide* books has been a great commercial success, dealing mostly with "practical" topics as varied as dog training and wedding planning. Useful to be sure, but not exactly intellectually stimulating. *The Complete Idiot's Guide to Global Economics,* by economist Craig Hovey and former FEE staff member Gregory Rehmke, changes all that. Written for the intelligent non-economist (easy reading, but clearly not for true idiots) the book informs about the fundamentals of international economics and dismisses numerous false beliefs. For libertarians it's most encouraging to see such a book reaching the mass market since the authors have no patience for coercive interference with the market order of production and trade.

The big message of the book is simple: If you want prosperity, leave people alone. The proper role of government is to keep the peace; it should not dictate what should and shouldn't be produced; it shouldn't impose tariffs or trade quotas; it shouldn't interfere with the value of money; it shouldn't give foreign aid or impede the flow of workers from place to place. The reader who pays attention will end up with a better grasp of global economics than the typical college economics major, whose professors often teach interventionist, anti-market nonsense.

Almost immediately, Hovey and Rehmke drive home the crucial point that economic freedom works far better than central planning—that is, domination and control by government authorities. That's because knowledge is widely dispersed. Free markets tap into that knowledge while government authorities act in a state of ignorance and blindness. In a passage reminiscent of Leonard Read's famous essay *I, Pencil*, the authors state, "What is amazing in the modern world is that we so easily benefit from vast knowledge distributed across the globe, from how to grow foods and spices, locate and mine minerals, cut and sew, design and assemble, carve and shape, program and debug, and all the vast range of skills that few of us possess but most of us use in finished products every day."

Cognizant that many readers will have absorbed elements of what Ludwig von Mises called the anti-capitalist mentality, the authors include numerous little "Warning, Pothole Ahead!" features in each chapter to deal with common misconceptions. For example, they confront the notion that profits are the evil consequence of greed and exploitation early on. They observe that profit just means obtaining benefits in excess of costs: "The saint who helps shelter the homeless and the cold-blooded bond trader both have profits in mind—that is, gains over and above the effort they invest."

Perhaps the most persistent error in thinking about global economics is the idea that trade between nations needs to be balanced. Hovey and Rehmke attack that error at its roots, explaining, first, that trade really doesn't take place between nations, but between people who happen to reside on different sides of a national border. If you think that individuals can and should manage their own buying and selling, then there is no problem, no matter what aggregate trade statistics show. But what about the menacing "trade deficit"? Don't "we" lose jobs in the face of one? Relax, say the authors: "As much attention as is paid to job losses resulting from imports, little notice is given to how this promotes the creation of new businesses, jobs, and wealth."

A favorite line of the anti-capitalists is that "globalization" is to blame for the poverty of underdeveloped nations. The authors show that's pure bunk. International trade and cultural exchange do not keep poor people poor, but many formerly poor people have become pretty wealthy as a result of trade and cultural exchange. The crucial ingredients for economic progress, including freedom, stable money, and the rule of law, are not indigenous to most "third world" countries. Hong Kong and Singapore, to cite just two examples, are no longer poor thanks to globalization.

The authors ask if foreign aid is necessary for poor countries to break out of poverty. When people are poor, how can they save and invest? Isn't foreign aid essential? No: Under the proper conditions for economic growth (noted above), even very poor people can save, invest, and progress economically. Foreign aid, by giving money to government officials, usually gets in the way of progress.

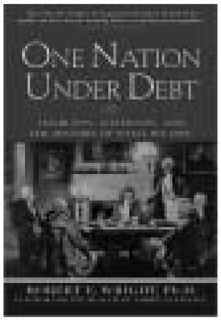
This book covers a lot of economic terrain and does so effectively. It would make enlightening reading for anyone who isn't familiar with international economics (or economics at all) but wants to learn. FEE

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

One Nation Under Debt: Hamilton, Jefferson, and the History of What We Owe

by Robert E. Wright
McGraw-Hill • 2008 • 256 pages • $27.95 hardcover;
$15.37 Kindle

Reviewed by David L. Littmann



In his latest work, *One Nation Under Debt*, Robert E. Wright, who has written extensively about debt and finance during the decades that marked America's climb to economic preeminence, carefully documents the evolution of U.S. dependability and integrity in the international investment community. This reputation led to the acceptability of U.S. financial markets and government bonds, especially in critical periods of economic and military conflict.

Wright, curator for the Museum of American Finance and author of 11 books, has dedicated years of research to the lives and times of those individuals who bought, sold, and held the variable forms of U.S. debt issuances of the day. Tedious as that might sound, it's actually fascinating. By recounting the trading of early U.S. government bonds, the author deepens the reader's understanding of why people accepted the debt obligations of a new nation without a track record for repayment. In so doing, Wright destroys some myths, such as that only relatively wealthy Americans purchased the new debt securities, that the debt was just held domestically, and that debt securities were concentrated in only a few states and urban locales.

