THE FREEMAN
IDEAS ON LIBERTY

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From the President

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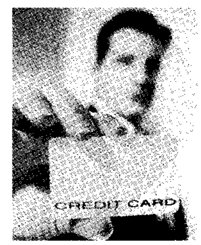

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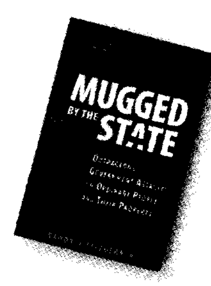

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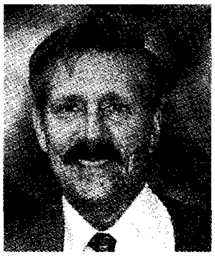
Beware Democracy Without Liberty



BY RICHARD M. EBELING

A fundamental fallacy of our time is that democracy is the open-sesame to peace, freedom, and prosperity. The recent elections in Ukraine, Iraq, and Saudi Arabia, and the promise of a contested presidential election in Egypt, are hailed as evidence of a new dawn for mankind. And, indeed, maybe they are. But democracy in itself does not define or guarantee a free society. History has told many stories of democratic societies that have degenerated into corruption, plunder, and tyranny.

This April marks 60 years since the death of Adolf Hitler in the ruins of Berlin as World War II was reaching its end in Europe. It is worth recalling the mass appeal that both the Nazi and Communist parties had in Germany in the early 1930s during the twilight of the Weimar Republic. In the German national election on July 31, 1932, Hitler's National Socialists emerged as the largest party represented in the parliament (though not a majority), while the Communist Party came in a strong third behind the Social Democrats. In the last free election, on November 6, 1932, before Hitler came to power the following January, the Nazis lost seats, but still were the largest parliamentary party, with the Communists still in third place but gaining on the Social Democrats.

Neither the Nazis nor the Communists were shy in letting the German voters know what was in store if they came to power. Indeed, the Austrian economist Ludwig von Mises observed in 1926 that many Germans "are setting their hopes on the coming of the 'strong man'—the tyrant who will think for them and care for them." Men have sold their freedom, even through the ballot box, when they have been seduced by the promises of political paternalism.

In today's world, especially in Western Europe and North America, such extreme forms of tyranny have little appeal for most people. Few are ready to vote away their freedom for a totalitarian utopia. No, today people merely wish to use the state for mutual plunder through government intervention and coerced welfare redistribution. What is practiced in the democratic nations of the world is what in 1896 the Italian economist Vilfredo Pareto called "bourgeois socialism"—the use of the state by a vast array of special-interest groups for trade protectionism, income subsidies, monetary manipulation, and domestic regulations to stifle competition.

Furthermore, Pareto also understood over a hundred years ago what Public Choice theorists in the twentieth century came to call the asymmetrical incentives resulting from the concentration of benefits and the diffusion of burdens arising from government intervention in a democratic system:

> Let us suppose that in a country of thirty million inhabitants it is proposed under some pretext or other, to get each citizen to pay out one franc a year, and to distribute the total amount amongst thirty persons. Every one of the donors will give up one franc a year; every one of the thirty beneficiaries will receive one million francs a year. The two groups will differ very greatly in their response to this situation. Those who hope to gain a million a year will know no rest day and night. They will win newspapers over to their interest by financial inducements and drum up support from all quarters. A discreet hand will warm the palms of needy legislators, even of ministers. In the United States there is no necessity to resort to such underhand methods: these deals are made in the open; there is an open market for votes just as there are markets in cotton and grain. On the other hand, the despoiled are much less active. A great deal of money is needed to launch an electoral campaign. Now there are insuperable

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> material difficulties militating again asking each citizen to contribute a few centimes. . . . [T]he individual who is threatened with losing one franc a year—even if he is fully aware of what is afoot—will not for so small a thing forego a picnic in the country, or fall out with useful or congenial friends, or to get on the wrong side of the mayor or the prefect! In these circumstances the outcome is not in doubt: the spoliators will win hands down.

What we have, in other words, is a system of *democratized plunder*, under which, as Frédéric Bastiat said, everyone attempts to use the state to live at the expense of everyone else.

Merely a Mechanism

We need to remember that democracy, in essence, is merely a mechanism for the peaceful selection of political officeholders. As such, it is certainly superior to revolutions and civil wars. As has often been said, democracy replaces bullets with ballots. Its inestimable importance for this purpose should never be discounted or forgotten.

But democracy is not liberty. The meaning of liberty was explained by the French classical liberal Benjamin Constant in a famous lecture he delivered in 1819, *The Liberty of the Ancients Compared with that of the Moderns*.

> First ask yourselves, Gentlemen, what an Englishman, a Frenchman, or a citizen of the United States of America understand today by the word "liberty." For each of them it is the right to be subject only to the laws, and to be neither arrested, detained, put to death or maltreated in any way by the arbitrary will of one or more individuals. It is the right of everyone to express their opinion, choose a profession and practice it, to dispose of property, and even to abuse it; to come and to go without permission, and without having to account for their motives or undertakings. It is everyone's right to associate with other individuals, either to discuss their interests, or to profess the religion which they and their associates prefer, or even simply to occupy their days and hours in a way which is more compatible with their inclinations or whims. Finally it is everyone's right to exercise some influence on the administration of the government, either by electing all or particular officials, or through representations, petitions, demands to which the authorities are more or less compelled to pay heed.

Constant, we see, believed that an essential element of liberty is the ability to participate in the political process, with elected officials answerable to the citizens. But "democracy" is not the core ingredient of human liberty. The core is the individual's freedom to be self-governing.

By extension, he must leave all other individuals alone to be the same. His relationships with them must be based on consent, without government restriction or regulation.

The task of government is to secure the individual in his freedom from violence and coercive interference; to protect his life, liberty, and property from aggression. When it goes beyond this his liberty has been abridged, even when that government is democratically chosen.

The triumph of democracy around the world will be a hollow victory if it does not grow out of the more fundamental idea of liberty. Otherwise, men will continue to live under a tyranny—the tyranny of electoral majorities.

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Perspective

Déjà vu All Over Again

"[A]ll things recur eternally. . . ."

—*Nietzsche, Thus Spake Zarathustra*

Sometimes I think Nietzsche was right.

It happens when I read things like this from the *New York Times* last January: "An international team sponsored by the United Nations proposed a detailed, ambitious plan on Monday that it says could halve extreme poverty and save the lives of millions of children and hundreds of thousands of mothers each year by 2015. The report says drastically reducing poverty in its many guises—hunger, illiteracy, disease—is 'utterly affordable.' To fulfill this goal, industrial nations would need to double aid to poor countries, to one-half of 1 percent of national incomes, from one-quarter of 1 percent."

This is the recommendation of the UN Millennium Project, headed by Columbia University President Jeffrey Sachs. In the dog-bites-man department, the World Bank and International Monetary Fund eagerly endorsed the program.

The report was greeted more skeptically by others. A member of the project, Nancy Birdsall, president of the Center for Global Development, said poor countries' governments could do many things to help their populations that require no outside money, such as changing their political systems. She nevertheless favors increased transfers from the developed countries.

New York University economist William Easterly had a more trenchant criticism of the project's report. "Its approach is a sort of utopian central planning by global bureaucrats, a crash program like a Great Leap Forward for poor countries. This will not work any better than central planning by bureaucrats has worked anywhere else, which is to say not at all."

In the year 2005, 60 years after the binge of post-World War II foreign "aid" began, you'd think we'd stop seeing such obviously futile proposals. The countries that have climbed out of poverty are precisely the ones that got little or no money from Western taxpayers and that followed market-liberal paths. The biggest recipients of handouts remained dependent and poor—until they began to liberalize their societies and let markets work.

Nothing has occurred to refute the late Peter Bauer's critique of the foreign-aid lobby. To begin with, the term foreign "aid" begs the question and prejudices the case. What we're really talking about are government-to-government transfers, with taxpayers as coerced accessories. This can hardly be called "aid" once we realize that governments have no constructive role in economic matters beyond protecting life, liberty, and property. Giving money to a government for economic development is like giving a china shop to a bull. Call it what you will, it's not *aid*. Governments are by nature unequipped to spend money intelligently for such a purpose. The planners can't know what needs to be produced in what quantities and how. They cannot know what tradeoffs people are willing to make to obtain any particular thing. That information can only be determined by the market process, which means through social cooperation in a regime of private property and free exchange.

Second, the champions of foreign transfers should be required (I'm tempted to say compelled) to explain how, if they are correct, *any* society ever became rich. I suppose the first modern countries to emerge from poverty might have petitioned for foreign aid. But from whom? This creates a tricky situation for the UN Millennium Project. If economic growth required handouts from wealthy societies, there would be none to provide them. And if economic growth didn't require handouts, then poor countries today don't need them. Either way, the UN Millennium Project's plan is futile.

Only it's worse than that. It's dangerous. Government leaders may not know how to create prosperity with cash transfers, but they definitely know how to increase their power, help their friends, and suppress their opponents. We've seen quite enough of that over the years. When will the UN-types learn?

Compassion carried out with collectivist economics is indistinguishable from brutality. The path to prosperity is well lit.

* * *

Few people would want the government to tell their doctors how to practice medicine. But thanks to the war on drugs, it does just that in the treatment of chronic pain. Frank Fisher, M.D., has the horrifying details about suffering patients and persecuted doctors.

Dr. Fisher was himself victimized by a system that is eager to stigmatize chronic-pain treatment as "pill pushing." Radley Balko reports.

Reform of Social Security remains the hot topic. Many opponents of change maintain that the system can be made sound with only some minor adjustments. Robert Murphy examines one such claim: that the rich industrial societies can easily support their aging populations.

The Vienna in which Ludwig von Mises emerged as an intellectual was a uniquely fascinating place. But events in Germany eventually changed all that. Richard Ebeling presents the second of his two-part article on the milieu in which Mises developed his liberal worldview.

We do not always rely on government to obtain justice. Instead, we have come to expect it from the marketplace itself. Exhibit A: the mundane credit card. J.H. Huebert explains how self-interested companies look out for us.

The connection between economic development and freedom has become increasingly appreciated by people of many political persuasions. Gerald O'Driscoll focuses on the key element of freedom.

Our columnists have these matters on their minds: Richard Ebeling distinguishes freedom from democracy. Donald Boudreaux defends "price gouging." Stephen Davies looks at a much-disparaged source of economic growth. Russell Roberts claims the moral high ground in the debate on privatizing Social Security. And George Leef, hearing Bill Moyers sound alarms about a new threat from corporate power, replies, "It Just Ain't So!"

Books undergoing scrutiny this issue examine institutional economics, government bullying, the death tax, and the economy of the 1990s.

— *Sheldon Richman*
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"Corporate" Power Alone Is the Problem? It Just Ain't So!

BY GEORGE C. LEEF

One of the tried and true formulas for giving a speech is the "loss of the golden days" approach. The speaker contrasts an imagined time in the past when things were good with present conditions. The present, of course, is bad and rapidly getting worse. Some evil force that the listeners are bound to dislike is then blamed for the deplorable state of affairs, and the speech concludes with an exhortation to the faithful to go forth and battle the nemesis.

Such a speech was given last June at New York University by Bill Moyers. (See www.inequality.org/moyerstranscript.pdf.) Moyers, whose career as a public figure allied with the redistributive and managerial state goes back to the presidency of Lyndon Johnson, has lately been pontificating about the condition of the world on PBS, from which he recently retired. Moyers seems to view himself as an *eminence grise* of modern American "liberalism," revealing all the nation's shortcomings to his spellbound audience. That would be a respectable role if he got the analysis of our shortcomings right. Alas, he doesn't even come close.

Part of what bothers Moyers—and the supposed cause of the loss of the "golden era"—is the recent dominance of "the corporate Right" in Washington. Thanks to the greedy moguls of business, we have turned our backs on the goodness of "commonwealth" (the compassionate, sharing society that gave us subsidized universities, the "safety net" of welfare, progressive taxation, and so forth) in favor of a cold, blind, pursuit of mere wealth. Moyers begins with particular instances of suffering that he blames on that shift. For example, a working-class family loses its home because the husband can't earn enough to pay the rent; a woman can't find a good job because her Medicaid-provided dentures fit badly and give her a strange appearance. Moyers wants us to "get mad" about such cases. He wants us to blame the rise of "the corporate Right" for our shameful national decline that allows such tragedies to occur.

There are just two things wrong with Moyers's analysis. First, the use of government power to assist individuals and interest groups in amassing unearned wealth is not a recent phenomenon in the United States. Second, the deleterious effect of the manipulation of politics is not just a creature of Moyers's hated "corporate Right." It is equally a creature of the Left, and the pursuit of self-interest through government power is every bit as harmful when done by so-called liberals as when done by conservatives. Instead of clinging to the tribalistic groupthink that labels one "wing" good and the other bad, Moyers ought to realize that the coercive use of government power has undesirable effects no matter which ideological camp is behind it. The problem, in short, is government power itself, which inevitably attracts rogues and schemers.

Returning to my first point, Moyers is apparently under the impression that it is some recent development that the power of the government has been harnessed for private gain.

Did Big Business tycoons suddenly wake up to the profit-making potential of government favors circa 1970? Hardly. Looking back over U.S. history, one finds that attempts to use the government for private gain began early on and have never let up. Devious businessmen secured subsidies for canal projects, shipbuilding, and, most notoriously, railroad construction

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throughout the nineteenth century. Nor is such favor-seeking uniquely American. Centuries before it had colonies in the New World, the British monarchy was in the business of conferring monopolies and subsidies on favored businesses.

Not only is the problem of which Moyers complains not new, but it is also not confined to "the Right." "Liberals" are just as interested in and adept at manipulating government power for self-serving ends as conservatives, but Moyers is too enthralled with their egalitarian rhetoric to see what's going on. He contends, for example, that "public education" was instituted in America to give all children an equal chance at success. But that's wrong on two counts. Nongovernmental educational opportunities were available to all in the early years of the United States, and people were able to obtain the optimal degree of education for themselves and their children without any government schools. Naturally, Moyers fails to take note of the fact that the gap between black and white educational accomplishments narrows considerably for children who attend nongovernment schools.

Bill Moyers is apparently under the impression that it is some recent development that the power of the government has been harnessed for private gain.

Furthermore, government schools were instituted not from a desire for an egalitarian society, but rather because educators wanted to guarantee and expand their market. Self-interest was behind public education in the early 1800s, and self-interest perpetuates it. Arguably, nothing does more to cause the socio-economic disparities Moyers laments than the education establishment's rabid opposition to a free market in education. But he does not criticize it in the least.

Environmentalist Privilege

A more recent example of leftist use of government power is the ability of environmental groups to get government to set aside land to prevent its being put to commercial use. As a consequence, wealthy folks can hike in their $200 boots, enjoying unspoiled vistas and feeling good about themselves for "saving the planet," while poor people have fewer job opportunities and pay higher prices for resources kept artificially scarce.

If Bill Moyers believes that it is only conservative interest groups that play the game of politics for private gain, he should open his eyes.

Of all the nonsense in Moyers's speech, none more clearly shows his failure to understand reality than his ritualistic denunciation of tax cuts. He moans about the recent (and small) reductions in income-tax rates because they were "tilted towards the wealthiest people in the country." To Moyers, that is the end of the argument. But he overlooks the crucial difference between money in the hands of people who earned it (whether wealthy or not) and money in the hands of politicians: In the former case, some of it will be invested productively, whereas in the latter, none will be invested productively and some will even be devoted to purposes that hinder production.

Millions of Americans who are not poor owe their standard of living to the fact that the government didn't tax away more money than it did, leaving enough in private hands to create goods and employment. If it had taxed less, there would be fewer people living in poverty today. Egalitarians, however, prefer to gratify their own desire to control the distribution of wealth than to allow a free society in which more people can prosper.

Contrary to Moyers's assertion, there has been no "profound transformation" in America, no "powerful shift toward private and corporate control." If he means a shift to private property, freedom of association, and free trade, it would be a glorious thing, but the leviathan state continues to grow. It enriches those with political pull regardless of professed ideology, while it chisels away at freedom and throttles our potential for progress and greater prosperity.

Bill Moyers has fallen for one of the biggest myths of all time, that you can have a powerful state that will only do the supposedly good things that you want. I guess that's the adult version of the tooth fairy.

The Myth of Available Pain Care

BY FRANK B. FISHER

America is in the midst of an ongoing epidemic of undertreated chronic pain. This fact is confirmed by surveys such as "Chronic Pain in America: Roadblocks to Relief," which is posted on the American Pain Society website (www.ampainsoc.org/whatsnew/toc_road.htm). The economic cost of this epidemic can be estimated, in terms of lost productivity, at about $100 billion per year. The human costs are more difficult to quantify. These include unnecessary suffering and lives ruined through inability to work. To physicians facing unwarranted criminal charges of drug dealing, the consequences of such an accusation range from damage to reputation to life imprisonment. In cases in Florida and Virginia, prosecutors have even contemplated seeking the death penalty against pain-treating physicians.

Opioid analgesics are a class of medications, which includes morphine and oxycodone. In lay terms they are recognized as endorphins. After centuries of successful use they remain the cornerstone in the treatment of chronic pain. They are natural substances that the body itself uses in the regulation of pain. When used as directed by a physician, opioids are categorically safe, and addiction is a vanishingly rare side effect.

The failure of physicians to prescribe opioid medications in quantities sufficient to control chronic pain is the immediate cause of the epidemic. The deeper causes are attributable to social forces, the most significant of which is the intrusion of the war on drugs into the medical profession and the relationship between the physician and his patient.

Most people believe that if they develop chronic pain, their physician will take care of them. They are sadly mistaken. Both scientific and anecdotal evidence inform us that chronic pain is ineffectively treated. The previously mentioned "Roadblocks" survey reveals, alarmingly, that the more severe a patient's pain is, the less likely the sufferer will be to obtain relief. This experience is described by patients all around the country who can't find a physician willing to risk prescribing the amounts of opioids necessary to bring their disease under control.

