THE FREEMAN

IDEAS ON LIBERTY

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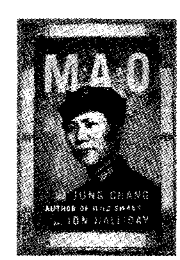

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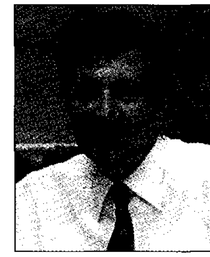
Abolishing Social Security—Through *Real* Privatization!



BY RICHARD M. EBELING

Liberty is inseparable from self-responsibility. A free man looks after himself and the members of his family. He also recognizes a personal and voluntary obligation, as a decent human being, to be willing to assist those who may be deserving of support when they have fallen on "hard times."

But liberty is inconsistent with any use of the government to obtain supposed "security" for oneself or others through coerced redistribution of income and wealth. The free man considers it immoral to obtain any benefits at the forced expense of others in society. For this reason the existing Social Security system should be abolished, and not be merely tinkered with as the current "reform" plans propose.

For 70 years the United States government has assumed the paternalist role of overseeing and planning our retirement. We Americans have been viewed and treated as irresponsible children who cannot be trusted to plan for our own future. Government has claimed the right to take a portion of our honestly earned incomes supposedly to care for us in our "golden years."

In addition, the government has deceptively fed us what Plato would have called a "noble lie": that our money has been put aside and invested for our own retirement, when in fact the money collected during any given year has been spent to cover the Social Security costs for the current retirees. Any "surplus" has been "invested" in U.S. government bonds, with nothing behind them other than the government's own police power to tax the next working generation to cover any shortfalls in the future.

> If the revenues from the sales of government lands and the accompanying mineral rights were to come even close to their current estimated market values, their privatization would equal the projected present value of all Society Security obligations over the next 75 years.

Now the deception is coming to an end. The demographics of the country are undermining the illusion behind the Social Security shell game. Thirty years ago there were about five workers in the labor force for every retiree who was receiving Social Security payments. That number is rapidly shrinking to a mere two to three workers per retiree. To make good on the government's pension promises the working population will have to be taxed a lot more—or benefits will have to be cut back significantly, along with raising the retirement age for Social Security eligibility.

The government's own projections highlight the trends at work. At the end of 2004, 48 million Americans received Social Security benefits: 33 million retired workers and their dependents; seven million survivors of deceased workers; and eight million disabled workers and their dependents. Total benefits paid in 2004 came to $493 billion. During 2004 an estimated 157 million working Americans paid into Social Security "trust funds." The system had tax revenue of $658 billion, with "assets" of $1.7 trillion dollars in the form of U. S. Treasury securities.

Because Social Security revenues will continue to exceed annual expenditures on retirees between 2005 and 2014, the total "assets" in the trust fund in the form of Treasury securities are projected to increase to $3.9 trillion. But with the coming retirement of the Baby

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Boom generation, Social Security expenditures will rapidly rise between 2010 and 2030.

Present government projections anticipate that annual Social Security expenditures will start to exceed Social Security taxes collected in 2017, with the resulting deficit covered by cashing out the Treasury securities. By 2041 all of these "assets" will have been cashed out and used up in payments to retirees. The total unfunded obligations over the next 75 years have been estimated to have a current present value of about $4 trillion.

Some critics of the current system have proposed a partial "privatization" of the Social Security funds. But these personal retirement accounts are just another version of the same deceptive game. Americans are to be "allowed" to "invest" a small portion of their own money in a group of government-approved mutual funds, with the bulk of their Social Security taxes continuing to go into some "reformed" version of the existing system. The government will decide for you what it considers "safe" investments. Over time the payoffs from these mutual funds and the stock market in general will become, even more than now, politically sensitive issues that will make them targets for increased regulatory manipulation by the "public policy" masters in Washington.

The only answer, therefore, is to abolish Social Security and return responsibility to individual citizens. In other words, what is needed is a full and real privatization of retirement planning by removing it completely from the hands of government.

But how can the Social Security system be abolished when so many people over several generations have had a significant part of their income taxed away? How would those who have paid into the system over many years, especially among the older and retired members of society, have the wherewithal to take responsibility for their own futures?

What I propose for ending Social Security is the privatizing of government-owned and -managed property. The territory of the United States totals about 2.3 trillion acres of land, out of which the U.S. government owns and manages 507 million acres—or slightly more than one-fifth of all the land in the country. Over a reasonably short period, say, five years, a vast majority of this land could be sold at public auction, with the proceeds being used to pay back what has been taxed from the American citizenry.

The revenues from the sales would be disbursed beginning with the oldest groups until as many Social Security taxpayers as possible had their wealth returned to them. As each group was being paid back, Social Security taxes on workers would be commensurately reduced, leaving them free to plan more of their own retirement. At the end of five years, all Social Security legislation would be repealed.

Expected Land Revenues

Just how much revenue might be available from these land sales? According to a variety of government departments, bureaus, and agencies responsible for control and management of these lands, federal land and the mineral reserves on them have, in 2005, an estimated total value of over $4.5 trillion.

The following are the estimated market values of just some of the leading mineral reserves on government-owned land: copper, $1.9 trillion; nickel, $837 billion; gold, $531 billion; zinc, $151 billion; platinum, $44 billion; lead, $29 billion; and silver, $27 billion.

There is, in addition, 250 million acres of timberland and 257 million acres of grazing land under federal control; these are estimated, respectively, to have market values of $214 billion and $350 billion, for a total of $564 billion.

In other words, if the revenues from the sales of government lands and the accompanying mineral rights were to come even close to their current estimated market values, their privatization would equal the projected present value of all unfunded Society Security obligations over the next 75 years.

Of course, if Social Security were in fact abolished over a relatively short period through the type of real privatization plan proposed here, there would be no future governmental pension obligations, and the cost of ending the system would likely be a dollar amount significantly less than presently projected over the remainder of the 21st century.

The great financial albatross of the coming decades would be eliminated, and a crucial aspect of freedom would be restored to the American people.

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Perspective

Property Protects

Opponents of authentic liberalism have long held that the state must be powerful enough to protect the powerless from the ravages of private property. The Supreme Court's decision in the *Kelo* eminent-domain case last summer shows what that principle is worth.

To recap, the city of New London, Connecticut, condemned 15 working-class homes for an upscale private development scheme that is to include a luxury hotel. Some of the targets, including an elderly woman who has lived in her house her entire life, refused to sell and went to court. After losing in the state courts, they moved to the U.S. Supreme Court, where the justices ruled 5–4 for the city.

The crux of the case was the phrase "public use," since the takings clause in the Fifth Amendment to the U.S. Constitution permits government to acquire private property through eminent domain only so long as it is for public use and "just compensation" is paid. (Of course, no takings can be reconciled with individual liberty.) The key question was: does the city's plan constitute a public use? The city argued that although the public will not use the land as it uses roads, the increased tax revenues and jobs yielded by the project will benefit the public. The property owners countered that the Bill of Rights says "public use" not "public benefit."

The Court's majority sided with the city, delighting government officials everywhere. Quoting a 1984 case, Justice John Paul Stevens said that the "Court long ago rejected any *literal requirement* that condemned property be put into use for the general public" (emphasis added).

The dissenters were stunned. In separate opinions Justices Clarence Thomas and Sandra Day O'Connor criticized the majority for purging the words "public use" from the Fifth Amendment. (For more detail see my FEE web article "The Supreme Court and the End of Limited Government" at www.fee.org/vnews.php?nid=6991.)

The threat to individual rights is obvious. But the ruling also sheds light on whether the state or the institution of property better protects society's powerless. A political-science professor of my acquaintance said that while the facts of the case bother him, he applauds the principle. He meant that while he believes government should have the power to take property and put it to "better" uses, he was uncomfortable that working-class people were losing their homes to big corporations. I suppose he'd prefer that property be taken from big corporations and given to working-class people. His only objection is that *he* is not choosing the victims.

He is not naïve. As a well-informed political scientist, he knows that eminent domain victimizes those with the least money and fewest connections. But if he has to choose between government power and protecting the powerless, he'll take the power.

O'Connor and Thomas chose otherwise. O'Connor writes, "[T]he fallout from this decision will not be random. The beneficiaries are likely to be those citizens with disproportionate influence and power in the political process, including large corporations and development firms. As for the victims, the government now has license to transfer property from those with fewer resources to those with more. The Founders cannot have intended this perverse result."

And Thomas: "Allowing the government to take property solely for public purposes is bad enough [Yes!], but extending the concept of public purpose to encompass any economically beneficial goal guarantees that these losses will fall disproportionately on poor communities. Those communities are not only systematically less likely to put their lands to the highest and best social use, but are also the least politically powerful." He adds, "Urban renewal projects have long been associated with the displacement of blacks. . . . Regrettably the predictable consequence of the Court's decision will be to exacerbate these effects."

If liberty is to be won, its defenders must emphasize that property *especially* protects the most vulnerable against government impositions. Perhaps some good will come from *Kelo* after all.

★ ★ ★

In this issue we acknowledge—but do not celebrate—the 70th anniversary of Social Security. In 1935 President Franklin Delano Roosevelt signed the historic legislation that insinuated the central government into our retirement. This month's contributors explore the history and ramifications of this most lamentable governmental imposition. Can nothing positive be said of it? Only that it is perhaps the longest-running chain letter in history.

All technical criticisms aside, the most fundamental thing to be said about Social Security is that it violates the liberty and autonomy of the individual. Aeon Skoble shows why.

To hear its champions tell it, everyone loved Social Security from the start. Oh really? Check out what Jude Blanchette has dug up.

You might think Social Security is insurance—that is, if you have no idea what insurance really is. Will Wilkinson explains.

But what about the Trust Fund? In this FEE Timely Classic William Conerly explores how well the Social Security principle would work within the family.

And speaking of the notorious Trust Fund, John McGinnis dispels the popular impression that it has no assets.

The negativism about Social Security can be wearisome. So in the interest of uplift, here's Dwight Lee's FEE Timely Classic in which he looks for the bright side of the program.

Anyone who proposes to privatize the financing of retirement will be told that this would cause people to starve in their old age. Former *Freeman* editor Paul Poirot anticipated this objection long ago. His reply is a FEE Timely Classic.

In other articles, Andrew Morriss tours the Cayman Islands and Chris Matthew Sciabarra delves into the dialectics of liberty.

Our columnists will entertain and astound: Richard Ebeling further dissects Social Security. Donald Boudreaux suggests some economic research. Burton Folsom shows why he prefers entrepreneurs to bureaucrats. Walter Williams continues his economics course. And Alan Reynolds, bombarded with the cant that there are no jobs for young people, ripostes, "It Just Ain't So!"

Books on Mao Zedong, economic misconceptions, the threat from local governments, and guns engage our reviewers.

—*Sheldon Richman*
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No Jobs for Young People? It Just Ain't So!

BY ALAN REYNOLDS

In "The Young and the Jobless," *New York Times* columnist Bob Herbert recently wrote that "American workers, especially younger workers, remain stuck in a gloomy employment landscape. . . . The simple truth is that there are not nearly enough jobs available for the many millions of out-of-work or underworked men and women who need them."

If the number of people seeking work had actually been growing faster than the number of jobs they are willing and able to fill, then the U.S. unemployment rate would have been rising. Yet the unemployment rate fell from 6.3 percent in June 2003 to 5 percent in July 2005. The author's emphasis on "American workers" seems particularly misplaced, since unemployment in April was 10.2 percent in France and 11.8 percent in Germany.

Herbert then changes the subject, bemoaning the long-term decline in teenage employment rates—that is, the declining percentage of young people who work rather than attend high school: "A recent report from the Center for Labor Market Studies at Northeastern University in Boston tells us that the employment rate for the nation's teenagers in the first 11 months of 2004—just 36.3 percent—was the lowest it has ever been since the federal government began tracking teenage employment in 1948. . . . 'Younger workers,' said Andrew Sum, the center's director, 'have just been crushed.' "

The main reason a smaller percentage of American teenagers are employed than in the past, however, is that many more are attending school and far fewer are employed on the family farm. At the time of the April 1947 census, only 27.7 percent of those aged 18-19 were enrolled in school. By 1950, only 34.3 percent of Americans over the age of 25 had finished high school, compared with more than 85 percent today.

A September 2002 report from the Bureau of Labor Statistics (BLS) noted that the labor-force participation rate for teenagers has been falling for years because of "an increasing rate of school enrollment during the summer." The percentage of those aged 16 or 17 enrolled in school during the month of July rose from 21.4 percent in 1994 to 31.1 percent in 2000, while the percent in the labor force simultaneously declined from 57 to 51.2 percent.

The percentage of those aged 20–24 enrolled in college rather than working has likewise been rising. From 2000 to 2004 the number of adults who said they were not in the labor force because they were attending college increased by 750,000. Herbert views this as evidence that young adults are "faring poorly."

Given his anxiety about young people being in school rather than at work, it is ironic that he complains that "workers can't even get a modest increase in the national minimum wage." The BLS reports that only 520,000 workers were paid the minimum wage in 2004 and a third of those were teenagers. Although 168,000 teens were paid the minimum wage, however, nearly twice as many (329,000) were paid less than the minimum wage. Whenever the minimum wage has increased, the percentage of workers displaced into even lower-paying jobs has grown larger.

Herbert frequently compares employment figures for 2004 with the cyclical peak of 2000, as though unemployment during the third year of recovery from the recession of 2001 should be expected to be just as low as it was during the ninth year of the preceding

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boom. In fact, the teenage unemployment rate in 2004 was lower than it was in the third year of two previous recoveries—17 percent in 2004 compared with 18.6 percent in 1985 and 17.6 percent in 1994.

Although the monthly unemployment rate among teenagers is always higher than among mature adults, spells of teenage unemployment are typically brief. Of those aged 16-19 who were unemployed at some point in 2004, nearly 45 percent were out of work less than five weeks, and an additional 32 percent were out of work less than 14 weeks.

Herbert attributes to Andrew Sum the belief that "Gains among recently arrived immigrants seem to have accounted for the entire net increase in jobs from 2000 through 2004." That is surely false, regardless how creatively "net increase" may be defined.

Immigrants accounted for half the increase in the labor force so they would be expected to have accounted for no more than half the increase in employment unless unemployment declined more dramatically among recent immigrants than among natives. On the contrary, the Census Bureau estimates the unemployment rate in 2003 was 10.9 percent among immigrants who arrived since 2000 and 7.7 percent among those who arrived in the nineties, compared with 6.2 percent among native-born citizens.

"Workers have been so cowed by an environment in which they are so obviously dispensable," writes Herbert, "that they have been afraid to ask for the raises they deserve. . . . The wages of those who are employed are not even keeping up with inflation." The common misperception that wages have fallen in real terms results from a badly flawed average of aggregate earnings divided by hours among "production and nonsupervisory" workers—a series the BLS is about to discontinue. That flawed series was also badly adjusted for inflation by an archaic measure (CPI-W). If benefits and salaries are properly included, and deflated with a properly chain-weighted measure of inflation, then real compensation per hour among nonfarm businesses rose 3.9 percent between the first quarters of 2004 and 2005.

Herbert nonetheless writes of "an entire generation of essentially powerless workers largely at the mercy of employers," and claims that "very little has gone to the typical worker." Yet his examples are not about typical or median workers, but about such atypical groups as teenage dropouts in certain regions. "In Illinois," he writes, "fewer than one in every three teenage high school dropouts are working." But this too is a problem that has been diminishing over time.

The misnamed "dropout rate" measures the percentage of young adults aged 16-24 at the time of a census survey who were not enrolled in a high-school program and had not received a high-school diploma. It fell from 21.3 percent in 1972 to 10.5 percent for young black Americans and from 14.6 to 6.5 percent for non-Hispanic whites. The figure for Hispanics appears much higher (25.7 percent in 2002), but the Pew Hispanic Center found that half of those counted as U.S. dropouts were actually young immigrants who "quit school before coming to this country," and thus did not drop out of U.S. schools.

Squeeze on the Young?

Citing Andrew Sum, Bob Herbert also claims, "The squeeze on the younger generation of workers is so tight that in many cases the young men and women of today are faring less well than their parents' generation did at a similar age."

Since most of Herbert's concerns are about non-working teenagers, it is difficult to make much sense of comparing their living standard with that of their parents "at a similar age." Most of them are now supported by their parents, sharing the family's living standard.

Three days after Herbert's column appeared, on May 15, the *New York Times* launched a series on "Class in America" that I subsequently critiqued in the *Wall Street Journal*. Yet that article included a useful *Times* poll that specifically asked, "Compared with your parents when they were the age you are now is your standard of living" better or worse? It turns out that 39 percent said their standard of living was much better and another 27 percent said it was somewhat better. That is scarcely surprising, since real disposable income per person rose from $15,094 in 1974 (in 2000 dollars) to $27,281 in 2004—an increase of more than 80 percent.

Life, Liberty, and Retirement Pensions

BY AEON J. SKOBLE

The right to acquire property is a staple of liberal political theory. But why would anyone bother *accumulating* property? If my monthly expenses are a thousand dollars, then what use could I possibly have for any monthly income larger than a thousand dollars? I could plausibly reason that if I work harder today, I might be able to relax tomorrow. This presupposes, of course, that by working, I earn money, so if I earn more than I need today, I will be able to spend it tomorrow even if I am not working. In broad terms, this is what we do when we save for retirement. We take some of our earnings from work and save it for when we are older. Then we can stop working and still have money to live on. If we have a right to earn money at all, then we have a right to save for the future in this manner. In this essay I would like to discuss what that means, and give some reasons why it is true.