Wright sees a template for all successful economic growth in the evolution of U.S. dependability. He portrays it as a baseball infield where home plate is the government protection of life, liberty, and property. First base is the all-important financial system; second base is the entrepreneurial firm; and third base is the cadre of management expertise. The more solid each base becomes, the easier it is for the nation to rack up runs on the wealth scoreboard.

And so it is with debt. America entered a century of enviable growth in which federal bonds were regarded as outstanding investments. Thanks to Wright's painstaking research, the midsection of the book fully illustrates the lives and times of bondholders. We learn about the people who held the debt and why they bought and sold it. We learn how debt issuances helped Revolutionary War veterans settle the frontier. We also learn how modern the new American financial markets quickly became. It wasn't long before "flight to quality" had become an international stamp of approval for U.S. debt.

All told, Wright contends that U.S. national debt became a "national blessing" because we had a "non-predatory" government. The debt system was workable and credible because Washington had not become the all-consuming leviathan it grew into during the twentieth century.

Wright does include warnings aplenty, explaining why public debt, while serving as financial cement and trust among people and nations, is also to be feared. He quotes Adam Smith: "When national debts have once been accumulated to a certain degree, there is scarce . . . a single instance of their having been fairly and completely paid."

Even Alexander Hamilton noted that there was a tipping point beyond which additions to the national debt would be deleterious: "Where this critical point is cannot be pronounced; but it is impossible to believe that there is not such a point." Before leaving office as Treasury secretary in 1795, his final report on public credit sought to rectify "and to prevent that progressive accumulation of debt which must ultimately endanger all government." The danger, though, is not to *government*, but to *the people*. When politicians can borrow and spend without restraint, people's liberty and property are imperiled.

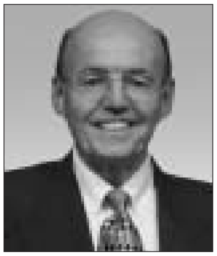
Some of the Founders knew that, and Wright adds gravitas to his book by contrasting the Federalists' advocacy of a centralized financial system with the stance of the Antifederalists. One Antifederalist in particular, writing under the pen name Brutus, provided one of the most sagacious, prescient, and potent predictions in American history when he warned in 1788 that the federal government eventually would use the "necessary and proper" clause of the Constitution [last paragraph of Article 1, Section 8] to greatly extend its powers, thereby subverting state authority. We would have avoided many national disasters if people had heeded that warning.

Wright notes, "Unlike Adam Smith, Hamilton believed that the issuance of bonds by government augmented rather than destroyed capital." Considering how much government in 21st-century America uses debt to finance astounding amounts of wasteful spending and the erosion of capital, I'd say Smith had the more realistic long-term vision.

One Nation Under Debt provides valuable history on the origin and development of U.S. fiscal affairs and warns us about where we are headed. The author looks on our national debt as a good idea gone awry, but I believe that the better view is that Hamilton's debt system was a grave danger from the very beginning. FEE

David L. Littmann (David_littmann@hotmail.com) is senior economist with the Mackinac Center for Public Policy

EFCA and Compromise



BY CHARLES W. BAIRD

As proposed, the Employee Free Choice Act (EFCA) would 1) replace secret-ballot union representation elections with card-check certification of unions as exclusive (monopoly) bargaining agents for workers in their workplaces; 2) impose compulsory-interest arbitration on employers who do not agree to a first union contract within 130 days; and 3) increase penalties on alleged unfair labor practices by employers. Union bosses assert that EFCA is necessary because employers routinely break the law during prolonged representation elections, especially by firing pro-union workers.

Passage by the House is certain, but it may not pass the Senate in its present form. As we will see, compromises that have been suggested are just as indefensible as EFCA itself.

Workers can avoid union intimidation by signing union cards and then voting against the union on a secret ballot. They would have no such escape under the EFCA.

Legal scholar Richard A. Epstein has laid out a convincing case against the first two provisions in a new Hoover Institution book (a draft pdf version of which can be found at www.tinyurl.com/kqbhcc). Under card check, a union would become the monopoly representative of all nonmanagerial workers in an enterprise if 50 percent plus one of those workers signed a card (or other piece of paper or petition) indicating their support for such representation. Signatures would be collected by union organizers who would likely remind any dissenters that the union knows where they and their families live. Under the current National Labor Relations Act (NLRA), signatures collected on authorization cards are used as the basis on which secret ballot elections are called. Workers can avoid union intimidation by signing cards and then voting against the union on the secret ballot. Because of this unions now hesitate to request an election unless they get somewhere near 70 percent of the targeted workers to sign.