The behavior of the medical profession in its approach to the treatment of chronic pain extends far beyond neglect. Many physicians accept patients suffering from severe chronic pain into their practices. But they rarely treat these patients with dosages of medications that will allow them to return to productive lives. Instead, these unfortunate souls are subjected to a series of abuses that systematically violate their basic human rights.

This seems shocking and unbelievable. Here's how it works. Physicians are actually trained to scrutinize patients for signs of impending drug addiction. This is accomplished through the use of a set of "aberrant drug-related behaviors." These behaviors are essentially measures of compliance. Apart from pain management, compliance with medical treatment is generally thought to be in the patient's best interest and is voluntary. This is consistent with the principles of informed consent and patient autonomy, which are pillars of ethical practice. Around the issue of pain management, however, compliance takes a strange twist. It becomes, as we will see, a prerequisite for further treatment. It also becomes less than voluntary.

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The classic examples of "aberrant" behavior occur when a patient uses up his pain medications and either calls in "early" for a refill or asks his physician for a larger prescription. The list of "aberrant" behaviors for which physicians are trained to be vigilant extends to a number of other supposed transgressions, such as a request by a patient for a specific medication that the patient knows from past experience will work. Physicians are trained to regard these sorts of reasonable conduct as a sign of addiction or possibly even of illegal diversion of pharmaceuticals to the black market.

Physicians are both trained and required to react to these behaviors by imposing structure and sanctions. Structure may take the form of more frequent visits to receive smaller amounts of medication and intrusions into patient privacy that may include unannounced pill counts and mandatory drug testing. Many physicians keep a log of transgressions and employ a "three strikes and you're out policy," terminating opioid treatment after three supposed transgressions.

All of this places the pain sufferer in a terrible bind. If he can't obtain the medications he needs in sufficient quantity, he can't live a normal life. On the other hand, he isn't allowed to ask for it. If he makes his needs known, he runs the risk of being accused of addiction and criminality, and of being cut off from treatment entirely. As a result, undertreated patients suffering from chronic pain who need to ask for increased dosages are truly damned if they do and damned if they don't. Under these circumstances, it is not surprising that surveys reveal widespread undertreatment of this disease, particularly among those most severely afflicted.

This conduct is required of physicians by guidelines set out by academic pain specialists and their organizations. It is an abomination that systematically violates the central ethical obligations of the physician to his patient. These obligations include putting the patient's interests first and controlling pain. Informed consent and patient autonomy, the pillars on which ethical medicine is based, are abrogated as compliance is replaced by coercion.

Among pain victims, this results in bewilderment, increased pain, progressive disability, and general deterioration of health.

One may reasonably conclude that pain management, as it is currently practiced, is a sham. Patients who approach their physicians expecting they will receive pain control are instead subjected to an abusive program of drug control that systematically violates their basic human rights. Chronic pain sufferers are accurately characterized, along with their well-intentioned but nevertheless abusive physicians, as noncombatant casualties in the war on drugs.

The Root of the Problem

The Controlled Substances Act of 1970 assigned the criminal justice system the responsibility of regulating controlled substances. In so doing, law enforcement was inadvertently established in its current role as the regulator of medical practice. Legislative intent was to leave the practice of medicine unmolested. Instead, the law of unintended consequences, which apparently accompanies all drug-war–related endeavors, prevailed. Here's how it happened.

A *safe harbor* provision for the medical use of opioids was inserted into the act. The provision states that physicians may prescribe these medications in the usual course of their professional practice. That sounds pretty good on the surface, but that is only before one comes to understand the consequences. This provision implicitly, but unavoidably, requires that law enforcement distinguish between medical practice and drug dealing. Regardless of what one might choose to call this, the result is that law enforcement regulates the practice of medicine. Naturally, law enforcement carries out this task through the use of criminal prosecutions against physicians. It couldn't be otherwise. When society assigns law enforcement to regulate an issue, criminal prosecutions necessarily result.

The unfortunate truth underlying the pain crisis is the fact that it is impossible to regulate medicines without also regulating the practice of medicine.

Every doctor who contemplates treating chronic pain with opioid analgesics must answer the following question to his own satisfaction: By engaging in this practice, might he be misperceived by medical regulators, in this case law enforcement, as a criminal? By prescribing opioids, is he risking his career, his livelihood, his freedom, and perhaps even his life? The answer comes down to one issue. Is the safe harbor promised by the Controlled Substances Act really safe? Can law enforcement be counted on to regulate the practice of medicine correctly? Is this even a reasonable expectation?

Physicians are good at assessing risk. This is a large part of the work they do in their professional lives. As a group, physicians seem to understand that their risk of unwarranted prosecution is real and unacceptable. They demonstrate this through their prescribing behavior or, in the case of pain management, their failure to prescribe. Many physicians may not say that this is why they undertreat chronic pain or even admit that they undertreat the disease at all, but their collective inaction speaks louder than words. The facts revealed by the surveys of pain victims are as irrefutable as the stories of abuse and undertreatment told by the individual victims of this deadly disease.

Lack of Social Conscience

While most think of medicine as an institution that can be expected to respect human rights, this is a misconception. Medicine as an institution is not possessed of a social conscience. Instead, it reacts to existing social forces, and in this sense the behavior of physicians is best understood as a reflection of the core values of society. Unfortunately, society currently places its highest value on the control of drugs including opioids, which are incorrectly regarded as dangerous and highly addictive.

The medical profession has unfortunately, but predictably, taken on the value system of society in general and of those who regulate it. Social forces do not currently allow for ethical conduct within the realm of pain management. As a result, the professional conduct of individual physicians and the behavior of the institution of medicine as a whole are neither ethical nor humane. The following explanation will clarify why this is so.

The underlying problem is that no bright line exists between what is legal and what isn't concerning the prescribing of controlled substances. In fact, many of the expected characteristics of a medical practice where chronic pain is treated effectively are viewed by law enforcement as red flags indicating criminality. This conundrum is best understood through an examination of what transpires as the criminal-justice system targets, investigates, and prosecutes a physician suspected of abusing his prescribing privileges, a physician who becomes in the minds of law-enforcement officials nothing more than a drug pusher in a white coat.

Every prosecution begins with a targeting phase. Something must occur to cause law enforcement to scrutinize a particular physician in the first place. Law enforcement regards pharmacists as their eyes and ears in the community for the purpose of assisting in targeting drug-dealing doctors. As a result, a complaint from a pharmacist who suspects a physician is prescribing too much medication, or is doing so for the wrong people, is commonly the triggering event. Typically, the pharmacist believes, as do his counterparts in law enforcement, that outrageous quantities of dangerous addictive medications are being prescribed to drug addicts posing as pain patients. These patients are assumed to have become drug addicts as a result of the accused physician's criminal prescribing habits.

Such concerns belong to a category of evidence recognized as red flags. Just as physicians are trained to recognize "aberrant" drug-related behaviors, police and pharmacists learn, while attending educational conferences, to recognize red flags. These are the basis of a system of standards developed by law enforcement to identify illegal prescribing.

Having not been validated in any systematic manner, these red-flag standards are not included within the realm of medical science. In fact, many red flags actually describe the characteristics one would expect to be associated with medical practices where chronic pain is effectively treated. This is precisely why there exists no bright line between drug dealing and legitimate medical prescribing. In fact there is no line at all. Any such line that might have existed was unavoidably crossed when the Controlled Substances Act effectively assigned law enforcement, a nonmedical institution, to regulate the practice of pain management. This fundamental error in social policy is the very root of the pain crisis.

The following serve as examples of the problem.

The biggest red flag is high-volume opioid prescribing. Common sense dictates that significant volumes of opioids are necessary to treat chronic pain effectively. In the context of drug-war ideology, this necessary medical practice resembles drug dealing. When substantial amounts of drugs and money change hands, what else is a cop to think? This is why, when law enforcement regulates pain management, a head-on collision between necessary medical practices and the war on drugs inevitably occurs.

The appearance of poverty is another red flag. All it takes for a doctor to be targeted is a pharmacist who becomes uneasy with the looks of a patient and responds by lodging a complaint. Then the game is on. Police respond by conducting surveillance. Patients with a shabby appearance are observed and are assumed to be drug addicts intent on scoring a fix. Here, again, the drug war collides with medical reality. Chronic pain is a disease, which predictably reduces its victims to poverty and a poor appearance. It accomplishes this by limiting or removing the ability to engage in gainful employment or even to care for oneself properly. As a result, patients suffering from this disease often just don't look good. Physicians are arrested over this sort of "evidence."

Another red flag is a dosage of medication out of line with what a pharmacist or law-enforcement official believes the patient should require. This red flag conflicts with medical reality. A fundamental principle underlying the treatment of chronic pain is the individualization of treatment. There exists an enormous range within which appropriate opioid dosages may vary from one patient to the next. The correct amount of medication is whatever works to return a patient to functionality, not the amount some cop or prosecutor thinks it should take.

The Sting Operation and the Myth of Legitimate Prosecution

Rational people assume that if accusations of drug dealing go to trial, the government will be obligated to produce convincing evidence to prove that the physician stepped across a clearly defined line into the realm of criminal misconduct. We assume that unless the physician has done something like prescribing drugs to an undercover agent who asks for them but gives no medical reason, he will be left undisturbed. Our assumptions are mistaken.

The following testimony from a preliminary hearing in my own case, in which all charges, including even murder, were eventually dismissed, illustrates this point (see sidebar):

> Mr. *Hallinan:* [Y]ou were told that numerous agents were sent into Dr. Fisher's office to try to con him into giving them narcotics without any medical reason; right?
>
> *Agent Weatherford:* I believe that's the reason.
>
> Q: And none of them got them; did they?
>
> A: I don't believe so.

Regardless of how the sting operation turns out, physicians suspected of drug dealing are routinely prosecuted. After the targeting process, which is based on red flags, is completed, the presumption of guilt is apparently so firmly established in the minds of law-enforcement officials that evidence to the contrary is overlooked. The physician's fate is all but sealed. It is difficult to imagine the rationale employed by law enforcement in prosecuting a case under these circumstances, but it is known from bitter experience how they go about it.

After the sting operation fails to produce evidence of illegal prescribing, instead of re-evaluating the legitimacy of their case, prosecutors intent on obtaining a conviction go to plan B. They have failed to prove that the targeted physician's *behavior* was illegal, so it becomes necessary to prove that, while maintaining the appearance of the practice of medicine, the accused physician actually *intended* to deal drugs. To this end, a "records case" is constructed.

To generate evidence of criminal intent, "experts" in the fields of pain management and addiction medicine are hired to review the accused physician's medical records. These "experts" then take the witness stand and deliver what amount to sermons regarding the dangerous, addictive, and even lethal qualities of opioid analgesics. Typically, they refer to these substances as narcotics. This language inflames the pre-existing biases of jurors, who are usually unfamiliar with the science pertaining to these beneficial substances. The "experts" then proceed to offer a litany of examples purporting to show that, *in their opinion*, the accused doctor deviated from acceptable medical practice. If what the accused physician had done was clearly not medicine, there would be no need for expert testimony. This "evidence," based on an interpretation of the standard of care, is presented as if it had something to do with drug dealing. The resulting legal affairs are best characterized as morality plays.

The role of academic physicians in the pain crisis is particularly troubling. They have turned away, as a group, from their ethical obligations to control pain. Instead, they teach the aforementioned system of "aberrant" drug-related behaviors, ensconcing them into textbooks and professional journal articles. Academics also turn with regularity against their colleagues who have attempted in good faith to treat chronic pain. By doing so, they increase both their professional standing and their personal wealth.

Witch-Hunts

To understand the pain crisis, it is useful to know a little bit about the history and general characteristics of witch-hunts. A look into the situation that developed in Salem, Massachusetts, during the late 1600s is instructive. It exposes two outstanding features that pertain to witch-hunts in general. The first is that anyone can be targeted and the triggers are social. The second is that the evidence employed to get convictions, when examined rationally, is tenuous. A category of evidence known as spectral evidence was employed in Salem. This consisted of the supposed victim's accusing the suspected witch of appearing before her in a dream.

The circumstantial evidence of criminal intent provided by government witnesses is the modern-day equivalent of spectral evidence.

Another Victim of the Drug War

BY RADLEY BALKO

It's not pleasant to hear Dr. Frank Fisher speak. I first heard him several months ago at a briefing on the Drug Enforcement Administration's war on prescription painkillers in Washington, D.C. His eyes tend to glass over through much of his speech, seemingly on the verge of tears. Above them rests a sweeping coif of white hair; below, a thick, well-manicured white beard. He speaks softly, with jaws and temples tensed, projecting a labored voice that moves from sentence to sentence. As he talks, you get the impression that a sneeze might shatter him into a thousand pieces.

There's a reason Fisher projects the image of a broken man. He is one. Fisher—a Harvard-trained physician—once specialized in the treatment of chronic pain. He served a predominantly rural and poor population in California. About 5–10 percent of his 3,000 clients were pain patients—victims of cancer, multiple sclerosis, steep falls, botched surgeries, or car accidents.

A little more than five years ago, California Attorney General Bill Lockyer initiated a high-profile campaign against pain doctors who prescribe large doses of opioids—drugs such as OxyContin, Vicodin, and codeine. He wasn't alone. Several other attorneys general across the country had or were in the process of implementing similar campaigns. At about the same time, the DEA was launching its own plan to combat what is called a nationwide epidemic of OxyContin abuse.

Lockyer made Frank Fisher his example, his trophy. He dispatched a squad of heavily armed agents to Fisher's community health center. The cops detained the center's employees while they raided the facilities for incriminating evidence. Soon after the raid Lockyer put out a press release. Fisher, Lockyer said, was party to a sophisticated drug ring. He and other California prosecutors likened Fisher to a crack dealer. Then to a mass murderer. Fisher was charged with multiple counts of drug distribution, fraud, and most sensationally, several counts of murder. The state seized his assets. His bail was set at $15 million, and he faced a possible life sentence.

Over the next five years, every one of the charges against Fisher slowly fell away. A Superior Court

Long before the witch trial of an accused physician begins, he is burned at the stake in the media. He is portrayed as a greedy Dr. Feelgood who represents a menace to society. The following are among the remarks that may appear in the local newspaper concerning the accused physician and his practice: "We are shutting down suppliers of a highly addictive drug that has been improperly allowed to saturate the community." "I think he'll turn out just like Kevorkian. These are highly toxic drugs. We're not even allowed to flush them down the toilet, for fear we'll contaminate the drinking water."

Prosecuting pain-treating physicians as drug dealers relies on the myth that there are bad doctors eager to prostitute their medical licenses. This myth is driven by media hysteria around opioids because stories about drug panics sell newspapers. As a group, physicians avoid risk whenever possible. It is unlikely that physicians who commit a dozen years of their lives to achieving an educational and professional status that guarantees them a generous living would choose to risk it all by dealing drugs. That is why pain is undertreated in the first place. The risks associated even with necessary prescribing are deemed unacceptable by the vast majority of physicians.

It is generally understood that people get the government they deserve. It also appears that because medical practices reflect social values, we also get the medicine we deserve. It is therefore incumbent on society to transform its core value of drug control to one that gives pain control priority. This will undoubtedly occur as people become aware of the implications of the medical and human-rights disaster that currently passes itself off as the management of chronic pain.

judge immediately threw out the murder charges in a preliminary hearing. Four years later, another judge threw out the other felony charges—manslaughter and fraud. Last May a jury considered the remaining misdemeanor charges against Fisher and acquitted him on every count. One juror said Fisher had been the victim of a "witch-hunt."

The state of California of course has done nothing to address Fisher's wrongful persecution. He spent five months in prison and paid hundreds of thousands of dollars in legal fees. He has yet to get his assets back, faces several civil lawsuits spurred by his arrest, and still awaits hearings on the status of his medical license—which means he still can't earn a living.

Not only was Fisher the farthest thing from a drug dealer, he wasn't even an effective "dupe"— a doctor that dealers can easily fool into thinking they're pain patients. Fisher's clinic ejected more than 400 patients from treatment for, as his website describes, "lying, diverting medications or ingesting non-therapeutic doses." He also sent away numerous undercover agents posing as pain patients in an attempt to collect evidence against him.

There are about a hundred cases like Fisher's. Most recently, Virginia doctor and pioneer in pain management Dr. William Hurwitz was convicted on 50 counts related to prescription-painkiller distribution. After a trial rife with miscarriages of justice and shifting evidentiary standards, Hurwitz now faces a possible life sentence.

After his own acquittal Fisher drew attention to the often unmentioned but most tragic aspect of the persecution of a pain specialist: the status of his patients. "The part of this story that's always missing is the suffering of the patients I was treating," Fisher told the *San Francisco Chronicle*. "For my patients, my arrest was an unmitigated disaster. Many of them survived, but many of them not well. A lot of them look like they've aged 20 years."

Fisher looks old for his 50 years too. But then, five months in jail, the loss of one's assets, wrongful homicide charges, and the loss of reputation and livelihood might have that effect. Add Dr. Frank Fisher to the roll of victims wronged by America's endless war on illicit drugs.

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On Price Gouging

BY DONALD J. BOUDREAUX

The immediate aftermath of a natural disaster inevitably brings much higher prices for staple goods, such as lumber, batteries, fuel, and bottled water. Just as inevitably, these higher prices are roundly decried as unjust and inexcusable.

Such price hikes are slapped with the derisive name "price gouging." And even people who typically endorse markets often call for it to be outlawed.

A recent example comes from *Times of India* columnist Swaminathan Aiyar, who describes himself as a market liberal. In his January 9 column, Aiyar condemned the price hikes that followed the tsunamis, referring to them as an additional tragedy visited upon already-suffering victims.

This interpretation of the price hikes is as unfortunate as it is mistaken. Let's review here some basic economics of "price gouging."