> When the state dictates how I must spend my money, it is a violation of my liberty, for my actions no longer serve my own ends, but are being made to serve the ends of another against my will.

In classical-liberal political theory the right to acquire property follows from the fundamental rights to life and liberty. The argument goes something like this: If I own my life and my liberty, then the work I do is mine as well. Thus the fruits of my labor become my property. John Locke, for example, describes the "mixing of one's labor" with unowned natural resources as the origin of our right to material property. Locke actually uses the word "property" to refer not only to material goods, but to life and liberty. So to say that Locke sees property rights as fundamental is potentially misleading: the rights to life and liberty, or "self-ownership," are the conceptual underpinnings of any rights to what we would normally call "property." Just as self-ownership is a right that exists prior to the establishment of government, so too is the right to enjoy the fruits of our labors. If I have the right to acquire property, then I have the right to save it for a rainy day.

When the state dictates how I must spend my money, it is a violation of my liberty, for my actions no longer serve my own ends, but are being made to serve the ends of another against my will. Arguably, all taxation is thus a violation of liberty, but we need not settle that question to see that state-run "social security" programs violate our rights to plan for our own retirements. Indeed, under the current system, we aren't actually *investing* money for our retirement at all—our Social Security taxes pay benefits for today's recipients, and theoretically, tomorrow's workers' taxes will pay for our benefits. That's very different from investing, for two important reasons: one, it doesn't encourage responsible attitudes toward saving for the future, and two, it is far less profitable.

It's true of course that anyone is free to invest *additional* money in, say, a mutual fund or an IRA, above his government-mandated retirement "contributions." But with the exception of the more affluent, this is illusory: the average worker cannot readily afford to pay into

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both the government's retirement plan and a private plan. But even the affluent, who can afford this, nevertheless have their rights violated as well. In general, if Smith forces Jones to spend $100 on something Jones doesn't prefer to spend it on, then Smith has violated Jones's liberty, even if Jones is still free to spend the remainder of his money his own way. Jones has $100 less to spend on his own retirement fund.

Consider how the statist model of retirement planning operates: you do not choose whether to participate; you have no say in how the money is to be invested; and you cannot withdraw in response to poor performance. The ostensible upside to this is a guaranteed return. You do not have to worry about market crashes and depressions, nor do you have to worry about poor investment strategy. But the flip side of not having to worry about poor strategy is not being able to pursue a highly effective one. Even modestly performing mutual funds yield higher returns than Social Security. And while market crashes are less of a concern, government insolvency is a big concern. To forestall it, you (or your children) will have to pay even more to fund the system, which cuts into how much you (or they) will actually save for the future.

To whatever extent the average Joe doesn't know how to invest prudently, it is because he does not have to. If bicycling were banned, few of us would develop good bicycling skills.

One argument often advanced in favor of a state-run model is that the average working person cannot be counted on to invest wisely. This assumption is as unverifiable as it is paternalistic. (It is also a straw man, as I argued in the July/August 2005 issue of *The Freeman*, since modern-day financial services such as mutual funds, annuities, and IRAs are administered by professionals who *do* know how to invest wisely.) But more important, it's circular: to whatever extent the average Joe doesn't know how to invest prudently, it is because he does not have to. If bicycling were banned, few of us would develop good bicycling skills, and then the government would have a rationale for continuing the ban, namely, that bicycling is too dangerous—since most people don't know how to do it.

Even though it's true that there is some risk involved in riding a bicycle, people have the right to develop their faculties. They have the right to learn to ride bicycles—for without the right to learn to cycle, they are being denied the right to cycle. Similarly, people have the right to learn prudential savings and investment habits. Why should we value having the liberty to develop our faculties, even if there is some risk involved? That's the essence of personal growth. We take risks and learn new things. Learning to save for a rainy day is a basic skill, a virtue straight out of Aesop. While not everyone can skillfully manage an investment portfolio, everyone can learn the importance of thrift and planning for the future. Those who can (and want to) manage their investments in a hands-on way ought to be free to do so, and those who cannot (or prefer not to) ought to be free to let financial professionals do it for them, via mutual funds, annuities, IRAs, and the like.

Anytime the government forces you to act in prescribed ways for your own good, it is an insult to your sense of autonomy, even when the government is right. It's true that you ought to buckle your seat belt when driving, but it's still a patronizing insult to be coerced into wearing one. In many cases, of course, the government isn't right—Social Security, for instance. My retirement would come earlier and be more comfortable if I were entirely responsible for it.

Social Security as Entitlement Program

But it's not just anti-paternalism that we need to invoke, for the current system isn't merely a paternalistic requirement that I save for my retirement. It's an entitlement program in which everyone gets to claim a retirement pension from the state (that is, from working taxpayers), regardless of whether they've been industrious and thrifty. So you are not saving for your retirement at all; you are paying for the retirement of others, and hoping that later on someone else will pay for yours and that someone will manage this system efficiently. (If any private company offered a program like this, it would be indicted for operating an illegal pyramid scheme!) Wouldn't it be easier to allow people to save for their own retirements? But let's state the point more plainly: individuals have a right to plan for their own retirement without coercion or interference from the state.

When I claim that individuals have such a right, anyone familiar with the current system might well reply that in fact we do *not* have this right, inasmuch as the system isn't structured that way. The government *does* interfere and use coercion to maintain Social Security. But I am not referring to legal rights—obviously we have just those legal rights that the lawmakers say we have—but to natural, that is, pre-political, rights. Consider the way this is formulated in the Declaration of Independence: we are said to have some rights by nature, for instance the right to live and be free. Then, "to secure these rights," governments are "instituted." In other words, the whole point of the government is to protect rights we already have. So it's not the case that we get a right to the fruits of our labors *from* the government, but rather that the government's *function* is to help us secure our right to the fruits of our labor. On that model, then, individuals may very well have rights the government doesn't respect adequately (or at all). If we have a right to the fruits of our labor, then we also have a right to save for our retirement.

Consider the spectrum of possible rationales for the state to usurp this right and their corresponding policies. One: the government thinks we are too stupid to care about planning for our retirement, so they will do it for us. Two: they recognize that we do care, but we don't know enough to be able to save effectively, so they will do it for us. Three: same as two, except that they admit they don't know any better than we do how to save effectively, so they mandate participation in non-state investment programs. Four: same as three, except they don't mandate participation, but then they provide old-age pensions for those who did not participate. Then consider number five: same as four, except without state pensions for those who refused to invest earlier. Clearly either scenario three or four (which in general represent some of the current proposals for reform) would be more consonant with liberty than scenarios one or two (which essentially represent the status quo), but it is really only five that captures both sides of individual liberty: personal freedom and personal responsibility. To say that we have the right to save for our retirement is not to say that someone else has a duty to provide for our retirement.

Positive and Negative Rights

In general, rights are always correlated with duties, but different conceptions of rights entail correspondingly different sorts of duties. Some theorists characterize rights as being "negative" or "positive," the difference being that positive rights entail a duty of others to provide that which is being claimed, whereas negative rights entail a duty of others to abstain from interfering with the pursuit of what is being claimed. "Natural," or pre-political, rights would have to be negative, for if all are moral equals, then no one can have a claim to authority over another without that person's consent.

The right to save for one's future is a negative right: others must refrain from interfering with my accumulating and investing property. Under the current model, we seem to have positive rights to a retirement pension, meaning that someone has a duty to support me in my retirement, even if he does not wish to do so and without regard to whether I've been thrifty. This is simultaneously compounded and obscured by the fact that the current system makes *everyone* the bearer of this duty toward everyone else by taxing all current workers to pay the pensions of current retirees and promising the workers that they will be entitled to a pension later on. But again, besides the interference with natural rights that this entails, it is also inefficient, since we end up with smaller pensions (and a large bureaucracy).

If we are to take seriously the conception of rights spelled out in the Declaration of Independence, we need to assert a right to financial independence—the right to work, the right to exchange our labor for money, and the right to control the fruits of our labor. This necessarily includes the right to plan and save for our own retirement, free from coercion or interference. The best "reform" would be to allow people full rights over their own lives, liberty, and property. As the founders recognized, this is a necessary condition of our having any meaningful right to pursue happiness.

Opponents of the "Crown Jewel"

BY JUDE BLANCHETTE

There was a time when self-reliance wasn't such a tough sell. Today, however, the thought of dismantling Social Security strikes most as somehow un-American. It is, after all, the "cornerstone of the New Deal." It saved the poor and elderly from indigence and provided dignity in a monthly paycheck. Legend has it that 70 years ago the nation was unanimous in its support for FDR's plan to nationalize retirement.

Yet not withstanding Roosevelt critic John T. Flynn's remark—"There was no real objection to social security—everybody was for it."—not all were duped. There did exist a group of conservatives, libertarians, Republicans, members of what we now call the "Old Right," who fiercely opposed President Roosevelt's plan for Social Security. They saw the program for what it was and understood its long-term consequences even if Roosevelt didn't. In short, they smelled a political scam. Behind the rhetoric of "safety" and "security" they knew it was an unconstitutional usurpation of the traditional powers delegated to the states and an infringement on individual liberty.

> To a large extent it was business leaders who understood the consequences of imposing a tax on labor during a massive economic contraction.

Historians today like to emphasize the opposition to Social Security by business groups and leaders. Blinded by the pursuit of power and mammon, they were the only Americans shortsighted enough to oppose aiding the poor and elderly. To a large extent it *was* business leaders who understood the consequences of imposing a tax on labor during a massive economic contraction. Taxes are almost always an economic drag, especially during a recession. Former head of General Motors and FEE board member Alfred P. Sloan declared, "Industry has every reason to be alarmed at the social, economic and financial implications [of Social Security]." Looking to profit and longevity and not votes, the business community was in a better position to evaluate the effects of the employer's and employee's "contribution" to Social Security.

In early 1935 James A. Emery, chief counsel for the National Association of Manufacturers, appealed to the House Ways and Means Committee to rethink its push for national Social Security legislation. He argued that the Social Security bill before Congress would "discourage employment rather than encourage it." Why would the federal government raise taxes on business in the midst of a recession? According to Emery, "General recovery depends on our ability to enlarge our production, to employ more people, and to cut down and not raise up the price of goods. Every time we increase the price of goods in a diminishing market, we are diminishing the possibility of employing other men, because we are making it more difficult, not less, to sell goods. Until we can market goods, we cannot employ men."

Emery's attack on FDR and the New Deal lasted through much of 1935. Later that year he declared, "We

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are steadily confronted with an almost continuing attempt to evade the plain limitations placed upon the exercise of political power." He continued, "We face, in our opinion, evident determination to evade by indirection what centuries of experience have written into constitutional prohibitions against doing directly."

Delegates to the Chamber of Commerce's 1935 annual national convention roundly denounced FDR's New Deal, including Social Security. Regarding the Social Security bill being debated in Congress, the Chamber warned that "if the provisions in the bill pending should be adopted, the country will realize that within a decade there will be a tax burden amounting probably to as much as $1,000,000,000 a year." In July 1935, 200 business executives met at the Waldorf-Astoria Hotel and concluded that most of the New Deal would be thrown out as unconstitutional.

Unlike today, when both parties seem enamored with the basic tenets of "social insurance," congressional opposition to the 1935 bill was fierce. Once again, however, modern interpretation of this principled dissent is saturated with disdain for those who couldn't understand the "progressive" nature of FDR's plan. In his book *The Coming of the New Deal*, the historian Arthur M. Schlesinger, Jr., detailed the congressional opposition to the Social Security bill. Most of the objections, Schlesinger notes, were toward the old-age provision, not the unemployment coverage. Through clenched teeth Schlesinger quotes congressman after congressman who (rightly) decried Social Security as a financial monster. Rep. Thomas A. Jenkins of Ohio thought the legislation "nefarious" and that it placed "a financial lash upon the backs of the people whose backs are breaking under a load of debts and taxes." Rep. Allen T. Treadway of Massachusetts predicted the program would "destroy old-age retirement systems set up by private industries, which in most instances provide more liberal benefits." And Rep. John Taber of New York said, "Never in the history of the world has any measure been brought in here so insidiously designed as to prevent business recovery, to enslave workers, and to prevent any possibility of the employers providing work for the people."

> Foreshadowing the criticisms of today, Hazlitt concluded, "All this is an elaborate hocus-pocus by which the Government issues IOU's payable to itself."

Immediately after the bill's passage, stories of popular revolt began to appear in newspapers. In Brooklyn 26,000 business owners refused to file for employer-identification numbers. Julian Olney of County Presentations, Inc., simply wrote across his application, "You don't need to bother me any more. I don't believe in this." As the *New York Times* reported at the time, Olney "held that the Securities Act [sic] is unconstitutional, inasmuch as it provides no contract and no assurance of any return upon money paid by either employers or employees."

Popular revolt against Social Security continued for over a decade after the bill's passage. In 1951, 18 "housewives" emptied their bank accounts after they learned that the Internal Revenue Bureau (later the IRS) was authorized to seize money owed in back Social Security taxes. The women thought it unconstitutional that they were required by law to act as tax collectors for the federal government by withholding Social Security taxes from those who worked at their homes.

The *Times* also reported the case of 72-year-old Frederick C. Perkins, who in 1942 was sentenced to jail for not paying $51.16 in Social Security taxes. (He had served 18 days in 1934 for failure to comply with the National Recovery Act.) According to the *Times*, "Mr. Perkins asserts that Social Security tax is 'confiscatory, discriminatory and unconstitutional' and says he will go 'all the way to the Supreme Court, provided I have some help from friends.'"

The Court Approves

Although the Supreme Court found many of FDR's New Deal programs unconstitutional, Social Security was not among them. On May 24, 1937, the Supreme Court upheld the program in three cases: *Helvering v. Davis*, *Steward Machine Company v. Davis*, and

Carmichael v. Southern Coal & Coke Co. and Gulf States Paper. In his dissenting opinion in *Steward Machine,* Justice James Clark McReynolds held "That the portion of the Social Security legislation here under consideration, I think, exceeds the power granted to Congress. It unduly interferes with the orderly government of the State by her own people and otherwise offends the Federal Constitution." The passage of the Social Security bill, McReynolds said, "opens the way for practical annihilation of [federalist] theory; and no cloud of words or ostentatious parade of irrelevant statistics should be permitted to obscure that fact."

Also in 1937 came a stinging rebuke by the First Circuit Court of Appeals in Boston. In a two-to-one decision the court found Social Security unconstitutional. Judge Scott Wilson's majority opinion, surely forgotten today, is perhaps the most eloquent attack on the program:

> It is not a question of what powers Congress ought to have to meet certain conditions, but what powers are vested in Congress under the Constitution. In determining what they are, we must return to first principles.
>
> The care of the unfortunate and the dependent and the relief of those unable to labor is the burden imposed on the State and until recently has always been so considered. Congress has no power either directly or indirectly to invade this province of the States.

Wilson continued:

> We think that the power to provide for old age benefits was among those powers reserved to the States under the Tenth Amendment, and that a tax imposed to benefit slightly over half of the people over 65 years of age, and who are the care or burden on the State, cannot be said to be imposed for the general welfare of the United States. . . .

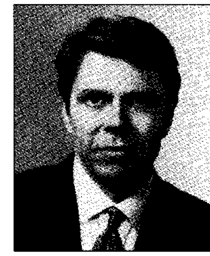
Another critic of Social Security was Henry Hazlitt, then lead economic editorialist for the *New York Times.* Hazlitt and many of the program's fiercest opponents soon began to see the new influx of Social Security taxes squandered. As Hazlitt wrote in a 1937 editorial, "What is now happening to the proceeds of the social security taxes substantiates the predications of the harshest critics of the reserve fund provisions of the Social Security Act." Foreshadowing the criticisms of today, Hazlitt concluded, "All this is an elaborate hocus-pocus by which the Government issues IOU's payable to itself." John T. Flynn similarly noted that the reserve was "a swindle and a solemn and cruel farce."

With Social Security today routinely called the New Deal's "crown jewel" and the most successful government program in history, we would do well to reread the prescient criticisms offered by these dissidents. In most cases, they were right. Now, 70 years later, we are living with FDR's legacy. Liberty and self-reliance in retirement are now unthinkable.

The Crisis of Social Security

It has been well said that, while we used to suffer from social evils, we now suffer from the remedies for them. . . . Though we may have speeded up a little the conquest of want, disease, ignorance, squalor, and idleness, we may in the future do worse even in that struggle when the chief dangers will come from inflation, paralyzing taxation, coercive labor unions, an ever increasing dominance of government in education, and a social service bureaucracy with far-reaching arbitrary powers—dangers from which the individual cannot escape by his own efforts and which the momentum of the overextended machinery of government is likely to increase rather than mitigate.

—F.A. Hayek, *The Constitution of Liberty*



Research Needed!

BY DONALD J. BOUDREAUX

If you're an economics graduate student looking for a good dissertation topic, this is your lucky day. Here are two topics that I sincerely believe are worthwhile, challenging, and—if done well—could launch you into academic stardom.