No Escape

Workers would have no such escape under the EFCA. Epstein writes that the NLRA was widely accepted because its infringement of individual workers' common-law freedom of contract was thought to be adequately offset by democratic protections for workers—the very protections that EFCA would eliminate: the secret ballot and a ratification vote on collective-bargaining contracts. Therefore, he argues, EFCA may not withstand constitutional scrutiny.

EFCA provides that a firm must begin bargaining with a union for a first contract within ten days of a card-check certification. Bargaining then goes on for up to 90 days. If no agreement is reached, the dispute goes into mediation for 30 days. If they still don't agree, the dispute is turned over to an arbitration panel that has the power to impose a two-year "contract" on both parties. The terms set by the arbitration panel would not be subject to judicial review or worker ratification.

The NLRA now imposes a duty on both parties to bargain in good faith over wages, hours, and other terms and conditions of employment. But they are not forced to come to an agreement.They each can exit the bargaining process and bear the consequences (strikes and lockouts). EFCA would eliminate the exit option. In ordinary contract law bargaining must be voluntary.

Charles Baird (charles.baird@csueastbay.edu) is a professor of economics emeritus at California State University at East Bay.

No one has a duty to bargain with anyone. Epstein says the duty to bargain in good faith was widely accepted because the exit option was preserved for both parties. This is another reason why the EFCA may not withstand constitutional scrutiny.

The NLRA also regulates employer speech during election campaigns. Employers cannot threaten to punish workers for voting for unionization, and they cannot offer to reward workers who vote against unionization; but they can point out the possible hazards of becoming union-impaired. EFCA would prohibit employer speech altogether. Epstein likens the distinction between regulating and prohibiting employer speech to the distinction in takings law between regulating the use of private property and government occupation of private property. Actual occupation of private property is subject to strict constitutional scrutiny, and so, too, may be the prohibition of employer free speech.

In the mid-1950s over one-third of private-sector workers were unionized. In 2008 only 7.6 percent were. Unions say their decline is due to weaknesses in the NLRA, which permit employers to thwart attempts to unionize. However, according to NLRB data illegal firings of union supporters occur in only 2.7 percent of representation elections. Moreover, unions won 56.8 percent of elections in 2000–2008. In 2008 they won 63 percent. If employers had as much power over elections as unions say, unions wouldn't do nearly as well. Nor does it seem that employers try to wear workers down with prolonged campaigns. The average election campaign is less than six weeks.

Unions are losing members because the number of elections held each year and the number of workers involved in the elections are declining. Fewer and fewer workers are interested in unions. Union decline has nothing to do with employer misbehavior during elections. Union election wins add fewer newly unionized workers than the number of workers they lose due to the contraction of already union-impaired firms.

Senate Support

Although there are 60 Democrats in the U.S. Senate, several of them have said they will not support EFCA as currently written. Some congressional supporters, and the union bosses they serve, have suggested compromises to get 60 votes to avoid a filibuster. All would eliminate card check, shorten election campaigns, increase penalties on unfair labor practices, and impose "equal access" rules to force employers to allow union organizers on company property during work times and to grant unions the same amount of time to argue for unionization as employers use to argue against unionization. The CEOs of Costco, Starbucks, and Whole Foods have endorsed a compromise that includes all of the above and drops compulsory arbitration.

Mandating a uniform, short election campaign arbitrarily restricts the ability of employers to make their case against unionization. Increasing employer penalties for unfair practices further inhibits free speech because it is not clear what speech would be considered unfair. Whatever the degree of risk aversion among employers, they would choose to speak less.

Equal-access rules are especially problematic. For government to coerce employers to stand by while union organizers invade their property with the sole intent of imposing harms on them during time they have paid for seems to be an obvious government occupation of private property. Therefore it should be subject to strict constitutional scrutiny under the Fifth Amendment. Unions already have extraordinary access to workers during election campaigns. Employers are forced to supply unions with the names and addresses of all workers within seven days of the notice of an election. Union organizers may make unlimited visits to workers' homes, contact workers by phone as often as they wish, and, unlike employers, make any promises they want to workers in pursuit of votes for unionization. The unions' problem is not lack of access to workers; it is lack of any service that workers want to buy.

The biggest problem with any EFCA compromise is what, during the New Deal, came to be known as the camel's-nose-under-the-tent strategy: First get what you can and then gradually grab the rest. Since President Obama seems determined to repeat and amplify the mistakes of Roosevelt, the only safe strategy against EFCA is to kill it outright. FEE