Prices are not set arbitrarily. They are what they are for a variety of reasons. These reasons are summarized by the two words "supply" and "demand." Prices reflect existing conditions of supply and demand. If the price of bottled water rises, it does so either because supplies have fallen or because people's demand has risen. In the wake of natural disasters, both of these effects kick in strongly.

A natural disaster destroys inventories, vehicles, and infrastructure (including water-treatment plants and roads). Existing stocks of bottled water and of close substitutes, such as tap water, are reduced. Also reduced is the flow of supplies of water. Many of the roads and vehicles ordinarily used to carry bottled water to market are now destroyed. Less bottled water makes it to market in the devastated region. In short, supply falls significantly.

At the same time, demand for bottled water rises, principally because tap water is now less available and more dangerous. This fall in supply combined with rise in demand means that the value of each available bottle of water rises. People are willing to pay more for each bottle.

The higher price per bottle reflects the underlying reality; it reflects the fact that bottled-water supply is lower and bottled-water demand is higher. In short, it reflects the fact that bottled water is now more valuable than it was before the disaster.

Therefore, the fact that is unfortunate is not the higher price; it's the underlying reality reflected by the higher price. That a natural disaster destroyed supplies and supply lines is indeed unfortunate. But this is the reality. Because, as Thomas Sowell reminds us, reality is not optional, we ought to deal with it as best as we can.

Dealing Honestly with Reality

And how best to deal with this unfortunate reality? To begin, never pretend that reality is other than what it is. Face reality squarely, fully, and soberly. If this advice sounds trite, understand that government-imposed prohibitions on "price gouging" mask the underlying reality, shielding people from the truth of it.

If the market value of a bottle of water is $25, preventing merchants from charging a price higher than $5 shields consumers from the fact that potable water is now more precious than it was pre-disaster. The price cap also shields suppliers from this same truth.

The inevitable consequences of this hoax only add to the problems caused by the natural disaster. With the price artificially kept low—at its pre-disaster level—consumers will try to use this now-more-precious commodity today with no more care than they used it yesterday.

But they can only try, for they'll not succeed in using bottled water with the same nonchalance as they did pre-disaster. Misled by the counterfeit low price,

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consumers initially will do nothing to use water more carefully. But as fast as you can say "tsunami," other signals will alert them to water's now-greater preciousness. Long queues to buy water will emerge, as will empty shelves, black markets, and reports of neighbors hoarding bottled water in their basements.

Not only will most people who want bottled water be unable to buy all they want at the counterfeit price, many will spend valuable time waiting in queues (often to no avail). Some will drive over obstructed roads to buy water in distant towns, while others will use their personal or political connections to obtain water. Time and resources that could be better spent cleaning up and launching the rebuilding effort are diverted to frequently futile efforts to obtain bottled water.

These consequences are avoidable misfortunes compounding the pain of the natural disaster. Note several regrettable facts.

Fact one: capping the price does not keep the cost of bottled water low. Time spent waiting, time and fuel spent driving to distant towns where supplies are greater, and the anxiety unleashed by the inability to obtain water are all costs. The fact that these costs are not revealed in the price of bottled water does not render them less significant or real.

Fact two: while a higher market price *both* prompts consumers *voluntarily* to economize more diligently on water's use *and* increases the quantity of water supplied (by giving incentives to suppliers to bring more water to this market), the queues and empty shelves generated by the price cap *force* consumers to economize, but do nothing to inspire suppliers to bring more water to market.

Fact three: the economization forced on consumers by price caps is ugly and arbitrary. Those obliged to do without are the unlucky ones who couldn't get into the queue early enough and who have no political or business connections. These unlucky consumers are also typically too poor to pay the high prices demanded on the black market. A fact always missed by proponents of price caps is that black-market prices are higher than the unregulated market prices would be. The reason is that unregulated market prices—being visible and legal—will stimulate a larger inflow of supplies than will black-market prices.

There's no denying that people dislike the higher prices. What is deniable is that the higher prices are the problem. They are not the problem; they reflect the problem. Because the problem itself is unfortunate, its undistorted reflection will reveal this misfortune. But only by revealing this misfortune as accurately as possible to everyone who can help to minimize its effects will reality be returned as quickly as possible to normal.

Shouldn't Merchants Be More Charitable?

Still, why must merchants profit from other people's misfortune? Surely sellers can and should choose to sell their inventories at pre-disaster prices? Such questions reveal a deep and persistent objection to post-disaster price hikes—namely, it's simply unfair for merchants to profit from disasters.

Of course, merchants can voluntarily keep their prices below market levels. But to do so would be not only harmful but also unfair! If a grocer refuses to raise the price he charges for bottled water up to the market level, he will find his store besieged by consumers. Only consumers near the front of the line will be lucky enough to get the water; those closer to the rear will go home empty-handed. Is queuing a fair means of deciding who gets the water?

Also, by not raising the price, the grocer will mute the price signal sent to the global market that bottled water is especially needed in this locale. Muting this signal will reduce how much or the speed with which additional, much-needed supplies of bottled water are shipped from where they are valued less to the disaster area where they are desired more.

A better way for the merchant to extend a helping hand would be to charge market prices and, out of the profits he earns, to make cash contributions to cash-strapped victims of the disaster. Those contributions will enable victims to better express on the market their need for bottled water and other supplies—thus communicating to suppliers worldwide just how desperately they need things to help rebuild their lives—without diluting the incentives of all consumers to economize on the now-much-scarcer goods or the incentives of suppliers to turn their supplies to where they are now needed most urgently.

Thwarting market forces only worsens calamities and is therefore most unfair.

An Aging Population Is No Threat to a Free Society

BY ROBERT P. MURPHY

In an essay last year, economist Phil Mullan, the author of *The Imaginary Time Bomb: Why an Ageing Population Is Not a Social Problem*, addresses widespread concerns over the rising proportion of older people in Western societies due to falling birth and death rates.* In particular, many analysts conclude that government pension schemes will go bankrupt because of this demographic shift. Yet Mullan disagrees:

> We are told we need to confront some pretty big questions. Can society cope with having so many more old people? Can we really afford our future? . . . But just because the mood of social pessimism is so ubiquitous does not mean we should simply accept it. If we address these questions seriously we find that we can cope with, and afford, an ageing society—and that it is something we should welcome as a challenge, rather than see as a problem from which we should shrink.

At this point, I am in perfect agreement with Mullan; it is great news that people are living longer, healthier lives. But he has unfortunately linked old age with government retirement and health-care programs. For Mullan, to argue that "ageing is affordable" is the *same thing* as arguing that the government will be able to finance its generous social programs:

> [I]f providing a decent healthcare service for all, long-term care for those in need, and a reformed and generous state pension system requires a higher taxation take over the next 40 to 50 years then this should be said openly. . . . Rising prosperity in the future makes the financial case easy to make—a failure of political leadership seems to be the issue holding society back, instead pandering to presumptions about "unaffordability."

Besides a few passing references to private pension plans, Mullan doesn't even seem to realize that the market is capable of providing health care, pensions, insurance, and all of the other benefits that he assumes must be provided by the government. Relatively free markets can easily respond to shifts in age among customers. After all, nobody worries that an older population will force Hallmark to ration cards that say, "Happy Birthday, Grandpa!" The very idea is absurd, because we take it for granted that entrepreneurs will correctly anticipate consumer demand in these areas and will adjust their production plans accordingly. Because of his reliance on government, Mullan's optimism is misplaced. Yes, "the future is affordable," but *only if we return health care and pensions to the free market.*

Mullan seeks to comfort his readers by reminding us that aging "has been a remarkably constant feature of industrialised countries since the latter part of the nineteenth century, and societies have had no difficulties 'coping' with it in the past." Ah yes, but that was *before* large-scale schemes such as Social Security.

The reason Social Security will eventually go bankrupt is quite simple: It is a giant Ponzi scheme. When Franklin Roosevelt implemented the program, seniors received (relatively minor) payments that were collect-

* "Ageing: The Future Is Affordable," Spiked Essays, October 15, 2004, www.spiked-online.com/Printable/0000000CA4E3.htm, April 21, 2004.

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ed from existing workers' paychecks. Then, when the Depression-era workers retired, they received *their* Social Security benefits from the revenues taken from *new* workers. This is why demographic changes can alter the viability of programs such as Social Security.

In contrast, under a private pension plan it is your *own* contributions that roll over at interest and ultimately provide the fund to finance your lifestyle after retirement. Demographic changes have no effect whatsoever on this, since each worker provides for his or her own retirement.

The reason Social Security will eventually go bankrupt is quite simple: It is a giant Ponzi scheme.

No Worries

To his credit, Mullan (who writes from England) acknowledges this problem. He even concedes that Britain's "support ratio," which is "the number of working-age people for each elderly dependent," is currently 3.4 but is projected to fall to 2.4 in 40 years. Among other Western countries the forecasts differ, but Mullan grants that "the shorthand average often used is a fall in the ratio from four to two—meaning that each pensioner will be supported by half the number of 'workers' as pensioners are today."

It is forecasts such as these that lead to admittedly pessimistic conclusions, such as those of Adair Turner, chairman of Britain's Independent Pensions Commission. Turner believes society faces "essentially just three choices," which Mullan summarizes as "1) increased retirement ages; 2) poorer pensioners; and 3) bigger worker contributions."

Yet Mullan disputes these apparent choices. He argues that although "the trend of the statistical ratio might not 'lie'. . . it has so little bearing on the real world that any conclusions drawn from it are grossly misleading." Why does Mullan reject the standard statistic? First, not every member of the defined working-age population is actually a current contributor (some may be students or unemployed). Second, some members of the pension-age population are still contributing to the general support fund. Third, workers may become wealthier in the future and hence will be able to support more pensioners without suffering a drop in their own standard of living.

As opposed to the standard support ratio figure, Mullan proposes instead an *economic* support ratio, "which would compare active workers and *non*-workers." Using this new definition, Mullan finds that the economic support ratio in the United Kingdom is currently 0.84: 27 million active workers divided by 32 million non-workers, the balance of the total population of 59 million. Then relying on forecasts of Britain's employment level and total population in 2030, he estimates that the economic support ratio will fall to 0.71, "an increasing support requirement per worker of less than one fifth. This compares to that dramatic near doubling headlined by the conventional support statistics."

At first, it seems that Mullan has a great point: The conventional statistics, which focus merely on age distributions, are indeed less relevant than what Mullan has called the economic support ratio. However, even after conceding this point, it is still the case that society is faced with the stark choices Mullan had earlier lampooned. What I shall argue below is that the only way society can hold down the economic support ratio is to implement some or all of these hard choices, that is, to increase the retirement age, cut pensions, and/or extract more from workers.

Changes in Proportions

Despite Mullan's emphasis that not all working-age people actually work, the fact is that it is only *changes* in those proportions that count, even if we use Mullan's preferred statistic. Suppose that initially half the population is working age, while the other half are retired pensioners. In this case, each worker supports two people: himself and one pensioner. Now if the population ages, such that only one-quarter of the population is working age while three-fourths are pensioners, then each of those future workers will support four people: himself plus three pensioners. Thus the aging of the population has caused the burden on workers to increase 100 percent.

Now suppose I tell you that in reality, only half the working-age population actually works, and that at any given time, the other half of the people in this age group are students. Will this alteration affect the plight of the workers due to aging? No, it will not. In this case, under the original age distribution (where half the population was working age and half were pensioners), each actual worker supports four people—himself, two pensioners, and one working-age student. *Now* when the population ages, only one-eighth of the people are actually working. Thus each of these workers is supporting a total of eight people: himself, six pensioners, and one working-age student. As with the original scenario (where we assumed everyone of working age actually worked), in this case too (where we assume half of the working age people are students) the stipulated demographic change still causes the burden on workers to increase 100 percent.

When a privately financed pensioner retires, he then lives off the increased output due to his earlier savings.

Of course, if the proportion of full-time students in the overall working-age population should *drop*, then this would mitigate the effects of the aging population. And in the real world, if those who currently do not work (but are of working age) could be coaxed into working in the future, this would dampen the impact of an aging population on the "contributions" seized from those who currently work. On the other end of the age spectrum, the fact that people are now working more years of their lives also dampens the impact.

Let us sum up our discussion of the standard support ratio statistic versus Mullan's preferred economic ratio. Suppose that we have a family composed of one breadwinner who plans on retiring at 63, one housewife, and one daughter in college who works during the summers. After reading the forecasts of a growing population of elderly, the breadwinner exclaims, "Oh no! My payroll deductions will go through the roof! Our family can't afford this!"

In response, Mullan would calmly explain, "Not at all, my good man! So long as your wife gets a job, your daughter drops out and works full time, and you work until you're 67, there's no need for your payroll deductions to increase dramatically. The future is affordable."

Higher Future Incomes

The other major element in Mullan's analysis is that real incomes should rise in the future, such that each worker will have the ability to support more people and yet maintain his or her accustomed standard of living. Although certainly valid, this observation doesn't change the fact that actual contributions from workers will have to increase.

Another important point is that the *reason* incomes rise over time is the accumulation of capital. That is, when workers have more and better tools and equipment, each hour of their labor is more physically productive, and hence they will be paid more by employers.

Now where does this capital accumulation come from? It results from genuine *saving*, when people refrain from current consumption. This allows resources to be diverted from the production of consumer goods, such as pizzas and TV sets, and switched to the production of capital goods, such as drill presses and tractors.

Indeed, it is capital accumulation that explains why genuine pension plans—where each worker *invests* his contributions into a fund that rolls over at interest—can function regardless of the changes in age distribution. In effect, when a privately financed pensioner retires, he then lives off the increased output due to his earlier savings. He is thus not burdening younger workers, because their productivity is itself attributable (in part) to the investments he made during his working career. It is ironic, then, that Mullan views increased worker productivity as easing the financial crunch of government pension plans, since it is precisely private pension plans that (in part) cause this phenomenon.

Phil Mullan is certainly correct that it is far better to live longer lives than the alternative. He is also correct that "an ageing population" poses no threat to pension plans, health care, and insurance. However, the one caveat that Mullan misses is that, to remain viable, these systems must be taken out of the government's control and returned to the voluntary private sector. Only then can everyone hope for a secure future.

Ludwig von Mises and The Vienna of His Time

PART II

BY RICHARD M. EBELING

From the time of World War I, Ludwig von Mises's writings expressed the classical-liberal cosmopolitan conception of man, society, and freedom. Throughout the interwar period his works on the general principles of the liberal market order, the dangerous dead end to which socialist society would lead, and the contradictions and corrupting influences of economic interventionism all represented attempts to stem the tide of anti-Enlightenment thought—to hold back what he referred to as the "revolt against reason."[1]

Ludwig von Mises

For Mises, classical liberalism is the worldview that liberates mankind from the *ancien régime*, with its systems of caste and class, favors and privileges, inequalities and injustices.[2] If groups of individuals wish to cling to their traditional identities and their longing for custom, tradition, and rituals, they are free to do so in the liberal society. But they are prevented, or at least greatly hindered, from imposing them on others, since the agency of government is limited to securing peaceful cooperation through a rule of law with equal treatment for all. Under limited-government liberalism, the resentment, envy, and anger of some cannot be transformed into political malice and abuse toward others.

In the face of the ascending influence of socialist ideas, liberalism is the worldview and economic system, in Mises's eyes, that can forestall the establishment of a terrible collectivist tyranny, which can only produce stagnation and poverty. Socialism is merely the old petty resentments and personal envy now cloaked in the rhetoric of a grandiose theory of economic and institutional exploitation and injustice. Worse, the triumph of socialism would introduce an economic system without a rational method for economic calculation. Thus socialism also would lead to waste, inefficiency, and a standard of living far below that of the market order it would replace.

All of these anti-liberal forces were set loose by World War I: socialism, nationalism, racism, and fascism. Together they cumulatively represented a counterrevolution against all that classical liberalism had advocated and succeeded in creating in the eighteenth and nineteenth centuries. They were man's return to the master and to chains. They heralded the end of the free man.

Behind the anti-Semitic aspect of collectivism's counterrevolution, Mises believed, were envy and resentment against those who had succeeded socially and economically in the arena of free-market opportunity. While Mises did not discount the role of non-economic factors in generating anti-Jewish sentiments, especially in earlier ages, he was persuaded that the most important factor behind them in modern times was the frustration of those who had failed against competitors who happened to be Jewish or of Jewish ancestry.

Nazi race doctrine was unable to define and classify scientifically the incontestable characteristics of a "Jew" or an "Aryan." Indeed, in the context of Europe's long history of conquest and mixings of mul-

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titudes of ethnic and racial groups, there was no scientific meaning to a "pure" race in virtually any part of the continent. And after enumerating the many negative meanings that had been given to "Jewish" culture, attitudes, behavior, and influence on German society, Mises concluded that the only thing that could be found in common in them was that the critic did not like them. For example, the Jews were criticized for being either economic liberals in favor of rugged individualism or communists desiring the nationalization of the individual; for being either warmongers for profits or dangerous pacifists unwilling to fight for their country; for being either Zionist nationalists or rootless cosmopolitans with loyalty to no one; for being either crude materialists or utopian idealists; for being either advocates of democracy or agents of dictatorship. "Jew" was simply the covering term for whatever was disliked or considered undesirable in society.[3]

Under limited-government liberalism, the resentment, envy, and anger of some cannot be transformed into political malice and abuse toward others.

Pivotal Role

Yet it was a fact, as Mises pointed out, and as mentioned in part one, that the Jews played a pivotal role in the cultural and economic development of Central and Eastern Europe in the second half of the nineteenth century and the early decades of the twentieth century. Those who resented the passing of older and more traditional forms of social order or who were unable to adapt as easily to the rising currents of market competition saw the Jew as the cause of their "misfortune." The Jews were central to industrialization, modern commerce, railway infrastructure, and raw-material and resource development, especially in Imperial Germany and Austria-Hungary—even though at no time did the Jews represent more than 1 percent of the population of the German Empire, and scarcely 5 percent of the population of the Austro-Hungarian Empire.