The first topic is best expressed as a question: how much of our material standard of living do we owe to research funded by the government? Nobel-laureate economist Joseph Stiglitz asserts that we owe a great deal to government funding:

> While free marketers rail against industrial policy, in the US the government actively supports new technologies, and has done so for a long time. The first telegraph line was built by the US federal government in 1842; the internet was developed by the US military; and much of modern American technological progress is based on government-funded research in biotechnology or defense. ("Do as the US Says, Not as it Does," *Guardian*, October 29, 2003.)

But how would the resources marshaled by the government to promote these specific technologies have been used had they remained in private hands?

But how much is "much"? Does 1 percent of our material standard of living spring from government-funded research? Or 10 percent? Maybe 50 percent? More? It's an impossible question to answer theoretically, and a very difficult one to answer empirically.

Stiglitz is correct that we can point today to many useful technologies that first sprung into existence because of government encouragement. But how would the resources marshaled by the government to promote these specific technologies have been used had they remained in private hands? Would all of these resources have been consumed frivolously—say, on extravagant lawn parties for the idle progeny of the superrich—so that they would forever have been lost to research? Or would they instead have been directed to research that, because these resources were in fact confiscated by government, was never undertaken or was undertaken later than otherwise?

And what of the trillions of dollars worth of resources confiscated over the years by government and spent in ways that no one regards as research-oriented: programs such as farm subsidies, foreign "aid," and welfare? Even if you think these programs to be justified, they take resources away from the possibility of being used on research.

Finally on this topic, we must ask to what degree has the expansion of government's power prompted firms to transfer resources from efforts aimed at making better mousetraps into efforts aimed at making political hay? A government that refuses to pander to special-interest groups gives firms no incentives to spend resources lobbying for goodies such as tariff protection or subsidies. Resources that might otherwise have gone into lobbying are instead spent by firms on R&D and other efforts to lower production costs and improve product quality.

But because government today routinely doles out subsidies and monopoly privileges to firms and industries that lobby for such artificial entitlements, government's actions on this front reduce private-sector research efforts. But by how much?

Bottom line: any proper reckoning of government's contribution to the scientific research that makes our opportunity costs of *all* resources confiscated and divert-

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ed over the years by government. A careful, thorough empirical investigation of this question would be most welcome.

Workers and Wages

My second candidate for much-needed research poses an even greater challenge. It is to develop a more complete and correct *elementary* analysis of the effects on wage rates of changes in the supply of labor.

The standard analysis, I'm sure, is wrong. That analysis is one of simple textbook supply and demand (a tool, I hasten to add, that I generally find enormously helpful). According to this standard analysis, if the supply of labor increases, wages fall, just as a greater supply of anything causes its market value to decline. So, according to this textbook tool, a larger labor supply makes workers worse off. More immigrants, more women entering the work force, a higher birth rate—all should reduce real wages.

And yet, even the most casual observation belies this textbook prediction. Real wages in the United States today are at an all-time high, despite continued immigration of new workers and despite the massive entry, since the 1960s, of women into the workforce. Likewise, real wages in New York City are much higher than real wages in New Orleans, even though New York's working-age population is larger than New Orleans's.

> A greater supply of workers means far more than additional backs and hands available to perform existing tasks.

Why? I have some hunches.

Workers are not always substitutes for each other. Instead, workers often *complement* each other. Consider the simple example of the teamwork necessary to lift a 400-pound boulder onto a truck bed. Worker Jones can't perform this task alone. But if worker Smith shows up, then the two of them working together—as a team, complementing each other—can lift the boulder into the truck.

Much more fundamentally, however, is an insight that I regard to be among the most important and pioneering of the twentieth century, and yet one that has not even begun to be incorporated into economics. This insight is the late Julian Simon's understanding that the ultimate resource is human effort and creativity.

A greater supply of workers means far more than additional backs and hands available to perform existing tasks. It means a greater supply of human initiative to discover how better to organize work so that each worker is more productive; it means an increased flow of creative ideas about what new goods and services might better satisfy consumers; it means more human ingenuity at figuring out how resources and capital can be used in previously unimagined ways to lower production costs and expand output.

Of course, mainstream economics can qualify and contort its textbook theory into consistency with the observed fact of steadily rising wages. But the result is artificial and not compelling. I have a powerful hunch that thoroughly reworking labor economics so that it rests squarely on Julian Simon's insight will revolutionize this important branch of economics. This Simonesque reformulated economics will then be a broad platform from which insights that are impossible today will pour forth.

So, to you graduate students out there, get to work!

Social Security and the Insurance Illusion

BY WILL WILKINSON

In 1937, shortly after Franklin Roosevelt threatened to destroy the independence of the Supreme Court by "packing" it with ideological cronies, the Court came to heel and handed down verdicts in three cases affirming that the Social Security Act was, unlike several structurally similar pieces of pre-intimidation New Deal legislation, in accord with the U.S. Constitution.[1]

Wilbur Cohen, a ubiquitous figure in the history of Social Security, provides a window into the administration's state of mind on the Court's momentous decision. At the time of the ruling Cohen was an assistant to Social Security board chairman Robert Altmeyer and recalls gliding down the Supreme Court steps that day "in a glow of ecstasy. . . . When I got back to the office I received Mr. Altmeyer's approval to send out a memo to the staff stating that because of the decision, we could now call the old age benefits program 'old age insurance.' "

> By framing the program as insurance, it was possible to make benefits seem earned rather than part of a socially stigmatized "dole."

Why? Because *insurance* sounds a lot better to voters than a tax and stream of welfare payments, which is what Social Security is. Because, as Cohen explained it, "The American public was and still is insurance-minded and opposed to welfare, the 'dole' and 'handouts.' " The Brain Trust knew about the importance of "framing" decades before Berkeley linguist George Lakoff did.

The irony, or hypocrisy, of Cohen's ecstatic rush to reframe is that, executive intimidation aside, the government won the Social Security Act cases by arguing that Social Security is *not* insurance, but just a plain old tax on wages, falling under Congress's taxing power, and an entirely separate and unconnected welfare program, falling under the "general welfare" provision. The Act was scrupulously drafted to ensure that the tax and the government transfers would not appear to have anything to do with each other. And the program is never described therein as "insurance." The 1960 *Flemming v. Nestor* decision reaffirms that paying the tax creates no entitlement to benefits.

Nevertheless, FDR pushed hard for a dedicated payroll tax specifically so it would be connected in voters' minds to their benefits in the way the premiums are connected to insurance payments—to create the illusion of property, contract, and legal, moral, and political entitlement. As FDR infamously declared, the dedicated payroll taxes "are political all the way through. We put those payroll contributions there so as to give the contributors a legal, moral, and political right to collect their pensions. . . . With those taxes in there, no damn politician can ever scrap my social security program."[2]

In anticipation of a constitutional challenge, Social Security officials went out of their way to purge their informational materials of insurance language. A 1937 pamphlet, written shortly before the Supreme Court decisions, described the program accurately and with a minimum of manipulative art: "The United States Government will send checks every month to retired work-

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ers . . . under the old-age benefits plan . . . The same law that provides these benefits for you and other workers sets up certain new taxes to be paid to the United States government."

The 1938 pamphlet, published after the decisions, shows the insurance-framing project once again in full flower: "Your [Social Security] card shows that you have an insurance account with the U.S. Government—Federal old age and survivors insurance. This is a national insurance plan for all workers in commerce and industry . . . . [T]axes are like the premium on any other kind of insurance."[3]

From the program's inception the lack of a legally binding entitlement to benefits was deliberately obscured. By framing the program as insurance, it was possible to make benefits seem earned rather than part of a socially stigmatized "dole." Accordingly, during "fireside chats" and public speeches, Roosevelt told American workers that they have an "insurance policy" with the government, that "the insurance policy . . . is bought" with a payroll tax "premium" and is "far more favorable . . . than any policy that any private insurance company could afford to issue."[4] He told Congress that the "old-age insurance system" has created "individual accounts" for millions of workers who may be "likened to the policy holders of a private insurance company."[5]

Roosevelt's framing strategy calls to mind an old story attributed to another formidable American president, Abraham Lincoln, that goes something like this:

Abe asks, "How many legs does a cow have?"

The bemused reply: "Four."

"If we also call its tail a 'leg' how many legs does it have?"

"Five?"

"No, calling a tail a 'leg' doesn't make it a leg!"

Nor does calling Social Security "insurance" make it insurance. Nevertheless, "To challenge the insurance analogy or resist using the terms," writes Social Security scholar Martha Derthick, "was to show oneself an enemy of the program."[6] And this continues to be true today. Jonathan Chait of *The New Republic* writes, "Privatizers portray Social Security as a kind of low-performing 401(k) plan. But the program was never intended as a personal retirement plan. It's a form of social insurance, designed to spread risks throughout the population."[7] But is it really? Is Social Security a leg because we call it a leg? Let us challenge the insurance analogy and risk showing ourselves enemies of the program.

Transfer of Risk

Well, what is insurance, anyway? Insurance is a device for guaranteeing an individual against loss by transferring a risk from the insured individual to the insurer. In private insurance the agreement between the insured and the insurer is a legal contract, a "policy," which sets out the terms and conditions of coverage. The fee paid by the insured individual is the "premium." Reimbursement of losses incurred by the insured through the incidence of an event covered by a policy is paid from a fund constituted by the premium payments of many individuals exposed to a similar risk of loss. This fund is sometimes called the "risk pool." Premiums are determined by actuarial principles sensitive to the probability of the occurrence of the insurable event and the likely cost of the loss should the event occur.[8]

Presumably, social insurance, to be worthy of the name, should function roughly like private insurance. One of the core components of private insurance is the legal entitlement to benefits based on contractual agreement, and this component is conspicuously missing from Social Security. Another key difference—the difference that transforms mere insurance into *social* insurance—is that the risk pool for social insurance is the general public instead of merely those individuals who voluntarily decide to hold policies and pay the associated premiums. So, for example, for the disability insurance component of Social Security, all workers pay "premiums" in the form of payroll taxes, and all receive predetermined benefits when the "insurable event" occurs—namely, when a medical condition prevents the worker from performing his job.

However, the main element of Social Security, assistance for senior citizens, differs significantly from the disability component. It is altogether baffling how the prospect of reaching a certain age, or voluntarily withdrawing from the labor force, constitutes a "risk" of loss. Achieving the age of 62 or 65 simply does not carry with it a significantly heightened risk of poverty, nor does retirement. On the contrary, old age is correlated with wealth, the average 70-year-old being rather better off than the average 25-year-old. Becoming older and retiring from the work force is not a risk to insure against, but a near-inevitability to prepare for. A loss might occur on a birthday, but a birthday is not a reimbursable loss.

In his 1910 book *Social Insurance: A Program for Reform,* the first systematic American work on the topic, Columbia University economics professor Henry Rogers Seager laid out his criteria for determining which events should and should not trigger coverage by social insurance.

> If the need is one the wage earner clearly foresees as certain to arise, then I should be the last person to wish to relieve him of responsibility for meeting it . . . But the future needs we are considering are not of this sort. Many wage earners go through life without being the victims of industrial accidents, without serious illness, never lacking for work, and *not living long enough to become superannuated.* These are all risks to which wage earners are exposed, not certain needs which they can clearly foresee.[9] [emphasis added]

The need to prepare for the interim between retirement and death is now one "the wage earner clearly foresees as certain to arise," or, at least, foresees as very likely to arise.

When Seager wrote these words, life expectancy at birth was about 51 years. A 25-year-old in 1910 could expect to expire just before reaching 65, today's age of full Social Security eligibility. It was not unreasonable, then, to consider living well past that age, "living long enough to become superannuated," as an unforeseeable risk to which one is exposed and may wish to be insured against. Similarly, when Social Security became law in 1935, life expectancy barely exceeded the age of eligibility.[10]

Today, a representative 25-year-old can expect to make it to his 80th birthday.[11] The need to prepare for the interim between retirement and death is now one "the wage earner clearly foresees as certain to arise," or, at least, foresees as very likely to arise. Under these conditions, no honest proponent of social insurance should "wish to relieve him of the responsibility of meeting it." The phenomenal rise in life expectancy over the course of the twentieth century has simply removed retirement from the category of risk, and has therefore rendered the idea of old-age insurance obsolete.

Mutuality Lacking

Additionally, the retirement component of Social Security lacks the feature of *mutuality* that is at the center of the notion of a risk pool. Because all retirees—Bill Gates and Warren Buffett included—receive benefits regardless of their financial condition, it can't be that the lucky "winners" are indemnifying the unlucky "losers." Instead, the Social Security is a demographically unsustainable system of intergenerational transfers from current workers to current retirees. It is this feature of Social Security that has led it to be characterized as a "chain letter," or a "Ponzi scheme."

Now, if one wishes to play fast and loose with the language of insurance, one might argue that any government program that protects individuals from the suffering of poverty is a kind of insurance. But then the category has become so slack that almost anything gets in. Any means-tested anti-poverty program qualifies. Similarly, if an income-supplementing stream of government Social Security checks counts as insurance, then it is difficult to see how an income-supplementing stream of personal retirement account annuity checks fails to perform the same function. However, the entire point of the insurance frame was to cast Social Security as something unique and distinctive. "Social insurance" is supposed to differ from mere welfare. And contemporary status quo-ists like Chait deploy insurance rhetoric to distinguish Social Security from a system of personal retirement accounts.

In a 1973 debate with Wilbur Cohen, Milton Friedman argued that "social security is not in any meaningful sense an insurance program in which individual payments purchase equivalent actuarial benefits." It is a tax plus a program of government transfers "in which all sorts of considerations other than the amount paid determine the amount received."[12]

Arguing that a tail is a leg when you call it a "leg," Cohen maintained that Social Security must be insurance because the government calls it insurance, and that, furthermore, he once wrote an article in the *Encyclopedia Britannica* stating that it is. In any case, Cohen argued, rhetoric has its virtues. "I believe in rhetoric," Cohen said, "because it makes a lot of things palatable that might be unpalatable to economists."[13] But it is not only economists, Cohen goes on to clarify, to whom "a lot of things" might seem unpalatable: "Let me emphasize that the reason why [welfare] programs don't get appropriations, don't get support from the taxpayer, is simply that they do not appeal to the middle class, middle income person."[14]

"In the United States," Cohen argued, "a program that deals only with the poor will end up being a poor program." This belief—that the elderly poor will eat only cat food unless American voters are under the influence of the noble lie of insurance—is the key to Social Security as we know it.

It is not well known that under Social Security over 90 percent of payroll tax revenue goes back to the income bracket from where it came.[15] Welfare liberals often suppose that this largely pointless churn is necessary to preserve the illusion of an insurance-like connection between "federal insurance contributions" and Social Security benefits, under cover of which a relatively small quantity of residual redistribution to the elderly poor may fly. Social Security is a program that turns "the skies black with criss-crossing dollars," to use William Buckley's vivid phrase, in order to generate a sense of false entitlement and political support for welfare transfers that, so the argument goes, un-deluded voters would not otherwise support.

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1. On the legal history of Social Security, see Larry DeWitt, "The 1937 Supreme Court Rulings on the Social Security Act," U.S. Social Security Administration, 1999, www.ssa.gov/history/court.html.
2. Quoted in Martha Derthick, *Policymaking for Social Security* (Washington: Brookings Institution, 1979), p. 199.
3. Quoted in Jerry R. Cates, *Insuring Inequality* (Ann Arbor: University of Michigan Press, 1983), pp. 32–33.
4. Franklin D. Roosevelt, "Madison Square Garden Speech," October 31, 1936.
5. Franklin D. Roosevelt, "A Message Transmitting to the Congress a Report of the Social Security Board Recommending Certain Improvements in the Law," January 16, 1939, www.ssa.gov/history/fdrstmts.html#1939.
6. Derthick, p. 199.
7. Jonathan Chait, "Blocking Move," *The New Republic*, March 21, 2005, p. 21.
8. For standard definitions of insurance see, for example, "Insurance," *The Columbia Encyclopedia, Sixth Edition* (New York: Columbia University Press, 2004); or "Insurance," *Wikipedia: The Free Encyclopedia*, http://en.wikipedia.org/wiki/Insurance (retrieved May 10, 2005).
9. Henry Rogers Seager, *Social Security: A Program for Reform*, (New York: Macmillan, 1910), p. 21.
10. Elizabeth Arias, "United States Life Tables, 2002," National Vital Statistics Reports (Washington, D.C.: U.S. Department of Health and Human Services), vol. 53, no. 6, November 10, 2004.
11. Ibid.
12. Wilbur J. Cohen and Milton Friedman, *Social Security: Universal or Selective?* (Washington, D.C.: American Enterprise Institute, 1972), p. 26.
13. Ibid., p. 54.
14. Ibid.
15. Jeffrey Liebman, "Redistribution in the Current U.S. Social Security System," in Martin Feldstein and Jeffrey Liebman, eds., *Distributional Aspects of Social Security and Social Security Reform* (Chicago: University of Chicago Press, 2002), p. 4.

A College Fund on the Social Security Model

BY WILLIAM CONERLY

Thanks to Social Security, my wife and I have discovered how to guarantee our children's college education without any sacrifice on our family's part. No, we aren't so old that our retirement checks will go directly to the university. We have an even better method: our family has adopted the Social Security model for a college trust fund.

It began when our 10- and 12-year-old children started asking us what college is like. After we described the wonders of exciting lectures, late-night bull sessions, and the newfound freedom for parents, our older son asked if it cost money to go to college. What an ugly question!

Later that evening my wife and I agreed that we ought to start saving some money for the kids' college education. But how to save? As we walked around the house, we saw the crumbling infrastructure. Well, not really crumbling, but the house is in need of some fresh paint and a decent lawn irrigation system.

Then there were the pressing social needs. The spring-break ski week helps to bring us together as a family, and the evenings out with my wife are vital to maintaining a solid marriage. What more pressing social needs could there be?

My wife proposed cutting back spending on computer games, to which I agreed. But the children pointed out that the games are an investment in the future, because both boys expect one day to make millions as game designers, or at least thousands as professional game testers. Who can be against investments in education and technology? Thus, we just couldn't cut the current budget, despite the looming college crunch.

A Great Idea

The great idea came when I studied the Social Security Trust Fund. I called a family meeting to announce the establishment of the Conerly College Trust Fund.

"Where will the money come from?" my wife asked. I assured her that we would put money into the fund, but not have to cut our current spending.

"How will the trust fund be invested?" asked my older son, who has a budding interest in the stock market.

"The fund will buy Conerly Bonds," I explained, waiting for cries of understanding and adulation. The family fell silent, so I explained: "We're following the Social Security model here. The Social Security Trust Fund buys bonds issued by the U.S. government. So, the Conerly College Trust Fund will buy bonds issued by the Conerly Family."

Still no response. "You see, a bond is just a loan. The trust fund will lend the family the money we need to continue spending on our infrastructure needs, social needs, and investments in the future. That way the family continues to spend as ever before, while the trust fund grows to a nice fat sum. I just hope that you kids can get into a college expensive enough to use up all of our big trust fund."

My younger son, who had been silent up to now, didn't understand. "But how will we pay off the Conerly Bonds? If the family isn't able to pay for our college without the trust fund, how will the family be able to pay off the bonds when we turn 18? I don't get it."

"Don't worry, son," I told him. "There are some things that Daddy just can't explain. But I'm sure you'll be able to understand it after you've gone to college. I suggest you study economics."

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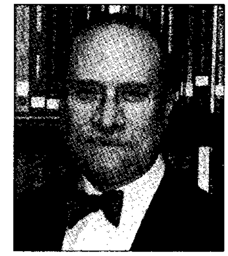

The Shady Origins of Social Security

BY SHELDON RICHMAN

Writing in the *New York Times* last January, Professor Barry Schwartz, author of *The Paradox of Choice: Why More Is Less*, described the creation of Social Security as though it were an act of divine intervention: "Social Security was created as an insurance scheme, not a pension scheme." The passive voice is good for shrouding important matters, such as responsibility.

The actual story of the genesis of Social Security sheds a good deal of light. According to Charlotte Twight's superlative book *Dependent on D.C.: The Rise of Federal Control over the Lives of Ordinary Americans*, "Contrary to conventional wisdom, the public did not desire the compulsory old-age 'insurance' program that we call Social Security when it became statutory law in 1935. It was passed and later expanded despite initial public opposition and strongly prevailing ideologies of self-reliance." Essentially, the government had to fool people into accepting the program. It did so by misrepresenting Social Security as insurance and by using many other devices to make it difficult for the public to find out what really goes on in Washington.

As Twight notes, after five years of depression, nothing like Social Security had been sponsored by a member of Congress. She quotes Carolyn Weaver, a historian of Social Security, who has written, "[T]here simply was no significant demand for such a program." When President Roosevelt had the idea proposed in Congress, according to another historian, Edward Berkowitz, "no ground swell developed in support of social insurance programs because they did not affect the major problems of relieving the victims of the depression."

Although most people did not want to see the government get into the pension business, they did favor federal help for the elderly who had lost their savings. A bill to that effect was wending its way through congressional channels—until Roosevelt, who wanted full-blown Bismarckian compulsory "social insurance," told Congress to hold off passing the ad hoc aid. Twight reports: "This postponement was critical in preserving needs-based old-age assistance as an issue that later could serve as a lever for moving Roosevelt's controversial program of compulsory old-age insurance through Congress." (German Chancellor Otto von Bismarck is credited with constructing the first modern welfare state in the late nineteenth century. The Social Security Administration pays homage to Bismarck by posting his photo on its website: http://www.ssa.gov/history/quickintro.html.)

> Obviously, FDR calculated that a clear and honest proposal would have been rejected.

Roosevelt set out to make opposition to his plan politically costly. Drawing on Weaver's work, Twight enumerates FDR's strategy: "(1) control information flowing to Congress and the public; (2) dominate the agenda with the presidentially backed bill; (3) package the compulsory old-age insurance provisions with other, more popular, programs, such as federal funds for old-age assistance, unemployment compensation, and maternal and child health services; and (4) refuse to sign individual sections of the bill if separated from other sections (an 'all-or-nothing' offer or tie-in sale)."

In other words, Roosevelt wanted to make it virtually impossible to oppose his unpopular socialistic plan without also effectively opposing more modest publicly supported measures. As Edwin Witte, executive director of Roosevelt's Committee on Economic Security, wrote, "I doubt whether any part of the social security have been enacted into law but for the fact that the Pres-

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ident throughout insisted that the entire program must be kept together." (Quoted in Twight, p. 63.)

No effort was spared in having Social Security ride on the coattails of old-age assistance. "Moreover," Twight explains, "they placed the popular old-age assistance title first, believing it [in Witte's words] 'had the effect of drawing away opposition from other titles, which had much less popular support.' When it seemed 'probable that the old age insurance titles would be completely stricken from the bill' and leading Democrats on the House Ways and Means Committee advised the president 'that the old age insurance provisions could not be passed,' Roosevelt 'insisted that this was the most important part of the bill and very definitely gave these Administration leaders to understand that all essential parts of the measure must remain intact.' "

According to Twight, Witte acknowledged in his 1962 book, *The Development of the Social Security Act*, that members of Congress received mostly "critical or hostile" correspondence about Social Security. He said that the "net impression [was] that there was serious opposition to the bill and no real support." He went on, "Few members of the Ways and Means Committee were sympathetic with the economic security bill." Many of them voted for it, Witte wrote, only because "it had the endorsement of the President."

Tying Social Security to a popular modest program of assistance to the elderly poor was not the only device used to win passage. Another device was gradualism—starting a radical program on a small and seemingly unthreatening scale, saving the major expansions until later when people have gotten used to the idea. As Twight explains, "The bill that became law established a compulsory old-age benefit program quite different from the one we know today. Many groups were excluded from coverage; the payroll tax rates were low." Seeming to divide the tax between employer and employee was another way to camouflage the full meaning of the program. While that division makes it appear that companies pay half the tax, in fact they may pay none of it at all (depending on the particular labor market). Employees may actually pay most or all the tax because their cash wages may be lower than they would be in the absence of the FICA tax. Businesses can't pay taxes; they can only collect them.

In later years, the program changed in important ways. Twight writes: "The record documents a sustained and systematic expansion: increases in worker categories covered, expansion of levels and types of benefits, increases in payroll tax rates and in the taxable wage base, the switch to pay-as-you-go financing (divorcing benefit increases from the necessity of immediate tax increases), and a decrease in the relative importance of means-tested old-age assistance."

Hiding the Costs

The American people eventually came to favor Social Security, but not until "[g]overnment officials . . . actively sought to reshape public opinion." Twight's book documents this campaign in great detail. That effort included hiding the program's present and future costs and describing Social Security in misleading insurance terms. This is how Americans came to believe they have a contractual relationship with Social Security similar to the relationship with a private insurance company. (They don't: The Supreme Court said so twice. Besides, a contract requires consent, which is lacking in Social Security.)

The upshot of the government's disinformation campaign was to diminish or eliminate the public's ideological opposition to a socialized retirement system.

Why did the Roosevelt administration engage in subterfuge to get Social Security established? Obviously, it calculated that a clear and honest proposal would have been rejected. A later Social Security administrator, Wilbur J. Cohen, once said of the language used to describe the program, "Its value is in what it conceals rather than what it reveals" (Twight, p. 75).

But why did Roosevelt want Social Security in the first place? One could advance the theory that FDR and the Brain Trust cared only about the public interest, their insight into which was superior to that of the people themselves. But the Public Choice school of political economy has provided ample reason to doubt such public-interest explanations for what politicians do. The more likely reason is that Roosevelt and his coterie saw the long-term political advantage of Social Security, namely, the vote-getting potential of making all Americans dependent on government for their retirement income. Later politicians have certainly enjoyed spending the billions of dollars taken in by the payroll tax that were not immediately paid to retirees.

Yes, Virginia, There Is a Social Security Trust Fund

BY JOHN D. MCGINNIS

My 12-year-old niece, Virginia, wrote me this letter. My reply follows.

Dear Uncle John,

I have a teacher, Mr. Pyrrho, who says there is no trust fund for Social Security. When I asked Mom about this, she said, "Ask your Uncle John. If he agrees then it must be so." Please tell me the truth, Uncle John. Is there a trust fund?

My dear Virginia,

Your teacher is wrong. He is probably affected by the skepticism of a skeptical age. He is one of those who do not believe except in what they see. Sure, there is no such thing as is commonly called a trust fund to make Social Security secure. Your teacher probably has pointed out that a typical trust fund holds stocks and bonds, which secure present ownership of the future cash flows of particular capital assets. Social Security's trust fund seems not to have any capital assets in place at all—the only clue to its existence are the electronic IOUs the Treasury creates when it takes Social Security taxes and spends them on whatever it wants.

Social Security's trust fund seems not to have any capital assets in place at all—the only clue to its existence are the electronic IOUs the Treasury creates when it takes Social Security taxes and spends them on whatever it wants.

But you should know, my dear Virginia, that there are capital assets now in place (and there will be more in the future) from which the Treasury will draw to continue Social Security. In fact, you yourself are one of those capital assets. Let me explain.

When a private organization starts a trust it purchases financial assets (stocks and bonds), which give it ownership of capital assets and the cash flows those assets will generate. We think of business assets such as plant, equipment, patents, and goodwill as capital goods because they generate cash flows over time. Your teacher sees no such assets set aside at present to support Social Security, but there are indeed assets the government owns and has set aside: you, me, and everyone else who tries to earn a living.

You see, Virginia, your government owns as large a portion of you and as much of your future earnings as it wants. Let me illustrate this with my own situation, Virginia. I am 51 years old and have been taxed since I was 16 years old for Social Security. If those taxes had been invested in a diversified portfolio of large-company stocks, I would have nearly half a million dollars today. Even if the money had been invested in low-return Treasury bills, I would have over $200,000. But what do I have instead? An order and a promise from the government. The order is that I will have to continue to pay taxes so long as I earn a living. The promise is that if I live to retirement age (and the government will decide what that age is) I can then, and only so long as I stay alive, start to receive some return. There's nothing for me to bequeath.

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I would like to make Uncle Sam an offer, Virginia. He can keep all the money he's taken from me in the past, and I won't ask for anything from him ever—just let me out of Social Security. Do you see the trust fund now, Virginia? Uncle Sam is never going to let us out of this program because we are the capital assets that support it. We, my dear Virginia, are the trust fund, owned and controlled by our government.

Yes, Virginia, there is a trust fund.

It exists as certainly as evil and coercion exist, and you know that they abound and threaten our lives continuously. Alas!

How great it would be if there were no trust fund! It would be as if you were running your own life and were not just a piece of chattel supporting the ten planks of the Communist Manifesto.

Not believe in the trust fund! You might as well not believe that government in America will want more than its current take of 45 percent of our earnings. You might never get to see or touch the money withheld from every paycheck you earn, Virginia, but what does that prove? It was taken as surely as if it was sitting in your pocket and an armed robber stuck a gun in your face and made you hand it over.

Not believe in the trust fund! You might as well not believe that government in America will want more than its current take of 45 percent of our earnings.

No trust fund? Then I guess there's no evil and coercion in the world; no masters, no slaves; no I.R.S., no taxpayers. A hundred years from now, Virginia, maybe a thousand years from now, the trust fund will continue to exist. Only then its assets will be your children and their children and so on.

I wish I could agree with your well-meaning teacher, Virginia. But even at your tender age, it's time you became aware that one of the most voracious predators alive already has a hold on you. Cato the Elder once said, "A king is an animal that lives on human flesh." So it is with the Social Security trust fund, Virginia.

Love and fondest regards,
Uncle John

The Dangers of Compulsory Benevolence

There has never yet come down from any government any substantial improvement in the conditions of the masses of the people, unless it found its initiative in the mind, the heart, and the courage of the people. Take from the people of our country the source of initiative and the opportunity to aspire and to struggle in order that that aspiration may become a reality, and though you couch your action in any sympathetic terms, it will fail of its purpose and be the undoing of the vital forces that go to make up a virile people. Look over all the world where you will, and see those governments where the features of compulsory benevolence have been established, and you will find the initiative taken from the hearts of the people.

—Samuel Gompers
Founding President, American Federation of Labor
December 5, 1916

Social Security Can Be Good for Your Health

AN OPEN LETTER FROM DWIGHT R. LEE

Until recently I took every opportunity to inform my students about the financial fraud of Social Security. Given demographic realities and the Ponzi-scheme nature of Social Security, those about to enter the work force will receive an anemic return on their "investment," assuming they receive any return at all. They would be far better off, and so would the economy, if they put the amount that will be taken from them by the Social Security Administration into a real investment, such as a broad-based mutual fund.

But I'm having second thoughts about presenting only the negative side of our national retirement program to the youth of America. I'll be eligible to begin collecting Social Security payments in a few years, so I've decided to take a more positive attitude. The Social Security taxes I have already paid are sunk costs, and therefore are not costs at all. Only the future taxes and income from Social Security are relevant to my return on the program, a return that is getting better all the time. What a shame to jeopardize that return by turning the taxpayers of the future against the Social Security program, which can also be there for them some day if only they consider the bright side of the financial mugging heading their way. In the hope that the young people of today can be encouraged to stay the course with their Social Security "contributions," I am writing them an open letter telling them the rest of the story. You see, Social Security is about more noble objectives than achieving financial success.

—DRL

Dear Young People,

There simply is no better feeling in the world than sacrificing for the benefit of others. That is particularly true when your sacrifice benefits me. I want you young college students to keep that in mind the next time you hear someone criticizing the Social Security system. I will be retiring about the time you are paying large sums into Social Security, and your tax payments, I mean contributions, will be sent directly to my buddies and me so we can afford to drive enormous motor homes to the local shuffleboard courts. None of it will be invested into your own personal account for your retirement.

Some of you may be asking, but then what kind of financial return can I expect from Social Security? That is the type of question we have to expect from those who, because of the damaging effects of natural selection, insist on thinking of themselves first. But let me consider the return a college graduate about to enter the work force can expect from Social Security. The news is better than some of you believe, especially those of you who believe

> The news is better than some of you believe, especially those of you who believe an invasion by the space aliens who kidnapped Elvis Presley is more likely than Social Security being solvent when you retire.

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an invasion by the space aliens who kidnapped Elvis Presley is more likely than Social Security being solvent when you retire. Let me give you my unwritten, but completely unenforceable, guarantee: you will receive Social Security checks when you retire. That is assuming you live past age 67, which you probably will because of a wonderful incentive built into the Social Security program for your benefit. Because of this incentive, your rate of return can be far better than the experts are now predicting. Let me explain.

Assume you work from age 22 to 67 and make only the median family income during your career. In this case your Social Security contribution will be about $3,000 a year, recognizing that you will generously help your employer with his contributions to your Social Security by accepting wages lower than you would otherwise have received. These contributions will make you eligible for Social Security payments at age 67. How much will you get? The maximum you can receive (as I write this) is $23,868, which assumes that your spouse is still alive, or at least appears to be, and also 67 or older. When you are 67, 45 years from now, the payments will be higher, assuming they keep up with inflation (your Social Security contributions will also increase with inflation, but let's ignore that minor inconvenience). Let's be optimistic and assume they will. Assuming a 3.1 percent inflation rate (the average over the last 70 years), then your annual income from Social Security will be $91,453 at age 67. And you thought Social Security was a lousy deal.

Social Security is right up there with conferences on global warming as a way of promoting long life.

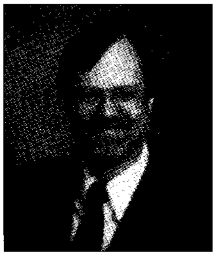
I'm tempted to rest my case right here, except someone is probably asking, "But how better off would I be if, instead of contributing to Social Security, I put the $3,000 a year into the stock market for the next 45 years? At the risk of encouraging people to think of Social Security only in crass financial terms, I will answer this question.

Over the last 70 years the stock market (as measured by the Standard & Poor's 500 index) has grown at an average annual rate of 10.9 percent. At that return, your $3,000 a year will be worth $3,182,779 when you are 67. With that amount of money, you could buy a lifetime annuity that pays over $356,000 a year. So a cynical, but completely accurate, conclusion is that the Social Security system will bamboozle you out of over $264,547 a year (the difference between $356,000 and $91,453) during your retirement.