For traditionalist Germans, the Jews represented "modernity" and secularization— especially in its free-market manifestation. For the various non-German nationalities in eastern Germany and Austria-Hungary, the Jews represented "German" cultural and economic domination, especially since the German and Austrian Jews saw German "culture" as the most enlightened and progressive force, something into which a large majority of them wanted to assimilate.[4]

But the fact remained that in the market, individuals continued to patronize the suppliers who could provide better and/or less-expensive products and services. People demonstrated their preferences and voted with their money for those with whom they found it advantageous to do business. As Mises explained it:

> Many decades of intensive anti-Semitic propaganda did not succeed in preventing German "Aryans" from buying in shops owned by Jews, from consulting Jewish doctors and lawyers, and from reading books by Jewish authors. They did not patronize the Jews unawares—"Aryan" competitors were careful to tell them again and again that these people were Jews. Whoever wanted to get rid of his Jewish competitors could not rely on an alleged hatred of Jews; he was under the necessity of asking for legal discrimination against them. Such discrimination is not the result of nationalism or of racism. It is basically—like nationalism—a result of interventionism and the policy of favoring the less efficient producer to the disadvantage of the consumer.[5]

And if the Jews were to be blamed for bringing anti-Semitism on themselves it would have to be for their most meritorious qualities:

> But if the cause of anti-Semitism were really to be found in distinctive features of the Jews, these properties would have to be extraordinary virtues and merits which would qualify the Jews as the elite of mankind. If the Jews themselves are to blame for the fact that those whose ideal is perpetual war and bloodshed, who worship violence and are eager to destroy freedom, consider them the most dangerous

opponents of their endeavors, it must be because the Jews are foremost among the champions of freedom, justice, and peaceful cooperation among nations. If the Jews incurred the Nazis' hatred through their conduct, it is no doubt because what was great and noble in the German nation, all the immortal achievements of Germany's past, were either accomplished by the Jews or congenial to the Jewish mind. As the parties seeking to destroy modern civilization and return to barbarism have put anti-Semitism at the top of their programs, this civilization is apparently a creation of the Jews. Nothing more flattering could be said of an individual or a group than that the deadly foes of civilization have well-founded reasons to persecute them.[6]

Contributions Exaggerated

Mises did not assert that civilization was the result of the Jews. He pointed out that the anti-Semites greatly exaggerated the contribution of the Jews to modern society and its accomplishments. What was distinct about the German and Austrian Jews was that they were small minorities in the greater society who could easily be targeted for economic discrimination through interventionism, with no ability to politically prevent more powerful special-interest groups from using the state at their expense. And "the Jews" were able to serve as a convenient hook on which could be hung all the excuses for individual disappointment and national humiliation, especially in the wake of defeat in World War I.[7]

What the Vienna of Mises's time demonstrated, especially in the decades before the war, is that classical liberalism in practice means the protection of freedom in reality. The reawakening of Jewish life in Germany and Austria was made possible by the Enlightenment culture of reason, experience, and individualism in place of superstition, blind faith, and cultural collectivism. The spirit of individualism fostered a growing environment of self-education and self-improvement in the Jewish community. However, that spiritual individualism would have been stymied if it had not coincided with the new epoch of political and economic liberalism in which the individual could apply his liberated mind to the external world.

But it was the ideology of interventionism and socialism put into practice in the period between the two world wars that enabled the prejudices of the envious and the resentful to be applied against their more successful competitors. Mises explained the methods by which the power of the interventionist state could be turned against a minority group such as the Jews:

> If, for instance, members of the minority are alone engaged in a specific branch of business, the government can ruin them by means of customs provisions. In other words, they can raise the price of raw materials and machinery. In these countries [in post-World War I Central and Eastern Europe], every measure of government interference—taxes, tariffs, freight rates, labor policy, monopoly and price control, foreign exchange regulations—were used against minorities. If you wish to build a house or use the services of an architect from the minority group, then you find yourself beset by difficulties raised by the departments of building, of health, of fire. You will wait longer to receive your telephone, gas, electric, and water connections from the municipal authorities. The department of sanitation will discover some irregularities in your building. If members of your minority group are injured or even killed for political reasons, the police are slow in finding the culprit. Against such obstacles all provisions of minority protection are useless. Think of the assessment of taxes. In those countries, Chief Justice Marshall's dictum "The power to tax is the power to destroy" was practiced against the minorities. Or think of the power that [occupational] licensing gives to a government.[8]

In the two decades following World War I the governments of Central and Eastern Europe, especially in countries such as Poland, Lithuania, Hungary, and Romania, used these types of interventionist policies to prohibit and restrict economic opportunities for the Jewish populations. This was often accompanied with brutal acts of violence against the lives and property of Jews.[9]

It was precisely through such interventionist policies that the Jews were excluded from German social and economic life in the years following the triumph of Hitler's National Socialist movement in 1933. During the first five years of the Nazi regime, restrictions, regulations, and prohibitions were imposed on the German Jewish community that completely reversed the previous hundred years of economic and social liberalization. Step by step Jews were legally banned from the professions, academia, the arts and sciences, and commerce, industry, and trade. This was matched by savage physical attacks on Jews throughout the country, in which thousands where killed, beaten, or arrested and imprisoned in the new system of concentration camps.[10]

What the Vienna of Mises's time demonstrated, especially in the decades before World War I, is that classical liberalism in practice means the protection of freedom in reality.

What had taken five years to accomplish in Nazi Germany itself was achieved within weeks and months in Austria following its annexation to the Third Reich in March of 1938. The following, admittedly lengthy, passages from Bruce Pauley's book on the history of Austrian anti-Semitism gives a chilling sense of the tragedy that befell the Jews of Vienna in the days and months after the *Anschluss*:

> The night of 11–12 March 1938 marked the dramatic end of a thousand years of Austro-Jewish history. On Friday, 11 March, all the Jewish newspapers of Vienna published their usual weekly editions. By the next day their offices and those of other Jewish organizations had been seized by Nazis. Within a matter of days, or at most a few months, nearly all Austrian Jews had lost their means of livelihood and in many cases their homes as well. . . .
>
> Gangs of Nazis invaded Jewish department stores, humble Jewish shops in the Leopoldstadt, the homes of Jewish bankers, as well as the apartments of middle-class Jews, and stole money, art treasures, furs, jewelry, and even furniture. Some Jews were robbed of their money on the street. All automobiles owned by Jews were confiscated immediately. Jews who complained to the police about the thefts were lucky if they escaped arrest or physical violence. . . .
>
> SA men stood at the entrances of Jewish shops; Christians who entered the stores were arrested and forced to wear signs saying they were "Christian pigs." . . . Within a few hours or at most a few days all Jewish actors, musicians and journalists lost their jobs. By mid-June 1938, just three months after the Anschluss, Jews had already been more thoroughly purged from public life in Austria than in the five years following Hitler's takeover of power in Germany. Tens of thousands of Jewish employees had lost their jobs. Only rarely were they given any warning or severance pay. Among those dismissed were all state and municipal employees (what few there were), including 183 public schools teachers, and employees of banks, insurance companies, theaters, and concert halls. Meanwhile, private Jewish businesses large and small were either confiscated outright or their owners were paid only a small fraction of the property's true value. Jews were also excluded from most areas of public entertainment and to some extent even public transportation by the early summer of 1938; similar rules were not imposed on German Jews until November. Austrian Jews were also subjected to all kinds of personal insults and indignities that were not the result of official Nazi legislation. If a gentile streetcar passenger did not like the looks of a Jewish fellow passenger in the summer of 1938, he could have the trolley stopped and the Jew thrown off. The number of coffeehouses and restaurants that would not serve Jews grew from day to day. All of the public baths and swimming pools were closed to the Jews. Park benches all over the city had the words "Juden verboten" stenciled on them. Jews were not admitted to theater performances, concerts, or the opera. Numerous cinemas had notices saying that Jewish patronage was not wanted. Sometimes Jews were ejected from a motion picture

theater in the middle of a performance if gentiles complained about them. SA men at times even stood at the last tramway stop in the suburb of Neuwaldegg in order to prevent Jews from strolling in the nearby Vienna Woods. . . .

After 2 July Jews were not allowed to enter certain public gardens and parks, and none at all after September 1939. At the end of September 1938 both Jewish physicians and Jewish lawyers lost their right to serve gentile clients. Only about fifty Jewish lawyers were able to make a living even briefly under these circumstances. After 5 October Jews were not permitted to enter sports stadiums as spectators. Shortly after the November Pogrom the Jews were not even allowed to appear in public during certain times of the day. After January 1939 they could not use sleeping or dining cars on railroad trains. . . .

The confiscation of Jewish homes and other kinds of wealth by Austrian Nazis both before and after Kristallnacht probably had less to do with Nazi ideology than it did with economic self-aggrandizement—that is, pure old-fashioned greed.

. . . Already by December 1938, 44,000 Jewish apartments had been Aryanized out of a total of about 70,000 [in Vienna]. . . . Jews were sometimes notified by a piece of paper on their front door that they had only a few days or even hours to move out of their apartments. . . . Likewise, the confiscation of Jewish jobs was also an answer to Viennese unemployment, which had been endemic during the entire interwar period, and especially in the 1930s.[11]

Illusory Gains

In the spring of 1940, shortly before Mises left Geneva to come to the United States, he pointed out that Austria had had a thousand outstanding entrepreneurs before the *Anschluss* in 1938. Of these at least two-thirds had been Jews. Now, two years later, all of these Jews either had been tortured and murdered, or sent off to concentration camps, or expelled from the country. The supposed gains to the remaining Austrian population through confiscation and expulsion of their Jewish neighbors were all illusionary, Mises insisted, based on the crudest of Marxian fallacies:

The so-called Aryanization of firms was based on the Marxist idea that capital (machinery and raw material) and the labor input of workers were the only vital ingredients of an enterprise, whereas the entrepreneur was an "exploiter." An enterprise without entrepreneurial spirit and creativity, however, is nothing more than a pile of rubbish and iron. Today the Aryanized firms, one and all, contribute nothing to exports. They are either working for the military or they have been liquidated. Commercial ties abroad, built up by more than one hundred years of unrelenting effort, have been broken. The core of skilled workers have been dispersed and displaced from its traditional skills.[12]

Thus the ideology of envy and the interventionist policies of discrimination under German National Socialism brought to a disastrous close the liberal epoch of freedom for the Jews in Austria. In 1938, Austria's Jewish population had numbered around 250,000. By May 1939 only 121,000 were still in Austria, with most of the rest having emigrated. Those who were not able to leave ended up in the inferno of the Holocaust.[13] According to one estimate, fewer than 300 survived the war in hiding in Austria.

Among those who left before or immediately after Germany's annexation of Austria were many members of the Austrian school of economics or Mises's private seminar circle (both Jews and non-Jews): Martha Steffy Browne, Gottfried Haberler, Friedrich A. Hayek, Felix Kaufmann, Fritz Machlup, Ilse Mintz, Oscar Morgenstern, Paul N. Rosenstein-Rodan, Alfred Schutz, Erich Voegelin, to name just a few.

Mises had departed in the autumn of 1934 for a teaching position at the Graduate Institute of International Studies in Geneva when it was clear that the collectivist darkness was starting to fall over the center of Europe. He made a new life for himself after 1940 in the United States, as did many of his Austrian colleagues and friends, where the spirit of freedom was not yet in the same shadow of tyranny as in their native country. America, for them, was still a land where Austrian Jews such as Mises could breathe the air of liberty.

For many Austrians, and especially Austrian Jews, there long remained a nostalgia for the old Vienna before World War I. It represented peace, freedom, security, and certainty with its liberal values and apparent tolerant atmosphere in which a vast diversity of peoples lived and worked, and culturally gained from each other. As the Austrian writer Stefan Zweig expressed it, "It was sweet to live here, in this atmosphere of spiritual conciliation, and subconsciously every citizen became supernational, cosmopolitan, a citizen of the world."[14]

Yet this appearance was deceiving. Beneath the surface, anti-liberal currents were at work that brought this idyllic epoch to an end. In too many people's hearts and minds, collectivist attitudes and sentiments dominated their conduct and desires. Ludwig von Mises explained the problem and danger in the years immediately after World War I. The mentality of people had lagged behind the political and economic changes in nineteenth-century society. Institutions had been transformed more rapidly than the everyday psychology of men. And a counterrevolution against freedom had emerged. It was characterized by the migrations of a growing multitude of people from the countryside to the cities, from traditional society to urban life, Mises argued:

> Immigrants soon find their place in urban life, they soon adopt, externally, town manners and opinions, but for a long time they remain foreign to civic thought. One cannot make a social philosophy one's own as easily as a new costume. It must be earned—earned with the effort of thought. . . .The growth of the towns and of the town life was too rapid. It was more extensive than intensive. The new inhabitants of the towns had become citizens superficially, but not in ways of thought. . . . More menacing than barbarians storming the walls from without are the seeming citizens within—those who are citizens in gesture, but not in thought.[15]

Classical liberalism requires not only a political and economic philosophy. Its survivability is also dependent on an attitude and a philosophy of life: the accepting of self-responsibility for both successes and failures; a respect for others as individuals; a realization that peace of mind comes only from within, and that purpose and meaning cannot be bought at others' expense; and an understanding that one's own freedom, and that of others, should not be traded away for a few pieces of silver and a false sense of security through political paternalism.

Men's unwillingness or inability to adopt this wider and deeper sense of a true citizenship of liberty brought all the ruin of the last 100 years, including the barbaric extermination of the Jews of Europe and the destruction of an entire continent in World War II. After analyzing the collectivist roots of Nazism and the anti-Jewish attitudes of both Germans and many others at that time, Mises concluded: "Mankind has paid a high price indeed for anti-Semitism."[16]

1. Mises's monumental work on *Socialism: An Economic and Sociological Analysis* (Indianapolis: Liberty Classics, 1981), originally published in 1922, is not merely a logical argument against the possibility of socialist central planning—which of course is a centerpiece of the book. It is also a sweeping and majestic analysis of the social, cultural, and political potential of a free and classical-liberal community, and the poverty and destructive tendencies of all forms of collectivism. His 1927 volume, *Liberalism* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1985) presents an integrated and coherent exposition of the truly humane world that a liberal society can bring mankind. All these themes on the nature of the free society were brought together in his masterful treatise, *Human Action* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996). On Mises as social and political philosopher, see Richard M. Ebeling, "Planning for Freedom: Ludwig von Mises as Political Economist and Policy Analyst" in Richard M. Ebeling, ed., *Competition or Compulsion? The Market Economy versus the New Social Engineering* (Hillsdale, Mich.: Hillsdale College Press, 2001), pp. 1–85.

2. See Ludwig von Mises, "The Clash of Group Interests" [1945] in Richard M. Ebeling, ed., *Money, Method and the Market Process: Essays by Ludwig von Mises* (Norwell, Mass.: Kluwer Academic Press, 1990), pp. 202–14; and Ludwig von Mises, *Theory and History: An Interpretation of Social and Economic Evolution* (New Haven, Conn.: Yale University Press, 1957), pp. 112–22.

3. Ludwig von Mises, *Omnipotent Government: The Rise of the Total State and Total War* (New Haven, Conn.: Yale University Press, 1944), pp. 171–77.

4. Many of these assimilated Jews were embarrassed and ashamed of their "eastern cousins" who continued to follow more traditional Jewish cultural and religious forms. Their physical appearance and religious practices seemed a reminder of what they had chosen to escape from. And the arrival of these more orthodox Jews in Berlin and Vienna in the years both before and after the first World War was viewed with great unease. Indeed, the assimi-

lated Jews were fearful that their country orthodox cousins would make them look "bad" in the eyes of their non-Jewish neighbors. They would be tarred with the negative impressions these orthodox Jews would (and did often) create in the minds of non-Jewish Germans and Austrians. See Jack Wertheimer, *Unwelcome Strangers: Eastern European Jews in Imperial Germany* (New York: Oxford University Press, 1987); Derek J. Penslar, *Shylock's Children: Economics and Jewish Identity in Modern Europe* (Berkeley: University of California Press, 2001), pp. 195–205; and Amos Elon, *The Pity of It All: A History of the Jews in Germany, 1743–1933* (New York: Metropolitan Books, 2002), pp. 231–57.

5. Mises, *Omnipotent Government*, p. 184.

6. Ibid., pp. 184–85.

7. Indeed, though Mises does not draw attention to this point, what most German and Austrian Jews shared with their non-Jewish countrymen was an enthusiasm for German imperialism on the eve of World War I, and they served in the German army in a proportion far in excess of their percentage in the general population. They also shared the same resentments and feelings of humiliation with the defeat of the German and Austrian armies at the end of the war, especially in the wake of the peace terms imposed by the Allied powers in 1919. See Elon, *The Pity of It All*, pp. 297–354; Howard M. Sachar, *Dreamland: Europeans and Jews in the Aftermath of the Great War* (New York: Alfred A. Knopf, 2002), pp. 205–82; and Marsha L. Rozenblit, *Reconstructing a National Identity: The Jews of Habsburg Austria During World War I* (New York: Oxford University Press, 2001). The perversity, as Mises does point out, is that many of the non-Jews in Germany tried to maintain their mental equilibrium in the face of German's defeat by looking for a scapegoat for the humiliation of 1919 and found it in a Jewish "stab in the back." See Mises, *Omnipotent Government*, p. 187: "It was salvation for the self-esteem of all these disheartened souls when some generals and nationalist leaders found a justification and an excuse: it had been the work of the Jews. Germany was victorious by land and sea and air, but the Jews had stabbed the victorious forces in the back. Whoever ventured to refute this legend was himself denounced as a Jew or a bribed servant of the Jews. No rational argument could shake the legend. . . . It must be realized that German nationalism managed to survive the defeat in the First World War only by means of the legend of the stab in the back." Mises later developed the theme of envy and resentment as the foundation for anti-capitalist attitudes; see Ludwig von Mises, *The Anti-Capitalistic Mentality* (Princeton, N.J.: D. Van Nostrand, 1956).