But why be so negative? After 45 years of 3.1 percent annual inflation, $264,547 will be worth only about $69,000 in today's dollars. Also, think of the incentive Social Security gives you to take good care of yourself. You can make Social Security pay if you live long enough. The present value of your Social Security income will be worth the $3,182,779 your private investment would have provided, if you simply refuse to die until you are 125 years old. (This assumes that your annual Social Security income of $91,453 grows at 3 percent a year—good luck—and you discount the future value of that income stream by 5 percent—ask your favorite finance professor why discount is necessary.)

So Social Security is right up there with conferences on global warming as a way of promoting long life. I'm certainly keeping myself in peak condition in anticipation of benefiting as long as possible from your Social Security contributions. I don't want to go face down in my oatmeal until you young folks retire.

Sincerely,
Dwight R. Lee
Ramsey Professor of Economics



Immaculate Planners or Messy Entrepreneurs?

BY BURTON FOLSOM, JR.

"We need help from government. We need to hire experts to pick winning companies, and then we can subsidize them to come and bring more jobs to our state." From time to time, for almost two centuries, that has been the battle cry from states across the nation. Most recently, Governor Jennifer Granholm of Michigan has unveiled a $2 billion Jobs Tomorrow proposal that will allegedly attract new industry to her rust-belt state.

Students of economic history will immediately ask: What is the government's track record for picking winners? The answer is that such experiments form a long train of disasters. As Henry Hazlitt once observed, "There is no more persistent and influential faith in the world today than the faith in government spending."

Since Michigan is where the latest government program is planned, let's use that state as a historical example. When Michigan first joined the union in 1837, its political leaders believed that their state's northern location was too remote. To induce industry, Governor Stevens T. Mason and the legislature sold $5 million in bonds to build the "high-tech" industries of the era—railroads and canals—to detour businesses and people northward to Michigan.

Sure enough, the bonds were sold and the "experts" surveyed routes for one major canal and two railroads. The canal cost $350,000, was poorly constructed, and earned $90.32 in tolls before it was abandoned. Then came the railroads, and the state ran out of money before completing either one. What's more, both tracks were so shoddily constructed that trains were barely safe moving back and forth on them.

At that point Michigan abandoned having politicians and experts pick winners and losers. The state sold the railroads to private investors, and in three years they had both railroads rebuilt, completed, and running smoothly across the state. Michigan voters celebrated this event by changing the state's constitution so that the state could "not subscribe to or be interested in the stock of any company, association, or corporation," or engage "in any work of internal improvement."

> The president of the Michigan Savings Bank in 1903 refused to back Ford Motor Company because "the horse is here to stay, but the automobile is only a novelty—a fad."

Governor Granholm's proposal is similar in kind to the state's early railroad fiasco. She wants independent experts—from the American Association for the Advancement of Science (AAAS)—to target future winning investments for the state, and she even wants to amend the 1850 state constitution to allow the state to hold equity in some of these new businesses.

There are three reasons why Michigan's $2 billion subsidy, if enacted, would probably do more damage to the state's taxpayers than good to the state's economy. First, economic projects shaped by politicians and "experts" use other people's money, in contrast to projects shaped by entrepreneurs and investors, who use their own money. Politicians have every incentive today, as they did in the 1830s, to employ economic development mainly to gain votes—governors and state legislators win elections when they bring outside industries into their districts.

Second, the so-called "experts" often have hidden agendas. The experts at the AAAS, for example, believe in harmful global warming and avoid publishing any argument against it in their magazines. They have every

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incentive to promote ideas (for example, solar panels and battery-operated cars) that fit their conception of how the world should work, rather than how it actually works.

Third, even when experts put aside their personal agendas, they are notoriously poor at picking winners and losers. This bad record goes beyond the canals and railroads they picked for Michigan in the 1830s. They almost did it with the auto industry too: the experts of 100 years ago picked horses and carriages over cars. The president of the Michigan Savings Bank in 1903 refused to back Ford Motor Company because "the horse is here to stay, but the automobile is only a novelty—a fad." Six years later, after Ford scraped up the private capital to build his first Model T, the experts at *Scientific American* concluded that "the automobile has practically reached the limits of its development. . . ."

David Hollister, Governor Granholm's labor and economic growth director, has asked a fair question: If not Jobs Tomorrow, "What is your alternative?" The best answer is: Low taxes and strong property rights attract investors; high taxes repel them. Therefore, cut the tax rate, kick out the planners, and thereby attract the world's best entrepreneurs to your doorstep.

That conclusion—that reality, if you will—is hard to see. It requires faith in the invisible workings of markets rather than faith in the visible actions of planners and politicians. To help understand why such faith in markets is well placed, let's look at the specific historical example of the Coolidge tax cuts, which were applied nationwide in the 1920s.

When the American economy slowed down after World War I, Presidents Harding and Coolidge argued that high tax rates were at least partly responsible for the double-digit unemployment the country faced. During the 1920s both presidents began slashing the tax rates until the top rate had fallen from 73 to 25 percent and the bottom rate from 4 to 1.5 percent. America's wealthy entrepreneurs could now keep three-fourths of their income instead of giving three-fourths of it to the government. The improved investment climate helped lead to a sharp rise in business starts, patents, and corporate expansion, and a big drop in unemployment, which averaged only 3.3 percent during Coolidge's presidency.

Experts Defied

During the 1920s entrepreneurs defied the logic of experts. The radio, for example, became the most popular innovation of the decade. But Lord Kelvin, the president of the British Royal Society, had warned earlier, "Radio has no future." Then in 1922, when radios began to sell, Thomas Edison predicted, "The radio craze . . . will die out in time." Six years later, when radios were becoming standard household items, H. G. Wells, the futurist, pronounced the radio to be a mere fad: "[T]he truth is that I have anticipated its complete disappearance. . . . [T]he unfortunate people . . . listening in will soon find a better pastime for their leisure."

Air-conditioners and zippers, two other innovations of the 1920s, had to overcome similar objections from experts. In the case of the zipper, the patent office had no idea how to comprehend such an invention and knew not how to classify it. When Gideon Sundback, its major inventor, first put zippered money belts on the market, sales were low; no one yet had the vision for how such a product could be widely used. Finally, in 1923, B. F. Goodrich took a chance and sewed zippers onto 150,000 pairs of galoshes. Their sales boomed. Putting zippers later on clothes was an unexpected afterthought.

Willis Carrier, the inventor of the air-conditioner, was fired by the heating and cooling experts at the Buffalo Forge Company, even after he had shown them that his contraption worked. Carrier finally struck out on his own and hit pay dirt in 1925, when he sold a large air-conditioner to the Rivoli Theater in New York. By 1930 he had installed 300 units in theaters across America. Office and home air-conditioning came later as an afterthought.

Who in 1920 could have anticipated or planned the dramatic success of radios, air-conditioning, and zippers during that decade. Markets are messy and unpredictable—they defy the plans of experts and the subsidies of politicians. The exciting inventions and business successes of the 21st century will probably surprise us, too.

If Michigan's politicians will oust the experts and use low tax rates to lure entrepreneurs, that state may again see the economy boom.

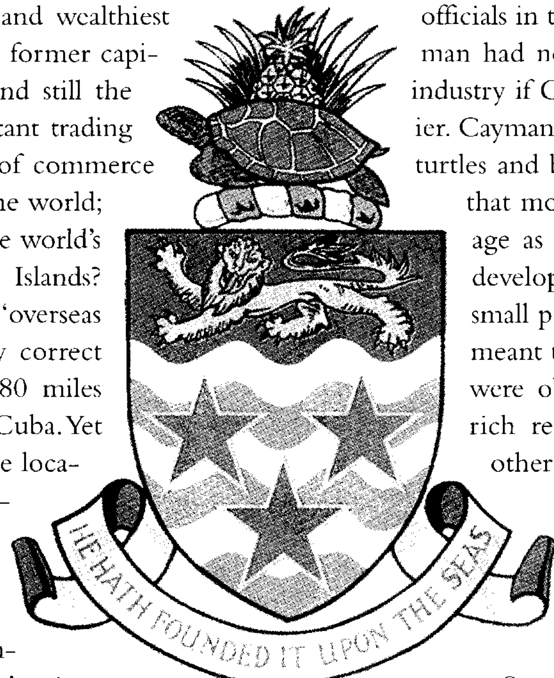
Offshore Prosperity

BY ANDREW MORRISS

Quick—without reading the next paragraph of this article, name the five largest financial centers in the world.

Answers: London, Tokyo, New York, Hong Kong, and the Cayman Islands. New York is the financial capital of one of the largest and wealthiest nations in the world; London, the former capital of a globe-spanning empire and still the capital of one of the most important trading nations; Hong Kong, the center of commerce for one of the largest markets in the world; and Tokyo, the capital of one of the world's wealthiest nations. The Cayman Islands? They are 100 square miles of an "overseas territory" (the modern, politically correct term for a colony) of Britain, 480 miles from Miami and 150 miles from Cuba. Yet those 100 square miles are now the location of billions of dollars of transactions and bank deposits.

Even more strikingly, 40 years ago Hong Kong, London, New York, and Tokyo were major financial centers and the Cayman Islands' major industries were exporting their men to work as sailors on merchant ships and making palm thatch ropes for sale to Jamaican fishermen. The three islands (Grand Cayman, Little Cayman, and Cayman Brac) were infested with mosquitoes and flies so fierce that inhabitants ran from their homes to their cars to escape the insects, and cows suffocated on the clouds of insects they inhaled. Today the islands are a tropical paradise, virtually free of biting insects, with more than a million tourists visiting annually and the islands *importing* labor (almost half the islands' population are foreigners). What happened?



The Cayman Islands Coat of Arms

A key reason for Cayman's success as an offshore financial center is that the islands proved a hospitable jurisdiction for policy "entrepreneurship." Several officials in the early 1950s recognized that Cayman had no choice but to develop a financial industry if Caymanians were to become wealthier. Cayman has no natural resources other than turtles and beaches. So little of its area is arable that most statistical reports list the percentage as zero. This ruled out the traditional development projects in agriculture. The small population and lack of a local market meant that industrial development schemes were obviously hopeless. Making Cayman rich required finding a way to convince other people to bring money to the islands and buy services.

These enterprising officials set out to create a legal and business climate that could compete with jurisdictions such as the United States for investors. They studied other jurisdictions' laws and selected the provisions they thought most likely to appeal to investors. They examined the islands' infrastructure and built what was needed to service a financial industry. For example, in the early 1960s communications from Cayman to other countries were handled by a single wireless station,

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operated by a man with a drinking problem. As one Cayman lawyer from that era told me, messages were fine if sent before lunch; after noon the content would be hopelessly garbled. To solve the problem, the government built an international telephone system to ensure that businesses would have reliable communications.

This entrepreneurial attitude continues. Today Cayman is the home of more hedge funds than any other offshore jurisdiction and second only to Bermuda in "captive" insurance operations (insurance companies owned by their insureds). More than 500 banks, including most of the leading banks in the world, have operations in Cayman. These successes resulted from Cayman's adoption of statutes that provided the legal environment necessary to lure such businesses to Cayman.

If you've heard of the Cayman Islands, chances are you've heard that they do not have an income tax. Not only is there no income tax, there is no direct taxation of any kind: no sales tax, no real-estate taxes, no value-added tax, nothing. What Cayman has is a series of fees for "service" (for example, for a banking license) and a 20 percent-plus duty on almost everything imported into the island. (The major exceptions to the high tariff schedules are luxury goods; luxury goods help the tourist industry and lower tariffs on them boost economic activity by allowing Cayman to offer attractive prices on goods from Rolexes to perfume.) Because virtually everything is imported, except for some fish and turtle meat, this is effectively a consumption tax rather than a trade-distorting selective tariff.

> Not only is there no income tax, there is no direct taxation of any kind: no sales tax, no real estate taxes, no value-added tax, nothing.

The absence of direct taxation is important for two reasons. First, it encourages foreigners to invest capital in Cayman. Income earned by a Cayman trust or business remains tax-free until it is paid to someone in a country (such as the United States) that taxes income earned worldwide. Investors thus need not worry about losing their assets to Cayman. To ensure that investors have confidence that it will not renege on this bargain and impose a tax later, business entities, when created, are routinely granted 20-year renewable tax exemptions from the nonexistent taxes. As a result, if the Cayman government attempted to impose a tax in the future, investors would have plenty of time to move their capital elsewhere.

Even more important, the absence of direct taxation means that the Cayman government simply does not collect the sort of information routinely gathered by most countries' governments. Want to know how much a Cayman business earns? You can't find out by asking the government, since it never asks the business. If other governments want information, the Cayman government can't tell them since it doesn't collect the information in the first place.

The Cayman government's unwillingness to pry into Cayman companies' (and individuals') private affairs is paralleled by the strong protection provided by Cayman's Confidential Relationships (Preservation) Law 1995. Building on a foundation provided by the English common law, Cayman criminalized the breach of privacy by anyone with access to confidential information. Moreover, Cayman protects confidential information by requiring those seeking it to provide assurances that they can pay the costs of collecting the information and any harm that results from the disclosure.

Rule of Law

A critical part of Cayman's success, and one reason it is more successful than some other offshore financial centers, is that investors have confidence in the legal system. Putting money in a foreign jurisdiction is risky—if a new government takes power, it can easily renege on prior government commitments. Since governments generally have a poor record in keeping their promises, this political risk is a serious problem for small jurisdictions seeking to lure investors.

Caymanians understand this and have taken several steps to guarantee to investors that the legal system is stable.

First, the final court of appeal is not a Caymanian court but the British Privy Council. By effectively "outsourcing" this critical judicial function to an entity trusted by outsiders and incapable of being pressured by Cayman politics, Cayman has shown investors that it can be trusted not to violate its legal obligations.

Second, Cayman brings in outsiders to handle sensitive cases, importing jurists from other Commonwealth jurisdictions for specific trials and even to serve on the islands' appellate court. This helps assure investors that local prejudices will not sway the court, much as "diversity" jurisdiction in the U.S. legal system moves cases between residents of different states (over a financial threshold) to federal court to avoid the appearance of a "home court" advantage for the in-state litigant.

Third, the Cayman constitution (embodied in a British Parliament-passed statute) limits the scope for local political pressure to result in changes adverse to outside capital. There is no chief minister in the Cayman government; cabinet meetings are chaired by the British-appointed governor (who is never a Caymanian); and three "official" members of the legislature are appointed by Britain rather than elected.

Fourth, Cayman has repeatedly rejected independence, preserving these crucial links to Britain. When the United Nations Special Committee on Decolonization visited Cayman in 1977, for example, Caymanians firmly rejected its efforts to push them toward independence. As Sir Vassel Johnson, former financial secretary, put it in his memoirs: "They were told by the people of the three islands in a loud clear voice, 'Leave us alone.'"

Fifth, the key Cayman regulatory body for the financial sector, the Cayman Islands Monetary Authority (CIMA), is an independent agency rather than a politically controlled one. CIMA oversees banks and other offshore financial entities. The potential for rent-seeking in such an agency is huge—the chance to get even just a small slice of foreign investors' money has tempted many a nation's political class to take regulatory steps inconsistent with economic liberty. To prevent such behavior, Cayman gave CIMA extensive autonomy from local politics. For example, four of the nine directors on its board are non-Caymanians (currently two Americans, a Canadian, and a Englishman). Independent agencies and central banks per se raise their own problems, of course, but the point here is that Caymanians recognized that the need to provide security to investors required depoliticizing the regulatory framework and so raising the cost of political expropriation of outsiders' assets.

Finally, Cayman's budget depends heavily on financial-industry fees. Given the mobility of capital, this vulnerability helps ensure that Cayman will not renege on its commitments. Indeed, Cayman's success was partially made possible by the Bahamas' post-independence attempt to benefit Bahamians at the expense of its offshore financial sector. In the 1960s the Bahamas was the leading offshore jurisdiction in the Caribbean. But when the newly independent Bahamian government refused in the 1970s to renew work permits for non-Bahamians in the financial industry, in order to shift lucrative jobs to Bahamians, capital fled to the Cayman Islands.

> A critical part of Cayman's success, and one reason it is more successful than some other offshore financial centers, is that investors have confidence in the legal system.

By guaranteeing its end of the bargain with foreign investors, Cayman has purchased prosperity at the price of some of its sovereignty. The price paid is remarkably low, however. Anytime Cayman wants full sovereignty, there is every indication that Britain would willingly cede it. The one thing Cayman can't do is get its sovereignty back fast enough to seize all the money and value in Cayman companies, banks, insurance companies, trusts, mutual funds, and hedge funds. By the time the British government had the paperwork done, investors would have had their accounts in a new jurisdiction if they wish. That gives investors the comfort to invest in Cayman.

Indeed, for many Caymanians, the highest cost of remaining associated with Britain comes from its imposing its own social-policy preferences on Cayman. For example, Britain unilaterally legalized homosexual sex in 2001 and abolished the death penalty in 1991. Both actions were unpopular in Cayman, a socially conservative and deeply religious society. Even more unpopular was Britain's action through an "Order in Council" that overrode local legislation.