8. Ludwig von Mises, "Postwar Reconstruction" [1941] in Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises, Vol. 3: The Political Economy of International Reform and Reconstruction* (Indianapolis: Liberty Fund, 2000), p. 13.

9. On how such interventionist policies were used against the Jews in the countries of Central and Eastern Europe in the period between the two World Wars, see Sachar, *Dreamland*, and Ezra Mendelsohn, *The Jews of East Central Europe Between the World Wars* (Bloomington, Ind.: Indiana University Press, 1983); see also P. G. J. Pulzer, "The Development of Political Antisemitism in Austria" in Josef Fraenkel, ed., *The Jews of Austria: Essays on Their Life, History and Destruction* (London: Vallentine, Mitchell, 1967), pp. 429–43.

10. For detailed accounts of the growing political and interventionist discrimination and prohibition on the social, civil and economic liberties of the Jews in Nazi Germany during the 1930s, see Raul Hilberg, *The Destruction of the European Jews* (Chicago: Quadrangle Books, 1967), pp. 43–105; Lucy S. Dawidowicz, *The War Against the Jews, 1933–1945* (New York: Bantam Books), pp. 48–69; J. Noakes and G. Pridham, *Nazism, 1933–1945*, Vol. 2: *State, Economy and Society, 1933–1939* (Exeter: University of Exeter Press, 1984), pp. 521–67; Arno J. Mayer, *Why Did the Heavens Not Darken? The "Final Solution" in History* (New York: Pantheon, 1988), pp. 113–158; Avraham Barkai, *From Boycott to Annihilation: The Economic Struggle of German Jews, 1933–1943* (Hanover, N.H.: University Press of New England, 1989); Saul Friedlander, *Nazi Germany and the Jews, Vol. I: The Years of Persecution, 1933–1939* (New York: Harper/Collins, 1997); Debrorah Dwork and Robert Jan van Pelt, *Holocaust: A History* (New York: Norton, 2002), pp. 82–102; also, Stephen Roberts, *The House that Hitler Built* (New York: Harper & Brothers, 1938), pp. 258–67; and Marvin Lowenthal, *The Jews of Germany: A Story of Sixteen Centuries* (Philadelphia: The Jewish Publications Society of America, 1938), pp. 392–421; on anti-Semitism in Germany in the 1920s, see, Donald L. Niewyk, *The Jews in Weimar Germany* (New Brunswick, N.J.: Transaction Books, 2001), pp. 43–81. And on the response of the Jews in Germany to mounting interventionist discrimination and violence in the 1930s, see John V. P. Dippel, *Bound Upon a Wheel of Fire: Why So Many German Jews Made the Tragic Decision to Remain in Nazi Germany* (New York: Basic Books, 1996).

11. Bruce F. Pauley, *From Prejudice to Persecution: A History of Austrian Anti-Semitism* (Chapel Hill: University of North Carolina Press, 1992), pp. 275, 280–84, 288–90.

12. Ludwig von Mises, "A Draft of Guidelines for the Reconstruction of Austria" [1940] in Richard M. Ebeling, ed., *Selected Writings of Ludwig von Mises*, Vol. 3: *The Political Economy of International Reform and Reconstruction*, pp. 135–36.

13. For an account of how it was the rise of immigration barriers across Europe and North America in the post-World War I period that closed the door and determined the fate of many German and Austrian Jews who therefore had no route of escape from the Nazis, see Dwork and van Pelt, *Holocaust*, pp. 103–32; also Arthur D. Morse, *While Six Million Died: A Chronicle of American Apathy* (New York: Random House, 1967); and David S. Wyman, *Paper Walls: America and the Refugee Crisis, 1938–1941* (New York: Pantheon Books, 1968). On the general development and effects of immigration restrictions, see, John Torpey, *The Invention of the Passport: Surveillance, Citizenship and the State* (Cambridge, Mass.: Cambridge University Press, 2000).

14. Stefan Zweig, *The World of Yesterday* [1943] (Lincoln: University of Nebraska Press, 1964), p. 13.

15. Mises, *Socialism*, p. 38.

16. Mises, *Omnipotent Government*, p. 192.

Peripatetics

The Unconstitutionality of Protectionism

BY SHELDON RICHMAN

Even the staunchest free trader might reluctantly concede that the apparatus of protectionism—tariffs, import quotas, and antidumping duties—is constitutional because clause 3 of Article I, Section 8, of the U.S. Constitution delegates to Congress "power . . . to regulate commerce with foreign nations. . . ."

Before we make too hasty a concession, however, let's take a closer look. Clause 1 of the section establishing Congress's powers states, in part, "The Congress shall have power to lay and collect taxes . . . to . . . provide for the general welfare of the United States. . . ." The preamble to the Constitution also declares that one purpose of the document is to "promote the general welfare."

What function does the phrase "general welfare" serve? We need not enter the debate over whether the phrase was intended to confer a plenary power on Congress or whether it was only to provide a context for the enumerated powers. That's an interesting discussion, but it has no bearing on my point, for whatever its function, the phrase contains the word "general," and the general cannot be the particular. That's a simple matter of syntax and logic. We are thus entitled to conclude that the government may not grant privileges to special interests.

It may be argued that clause 1 of Section 8, where the term "general welfare" appears, exclusively concerns Congress's power to tax. This ignores the fact, already noted, that the term also appears in the preamble. But let that go. Are we to believe that while Congress may tax only to serve the general welfare, it may borrow and coin money, raise a navy, regulate commerce, and do all the rest for any other purpose it pleases? That's implausible.

Moreover, when you consider that anything the government does requires taxation, we are back to the position that all the enumerated powers must be wielded for the general welfare only. Tariffs and antidumping duties of course are kinds of taxes. An import quota isn't a tax, but tell me how the government is to enforce quotas without taxing the population. How will it pay the customs agents, maintain their offices, and so on? If Congress may tax only for the general welfare, then it follows that anything else it does must be for the general welfare.

That principle having been established, let's look next at protectionism. Economic theory and history teach us that protectionism perforce harms large segments of society for the benefit of a smaller segment. It is classic special-interest government action. Every time the steel industry asks for restrictions on foreign competition, some sound thinker correctly points out that granting that wish would harm the U.S. auto industry and other steel users, not to mention consumers. As the old Paul Simon song says, "One man's ceiling is another man's floor." One industry's output is another industry's input.

The upshot is that since trade restrictions can never serve the *general* welfare but only *particular* interests (in the short run), and since the Constitution forbids the government from serving *particular* interests, all trade restrictions are unconstitutional.

This was driven home recently when it was reported that a group of retailers was trying to stop the Bush administration from doing American textile and clothing makers a favor by limiting competing products from China. According to the *Chicago Sun-Times*, "Four-decade-old quotas on textile trade are set to expire at the end of the year, ending a system that limited trade in 2,400 items, including cotton shirts and denim. The expiration is pitting U.S. textile makers, who fear more competition from China, against retailers, who want access to cheaper fabrics."

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The retailers' concern is legitimate. If Chinese imports are not allowed to reach the level they would have freely reached, then textile and clothing prices will be higher in the U.S. market than they would have been. That will hurt U.S. retailers, which will have fewer sales than otherwise. Of course, it will also hurt consumers, especially low-income consumers, over whom there is much hand-wringing even as they are heartlessly battered by trade restrictions.

This question thus begs an answer: how can limiting Chinese textiles and clothing be constitutional if it harms large segments of the American population? What about the *general* welfare?

The only possible answer would be one which shows that the restrictions don't really hurt consumers and retailers. But a wealth of free-trade literature has existed for a couple of centuries showing that this cannot be demonstrated. Trade is beneficial. Parties don't exchange money for goods and vice versa unless each expects to profit from the transaction. It matters not that the parties live on different sides of a national boundary. Nations don't trade; people do. Thus coercive interference with trade necessarily harms the people so imposed on, even if it temporarily benefits some third parties. (Eventually protectionism harms even those who seek it. The most dramatic example is the Smoot-Hawley Tariff of 1930, which turned what might have been a brief recession into the Great Depression.)

Why the Commerce Clause?

If my argument is right, one may ask why the commerce clause was put into the Constitution in the first place. We know the answer. Under the Articles of Confederation, the states to some extent imposed trade restrictions against one another. The Constitutional Convention was called, at least in part, to fix that flaw. The commerce clause was placed in the new constitution as a way of saying that the states may not "regulate" commerce, either among themselves or with foreign nations and Indian tribes. It is a mistake to read the clause as a license for the central government to interfere with free trade.

This is not to say that it wasn't read that way from the start. The first Congress passed a tariff. Tariffs were repeatedly used to limit imports and protect American manufacturers. (They were also used to raise revenue.) But this can't change the fact that each protective tariff, perhaps contrary to the belief of the policymakers, helped a special interest at the expense of everyone else and was thereby constitutionally defective.

Would the Supreme Court buy my argument? Not likely, considering the case law since the New Deal. In the 1937 case *Helvering v. Davis* the court essentially abdicated its responsibility and left it to Congress to decide what's general and what's particular.

Not once since then have the federal courts struck down an act of Congress under the general-welfare clause. It's one reason we're in the mess we're in today.

A constitution should be interpreted on the basis of its purpose and plain language. We need not resort to the imagined original intent or the private letters of its framers. The great libertarian lawyer and abolitionist Lysander Spooner made a mighty contribution to the philosophy of constitutional interpretation in his book *The Unconstitutionality of Slavery*. At the end of this shamefully neglected work, Spooner proffers 14 rules of interpretation, which he derives from the application of reason to the task at hand. Among the rules are "that the intention of the instrument must prevail," that "the intention of the constitution must be collected from its words," and "that all reasonable doubts must be decided in favor of liberty."

The Constitution proclaims its purposes in its opening words: "to form a more perfect Union, establish justice, insure domestic tranquility, provide for the common defence, promote the general welfare, and secure the blessings of liberty to ourselves and our posterity." Thus any particular clause must be read in light of these purposes. And any government action that violates one of these purposes is at least suspect. If earlier legislators violated common sense, and hence the Constitution, we need not be bound by their errors. Protectionism *cannot* serve the general welfare. Therefore, it fails to pass constitutional muster and ought to be forbidden.

Free-Market Justice Is in the Cards

BY J. H. HUEBERT

Nearly everyone takes it for granted that if government did not protect consumers from fraud, no such protection would be provided. The free market, however, protects consumers in countless ways, all without any government intervention. In fact, it does so more efficiently and effectively than the government can.

One of the most impressive examples of free-market justice involves something that might be in your pocket right now: your credit card. Through voluntary contractual arrangements—motivated by nothing more than a desire for customers and profit—credit-card companies provide an entirely private means of recourse when a merchant wrongs a customer.

Visa and MasterCard, the two most popular credit cards, are brand names jointly used by banks that have gotten together to issue the cards. Every bank that belongs to the Visa or MasterCard association can also open accounts for merchants who wish to accept the cards. The very existence of these organizations is a testament to the free market's ability to overcome the challenges of coordination to deliver to consumers the products they desire.

To understand how credit-card companies provide justice for consumers, we must first understand how an ordinary credit-card transaction works. Suppose Jones buys a camera from a merchant for $500 using his Visa card, which was issued to him by Bank A. The merchant, however, has a Visa merchant account through Bank B. How is the payment accomplished?

Today, it is most common for stores to have electronic terminals for processing credit-card transactions. So Jones would swipe his card through this terminal. When he does this, the terminal first determines that it is a Visa card rather than one of the other cards the merchant accepts. Then information about Jones's card goes to the computers of the bank with which the merchant has his Visa merchant account, Bank B. Bank B's computers contact Visa's central computer, which looks up Jones in its system and sees that his card was issued by Bank A. Visa then transmits an inquiry to Bank A to see if Jones has sufficient credit to buy the camera. The answer to that inquiry will come back to Visa, which will pass it back to Bank B, which in turn will pass it back to the merchant. If the answer is no, because Jones does not have enough credit, he will not be able to make the purchase. If the answer is yes, he will sign the familiar slip accepting the charge to his credit card, and that will complete the sale. Today, this entire process may take as little as two seconds.

The merchant, of course, still needs to be paid. He transmits the request for payment to Bank B. That request goes through the same channels as the authorization request. The cardholder's bank pays the merchant's bank, which then pays the merchant. At that point, it is up to the cardholder's bank to collect the amount due from the cardholder.

The banks make money from this process through the "merchant discount" they charge. This is often around 2 percent. In the case of Visa, for example, 1.4 percent goes to the card issuer. This is called an "interchange fee" and is set by Visa. The remainder, 0.6 percent, goes to the merchant's bank.

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When Things Go Wrong: The Government Solution

What if Jones's camera is something other than advertised? What if he was promised one kind of lens and got a different, inferior one, or the camera just doesn't work? Because of the free market's incentive to satisfy customers, most stores would allow Jones to make an exchange or get his money back. But surely there are some disreputable merchants who would not do this for Jones, since they are out to make a quick buck with no concern for their long-term reputations. Thus sometimes a consumer must appeal to a third party for redress.

If Jones had paid cash for the camera, his only recourse would be to go to a government court, probably his local small-claims court. Filing a lawsuit, even in a small-claims court, is costly, cumbersome, and time-consuming. In most jurisdictions, one must pay a fee just to file a suit. To have a reasonable chance of success, a defrauded consumer probably would need to hire a lawyer. If the seller he is suing is large and sophisticated, it might have superior lawyers who are experienced in fighting consumer lawsuits, perhaps often killing them quickly through procedural maneuvers and the like. Alternatively, the merchant might not show up to defend himself against small claims and the plaintiff would win. But then he would have to collect a judgment, which might be difficult to impossible. A large percentage of small-claims-court judgments are never collected at all, perhaps because the defendant is insolvent or located prohibitively far away, making the lawsuit a waste of the plaintiff's time and effort, as well as a waste of taxpayer dollars.

The cash-paying customer with a complaint may also have problems with evidence. What if he has lost his receipt? The case might come down to his word against the seller's.

The customer who pays with cash or a money order is in even worse shape if he buys something from someone located in another country. If a customer located in the United States sues a foreign merchant in an American court, it may not have jurisdiction or the ability to enforce a judgment against the seller even if the customer wins.

If the customer tries to sue in the foreign country, he will almost certainly have to be present there and will have to hire a foreign lawyer. Even if this were not a major obstacle, the foreign country's legal system might be significantly less accessible than that of the United States, even for locals, especially in developing countries. Then, of course, there are the further potential difficulties of language barriers and court bias against foreign parties, among other things. As a result, the high costs make almost any consumer-fraud lawsuit across international borders prohibitively expensive.

Chargebacks: The Private Alternative

So government does provide consumers with nominal, if often useless, opportunities to pursue redress. On the other hand, credit-card companies know that no one wants to go to small-claims court. More important, they know that the presence of their logos on merchants' doors and in advertisements is interpreted as a seal of approval, even if not intended as such. It is not good for Visa and the other brands to appear to be associated with crooks or anything else unpleasant to consumers.

Thus the card companies have created their own system for pleasing consumers who have problems with credit transactions. This is called the chargeback. Under the card companies' chargeback procedures, a consumer can inform his card issuer of his dispute and the issuer will then help him settle things.

To begin chargeback proceedings, a cardholder files a complaint for free, using a form provided by the card company. (It is often included on the back of each month's billing statement.) On receiving the complaint, the card company may ask the cardholder for documentation to support his claim. If he appears to have a legitimate grievance, the bank will then initiate a chargeback against the merchant's bank—that is, the cardholder's bank will take the money back from the merchant's bank. The merchant's bank has no choice but to allow this because each bank in each card system has contractually agreed to these recourse procedures.

The merchant will then be given an opportunity to produce evidence on his behalf. If his bank believes the transaction was valid, it will initiate a chargeback against the cardholder's bank—that is, it will take the money back from the cardholder's bank. If the dispute continues and cannot be resolved between the two banks, it will be arbitrated by the credit-card organization.

Are chargebacks better for consumers than the government's dispute-resolution system? There is no guarantee that any system of justice will reach the correct result. But consider the following advantages of the private system.

Under the chargeback regime, the procedure for the aggrieved consumer is much simpler and better. When a consumer wants to file a complaint, his card issuer is available to assist him by phone, usually toll-free, 24 hours a day, 365 days a year. Once he files his complaint, he does not need to hire a lawyer—his bank uses its own resources to go to bat for him and puts him on an equal footing with the merchant, regardless of how wealthy or powerful the merchant is.

The bank will be able to reach and process chargebacks against any of its merchants anywhere in the world—except in a few countries, such as France, whose governments have abolished chargebacks by law to protect merchants.

Given these advantages, and the disadvantages of the government system, what credit-card holder wouldn't prefer the nongovernmental alternative?

This goes to show that the common belief that only government can provide justice in consumer-fraud cases is false. Indeed, as we have seen, government is an inferior provider of justice in this realm.

> Credit-card companies have created their own system for pleasing consumers who have problems with transactions involving credit cards. This is called the *chargeback*.

Subject to Court Review?

It might be argued that the relationships among the banks, merchants, and cardholders are governed by contracts, and those contracts, even if they contain private-arbitration clauses, are ultimately subject to review in government courts. That is true, but not really important.

What primarily holds these arrangements together is not the threat of government intervention but the desire of all involved to do business with one another. Cardholders want to pay with plastic, and merchants want to accept it. Thus both cardholders and merchants agree to the terms set forth by their banks and the card associations. This would not change even if government stayed out of disputes; that is, if a card association could not rely on government to enforce a member bank's agreement to comply with chargeback procedures, that would not spell the end of credit cards or doom the chargeback process.

To minimize risks of noncompliance in the absence of government enforcement, the parties involved might have to spend more to acquire knowledge about the trustworthiness of their contracting partners. For example, more resources might have to be used to investigate merchants before allowing them to accept credit cards. A well-developed credit-bureau system would be ready to assist.

Under such circumstances the banks would have the right incentives to spend the optimal amount of resources to determine who will keep their promises. This is in contrast with government, which has no incentive to spend an optimal amount—even if it could determine that amount—in resolving contract cases when things go wrong.

Today over 18 million merchants accept Visa, and MasterCard runs a close second. In the United States, credit-card acceptance in certain market segments, such as department stores, supermarkets, and gas stations, is nearly universal. On the Internet, of course, it is by far the most commonly used form of payment.

Technology has opened up countless new opportunities for trade for individuals in every part of the world. The credit-card chargeback regime advances those prospects by letting consumers know that they will have an opportunity for redress if they are wronged, and that they will not be forced to rely on outdated, inefficient, ineffective, and costly government courts.

Economic Freedom: The Path to Development

BY GERALD P. O'DRISCOLL, JR.

Economic development has historically been exceptional rather than typical. As Peruvian economist Hernando de Soto has observed in *The Mystery of Capital: Why Capitalism Triumphs in the West and Fails Everywhere Else*, capitalism has been successful mainly in the West. Consequently, there are tremendous income disparities around the world. In 2000, real income per person in Luxembourg was over $50,000; by contrast, it was under $500 in Sierra Leone. That is a difference of over 100 times.[1]

There is a long tradition in law, economics, and politics focusing on critical institutions as the source of development. Notable among these institutions are private property, the rule of law, and a stable monetary system. Together they undergird a market economy. In recent years, abundant empirical evidence has accumulated supporting the case for the free market as the path to development.

While supporters of a market economy have largely won the war of ideas, they have been less successful in winning the battle over public policy. Even in developed countries, which owe their material success to economic freedom, the market is under constant political attack. In the many undeveloped economies, the situation is far worse.

What are the incentives for political leaders to adopt good economic policies? And why has that occurred in only a few countries? To answer these questions, one must look at what motivates political leaders.

All political leaders need legitimacy to continue to govern. In democracies, that legitimacy is subject to periodic tests called elections. Between the political cataclysms of elections, politicians daily seek out support to advance their political agenda. Legitimacy is tested in a government's every political battle.

When leaders of democratic governments lose legitimacy, those governments fall. Witness Argentina. Twice in recent history, an Argentine president has left office before his term expired because he had lost political legitimacy. Recall the experience of President Nixon, who resigned his office when he lost political legitimacy.

By contrast, a leader can do unpopular things if his legitimacy is accepted. Prime Minister Tony Blair led his country into an unpopular war. His Spanish counterpart, José María Aznar, did the same against even greater opposition. Aznar's party eventually lost power, but only after a miscalculation by Aznar over the identity of the perpetrators of a horrific terrorist act on March 11, 2004.

As the examples illustrate, it matters little whether the form of democratic government is parliamentary or presidential. Loss of political legitimacy is a democratic government's downfall.

Authoritarian governments lack the many sources of political feedback that are a hallmark of democracy. Thus systemically bad economic policies can endure in such countries. North Korea is a prime example. As authoritarian and totalitarian as that regime may be, however, it must keep its legitimacy to govern. There are signs that its legitimacy has been undermined and the political leadership is changing its economic policy as a consequence.[2]

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Even the most cynical observer must accept that political leaders take account of the most important desires of the citizens. One need not ascribe benevolence to politicians, only a desire to stay in office. Citizens of all countries not only want to avoid starvation; they want to enjoy a higher standard of living for themselves and their children. In short, they want to prosper.

Whether governments care about economic freedom depends on how widespread is an understanding of the connection between that freedom and prosperity. The evidence is that empirical measures of economic freedom have broadened and deepened that understanding among leaders and ordinary people alike.

Economic and Political Freedom

Milton Friedman's analysis of the relationship between economic and political freedom, his book *Capitalism and Freedom*, was the inspiration for the empirical measures of economic freedom. He debunked the myth that the two freedoms are disconnected; that, Chinese menu-style, one can choose freely from political systems and then pair that choice with an economic system. He went so far as to say that "a society which is socialist cannot also be democratic, in the sense of guaranteeing individual freedom."

Friedman reversed the priority customarily accorded to political freedom, describing economic freedom as "an indispensable means toward the achievement of political freedom." He argued that societies could be economically free but not politically free. There is at least the appearance of a contradiction in Friedman's argument. On the one hand, he asserts that you cannot pick and choose among freedoms. On the other hand, he suggests that you may be able to do so to a limited extent. Societies can possess economic freedom without political freedom (but not the other way around). Yet in the end, economic freedom will lead to political freedom, although political freedom will not necessarily lead to economic freedom.

Controversial when made, the argument became more so when economic reforms in Chile were introduced under the authoritarian government of General Pinochet. Today we have other examples of economic freedom advancing more quickly than political freedom, China being the most notable case.

When Friedman wrote *Capitalism and Freedom*, "economic freedom" was a scarcely used phrase, much less understood. It needed definition. And it needed to be measured if there were to be widespread acceptance of its importance for economic development. Hence, two indexes of economic freedom were born, from the Heritage Foundation/*Wall Street Journal* and Fraser Institute.[3]

> There is a long tradition in law, economics, and politics focusing on critical institutions as the source of development. Notable among these institutions are private property, the rule of law, and a stable monetary system.

Economic freedom is "*the absence of government coercion or constraint on the production, distribution, or consumption of goods and services beyond the extent necessary for citizens to protect and maintain liberty itself.*"[4] The definition is inherently Lockean in conception. Accordingly, it echoes the truth set down in the most important American political document, the Declaration of Independence: "that all men are created equal, that they are endowed by their Creator with certain unalienable Rights, that among these are Life, Liberty, and the Pursuit of Happiness—That to secure these Rights, Governments are instituted among Men, deriving their just Powers from the Consent of the Governed."

Economic freedom cannot be directly measured. But its institutional determinants are susceptible to measurement. These are the institutions that guarantee "personal choice, voluntary exchange, freedom to compete, and protection of person and property."[5] Foremost among these is private property.

The great English jurist William Blackstone defined property as "that despotic dominion that one man claims and exercises over the external things of the world, in total exclusion of the right of any other individual in the universe."[6] That stark formulation emphasized an important element of property ownership—the ability to exclude other users and uses.

Only with a protected domain of choice can a property owner appropriate all the benefits and incur all the costs of his decisions to allocate his property to different uses. That weighing of costs and benefits ensures that maximum value accrues from the use of property. It is only through the protected domain of private property and the calculus of decision-making that claims can be sustained about the efficiency of a market economy.

Economic freedom cannot be directly measured. But its institutional determinants are susceptible to measurement.

Along with Ronald Coase and Harold Demsetz, Armen Alchian is the founder of the modern property-rights school of economics. He formulated the scope of property rights as follows:

> By a system of property rights I mean a method of assigning to particular individuals the "authority" to select, for specific goods, any use from a nonprohibited class of uses. . . . [T]he concepts of "authority" and "nonprohibited" rely on some concept of enforcement or inducement to respect the assignment and scope of prohibited choice. A property right for me means some protection against other people's choosing against my will one of the uses of resources said to be "mine."[7]

Enforcement and Transferability

In addition to exclusivity, there must be enforcement and transferability of property rights. Without protection and enforcement of private property rights, the right would be nugatory. Transferability enables an owner to produce and exchange on the market, and to capture the full value of his property.

These elements enable individuals to choose and act, and to engage in voluntary exchange. It is out of that human choice and human action that competition arises. "Competition" is a term of art in economics. A competitive system is one in which producers strive to satisfy consumers at the lowest cost. It is a system in which anonymous individuals cooperate through the market, each to achieve his own goals.

The stronger the protection of private property, the more will individual choice guide economic decisions. These choices will respond to market prices; it is prices that guide decision-making. They communicate information to producers about the intensity of consumer preferences and the relative scarcity of resources needed to satisfy those wants.

Private property ensures that producers can appropriate the returns from efficient use of resources to satisfy consumers. That expectation provides the incentive for individuals to invest their assets productively in the service of consumers they may never know. The stronger the protection of private property, the more effective an economy will be in creating wealth.

Richard Pipes, the distinguished historian of Russia, argues in *Property and Freedom* that property is the source of liberty: "While property in some form is possible without liberty, the contrary is inconceivable." Property is the source of the legal and political institutions guaranteeing liberty. As such, property is the bedrock of a free society.

Pipes's view reverses the normal analysis in which the rule of law and political liberty are the preconditions for the emergence of private property. His view, however, better explains the history of liberty. Property took the form of possession long before there was legal recognition of such claims, much less formal legal title. "Prolonged tenure" was the source of such claims, which "custom" recognized.

A system of law recognizing property in land, titling it, and governing its transfer comes only after possession and prolonged use. For Pipes, the fact of inherited property is the source of a law of inheritance, not the other way around.

Pipes's historical treatment is consistent with de Soto's analysis of possession as the basis for titling land. De Soto has identified the absence of a system of legal titling of property as the source of *un*development. He contends that "the only way to find the extralegal social contract on property in a particular area is by contacting those who live and work by it."

Pipes's position is somewhat different from Friedman's. In *Capitalism and Freedom*, Friedman acknowledged that the relationship between economic and political freedom "is complex and by no means unilateral." He supports the priority of economic freedom, however.

By contrast, Pipes argues that *property rights are the source of both economic and political freedom.*

I am not suggesting a great chasm on the issue. Pipes's view focuses our attention, however, on one key institution as the source of both economic and political liberty: property rights. If he is correct, then the debate over economic and political freedom has been misguided. Neither is prior to the other. Instead, each is a consequence of a third factor, private property. Property is the source of all liberty.

Richard Pipes, the distinguished historian of Russia, argues in *Property and Freedom* that property is the source of liberty.

The Scope of Private Property

While there are multiple factors, or variables, used in both the Heritage and Fraser indexes, a number of them are really measuring aspects of property rights. For instance, when government regulates economic activity it attenuates property rights. It does so by putting conditions on the use of property over and above those imposed by the abstract rules of the law of property.

Economists have long understood how economic regulation can hobble market activity. That insight has been confirmed on a global scale by a surprising source: the World Bank. In its second annual report on regulation, *Doing Business in 2005*, it measures the regulatory burden in 145 countries. Using seven measures of the ease with which a business can be started, gain credit, expand and hire labor, and contract and discharge labor, the Bank finds that the regulatory burden is negatively associated with prosperity in individual countries.

Inflation erodes the value of private property and effects nonmarket transfers of wealth among creditors and debtors. Inflation also interferes with market pricing by distorting relative prices and resource allocation. Consequently, inflation undermines the system of property rights.

Restrictions on trade and capital flows interfere with the rights of property owners. What is called "foreign" trade and investment are just transactions between contracting individuals. They are not transactions between nations. When governments inhibit these transactions, they attenuate private property rights of their own citizens.

Measures of the degree of black-market activity and corruption—the two being highly correlated—actually measure the consequences of other market interventions. If individuals are prohibited from engaging in mutually beneficial exchange, they will seek to circumvent the prohibitions. That may lead to extralegal market transactions and payments to officials to overlook the prohibited activity. Yet corruption introduces its own problems, in addition to those resulting directly from the interference with property rights.

Corruption is an effect of interference with property rights. But it attenuates property rights further by making them insecure. In corrupt societies the rule of men is substituted for the rule of law. The ability to conduct business is governed not by rules, but bureaucratic whim.

Of course, eliminating the attenuation of property rights would go a long way to rooting corruption out of a society. As a practical matter, that is easier said than done. The conceptual point, however, is that even when there appear to be other determinants of liberty, they are either aspects of, or intertwined with, property rights.

Economic Freedom: The Record

Economic freedom has increased every year since the first Heritage *Index* was published in 1995.

The Fraser report goes back to 1970. According to that measure, economic freedom declined in the 1970s, reached its nadir in 1980, and has been increasing ever since.

Economic freedom improved despite any number of regional economic crises and upheavals in individual countries. There was the Mexican peso crisis of 1994–95, the Asian financial crisis of 1997–98, the Russian debt debacle of 1998, and more recently, the return of left populism in Latin America.

There are two striking features of the most highly rated countries. All have strong protection of private property. And nearly all are seafaring nations with a long history of international trade.

Trade is important because it opens countries up not only to goods, but also ideas, including political ideas, and institutions, including the rule of law. As countries become more commercially driven and outwardly oriented, they evolve strong commercial codes. Sometimes the legal codes are imported, as when Dutch-Roman law became the basis for Scottish law.

There are two notable groupings of such highly rated countries with a common history. First are Great Britain and its former colonies. Britain and five of its former colonies occupied six of the top ten positions in the Heritage 2004 *Index*. The former colonies are Hong Kong, Singapore, New Zealand, Ireland, and the United States. And Australia fell next at number 11. (In the 2005 *Index* the United States dropped to number 12.)

The second grouping consists of the Nordic countries: Estonia, Denmark, Sweden, and Iceland. (Estonia is typically listed as a Baltic country, which it clearly is. But in temperament, history, culture, and language, it is also a Nordic country. Ask an Estonian.) The Netherlands also fits the overall theme of strong property rights and a history of openness to trade. The Nordic countries also share a common history of alliance with the Hanseatic League.

Economists have long understood how economic regulation can hobble market activity. That insight has been confirmed on a global scale by a surprising source: the World Bank.

The good showing of many member states of the European Union puts the lie to the contention that Europe is a monolith. Brussels's bureaucrats may very well wish that every policy were centralized. But their pleadings for tax harmonization and centralization only prove that economic policies remain diverse within the Union.

Some governments use Brussels as an excuse to implement bad policies. Others, such as Ireland and Denmark, persist in asserting their sovereignty against *diktats* from Brussels. Ireland is a low-tax country for business; Luxembourg remains a tax haven for financial capital; and Britain, Denmark, and Sweden retain their monetary sovereignty. (Europe's political leaders are generally rhetorically anti-Thatcherite, but often practically Thatcherite in their policies.[8])

One can go on with the theme of trade and property. Bahrain is a bright spot in the Middle East. It has a seafaring history and strongly protects property rights. Chile, the freest economy in Latin America, is a trading nation that has strong protection of private property. And Chile pioneered the privatization of social security.

There are no counterexamples to this theme until the Bahamas. A former British colony that still strongly protects property rights, the Bahamas is highly protectionist. As with a number of Caribbean nations, it finances government spending with tariffs.

Needless to say, countries at the bottom of the rankings have weak property-rights systems and are protectionist. While Asia has four of the freest economies in the world, it also has the largest number—six—of repressed economies: Tajikistan, Uzbekistan, Turkmenistan, Burma (Myanmar), and North Korea.

With this overview in mind, I now turn to the central question of the article. Do governments care about economic freedom and have the economic indexes had an impact?

How Governments Respond

The difference between poverty and prosperity is freedom. How well do governments understand that connection? Surely, the answer is that it varies. That variation helps explain why some governments put in place policies promoting prosperity, while others promote penury.

Understanding is not enough. Politics play a role. Frequently, leaders understand that free markets and open economies underpin economic growth. But they face political hurdles erected by rent-seeking beneficiaries of an interventionist system.

The political leaders of Estonia grasped the connection and overcame the political opposition.[9] That country and its economy suffered under 50 years of Soviet occupation, and the economy was a "shambles," according to Mart Laar, the prime minister who led a successful government of reform. The reformers understood the importance of the rule of law: "There can be no market economy and democracy without law, clear property rights, and a functioning justice system."

The Estonian reformers stuck with their plan even when the going got tough:

- All tariffs were abolished, forcing domestic producers to compete on the world market.
- All subsidies to enterprises were ended.
- A flat personal income tax was introduced. The tax on corporate income was abolished for reinvested profits.

The term "shock therapy" has been used to describe the transition in some countries. If Poland employed shock therapy, then Estonia employed electrocution for the old economic regime. The reformers introduced so many changes so fast that their opponents had no time to regroup. There is a lesson there for other reformers. Gradualism can become a death sentence for economic reform.

In western Europe, Ireland is a standout for its economic reforms. In the 1970s it was an economic basket case. Human capital was a major export—people emigrated. Ireland underwent a series of reforms, including tax reform and deregulation. The "Celtic Tiger" has experienced a return of its diaspora, and now imports labor from all over the EU and the rest of Europe.

When he became prime minister of Great Britain, Tony Blair made a decision not to undo the main features of Thatcherism but to tinker at the edges. It is unlikely, however, that Britain's freedom rankings played a role in that calculus. Nonetheless, at some level the Blair government understands that free markets deliver the goods to its constituents.

The most notable successes chronicled in both indexes have been Hong Kong and Singapore, ranking in the top two positions. They are two open economies, virtual free ports. Each has strong protection of property rights and takes a light regulatory touch with business. Neither is a Western-style democracy, though elections are held in each city-state.

There has been intense rivalry between Hong Kong and Singapore for top position not only in the Heritage and Fraser rankings, but also in other measures of economic success. The Hong Kong government has always been jealous of its rankings. Both governments vigorously defend policies when criticized.

Hong Kong in particular has shown a willingness, however, to moderate or even reverse policy if its preeminent position as a free economy is threatened. The most notable example of this flexibility involved the company shares purchased by the government on the open market in August 1998 to support the Hong Kong dollar. In June 1999, under intense criticism from the Heritage Foundation and others, the government announced it would place the shares in a "Tracker Fund" and sell most of them off.

Receptive to Criticism

For many years, Singapore dismissed outside criticism of its policies. In recent years, however, the government has become more receptive to criticism and even solicits it. Whether in response to that criticism or for its own domestic reasons, the government is lowering marginal tax rates. The cuts will be phased in over three years. Whether by accident or design, the cut in the first year was just sufficient to improve its freedom score in the Heritage rankings.