Pressures to Change

Offshore jurisdictions face a variety of pressures to change their laws to eliminate their competitive advantages. Not surprisingly, for example, the countries that "lose" tax revenue to Cayman and other offshore jurisdictions aren't happy about it. The Organization for Economic Cooperation and Development (OECD; the cartel of wealthy developed countries) dislikes the whole idea of tax competition, the "harmful" lowering of tax rates to lure business. Fortunately, the Bush administration has shown less interest in helping the other high-tax OECD countries in their quest to reduce tax competition than the Clinton administration did, but the problem lurks in the background.

The offshore financial industry also faces threats from crime. The term "offshore" often calls to mind unsavory deals of the type John Grisham wrote about in *The Firm*. And some offshore jurisdictions have fallen victim to corruption and crime. For example, historian Jan Rogozinski called Aruba "the world's first independent mafia state," and most of Montserrat's banking industry was closed down after a financial scandal involving money laundering.

Resisting illegal activity is essential for successful offshore jurisdictions for at least two reasons. Most important, illegal transactions often bring with them corruption that is destructive of the level of trust necessary for a civil society to function. More pragmatically, illegal activity threatens the toleration of offshore jurisdictions by "onshore" jurisdictions such as the United States and the European Union. The physical and legal independence of jurisdictions such as Cayman, Bermuda, or the Channel Islands is precarious. It would take little effort for Britain to simply override Caymanian laws by altering the constitution or, in a more extreme case, for a company of U.S. Marines to overrun the island.

Cayman has struck a balance between cooperating enough with onshore jurisdictions to preserve their toleration of offshore activity and maintaining its competitive advantage.

Less extreme onshore legal changes could cripple important aspects of the offshore financial industry. Of course, offshore jurisdictions are useful to European and American investors, which provides a degree of political protection against such threats. If, however, offshore centers become identified with al Qaeda financing, they are extremely vulnerable to onshore nations' pressure. Keeping their businesses in the legitimate financial sectors helps offshore financial centers protect their independence.

Cayman has struck a balance between cooperating enough with onshore jurisdictions to preserve their toleration of offshore activity and maintaining its competitive advantage. Three steps help Cayman succeed in doing so. First, it insists on the principle of dual criminality in all cooperative efforts. That is, it will help other jurisdictions obtain information about funds in Cayman only if the activities being investigated are illegal there also. The result: cooperation on terror financing but not on tax investigations.

Second, Cayman assists foreign governments only in response to requests for specific information; it will not participate in "fishing expeditions" into a suspect's funds or activities.

Third, Cayman has expanded the areas in which it offers a competitive advantage well beyond tax levels. Caymanian accounting rules and insurance laws, for example, are far more favorable to the operation of captive insurance companies (through which firms can self-insure against some risks) than either U.S. accounting rules or most U.S. states' laws.

Not Quite Perfect

But wait—isn't this the Cayman *government* that is doing these things? Doesn't that compromise the integrity of the system? We should be skeptical of the classical-liberal pedigree of offshore jurisdictions for precisely this reason. Cayman may be freer than most places with respect to financial matters, but it is still not a libertarian haven, and so there had to be a flaw.

And it definitely is not a libertarian haven. A socially conservative society, Cayman has plenty of laws that many libertarians would object to: drug prohibitions, bar closing rules (midnight on Saturdays) built around religious observance, and the like. Cayman has also made many of its investments in infrastructure through government entities. The government built the airport, runs a national airline that frequently loses money, created the law school, set up the telecommunications network, and has undertaken a host of other activities that most libertarians and classical liberals would reject as outside the acceptable range of government activities.

Despite all these flaws, Cayman plays an important role in limiting government elsewhere. What Cayman provides is competition that keeps larger states more honest. All aspects of Cayman's legal system need not meet the ideal for it to play this role. Cayman's tax and regulatory rules force governments elsewhere to restrain their resource grabs. By providing an alternative, Cayman forces a sorely needed measure of discipline on the United States, European Union, Japan, and other "developed" countries not just with respect to taxes but also to a host of regulatory measures.

Moreover, because Caymanian society is small, the government is a lot less like the grasping Leviathan of larger states. Indeed, the society seems to have reached a consensus on the value of the offshore financial industry that is making the population among the wealthiest in the Caribbean, and that consensus is reflected in the tenor of the politics. Parties have not yet taken root in Cayman, and competition for office seems more based on personalities and competency than partisan divisions. The Cayman government has certainly made missteps from a libertarian perspective. Nonetheless, they have been less destructive of liberty, particularly economic liberty, than those of many of its larger neighbors.

Cayman's success is due to thinking differently about government. Cayman has gotten rich by realizing that the fundamental problem of government is to find institutions that convince people that the government won't take their money. In part, it is because it is small that Cayman is able to make credible commitments in the ways I have described. But it is also due to the creative design of its institutions that Cayman has succeeded. For example, in 1776 separating from Britain was a means of limiting government rent-seeking; today remaining connected to Britain offers Cayman an equivalent set of limits.

Can Cayman serve as a model for other governments? Many of the specific solutions chosen by Caymanians are unlikely to function if scaled up to a country the size of the United States. It could, however, prove an important model for local governments seeking to reassure investors that they will not find a new set of rules in place the day after their investment becomes final.

The entrepreneurial attitude that made Cayman the fifth largest financial center less than 40 years after the biggest local industry was thatch-rope manufacturing could be translated even to larger-scale governments. If people can learn to stop viewing governments as the source of subsidies and recognize the connection between institutions that protect property rights and wealth, other entrepreneurs may discover institutions that effectively limit even the most rapacious Leviathan.

Read More

Literature on Cayman history is hard to come by, and most Caribbean histories give Cayman little attention. The story of it offshore industry is told in Sir Vassel Johnson's somewhat uneven autobiography, *As I See It* (Book Guild Ltd., 2001). Michael Craton's *Founded Upon the Seas* (Ian Randle, 2004) is an excellent general history of the islands and includes some material on the financial industry. If you visit Grand Cayman, the government archive (near the airport) has a fascinating collection of oral histories; unfortunately none are available on the web. The Cayman Islands also feature in a sadder story involving classical-liberal principles, the destruction of a highly successful private conservation effort to save the endangered Atlantic green sea turtle by U.S. environmental legislation. This is described in Peggy Fosdick, *Last Chance Lost* (I.S. Naylor, 1994).

Dialectics and Liberty

BY CHRIS MATTHEW SCIABARRA

Ten years ago the first two books of what has become known as my "Dialectics and Liberty" trilogy were published. Those books—*Marx, Hayek, and Utopia* (SUNY Press) and *Ayn Rand: The Russian Radical* (Penn State Press)—together with the culminating work, *Total Freedom: Toward a Dialectical Libertarianism* (Penn State Press), constitute a defense of dialectical method in the service of a libertarian social theory.

It is odd to find the word "dialectics" conjoined with anything remotely having to do with "libertarianism." And this is, perhaps, a result of the profound socialist influence on contemporary thought. Say the word "dialectics" and what might come to mind is the "thesis-antithesis-synthesis" waltz usually associated with Hegel (even though that triad more appropriately belongs to Fichte). Or one might think of the "historical materialism" of the Marxists, who view communism as the ultimate "synthesis." Or one might even think of the claims made by some that dialectics is a means of "resolving" actual, logical contradictions, a means of showing that "A" and "non-A" are one and the same.

> It is odd to find the word "dialectics" conjoined with anything remotely having to do with "libertarianism." And this is, perhaps, a result of the profound socialist influence on contemporary thought.

It is no coincidence that the same people who dismiss dialectics as an assault on logic are often the same people who view it as the methodology of socialism. But even some of the proponents of socialism would agree, for they have dismissed logic as a "bourgeois" prejudice, while viewing exploitation as the "logic" of capitalism.

The socialists have also criticized many of the advocates of capitalism for having embraced a dogmatic, ahistorical social ideal. Marx himself had derided bourgeois theorists as "Robinsonades"; the bourgeois, said Marx, had put forth an atomistic notion of human liberty that saw individuals as entirely separate from one another. Like "Robinson Crusoe" on a desert island, the bourgeois individual is unrelated to other individuals and unrelated to any social or historical context. And, for the most part, mainstream neoclassical economists agreed with him. Their static conceptions of "perfect" competition posited a rationalistic model of "Economic Man" in possession of "perfect" knowledge. Such a model had little to do with the dynamics of the real world.

But as F. A. Hayek and others have pointed out, the very word "capitalism" was a product of the socialist conception of history. It took a major effort by twentieth-century thinkers to provide a thorough reconceptualization of the market society and its foundations. Among these were Austrian economists, such as Ludwig von Mises and Hayek himself, who viewed the market in dynamic and institutional terms, and philosophers, such as Ayn Rand, who articulated an objective moral ethos at the base of "capitalism: the unknown ideal."

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A proper defense of the free society is one that must lay to rest the notion that classical liberalism, or libertarianism, as such, depends on static, ahistorical, or atomistic thinking. It is possible, nay, *necessary*, to present a form of libertarian social analysis that makes use of the very *dialectical* techniques that are its birthright. It is time to recapture dialectics as a tool for liberty.

That was the goal of my "Dialectics and Liberty" trilogy. On this tenth anniversary of the publication of its first two installments, I look back on the genesis and development of this project.

What is dialectics? Dialectics is the art of context-keeping. It counsels us to study the object of our inquiry from a variety of perspectives and levels of generality, so as to gain a more comprehensive picture of it. That study often requires that we grasp the object in terms of the larger system within which it is situated, as well as its development across time. Because human beings are not omniscient, because none of us can see the "whole" as if from a "synoptic" godlike perspective, it is only through selective abstraction that we are able to piece together a more integrated understanding of the phenomenon before us—an understanding of its antecedent conditions, interrelationships, and tendencies.

Society is not some ineffable organism; it is a complex nexus of interrelated institutions and processes, of volitionally conscious, purposeful, interacting individuals—and the unintended consequences they generate.

In social theory, the object of our inquiry is society: social relations, institutions, and processes. Society is not some ineffable organism; it is a complex nexus of interrelated institutions and processes, of volitionally conscious, purposeful, interacting individuals—and the unintended consequences they generate. A dialectical approach to social theory is one that recognizes that any given social problem will often entail an investigation of related social problems. What makes a dialectical approach into a *radical* approach is that the task of going to the root of a social problem, seeking to understand it and resolve it, often requires that we make transparent the relationships among social problems. Understanding the complexities at work within any given society is a prerequisite for changing it.

It is simply mistaken to believe that Marx and Marxists have had a monopoly on this type of analysis. It is also mistaken to believe that this emphasis on grasping the full context is, somehow, a vestige of Marxism.

In fact, the father of dialectics, the man whom Hegel himself called the "fountainhead" of dialectical inquiry, was Aristotle. In works such as the *Topics*—the very first theoretical treatise on dialectics—Aristotle presented numerous techniques by which one might gain a more complete picture of an issue by varying one's "point of view." The *Topics* serves as a grand discussion of how shifts in one's perspective can reveal different things about the objects of our inquiry, and about the perspectives from which those objects are viewed.

I examine the broad history of dialectical thinking, from the ancients to the postmoderns, in part one of *Total Freedom*. Presenting that history is beyond our current scope. But it is important to recognize that these methodological techniques have long been an unheralded aspect of classical-liberal and libertarian analytical frameworks, as presented by such thinkers as Herbert Spencer, Carl Menger, Mises, Hayek, Rand, and Murray Rothbard.

Hayek's Critique of Utopianism

For example, Hayek, who absorbs from Menger an Austrian emphasis on process and spontaneous order, enunciated a profoundly dialectical critique of utopianism. As I argue in *Marx, Hayek, and Utopia*, Hayek railed against both collectivist and atomist viewpoints. For Hayek, since no human being can know *everything* there is to know about society, people cannot simply redesign it anew. Human beings are as much the creatures of their context as they are its creators. Hayek's rejection of utopianism is a repudiation of what he calls "constructivist" rationalism. The utopian relies on a "pretense of knowledge," Hayek argued, in an attempt to construct a bridge from the current society to a future one. Whereas the collectivists have criticized bourgeois theorists for embracing "ahistorical" and "state of nature" arguments for capitalism, they themselves have embraced an ahistorical, exaggerated sense of human possibility in their projections of an ideal communist society.

Marx himself was critical of this "constructivism" in the works of the utopian socialists, but his own work succumbs to the same constructivist impulse. Implicit in his communist ideal is the presumption that human beings can achieve godlike control over society, as if from an Archimedean standpoint, virtually transcending unintended social consequences such that every action brings about a known effect. Hayek saw this as a "synoptic delusion," an illusory belief that one can live in a world in which every action produces consistent and predictable outcomes. And, invariably, the quest for total knowledge becomes a quest for totalitarian control.

Whatever problems one might detect in Hayek's various theories of social evolution—and I discuss these in *Marx, Hayek, and Utopia*—I believe that he contributes much to a dialectical-libertarian social theory. For example, in his classic book, *The Road to Serfdom*, Hayek presents us with a multidimensional view of the corrosive nature of government control. He does not focus on the one-dimensional *economic* effects of state regulation. In fact, one might say that his primary concern is with the insidious, *multidimensional* effects of statism—how its consequences redound throughout a nexus of social relations: economic, political, and even social-psychological. In other words, Hayek analyzes statism not only as a politico-economic scourge, but as a phenomenon whose effects can be measured on many different levels of generality and from many different vantage points. The more perspectives we take on statism, the greater will be our grasp of its characteristics and the means by which to undermine it.

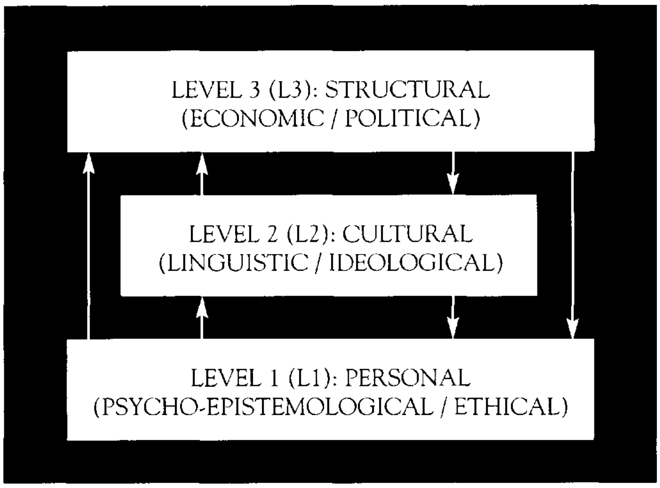
For Hayek, "the most important change which extensive government control produces is a psychological change, an alteration in the character of the people." There is a social-psychological corruption at work, therefore, in which causes and effects become preconditions of one another, part of a system of mutually reinforcing processes. "The important point is that the political ideals of a people and its attitude toward authority are as much the effect as the cause of the political institutions under which it lives," he writes.[1] This is a system, then, of mutual implications, of reciprocal connections between social psychology, culture, and politics:

> Freedom to order our own conduct in the sphere where material circumstances force a choice upon us, and responsibility for the arrangement of our own life according to our own conscience, is the air in which alone moral sense grows and in which moral values are daily re-created in the free decisions of the individual. Responsibility, not to a superior, but to one's conscience, . . . the necessity to decide which of the things one values . . . and to bear the consequences of one's own decision, are the very essence of any morals which deserve the name. That in this sphere of individual conduct the effect of collectivism has been almost entirely destructive is both inevitable and undeniable. A movement whose main promise is the relief from responsibility cannot but be antimoral in its effect, however lofty the ideals to which it owes its birth.[2]

Hayek understood that under advancing statism, culture tends to both promote and reflect those social practices that undermine individual self-responsibility. Likewise, a free society is one in which the culture tends to promote and reflect those social practices that require individual self-responsibility. For Hayek, political change is built on a slow and gradual change in cultural mores, traditions, and habits, which are often tacit; trying to impose such change, without the requisite cultural foundations, is doomed to fail. Moreover, Hayek argued, those cultural foundations are reflective of the historically specific circumstances of a particular time and place. For somebody who has often been derided as a conservative, Hayek embraced the essence of a radical, rather than a utopian, approach. "[W]e are bound all the time to question fundamentals," he said; "it must be our privilege to be radical."[3]

Rand and Dialectics

Despite serious differences with Hayek, Ayn Rand also appreciated the role of culture in shaping political realities. In *Ayn Rand: The Russian Radical*, I reconstructed Rand's critical approach as a tri-level model of analysis:



In her examination of any social problem, Rand focused on the reciprocal connections among personal factors (Level I), that is, a person's methods of awareness, or "psycho-epistemology," and ethics; cultural factors (Level II), that is, ideology, pedagogy, aesthetics, and language; and structural factors (Level III), that is, politics and economics. For Rand, each level of generality offers both a microcosm and a differential perspective on the growing statism of the mixed economy that was the object of her criticism. (Rand saw that system as an instance of the "New Fascism.") She traced the mutual implications and reciprocal interconnections among disparate factors, from politics and pedagogy to sex, economics, and psychology.

In terms of the implications for a dialectical-libertarian analysis, the important point here is that Rand never emphasized one level of generality or one vantage point to the exclusion of other levels or vantage points. So, for example, even when she'd focus attention on Level III—the nightmarish labyrinth of government taxes, regulations, prohibitions, and laws constraining trade—she was quick to dismiss those who thought that an attack on the state was a social panacea. In the absence of an alteration of Level I and Level II social relations, which have a powerful effect on the character of political and economic practices and institutions, a change in Level III is not likely to be sustainable. For Rand, then, just as statism exerts its nefarious influence on all the levels of human discourse, so too must freedom be understood as a multidimensional achievement. Think Russia or Iraq—where, in the absence of a culture of individualism, all the "democratic" procedural rules in the world are not likely to bring about a free society.