The Hong Kong and Singapore stories show the difficulty of identifying whether there is a feedback loop from freedom ranking to policy. Domestic political forces can push in the same direction as advice from U.S. think tanks. In the case of Hong Kong, outside criticism—especially from the Heritage Foundation, which has a Hong Kong presence—gets magnified in the local press and is soon echoed in local criticism.

Throughout east Asia, excluding Japan, the freedom rankings receive great attention in the local press. Governments must respond to what then becomes domestic opposition to policies. That is true even in a developed country like Australia. (I was in Australia for a release of the 2001 Heritage *Index*. There was a raucous debate in the Senate over whether the Liberal government or the Labor opposition deserved the most credit for the nearly 20 years of successful economic reform in the country. We were as warmly received by the Laborites as by the Liberals. In reality, both political parties deserve credit, as each recognized in private.)

There are two striking features of the most highly rated countries. All have strong protection of private property. And nearly all are seafaring nations with a long history of international trade.

New Zealand, one of the most open economies in the world, is an interesting case study. Free trade is supported strongly by the Labor party. Mike Moore, formerly the head of the World Trade Organization, is an old Labor Party politician. A firebrand, he can talk of manning the barricades in defense of free trade against the antiglobalists. "Free trade is the best hope of the worst off," he says.[10]

The Kiwis were proud of their 2004 third-place ranking in the Heritage *Index*. In New Zealand's case, however, no outside criticism is needed to keep the country on its free-trade path. Were it not for its large government sector and tax burden, along with intrusive environmental regulations, it could be the freest economy in the world.

In recent years, some governments produced elaborate reports to try to influence their rankings in the Heritage *Index*. One country even graded itself using the Heritage methods and format. It was accurate and quite a good job. Heritage staff did its own assessment, however.

In Asia, especially, a good case can be made that the freedom rankings have influenced public policy. That influence varies by country and is not significant in Japan.

Latin America

The Heritage *Index* has been taken note of in parts of Latin America since it began its Spanish-language edition in 2001. In late 2000 we visited with Chile's vice president, a member of the social democratic ruling party, who greeted us warmly. He clearly had read that year's report on Chile and absorbed it, including its critical elements. He repeated our argument about not slackening in the reform process. Later that week he gave a speech to a business group repeating that message. The *Index* certainly reinforced his better instincts on economic issues.

In Latin American countries the message of economic freedom is conveyed to the local population through the press and public events. It is not received equally well in every country. In a country like Chile the message can be accepted as reinforcing what is long-standing public policy. Surprisingly, some of the largest turnouts and most favorable receptions have been in Venezuela. The people of that country hunger for freedom.

Finally, if it need be said, countries not doing well in the rankings frequently complain. Those countries are typically more interested in improving their rankings than their policies. That they complain suggests that outside criticism matters to them. This category includes the government of one country on the State Department's list of state sponsors of terrorism.

The freedom rankings of both Heritage and Fraser can play a useful role in reinforcing good policies in countries committed to them. And they can occasionally help turn back bad policies. Not much can be done in a country with a political culture inimical to freedom. Even then, as with Venezuela, ordinary people can be reached by the message. There is no way to tell in the long run how that influence might be felt. We have witnessed the long-run influence of liberal ideas in countries in central and eastern Europe living under communist-party rule.

Governments care because they need to be re-elected and, ultimately, require legitimacy. At every stage, a government wishing to promote economic freedom will face opposition from entrenched interests. That some governments are able to overcome such opposition confirms that leadership matters in public policy.

The connection between government policy and a ranking in the freedom reports can become fairly indirect. Even in the case of North Korea, the most closed economy in the world, leaders must eventually respond when bad policies produce repeated catastrophes.

The Heritage and Fraser efforts can best be viewed as spotlights casting their beams on the dark corners of policy, bringing transparency and political accountability where they are lacking. And they brilliantly illuminate the policy successes in the world. That seems to be impact enough.

1. For more comparisons and sources, see Gerald P. O'Driscoll, Jr., and Lee Hoskins, "Property Rights: Key to Economic Development," Cato Institute Policy Analysis No. 482, August 7, 2003, pp. 2–3.

2. Gordon Fairclough, "North Korea Allows Markets to Grow, Eases Central Control," *Wall Street Journal*, June 20, 2003.

3. James Gwartney and Robert Lawson, *Economic Freedom of the World: 2004 Annual Report* (Vancouver, B.C.: Fraser Institute, 2004); and Marc A. Miles, Edwin J. Feulner, and Mary Anastasia O'Grady, *2004 Index of Economic Freedom* (Washington, D.C.: Heritage Foundation and Dow Jones & Company, Inc., 2004).

4. Miles, et al., p. 50. Italics in the original.

5. Gwartney and Lawson, p. 5.

6. William Blackstone in *Ehrlich's Blackstone*, ed. J. W. Ehrlich (San Carlos, Calif.: Nourse Publishing Co., 1959), p. 113.

7. Armen A. Alchian, *Economic Forces at Work* (Indianapolis: Liberty Press, 1977), p. 130.

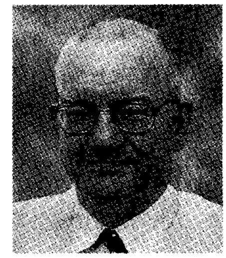
8. See Gerald P. O'Driscoll, Jr., and Sara J. Fitzgerald, "Thatcherism Triumphant? The New Business Climate in Europe," *In the National Interest*, February 26, 2003, www.inthenationalinterest.com/Articles/Vol2Issue8/vol2issue8Odriscollfitzgerald.html.

9. Mart Laar, "How Estonia Did It," in Gerald P. O'Driscoll, Jr., Edwin J. Feulner, and Mary Anastasia O'Grady, *2003 Index of Economic Freedom* (Washington, D.C. Heritage Foundation and Dow Jones & Company, Inc., 2003), pp. 35–37.

10. Quoted in "Moore's Code," *New Zealand Herald*, August 31, 2002.

The Business Revolution of the Nineteenth Century

BY STEPHEN DAVIES



The business corporation is one of the most maligned and disliked institutions of our time. The criticism comes from many parts of the political spectrum, and its substance has become a common-sense assumption for many. As ever, much of this criticism lacks historical perspective, despite the inclusion of historical accounts of the growth of large corporations. Quite simply, the large corporate business enterprise is perhaps the key institution of the modern world. As much as anything else, the invention of this form of organization created the world we live in and transformed the conditions of life for millions of people, much for the better.

The reason the corporation is of such profound importance is that it has transformed the nature of economic growth. Historically, economic growth has been slow and patchy. Most has been what economic historians call "extensive" growth. This happens when an increase in the factors of production leads to an increase in output. So getting more production from more people or from making use of a larger amount of land is extensive growth.

But this is not the same as a growth in productivity and so may not lead to higher living standards. Less historically common, but more significant, is "intensive" growth. The main feature here is doing more with less, that is, using resources and labor more productively. It is this that leads to a real increase in output per capita and hence to a rise in living standards.

For most of human history the main source of intensive growth has been the specialization brought about by trade. Economic historians have come to call this Smithian growth, after Adam Smith. Historically, Smithian growth, even when it was sustained over a long period, as in eighteenth-century Europe or thirteenth-century China, did not exceed an average of 1 percent a year compounded. So although significant over the long term, it was slow and its effects only became apparent over an entire lifetime or even longer. Moreover, growth was always associated with technological innovation, which was uneven, unsystematic, and most important, slow to spread.

However, from about the middle of the nineteenth century the whole nature of economic growth changed. Suddenly the compound rate of growth went up to 2 percent a year or more. At the same time technological innovation became systematic and rapid, with the gap between invention and application shrinking dramatically. The geographical diffusion of such innovations also became much swifter. Economic historians use the term "Promethean" for this kind of growth. The results were dramatic. As John Maynard Keynes noted, for a very large part of the world's population the 50 years between 1850 and 1900 saw a bigger rise in average living standards than the previous 500. This dramatic acceleration had a number of causes, but the change in business organization was the immediate one.

Firms have been a feature of commerce and manufacturing from the very earliest times. At one time this was a puzzle for economists, since theory predicted that a market economy should consist of many small enterprises, coordinated by contracts and trade. Ronald Coase was able to show that the critical variable was the level of transaction costs—the costs of finding the other party to a transaction, making and enforcing the contract, and so forth. Transactions costs are analogous to friction in physics. If transactions costs are sufficiently high, it will be more efficient to coordinate many actions by other than market means. Hence the creation of firms. They coordinate the work and exchange of a number of people by nonmarket means, but are themselves embedded in a market, or exchange-based, system.

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Until the nineteenth century there were broadly two kinds of firms recognized in most of the world's legal systems. One had limited liability, ensuring that investors were liable only for their invested capital, but a limited lifespan. The other had perpetual succession, that is, an indefinite lifespan, but the owners had full liability for all the firm's debts. The only real exceptions were large trading companies chartered by states.

Moreover, most firms were unitary enterprises. They had only a rudimentary management hierarchy, and all activity was carried out in one single department with the owners managing the business. This was particularly the case in manufacturing. The great majority of firms were households or extended households and were owned and operated by families or coalitions of families. They raised most of their capital (or stock, as it was called) themselves, although there was an increasingly active market for trading stock from the mid-seventeenth century onward.

After about 1820 this way of organizing economic activity became less useful and governments increasingly granted special privileges to corporate businesses providing such services as canals; utilities, such as water and gas; and railroads. Legislatures did so because such enterprises required large amounts of capital and returns were long in coming.

Then, in the 1850s and 1860s, the whole structure of business was transformed. The change had two elements. The first was a set of legal changes that collectively created the modern limited-liability joint-stock company as a legal institution. In the United States this was largely done by a series of court decisions. Elsewhere it was brought about by legislation, the British Companies Act of 1855 being the model. The new laws made incorporation easy and cheap. An expensive and complex grant from the legislature was no longer needed. Moreover, limited liability was combined with perpetual succession.

Management and Complex Organization

The other crucial change was the creation of management as an occupation and the emergence of wide-ranging firms divided into departments coordinated by senior management. Together with the legal changes, this made possible truly big firms employing many thousands of people over a wide geographical area and in many different activities. Although there had been large trading firms before, they had not generally employed large numbers of people directly; they relied instead on contracts.

This change also separated ownership and investment from control, with businesses no longer run by their owners, but by professional managers organized in a hierarchy. The second half of the nineteenth century saw the appearance of large multidivisional firms in one area after another, starting with railroads but soon spreading to both manufacturing and retailing. This revolution took place initially in the United States and Germany.

Its effects were dramatic. Investment larger than anything possible before could now be undertaken. This led to dramatic economies of scale and increases in efficiency. It brought a great increase in the productivity of unskilled labor and a sharp rise in the real wages of unskilled and semiskilled labor. Most significant in many ways was the impact on technological innovation, with the new businesses deliberately undertaking research and applying its findings. In general, what the new business organization did was to increase productivity, lower costs (and real prices), raise all forms of income, and introduce a whole range of technological innovations and new products. There had been earlier intimations of this in areas such as iron and textiles, but it was this "Second Industrial Revolution," more widespread and general in its effects, that truly created the modern world. The era from 1870 to 1914 has gone down as the "Belle Epoque," an age of optimism, dynamism, and progress.

The great businessmen, entrepreneurs, and managers who brought about this revolution had little thanks, however. Despite the fastest and most widespread growth in human history, business people were cast as "robber barons," exploiters of the poor, and parasites on the social body.

Yet as the greatest of business historians, Alfred D. Chandler, has observed, it is business that has made our world and transformed the prospects of ordinary people.

Capital Letters

Was There Money in the Original "Star Trek"?

To the Editor:

In the December 2004 issue of *The Freeman*, P. Gardner Goldsmith criticizes "Star Trek" for foolishly postulating that we could do without money. He presents us with an argument of the following structure: X is stupid; someone told him that "Star Trek" creator Gene Roddenberry said X; therefore Roddenberry was foolish for having said X. That's why the legal system has a rule against hearsay! To be sure, the various "Star Trek" spinoff series were the work of "politically correct" types who may well have envisioned the abolition of money, but in the old original show, there most definitely is money, and indeed evidence of capitalism and the profit motive. For the record, the episodes "Mudd's Women," "The Trouble With Tribbles," "The Devil in the Dark," "The Enterprise Incident," "Let That Be Your Last Battlefield," and "Errand of Mercy" all include either explicit use of money or references to private property and capital exchange, and that's just off the top of my (admittedly fannish) head. The author's economic argument is correct—I agree it's a mistake to think society doesn't need money or property rights—but his unwarranted abuse of "Star Trek" doesn't help make the case. Perhaps he should have directed his ire at the more overtly socialist spinoff shows.

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Gardner Goldsmith replies:

It is true that in the original series, money was used in certain scenes. The episodes "Mudd's Women" and "The Trouble With Tribbles" are excellent examples. However, in writing my article, I recited nearly verbatim what the co-executive producer of "Voyager" told me. This producer had worked with Gene Roddenberry and explained to me that before he passed away, he had explicitly stipulated that there was to be no money in the Federation. There has been money shown in non-Federation societies and even in scenes where Federation members interacted with alien races, such as the space station in "The Trouble With Tribbles." But I can tell you with complete confidence that Roddenberry worked on the planning for three of the four "Trek" spinoffs and this policy was strictly his. It was not concocted by so-called politically correct producers under his watch who eventually took over the franchise (all terrific people, by the way). I must admit, given the manner in which things such as the fictional "Prime Directive" of the Federation have been disregarded in the four series, it is easy to find examples of where Roddenberry's orders were broken, but I am relating what other producers, who worked closely with Roddenberry on developing his shows, told me. They respected him, as did I, and they would not lie about his plans. The inventiveness of scriptwriters was often utilized to skirt hurdles presented by the institutional structure of "Star Trek," and I suspect that in the original series, Roddenberry did not hold firm to his rules. However, the later producers did, and I do not believe they held to the "no money" policy because of a devotion to postmodern, anti-capitalist sentiment. They suffered limitless headaches because they tried so hard to stick with Roddenberry's plan, and I think they knew it was unworkable for a real society.

We will print the most interesting and provocative letters we receive regarding articles in *The Freeman* and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations.

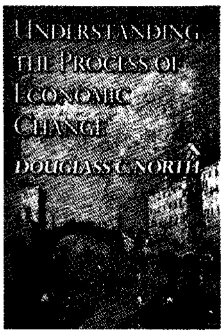
Address your letters to: *The Freeman*, FEE, 30 S. Broadway, Irvington-on-Hudson, NY 10533; e-mail: freeman@fee.org; fax: 914-591-8910.

Book Reviews

Understanding the Process of Economic Change

by Douglass C. North
Princeton University Press • 2005 • 187 pages • $29.95

Reviewed by Richard M. Ebeling



In the late 1980s, as the Soviet empire began to collapse in central Europe, a burning policy issue emerged: how to transform socialist economies into functioning market-oriented societies. As this discussion developed, it was astounding to discover how little the economics profession was able to contribute. For example, at an annual meeting of the American Economic Association, a number of prominent economists admitted they had no idea how to create the institutional order needed to establish a market economy.

In the first half of the twentieth century, a growing number of economists became increasingly interested in trying to make economics "rigorously scientific." In their eyes this required quantitative model-building, in which men and their actions were reduced to "dependent variables" in a series of mathematical equations. The individual became a mere passive "reactor" to various "constraints" in the arena of exchange. The surrounding political, legal, and economic institutions were simply the analytical "background" for people's constraint-determining choices. How these institutions emerge and evolve, and how men's ideas and actions might influence and change these institutions over time, were almost never discussed.

Over the last 30 years, however, there has slowly developed a field called the New Institutional Economics, which focuses precisely on the interaction between man and social institutions. One of the path-breaking contributors in this field has been Douglass C. North, the 1993 recipient of the Nobel Prize in economics for his writings on American and European economic history. In his recent book, *Understanding the Process of Economic Change*, North explains the importance of institutions for improving the human condition, and the difficulties in developing theories and policies for bettering society.

North's starting point is to emphasize the inherent uncertainty and unpredictability of the world in which man lives, a condition that precludes the application of the type of static and deterministic mathematical models that dominate most economics textbooks. The "scientific method" has worked wonders in enabling man to master the laws of the physical world, but it has inherent shortcomings when applied indiscriminately to the human condition.

Man possesses qualities that are uniquely distinct from the objects of study in physics and chemistry: intentionality and creativity. Man thinks, imagines, and plans. This introduces an element of unpredictability not present in the study of inanimate nature. Nor is human action open to stable statistical probability.

Adapting some themes from cognitive psychology, North argues that man is less a logical problem-solver and more a reasoning pattern-discoverer. In other words, the human mind seems to have evolved in such a way that it looks for order and relationships among things and events, even when they may not be there. As a result, man mentally searches for patterns and relationships in the world in order to attain both intelligibility and a degree of predictable certainty.

This is the origin of man's systems of beliefs and ideas about "how things work," from primitive superstitions to the most complex theories about the nature and functioning of the social order. These belief systems become intergenerationally transmitted and solidified in customs, traditions, and the other cultural institutions. Thus the institutional order is the cumulative result of generations of interacting minds.

The rules that men live by, North argues, have been generated by man's quest for reductions in social uncertainty. By constraining his own actions and those of others in his community through norms, values, and interactive procedures that define and determine the codes of conduct, as well as the rationales for legitimacy and obedience, man superimposes degrees of predictability on social and economic processes.

Some of these institutional rules and procedures are formally designed through legal and political codification. But a great many, if not the larger number of them, are informal rules that are learned through being born into and living in a particular society and that are often not fully articulated.

The great transformation in human societal evolution, North explains, occurred when exchange relationships changed from the personal to the impersonal: from the small tribe with its face-to-face relationships to the extended market in which men separated by time and space, and unrelated to each other, became increasingly interconnected through money transactions.