Much like Hayek, Rand proclaimed herself a radical "in the proper sense of the word: 'radical' means 'fundamental.' "[4] And as a "radical for capitalism," Rand argued that "*Intellectual* freedom cannot exist without *political* freedom; political freedom cannot exist without *economic* freedom; *a free mind and a free market are corollaries.*"[5]

When I teach this tri-level model to my students, I often ask them to consider any social problem of their choice. I then ask them to filter that social problem through the different levels of generality and the different vantage points offered within each level. As a prime illustration of this methodology, I point to Rand's own analysis of the social problem of racism.

Like other great classical-liberal and libertarian theorists, Rand maintained that government intervention in the economy creates a civil war of all against all; advancing statism makes masters and slaves of every social group, with each vying for some special privilege at the expense of others. Paradoxically, even as statists try to create and rule society as a collective whole, their policies simultaneously create vast social fragmentation. The rule of force has the effect of engendering the formation of pressure groups, each with a design on the levers of power. Every group threatens every other group while acting in self-defense against the aggrandizement of its political competitors. Over time, Rand argued, the group becomes the central political unit of a statist society, and every differentiating characteristic among human beings—be it age, sex, sexual orientation, social status, religion, nationality, or race—becomes a pretext for the formation of yet another interest group.

Racism, in Rand's view, was the most vicious form of social fragmentation perpetuated by modern statism. It was not a mere byproduct of state intervention; it was a constituent element of statism. From the perspective of Level I, Rand argued that racism was an immoral and primitive form of collectivism that negated individual uniqueness, choice, and values. Psychologically, the racist substitutes ancestral lineage for self-value and thereby undermines the *earned* achievement of any genuine self-esteem. Holding people responsible for the real or imagined sins of their ancestors, wielding the weapon of collective guilt, the racist adopts the associational, concrete-bound method of awareness common to all tribalists. This "anti-conceptual" tribalism is manifested in the irrational fear of foreigners (xenophobia), the group loyalty of the guild, the worship of the family, the blood ties of the criminal gang, and the chauvinism of the nationalist. Tribalism was "a reciprocally reinforcing cause and result" of the various caste systems throughout history.[6]

Such "psycho-epistemological" tribalism could only gain currency in a culture dominated by irrationalist and collectivist ideas (Level II). When the Nazis ascribed notions of good and evil to whole groups of people based on legitimating ideological doctrines of racial purity, they depended on the obliteration of individualism as a cultural ideal.

In terms of structural realities (Level III), Rand explored the various political and economic institutions and policies that both reflected and perpetuated racism—through outright slavery, genocide, or apartheid, or through the use of quotas, prohibitions, zoning laws, rent control, public housing, public education, compulsory codes of segregation and integration, and a self-perpetuating welfare bureaucracy that kept poor people poor, while inculcating a psychology of victimization among them.

What most interested Rand was the broad historical process by which racism predominates in modern societies. In Rand's view, statism was born in "prehistorical tribal warfare." Political elites often perpetuated racial hatred and scapegoated racial and ethnic groups in order to secure power. But "the relationship is reciprocal," said Rand: Just as tribalism was a precondition of statism, so too was statism a reciprocally related cause of tribalism.[7] "The political cause of tribalism's rebirth is the *mixed economy*," Rand wrote, "the transitional stage of the formerly civilized countries of the West on their way to the political level from which the rest of the world has never emerged: the level of permanent tribal warfare."[8] In Rand's view, advancing statism and tribalism went hand-in-hand, leading to a condition of "global balkanization."

What Is to Be Done?

Ten years later I continue to argue for the necessary integration of dialectical method and libertarian theory. A dialectical-libertarian approach to social inquiry exhibits one of the key hallmarks of radical thinking. If one's aim is to resolve a specific social problem, one must look to the larger context within which that problem is manifested, and without which it would not exist. This is why context-keeping is so indispensable to a radical libertarian political project.

As the brief example of racism makes clear, deeply embedded social problems demand analysis not only in terms of their political and economic dimensions, but also their preconditions and effects in the realms of morality, social psychology, psycho-epistemology, ideology, and culture. The dialectical theorist uses all the tools of empirical investigation to ascertain the factors at work across many dimensions in the consideration of any social problem. But it takes a supreme act of integration to note the connections among social problems, viewing these not only as related to one another, but as constituent relations of a larger system in need of radical change.

This large-scale theorizing might give the impression that one must analyze *everything* before one can change *anything*. But this is as much of a "synoptic delusion" as is the notion of central planning. What is required is a more fully developed critique of the *system* that generates such social problems—and a corresponding vision for social change that resolves these problems at their root, in all their personal, cultural, and structural manifestations. A genuinely radical project beckons, one that integrates the explanatory power of libertarian social theory and the context-keeping orientation of dialectical method.

1. F. A. Hayek, *The Road to Serfdom* (Chicago: University of Chicago Press, 1994 [1944]), p. xxxix.
2. Ibid., 231-32.
3. F. A. Hayek, "The Dilemma of Specialization," in *Studies in Philosophy, Politics, and Economics* (Chicago: University of Chicago Press, 1980 [1967]), p. 130.
4. Ayn Rand, "Conservatism: An Obituary," in *Capitalism: The Unknown Ideal* (New York: New American Library, 1967), p. 201.
5. Ayn Rand, *For the New Intellectual* (New York: Signet, 1961), p. 25.
6. Ayn Rand, "The Missing Link" in *Philosophy: Who Needs It* (New York: New American Library, 1982), pp. 50-51.
7. Ayn Rand, "Racism," in *The Virtue of Selfishness* (New York: New American Library), p. 128.
8. Ayn Rand, "Global Balkanization," in *The Voice of Reason* (New York: New American Library), p. 123.

"If We Had No Social Security, Many People Would Go Hungry"

BY PAUL L. POIROT

Compulsory Social Security has been the law of the land for almost three generations, and many citizens of the United States are now convinced that they couldn't get along without it. To express doubts about the propriety of the program is to invite the question: "Would you let them starve?"

Many Americans are old enough to remember things that happened prior to the passage of the Social Security Act in 1935, but where is one of them who ever watched a human being starve? No, we wouldn't "let them starve." So why is it so widely believed that, without Social Security benefit payments, many people would go hungry?

The social security idea is based on the questionable premise that a person's usefulness ends at age 65. He is supposed to be without savings and without capacity to continue to earn his living. If that premise were correct, it would be easy to see how hunger might develop among the aged. If they're really good for nothing, who wants to be bothered to look after old folks!

Lumping people into groups and jumping to conclusions about each group (that is, people over 65 would go hungry without Social Security) is a standard procedure of government planning. A corollary conclusion is that breadwinners under 65 must be compelled by force of law to respect and care for their elders. These conclusions rest on false assumptions made by those having no faith in anyone else as an individual. Their faith is in coercion, and they thus conclude that government holds the answer to every problem.

Reduces Incentives

To those of little faith, it is necessary to explain again and again and again that government is noncreative and can distribute only what it first taxes away from the productive efforts of individuals. "The people" are—first, last, and always—individuals, some more economically creative than others, but each worthy of respect as a human being. To tax a man's earnings and savings, for other than defensive purposes, is to reduce his capacity and his incentive to care for himself and for others, rendering him part slave to others and thus less than human. On the flip side, he who either volunteers or is forced to look to the taxing power of government for his livelihood is also enslaved and debased.

Slavery has been tried in the United States, unfortunately, and a major reason for its failure is that it was, and is, an unproductive way of life; it lets people go hungry. It is also morally degrading to master and slave alike. Yet, we are being told that without compulsory Social Security taxes upon the young and strong, the oldsters among us would go hungry—perhaps starve; we are invited to try once again a semi-slave system—under benevolent masters, of course. Well, those socialists are dead wrong. Their premises are faulty. Free human beings may be counted upon to care well for themselves and for their fellow men, voluntarily.

What should concern us all is that, *if we persist* under the false premises of the Social Security idea (socialism), many Americans *will* go hungry—not only physically hungry, but morally and spiritually starved as well.

The prime argument against Social Security is in the moral realm. Giving to one individual or group the fruits of the labor of others taken from them by coercion is an immoral procedure, with destructive effect upon the sense of personal responsibility of everyone involved. . . .

Paul Poirot was editor of The Freeman *from 1956 until his retirement three decades later. He now resides in Pennsylvania. This is adapted from an article that originally was published in* Clichés of Socialism *and reprinted in the updated* Clichés of Politics, *both published by FEE.*

Capital Letters

Government Should Not Transfer Wealth

To the editor:

Because "the only way to fix Social Security's many problems" is to abolish it, it is disappointing to read articles such as those by Michael E. Tanner ("Social Security Is in Good Shape?") and Philip Booth ("Britain's Pension Problem: Government Failure") in *The Freeman* of May 2005.

Tanner wrote that the only fix "is to change the system from a pay-as-you-go model to one based on savings and investment" and "Those who disagree have an obligation to tell the rest of us how they would deal with the grim demographic reality."

Booth advises the U.S. to avoid British mistakes and "copy the one thing we have got right—allowing individuals to opt out of the state social-security pension." If everyone opted out, would there be a system?

It makes no difference, because government to begin with has no business establishing retirement, medical, educational or any other kind of accounts for individuals or groups.

"[T]he grim demographic reality" is that too many people support the idea that government should be involved in retirement, etc., when the purpose of government is to protect life, liberty, and property, and to invoke a common justice.

Government was not created to transfer wealth from workers to nonworkers. Wealth transfers are a consequence of democracy (majority rule) shed of morality.

Individually, as children, I am of the belief that most of us are taught not to steal; when we magically become old enough to vote, we collectively have no moral right to authorize the state or the government to do on our behalf what we personally before would or could not ethically or lawfully do.

Social Security is a moral issue. It is either right or it is wrong for individuals to steal. It is either right or it is wrong for government, acting on behalf of individuals, to steal to fund Social Security, Medicare, Medicaid, public education, etc.

To me, it is wrong and indefensible.

Government, as noted above, should be limited to protecting life, liberty, and property (taxing [stealing] to accommodate this is bad enough). Anything else is unjustified. Hence, "privatizing" Social Security is merely delaying and putting off what should be done immediately—*abolish Social Security and its offspring.*

—EARL ZARBIN
Phoenix, Arizona

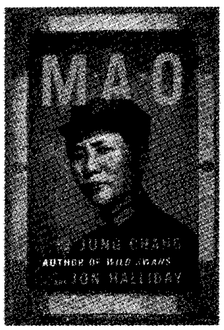
We will print the most interesting and provocative letters we receive regarding articles in *The Freeman* and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations. Address your letters to: *The Freeman*, FEE, 30 S. Broadway, Irvington-on-Hudson, NY 10533; e-mail: freeman@fee.org; fax: 914-591-8910.

Book Reviews

Mao: The Unknown Story

by Jung Chang and Jon Halliday
Alfred A. Knopf • 2005 • 823 pages • $35.00

Reviewed by Richard M. Ebeling



In their new book, *Mao: The Unknown Story*, Jung Chang and Jon Halliday estimate that under Mao Zedong's rule in China at least 70 million people were killed in one way or another in the name of making a socialist utopia. Jung Chang was a youthful victim of Mao's Cultural Revolution in the 1960s and 1970s, and wrote about this gruesome episode in modern Chinese history in her earlier work, *Wild Swans* (1991). Having been among Mao's multitudes of victims, she has spent more than ten years researching the history of the man who brought so much tragedy to her native country.

Anyone who has read *The Private Life of Chairman Mao* (1996) by Mao's longtime personal physician, Li Zhi-Sui, would already be disgusted with the man: his failure to bathe or brush his teeth for decades; his wanton use of hundreds of innocent peasant girls (to whom he passed a variety of venereal diseases) for his seemingly insatiable sexual desires; his pleasure in humiliating and hurting even his most loyal followers and fellow communist leaders; and his total disregard for any human life other than his own.

But Jung Chang and Jon Halliday show Mao to be a man of absolute evil. Like many Marxist leaders, Mao was not born into a working-class family. At the time of his birth in 1893, Mao's father was a relatively successful middle-class farmer in the province of Hunan in south-central China. From an early age Mao was interested neither in physical labor nor systematic education. He preferred to loaf about and read on his own. (Throughout his life he absorbed a vast amount of literature on many subjects, and had special editions of books prepared for himself that became forbidden works for the masses.)

Like Stalin in the Soviet Union, Mao seems to have had neither personal charisma nor the gift of oratory. Rather, he had the ability to manipulate people and situations to his own advantage, slowly rising to the top of the Chinese Communist Party in the 1920s and 1930s. He was ruthless with both friend and foe, viewing everyone he encountered as mere tools to use and then dispose of in pursuit of absolute power.

Mao was married four times. He treated each wife miserably, as he did most of his children, whom he often abandoned to their fate and sometimes to their deaths. During the famous Long March in 1934–1935, when Mao lead the Chinese communist forces from south-central China to a new Red-controlled territory in the northwest region of the country, he made his third wife abandon their baby son as Chiang Kai-shek's Nationalist armies were trying to surround them. Years later, she unsuccessfully hunted the countryside to find her lost child. Her only clue was the assumption that the son might have two of Mao's distinguishing characteristics: oily ears and an especially pungent underarm odor.

Both before and especially after the Long March, Mao instigated reigns of terror and tyranny on the Chinese peasants who fell under the sway of his forces. Slave labor, starvation rations, and merciless propaganda and indoctrination sessions late into the night became the hallmarks of Chinese communist rule. Cruel and excruciating tortures and methods of execution were devised to assure destruction of all opposition and disobedience to Mao's power. (The authors describe many of them in indelicate detail.)

Contrary to the leftwing myths of the time, especially in the American press, that Mao's Red Army was the main Chinese fighting force against the Japanese during World War II, Mao instructed all his commanders to avoid battles with the Japanese. Instead, he worked to conserve his forces as a prelude to the Chinese Civil War that began in 1945 and ended in the communist conquest of the Chinese mainland in 1949.

The authors detail how Mao's victory would have been impossible without the assistance of Stalin's Soviet army, which overran Manchuria in the last weeks of the Pacific war. Stalin allowed Mao's forces to occupy most of Manchuria behind the Soviet shield and turned over vast stores of captured Japanese weaponry.

The authors also explain how General George C. Marshall, then secretary of state in Harry Truman's administration, was totally manipulated and duped by Mao and his chief diplomatic negotiator, Chou En-Lai. They persuaded Marshall that they were merely "agrarian reformers" wanting justice for the Chinese people in a coalition government with the Nationalists. All the while they were strengthening and positioning the Red Army for a grand attack to seize the rest of China. They succeeded in making Chiang Kai-shek seem to be the stumbling block to a political compromise, which resulted in the U.S. government cutting off all armament sales to the Nationalist government in 1947, just as victory was possibly in the grasp of Chiang's armies.

Using Chinese and Soviet archival materials, the authors show that Mao happily assisted, with Stalin's help, in the North Korean invasion of South Korea in June 1950. Mao began assembling Chinese forces to enter the Korean War long before the United Nations forces pushed back the North Korean offensive and then crossed the 38th parallel to unify a free Korea. Mao was ready to continue the war indefinitely to kill tens of thousands of Americans in a conflict of attrition, even at the cost of hundreds of thousands of Chinese soldiers' lives. Only Stalin's death in 1953 and the desire of the new Soviet leadership to calm international tensions forced Mao to accept a ceasefire and an end to the Korean conflict.

At an international conference of communist parties in Moscow in 1957 marking the 40th anniversary of the Bolshevik Revolution, Mao delivered a speech calling for the start of a nuclear World War III against America. He declared that it did not matter if half of China's population was killed in the cataclysm, because there would still be hundreds of millions of Chinese left to rise out of the rubble to rule a communist world. Shortly after that, Chou En-Lai told a Soviet envoy visiting Beijing that they should be planning a new capital city for such a communist-controlled world somewhere on a man-made island in the Pacific, since both Moscow and Beijing would likely be incinerated in the nuclear destruction that was to come. That didn't seem to bother Mao at all.

In the 1950s and 1960s Mao pushed China into a crash program to make his country an industrial and nuclear superpower. Ignorant of all economic concepts, including the ideas of scarcity and tradeoffs, Mao crushed the Chinese population into abject poverty in an attempt to make himself ruler of the world.

While tens of millions of Chinese starved and died, he lived a life of luxury with dozens of atomic bomb-proof mansions built for his pleasure around the country, all with large swimming pools constantly heated in case he were to show up. But he spent most of his time in Beijing, lying in bed for days on end, eating his specially prepared foods, reading books banned for everyone else, and enjoying group sex whenever the urge came over him.

The authors explain that the Cultural Revolution of 1966–1976 was all a grand plan of Mao's to settle scores with real and imaginary enemies in order to assure his absolute and unchallenged power over China. In the process, the country was pushed into horrific violence and terror that almost destroyed everything left of civilization in China.

Mao Zedong died in bed, an old and sick man in 1976, at the age of 82. His legacy was the murderous destruction of an entire society.