Beliefs and ideas about what was fair, just, and right began to evolve in ways that made possible the development over the centuries of the institutions of modern market economies. North summarizes a number of these historical shifts in Western Europe, especially in banking, bills of exchange, and commercial contracts, which set the stage for the beginning of economic growth and rising prosperity in the Western world during the last five centuries. Greater respect for private property, acceptance of open and relatively unrestricted market competition, more individual liberty under the impartial rule of law, and limits on the regulatory and taxing power of governments liberated the creative energies of men in general and entrepreneurs in particular.

North also shows the inherent rigidities and potential corruption that arise when wrong beliefs and ideas generate institutions that place increased power in the hands of government—whether in its extreme form in, say, the Soviet Union, or in the milder, but no-less-damaging, form of the modern interventionist welfare state.

The dilemma, North argues, is that the right "lessons" are not always learned from these historical experiences. As he puts it, there is often too much "noise" in the historical processes; it is not always clear which causes (institutional and policy changes) have led to which effects (changes in economic well-being, including degrees of freedom). Furthermore, much of the information and interpretation about institutional and policy changes come to us through intellectual and political intermediaries who have their own agendas and misunderstandings about the actual societal processes at work.

The real danger from all this, North warns, is not only that many countries which have never developed the right market-oriented institutions may fail to do so. It is also that freedom and prosperity are not forever guaranteed in any society. In other words, even successful societies can regress and decay, sinking back into economic stagnation and political tyranny, due to the rise of beliefs and ideas that bring about wrong institutional change. North's hope is that the New Institutional Economics can assist us in seeing that this does not happen and can be used to reverse some of the bad policies already in place.

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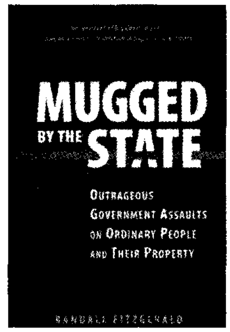
Mugged by the State

by Randall Fitzgerald

Regnery Publishing • 2003 • 155 pages • $27.95 hardcover

Reviewed by Jude Blanchette



Most Americans believe that if they raise their kids well, attend church, work 9 to 5, and pay their taxes, they can pretty much go about life unhindered by the government. Certainly there are the annoyances and trivialities that occur when visiting the department of motor vehicles or the post office, but grisly tales of life in the old Soviet Union and modern-day tyrannies remind us how safe and good things are in America. Many of us believe that images of armed federal agents smashing through doors and windows, conspiratorial stories of black government helicopters, and tales of corrupt and avaricious bureaucrats are products of media hype and desperate publicity hounds. Randall Fitzgerald's *Mugged by the State* shatters this naive belief.

Fitzgerald, a former *Reader's Digest* reporter and contributing editor, presents a compelling and emotional series of stories that highlight the bad things that the American government does to good people.

Take the case of Blair Taylor, whose new Italian restaurant in Denver had been open one week before he received notification that he was not in compliance with the Americans With Disabilities Act

(ADA). A second letter to Taylor informed him of the problem: eight of his tables were on an elevated platform without any wheelchair access. Although the majority of his tables were accessible, *all* had to be so. Rational thought would suggest that ramps would fix the problem. Yet Taylor soon found that he would have to obtain permits for the entire building even though he was putting the ramps only in parts of the building. In April of 1994 a federal lawsuit was filed against Taylor for further noncompliance. As Fitzgerald writes, "The lawsuit detailed a mind-numbing list of actions Taylor had to undertake to bring [his restaurant] into 'full' compliance with the law." On top of this, Taylor was forced to pay $1,500 to each of four "protesters" who had picketed outside his restaurant demanding he build the ramps sooner. After shelling out over $100,000, Taylor finally met all the ADA requirements.

Mugged by the State is filled with such cases, showing that ordinary, law-abiding citizens can easily be victimized by government.

Besides its value in awakening the public to the soft tyranny that is practiced every day here in America, Fitzgerald's book works well as a textbook in applied Public Choice theory. Behind all the notions of the "common good" and safety for "the children," the government officials in these stories have something to gain or some incentive to steal. The proceeds from property confiscated in the war on drugs are used to finance the activities of the confiscators. Eminent domain is used by local politicians to help favored businessmen. Environmental zoning regulations are used to keep out new developments in what Fitzgerald calls the "close the barn door" rationale. Health and safety regulations are used by businesses to shake down the competition. In the private sector these are called conflicts of interest; in the public sector these are called byproducts of the pursuit of the "common good."

I have one minor point of contention with what is otherwise an important book. Fitzgerald blames the inflexibility of environmental zoning laws for much harm done to property owners. While I would argue that the vast majority of those laws should not even be on the books, it is precisely their arbitrary interpretation and enforcement that create fear and anger in property owners. F. A. Hayek contended that rules, regulations, and laws should be fixed and independent of a regulator's whims. A builder, for example, should know with certainty whether he can build on a given plot of land—he should not have to divine the intentions or attitudes of the local zoning commission. Strict regulations may be foolish, but vague ones that give officials discretion can be far worse, as many of the cases in the book show.

Despite this exception, Fitzgerald successfully, powerfully, and subtly argues the case for property rights as a bulwark of freedom. Those who downplay or scoff at the necessity of a secure right to property would do well to read this slim volume.

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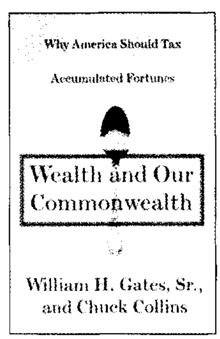
Wealth and Our Commonwealth: Why America Should Tax Accumulated Fortunes

by William H. Gates, Sr., and Chuck Collins

Beacon Press • 2003/04 • 166 pages • $25.00 hardcover; $15.00 paperback

Reviewed by Murray Sabrin



When the father of the world's richest individual and the cofounder of an outfit called United for a Fair Economy get together to write a defense of the estate tax, the result is one of the worst books ever written in American history about a public-policy issue.

Although Gates and Collins have written a tract that pays lip service to individual achievement, liberty, and free enterprise—the foundations of America's prosperity—they nevertheless embrace egalitarianism, the redistribution of wealth, and the welfare state as indispensable policies and institutions. Moreover, in their passion to maintain the estate tax, they assert that it "helps make America great." This is the first time, to my knowledge, that anyone has argued that this tax has been partly responsible for the American people's prosperity since 1916, when the federal tax was instituted.

The authors' defense of the tax rests on several dubious assertions, to say the least. They claim that the estate tax

- will reduce the "concentration of wealth and power" in the United States;
- forces individuals of great wealth to "pay back society" for the enormous "investment" in our public institutions;
- strengthens "equal opportunity" in our society by putting a "brake on the accumulation of hereditary wealth";
- will reduce the disparity in income levels that is so corrosive to democracy;
- will "level" the playing field, so that "runners start at the same starting line";
- is a good tax, because "for us, the progressivity of the tax system is a core principle";
- provides an incentive to charitable giving. Without the estate tax, wealthy families would reduce their charitable contributions.

They also argue that the three great religious traditions—Judaism, Christianity, and Islam—support the tax. They contend that it must be maintained because, after all, "taxes are a privilege in a democratic society, a necessary component for sustaining the common good."

Gates and Collins repeat *ad nauseam* that the "concentration of wealth and power" is a grave threat to the Republic. They argue, for example, that "fewer than ten multinational media conglomerates dominate the American mass media landscape." So what? Americans are tuning out network broadcasting and turning to cable and the Internet, the latest frontier of information freedom.

In reality, it is the concentration of *political power* in Washington that is undermining the American people's natural rights and prosperity. Taxes, monetary debasement, regulations, trade restrictions, out-of-control spending, overseas military adventures, and the military-industrial complex have eroded any chance of a sustainable prosperity.

The authors believe that the wealth of the "rich" could not have been created without the "investment" made by governments at all levels, particularly the federal government. In fact, the creators of wealth pay for so-called public services throughout their lifetimes in the form of income, sales, property, excise, and other taxes. Why should the federal government also confiscate up to 50 percent or more of their estates when they depart this world? How much is enough for the federal Leviathan?

Another of the authors' assertions, namely, that the estate tax will increase "equal opportunity" at birth is simply ludicrous. Even if Melinda and Bill Gates, Jr., donate all their wealth to their foundation, their children will always have more opportunities than the children born to any other couple in America, or for that matter anywhere in the world. The offspring of the very wealthy are the beneficiaries of their parents' genes and successes. The estate tax cannot change that.

The authors' true colors are revealed when they say that progressive taxes form the core of their beliefs. Marx is smiling in his grave. In the economy, the law of one price governs virtually all market transactions. Only when it comes to taxation do seemingly intelligent individuals parrot the "ability to pay" mantra as if it were a divine decree.

In the final analysis, William Gates, Sr., Bill Gates, Jr., Warren Buffett, George Soros, and the other wealthy supporters of the estate tax should keep making money and giving away as much of their fortunes as they see fit. America does not need an estate tax. America needs more economic freedom and the restoration of the liberties that Gates, Collins, and others are willing to compromise in the name of the "common good."

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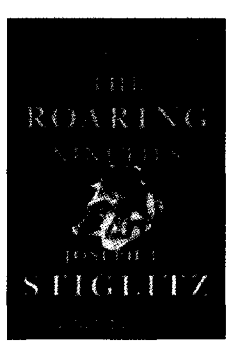
The Roaring Nineties: A New History of the World's Most Prosperous Decade

by Joseph E. Stiglitz
W.W. Norton • 2003/2004 • 416 pages • $25.95 hardcover; $15.95 paperback

Reviewed by Christopher Lingle



In an earlier book, *Globalization and Its Discontents*, Joseph E. Stiglitz argued that globalization was the tool of moneyed interests and was promoted by free-market ideologues. He conjured up the International Monetary Fund (IMF) as a straw man for these interests on whose behalf it caused great suffering among the people of Indonesia, Thailand, and Latin America.

Portraying the IMF as a bastion of laissez-faire principles is usually the rant of people who have no understanding of markets. For my money, that is an apt depiction of Professor Stiglitz. A Clinton White House insider who was a member and then chairman of the President's Council of Economic Advisers, he later became chief economist at the World Bank. After he resigned that post, he shared the Nobel Prize in economics with a pair of scholars. Their contributions related to their observations that the real world was different from the perfectly competitive model that specifies economic agents acting on perfect information. Their contention was that when information is imperfect, or "asymmetric"—that is, some people know more than others—markets may not function, especially if buyers don't trust sellers.

While the efforts that led to the Nobel Prize may have been technically impressive, most problems in markets are caused by extensive intervention, often inspired by bright chaps like Stiglitz who lack sufficient humility to understand the damage they cause.

In this new book, which purports to be a history of the economy of the 1990s, the author broadens his identification of global villains and goes beyond the IMF to include Wall Street interests along with big business generally. Among their sins, Stiglitz lists the following: demanding deregulation of electricity, providing stock options, messing up on pensions, using bogus accounting, and an irrational mania for mergers. It's all a thin conventional gruel from someone who is supposed to be a world-class economist. Stiglitz also ventures beyond the 1990s to excoriate President George W. Bush for the recent budget deficits, which were caused, of course, by tax cuts.

Stiglitz's main conclusion is that the economic debacles of the 1990s arose from "misregulation" and "underregulation" of markets. In that regard, he seems to suffer from a "fatal conceit" (to borrow from Hayek) that blinds him to the same failings in himself that afflict mere mortals. In a way, Stiglitz is like Lord Keynes, a "rational constructivist" who believes he can bring about order from the "chaos" of messy markets. Stiglitz similarly overestimates the ability of government planners to direct markets efficiently, while at the same time overlooking the enormous inefficiencies they cause.

The only praise our author seems to offer is for himself, since all his would-be fellow travelers cannot hold steady. While he heaps scorn on Republicans, he deeply resents betrayal by Democrats who cave in to their own craven instincts or pressures from Wall Street. The narcissistic streak in the book is not appealing.

In one of many instances where he is right for the wrong reason, he points out that deficit reduction did not cause the boom of the 1990s. Although he does not seem to understand this, the 1990s were like almost all booms in history. There was an illusion of rising prosperity promoted by hyperactive monetary policy. However, the author's description of the 1990s boom as "hyperactivity" caused by false hopes and lies shows his profound lack of understanding of the role of monetary policy in business cycles.

Stiglitz displays exceptional rhetorical skills, as well as an inclination toward character assassination. However, nothing in *The Roaring Nineties* demonstrates that he deserves the wide acclaim that identifies him as an outstanding economist. One might hope that he would turn to studying how markets work and thus become a better economist. But since that would require him to abandon his true comparative advantage and pleasure from engaging in political battles and mudslinging, that hope is probably forlorn.

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Half Full or Half Empty?

BY RUSSELL ROBERTS

It's easy being pessimistic about the future of America, especially for those of us who are classical liberals. We prefer limited government, yet government seems to continue to grow in all soils, in all weather, no matter which party's watching the farm. As dispiriting as this growth can be, it's good to remember that the glass might be half full after all.

Take Social Security. Please. Here we are in the richest society in human history, where most of us are able to take care of our own retirement. The current government system of Social Security treats us like children and imposes a significant tax burden on workers and employers, distorting the shape and productivity of work.

While I might long for a more real version of privatization rather than a government-run forced saving program, it doesn't change the fact that we've come a long way.

Social Security is mandatory for all workers, rich and poor alike. Masquerading as a pension plan, it is really a welfare system for the elderly. The benefit structure is arcane, and the government's promise to pay according to its own stated formula is broken at semi-regular intervals. The system is nominally financed by a payroll tax with the proceeds rolled into general funds. The coexistence of the regressive payroll tax and the progressive income tax makes tax reform opaque and unnecessarily contentious.

As the system heads toward a demographic crack-up, voices rise in opposition to any reform that might give workers more control over their earnings. We are told how risky the stock market is, how stupid most Americans are, and how incapable they are of making the right choices if they become free to direct just a fraction of their payroll tax "contributions" into assets they deem worthy, even when the list of those assets would be pre-approved by the government.

That's the half-empty story.

In my calmer moments, though, I think the glass is half-full. Truth is, that demographic crack-up being invoked to focus people's attention on the Social Security problem is a long way off. For a government, democratic or authoritarian, to worry about a problem that is decades down the road is highly unusual. And when that problem rolls around, it will probably be solvable through a mix of benefit cuts, tax increases, and changes in the retirement age.

And yet President Bush has made privatization, albeit a faint-hearted version, the focus of his second term. While I might long for a more real version of privatization rather than a government-run forced saving program, it doesn't change the fact that we've come a long way.

Until the 2000 presidential campaign, no serious presidential candidate in the last 50 years had dared to suggest such a fundamental change in the program that for many is enshrined as the centerpiece of the New Deal. That's 50 years—more than two generations. And while Bush's first term made no progress on Social Security, his decision to push it front and center shows that real change is no longer a fantasy.

What actually emerges from this discussion may turn out to be disappointing. There are likely to be unintended consequences—I worry about the political incentives for government to reduce the risk in private capital markets if government's hand gets entangled in the stock market.

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But on the positive side, the half-full side, we're having the discussion, and talk of private responsibility and smaller government gets a serious hearing. Sure, opponents of change still shriek of seniors starving in the streets. But that charge just doesn't have the traction it had 25 years ago. That change is truly remarkable. For the first time in the history of Social Security the defenders of the status quo are on the moral defensive. Those who would allow people control of their lives hold the moral high ground.

The lesson for liberty from this intellectual revolution is the virtue of calm insistence on the moral high ground of principle.

The most widespread defense of true privatization over the last 36 years has been made by Milton Friedman. He was not the first opponent of Social Security. But his eloquent defense of private, less coercive alternatives to government in *Capitalism and Freedom* in 1962 remains the most influential political document of the last 50 years.

Many of the ideas in *Capitalism and Freedom* have either been accepted or are now being taken seriously. Private Social Security, a volunteer army, educational vouchers, flexible exchange rates, a stable money supply, and so on. What is impressive about the list isn't its social or legal acceptance. What is impressive is that every one of these ideas was greeted with hoots of derision when it was first proposed.

Classical-Liberal Eloquence

Surely the eloquence of Friedman and fellow classical liberals has played a role in their acceptance. But it is possible that political forces simply turned in Friedman's favor and there is no causal connection between the ideas the defenders of liberty put forward and the resulting political success. It's simply a coincidence.

I doubt it. Ideas matter, and saying them well matters, too. But I think there is another lesson to be learned from the success of the ideas of *Capitalism and Freedom*. That lesson is particularly important as we debate the future of Social Security.

Friedman never advocates half a glass of freedom.

He advocates a full glass. And he relentlessly makes the case for that full glass regardless of the political incorrectness of the position. As a result, the reality we get is at least a half a glass and sometimes much more.

> I worry about the political incentives for government to reduce the risk in private capital markets if government's hand gets entangled in the stock market.

I suspect Friedman supports the President's rough outline of privatization. But he always notes that there is no reason for the government to be involved at all in our retirement decisions. This unrelenting advocacy of the fully principled position is part of the reason that some form of privatization is imaginable today.

The best is often the enemy of the good. And that is why in the political arena, compromise may be wise. But in the intellectual arena, we should always advocate what is best. That is the only way of hoping for something good out of the political process. And that leaves open the possibility that future reforms will lead us, ultimately, to the best.

Inevitable Market Solutions

David Henderson, author of *The Joy of Freedom*, argues that we should always talk about free-market solutions as if they were inevitable. For some reason this gives these ideas a respectability they might not otherwise have.

In the coming months and perhaps years that still lie ahead in the political fight over Social Security, I encourage all of us to talk about the virtues of allowing individuals to make their own decisions with their money, pointing out that this implies that government should get out of the retirement business. Saying this calmly and insistently (instead of prefacing remarks with apologies for proposing something that is "unrealistic") makes it likely we will get at least a half-full glass and holds open the possibility of a full glass down the road.