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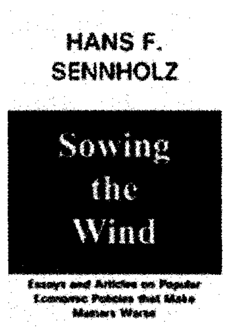
Sowing the Wind: Essays and Articles on Popular Economic Policies that Make Matters Worse

by Hans F. Sennholz

Libertarian Press • 2004 • 323 pages • $19.95 paperback

Reviewed by Bettina Bien Greaves



The world we live in today is a global economy. Entrepreneurs, traders, and investors are always searching for opportunities to better serve consumers. As a result, we are all interconnected. When the United States sneezes, so to speak, China, Argentina, or Mexico catches cold.

In our economy of complex interrelationships, economic crises with wide-ranging consequences have become almost daily occurrences. Yet practically no one seems to understand what causes them. Most modern economists look at statistics and try to anticipate what will happen by extrapolation. Only Austrian economists understand the economy as the outcome of complex interpersonal relationships and transactions. Only Austrian economists trace economic crises back to the actions, decisions, and choices of individuals under various circumstances. As one of this country's leading Austrian economists, Hans Sennholz not only analyzes many economic crises, but also suggests needed reforms.

This book contains 42 articles written during the years 1997 to 2003 by Professor Sennholz, who served as FEE's president from 1992 to 1997. He was the first student in this country to earn a doctorate under Ludwig von Mises. During almost 40 years as a professor at Grove City College, Sennholz introduced Austrian economics to thousands. He retired from Grove City in 1992, but Sennholz can't retire from teaching and communicating; he continues to lecture, write, and comment on current events.

When new technologies are developed, production can be improved and expanded. Economies in transportation and communication make the world smaller so that it costs less to deliver raw materials and finished goods to users. As information and money can now be transmitted almost instantaneously throughout the world, it is easier, faster, and less expensive to carry out transactions. Consumers throughout the world benefit. Despite all our progress, however, we still find that economic troubles beset many nations. The blame is almost always misplaced—on business greed, on foreigners, on the environment. Sennholz makes it clear that the seeds of economic troubles are sown by bad governmental policies.

Among the crises Sennholz considers here are stock-market bubbles, inflation in Mexico, the bankruptcy of Argentina's government, economic recession in Japan, the collapse of the Thai exchange rate, Germany's new welfare society, and the rise (or fall) of the Euro. According to Sennholz, a crisis creates the opportunity for a new beginning; it is never too late to reform.

Sennholz blames the Fed's monetary policy for the United States' soaring deficits and the shrinking purchasing power of the dollar: "No central bank on earth, not even the Federal Reserve, can continually inflate its currency and defy market rates of interest without harming both its currency and the economy," he writes. He recommends that we abandon the Fed's monetary manipulation and return to gold money. "[T]here cannot be any doubt that a gold dollar would restore justice in international relations and reassert American power and leadership. It would clear away much conflict and strife and pave the way toward a more equal and peaceful world order."

Regarding Argentina's disastrous experience with inflation and bankruptcy, Sennholz states, "Great crises call for extraordinary measures that redress the causes of the evil. The Argentinian crisis presents not only great dangers to the country's political and economic order but also an opportunity for a new beginning. . . . In a free and unhampered contract system, creditors and debtors, banks and depositors would soon come to reasonable and fair agreements about their contractual relations. A contract system would call for no new taxes, not even compensation for harm done by law and regulation. It would reopen all banks and allow them to meet their obligations to the best of their ability. It would expect the government to honor its peso obligations. But it would also demand that government cease and desist from any more regulations, new outlays, new taxes, and new disruptions of any kind. Argentinians need time and a period of peace for recovery."

That's the essence of the Sennholz approach—freedom works; government control doesn't.

Whether Sennholz is discussing an economic crisis in the United States or elsewhere, his analysis is always sharp, incisive, and enlightening. He makes understandable even the most complex situations. In the last analysis, he traces the origin of almost every crisis to government-fostered inflation and credit expansion. The scenario varies from time to time and country to country depending on many factors: government spending, regulations, interest rates, taxes, and more. But the culprit is always monetary manipulation.

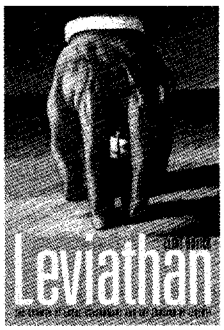
The excellent essays in *Sowing the Wind* will convince just about any reader that the economic troubles of our times are rooted in government policies that interfere with the functioning of the free market and that the way to escape them is to rely on the voluntary mechanisms of production and exchange.

Bettina Greaves (bbgreaves@aol.com) served FEE for more than four decades as a senior staff member, resident scholar, and trustee. She now resides in North Carolina.

Leviathan: The Growth of Local Government and the Erosion of Liberty

by Clint Bolick
Hoover Institution Press • 2004 • 173 pages
$15.00 paperback

Reviewed by George C. Leef



Does government have too much power? Certainly—just think of all the freedom Americans have lost on account of the income tax, Social Security, Department of Labor regulations, the threat of antitrust prosecution, and so on.

Note that in my short list of examples, each one is due to action by the federal government. In *Leviathan*, Clint Bolick reminds us that Americans have every bit as much to fear from authoritarian laws, regulations, and confiscations at the hands of local government officials as they do from the great circus of government camped in Washington. In fact, he argues that we actually have more to fear from our local Pooh-Bahs, writing, "If the president starts an unpopular war or raises taxes, people know who to blame and they direct their energy accordingly. But if your kid gets a lousy education in public school, or your local government decides to exercise eminent domain to take your home or business, it is often impossible even to find out who is responsible, much less to fight it."

Bolick, an attorney who has fought many legal battles against intrusive and authoritarian local government actions, gives us a depressing catalogue of the rights infringements that are becoming commonplace—violations of freedom of speech, freedom to engage in commerce, freedom to use and enjoy one's property, and more. He first disabuses his reader of the notion that the Constitution protects people against such infringements, noting that most judges—and crucially, the justices of the Supreme Court—don't take seriously the idea of individual rights. They choose only a few rights they like (for example, free speech, some of the time) and defend them against legislative or regulatory incursion, but adopt a posture of "deference" to the supposed expertise of politicians and their appointed agents on most other questions.

Consider the case of Garland Allen. Allen, a rather elderly black barber, had been practicing his trade for many years in a small town in rural Tennessee. In 1996 he was arrested in his barber shop for the crime of "impersonating a professional." No customer had complained about Allen's competence, but a competing barber had notified the august Tennessee Board of Barbering Examiners that Allen didn't have a license to work as a barber. When he was young, no barbering schools in Tennessee admitted blacks, and now Allen couldn't afford the nine months and $5,000 it would cost for him to go to school to be taught what he already knew. He was in danger of being put out of business and into poverty because of a completely needless regulation, the sole purpose of which was to restrict competition.

Fortunately for Allen, the Institute for Justice, for which Bolick works, threatened to sue to block the Board of Barbering Examiners from taking away his livelihood. The threat of action succeeded. Unfortunately, thousands of others are caught up in such occupational licensing snares each year. Freedom to engage in simple commerce is blocked by innumerable laws and regulations put in place by friendly state and local politicians—friendly, that is, to interest groups that want barriers to entry into their fields.

Bolick also details the vicious abuse of eminent domain, which under the Supreme Court's current reading of the Fifth Amendment (hostile both to the document's intent and to the rights of property owners) allows government to seize land from people whenever politicians decide that transferring it to someone else serves "the public interest." Again, he shows that the government that's supposedly the closest to the people can be the most callous.

Perhaps even more disturbing are the many civil asset-forfeiture laws enforced by state and local officials. Those laws permit officials to seize property without any compensation if they can convince a judge—and there are plenty of judges who don't give a hoot about private property except their own—that it was used in connection with a crime. In one case Bolick relates, a woman whose teenage son had been driving her car when caught selling drugs had to suffer the loss of the vehicle. Never mind that she had no knowledge of her son's activities. She was eventually able to show that local officials were living high on the proceeds of confiscated property. That particular statute was struck down by an appellate court on due-process grounds, but many others like it remain.

Bolick concludes with a helpful and hopeful chapter, "Fighting Big Government at the Local Level," which shows that people don't have to meekly tolerate these assaults on their rights.

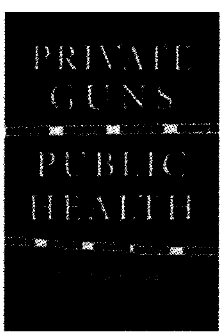
If the most useful books are those that make people justifiably angry, Clint Bolick has written an extremely useful one.

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

Private Guns, Public Health

by David Hemenway
University of Michigan Press • 2004 • 304 pages • $27.95

Reviewed by Timothy Wheeler



David Hemenway, a professor of health policy at Harvard University, harbors a deep aversion to guns. His book embodies the institutional prejudices of a cohort of academics notable for their abiding predisposition for state control over individuals for "the public good." So ingrained is the bias that it almost dashes one's hopes that firearms can ever be treated fairly in the academic literature.

The political movement to ban gun ownership began in earnest in the 1970s. Its partisans relied mostly on emotional appeals rather than on any scientific evidence of the efficacy of banning guns. When the faction's allies in organized medicine and public health began in the 1980s to publish advocacy research supportive of gun control, gun banners smelled victory.

But two parallel currents in the academy changed everything. First, as constitutional scholars began seriously to study the origins of the Second Amendment, they concluded with near unanimity that the founders meant to affirm an individual right to own and use firearms. Second, a mounting body of criminology research refuted the medical advocacy researchers' claims that gun owners are unstable, dangerous, and generally responsible for what the advocates called the "disease" of gun violence. The two most prominent criminology scholars disputing the public-health advocacy researchers are John Lott and Gary Kleck. Hemenway directs considerable firepower toward these two, since their work seriously impeaches his own.

One section (Self-Defense Gun Use) reprises a 1997 tussle between Hemenway and Kleck in the *Journal of Criminal Law and Criminology* over how to determine the frequency of defensive gun uses. This episode, which Hemenway now revisits with apparent gusto, was made possible by the inherent difficulties in studying complex phenomena such as gun ownership and use. Both sides marshal seemingly credible arguments, and one would need graduate-level competency in statistics and econometric modeling to sort out their conflicting claims. Unfortunately, the necessary imprecision of the social scientists' methods invite the influence of bias. And it is Hemenway's manifest bias that most characterizes his book.

A disturbing feature is his sprinkling of bigotry between bits of science. In the first chapter he pays brief tribute to typical gun owners being over 40 and in the higher income groups—not exactly a crime-prone demographic. But then quickly come withering deconstructions of the American frontier cowboy ("a hired hand with a borrowed horse, a mean streak, and syphilis"), owners of semiautomatic guns ("more likely than other gun owners to report that they binge drink"), and combat veterans with posttraumatic stress disorder ("likely to kill animals in fits of rage").

Hemenway is faithful to the public-health creed of guns as pathogens, and his description of this model reveals much about the psychology of public-health activists. Foremost is a nonjudgmental view of human behavior. In the public-health world there are no criminals and no victims. This tenet of progressivism guides the whole public-health anti-gun movement. To acknowledge, for example, a natural right of self-defense would require validating gun ownership and use.

So it's not surprising that Hemenway gives the public-health treatment to the seventeenth-century classical-liberal philosopher John Locke. Hemenway asserts that Locke's natural-rights tradition provides little evidence for an individual rather than a collective interpretation of the Second Amendment. He maintains that Locke meant that "rights should be determined and disputes resolved not through private judgment of each individual backed by private force but rather by the public judgment of the community." Thus does Hemenway in one sentence dispose of the notion that self-defense is a natural right.

Locke's second treatise, however, is unambiguous on the matter of self-defense. True, Locke's concept of political society requires resolution of disputes (for example, a highwayman taking a traveler's money by guile) through the judgment of the community. But in a separate example, the highwayman tries to take the traveler's money by drawing his sword. In this case, Locke writes, the traveler may use deadly force to defend himself against the highwayman, who has put himself into a state of war with the traveler.

Hemenway's clear misreading of Locke is proof enough of the author's blinding bias. It colors his science, his reading of history, and ultimately his credibility as a scientist. One need not be a scientist to observe human nature and to discern how it directs human events. Perhaps social science will someday be free of emotional warp and political prejudice. Until it is, common sense and our political tradition of freedom will serve to guide firearm policy.

Timothy Wheeler, M.D., (DRGO@adelphia.net) is director of Doctors for Responsible Gun Ownership, a project of the Claremont Institute.

"The Taxing Power, My Dear"

The legal committee soon broke into a row because the legal problems were so terrible. The constitutional problem was the greatest one. How could you get around this business of the State-Federal relationships? It seemed that couldn't be done.

We continued to wrangle about it for days. But one day I went out to tea, although not because I wanted to. In Washington you don't go to parties just because you want to go, you know; you go because you have to go. I had to call upon Mrs. Harlan F. Stone, the wife of the Supreme Court Justice. She was at home on Wednesday afternoons and so about 5:45, which is nearly the end of the day, I went to her house and presented myself. There were a lot of other people there. We went up to the dining room to get a cup of tea, and there I met Mr. Justice Stone who had just come home from the Court and was getting his cup of tea. We greeted each other and sat down and had a little chat.

He said, "How are you getting on?" I said, "All right." And then I said, "Well, you know, we are having big troubles, Mr. Justice, because we don't know in this draft of the Economic Security Act, which we are working on—we are not quite sure, you know, what will be a wise method of establishing this law. It is a very difficult constitutional problem, you know. We are guided by this, that, and the other case." He looked around to see if anyone was listening. Then he put his hand up like this, confidentially, and he said, "The taxing power, my dear, the taxing power. You can do anything under the taxing power."

I didn't question him any further. I went back to my committee and I never told them how I got my great information. As far as they knew, I went out into the wilderness and had a vision.

But, at any rate, I came back and said I was firmly for the taxing power. We weren't going to rig up any curious constitutional relationships. "The taxing power of the United States—you can do anything under it," said I. And so it proved, did it not?

—FRANCES PERKINS, Secretary of Labor, 1933–1945
"The Roots of Social Security" (1962)
www.ssa.gov/history/perkins5.html

Economics for the Citizen—Part II

BY WALTER E. WILLIAMS

There are four classes of behavior that can be called economic behavior: production, consumption, exchange, and specialization.

Production is any behavior that creates utility, that is, raises the want-satisfying capacity of something. When a mill smelts iron ore, it raises the want-satisfying capacity of the material by changing its form. The metal's want-satisfying capacity is raised further when it's made into steel, and the steel into rails, girders, and the like. Production also includes changing the spatial characteristics of a good. Navel oranges have no want-satisfying capacity for Philadelphians if the oranges are in California. The person sometimes called the middleman, or wholesaler, changes the spatial characteristics of the oranges by moving them from California to Philadelphia, thereby raising their want-satisfying capacity to Philadelphians.

Consumption is easy. It is simply the reduction of utility, the want-satisfying capacity, of something. When I eat a hamburger, I reduce its want-satisfying capacity. When I drive my car, I reduce its capacity to satisfy wants. By the way, if production is greater than consumption, the result is called saving. If it's the opposite, we call it dissaving.

Exchange is a bit more complicated; misunderstanding it leads to considerable confusion and mischief. The essence of exchange is the transfer of property rights. Here's what happens when I buy a gallon of milk from my grocer. I tell him that I hold property rights to these three dollars and he holds property rights to the gallon of milk. Then I say, "If you transfer your property rights to that gallon of milk, I will transfer my property rights to these three dollars."

Whenever there's voluntary exchange the only clear conclusion that an observer can reach is that both parties, in their opinion, not yours or someone else's, perceived themselves as better off as a result of the exchange; otherwise, they wouldn't have exchanged. I was free to keep my three dollars, and the grocer was free to keep his milk.

If you think it's obvious that both parties benefit from voluntary exchange, why do we hear pronouncements about worker exploitation? Say you offer me a wage of $2 an hour. I'm free to either accept or reject your offer. So what can be concluded if I'm seen working for you at $2 an hour? One clear conclusion is that I must have expected to benefit more by taking your offer rather than by taking my next best alternative. I must have perceived that all other alternatives were less valuable, or else why would I have accepted the $2 offer? How appropriate is it to say that you're exploiting me when you've given me my best offer? Rather than using the term *exploitation*, you might say you wish I had more desirable alternatives.

If you think it's obvious that both parties benefit from voluntary exchange, why do we hear pronouncements about worker exploitation?

While people might characterize $2 an hour as exploitation, they wouldn't say the same about $50 an hour. Therefore, for the most part, when people use the term *exploitation* in reference to voluntary exchange, they simply disapprove of the price. If we equate price disapproval with exploitation, then exploitation is rife. For example, I not only disapprove of my salary, I also disapprove of the price of Gulfstream private jets.

By no means do I suggest that one purge his vocab-

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

ulary of the term *exploitation*. It's an emotionally valuable term to use to trick others, but in the process of tricking others one need not trick oneself. I'm reminded of charges of exploitation Mrs. Williams used to make early on in our 45-year marriage. She'd charge, "Walter, you're using me!" I'd respond by saying, "Honey, sure I'm using you. If I had no use for you, I wouldn't have married you in the first place." How many of us would marry a person for whom we had no use? As a matter of fact, the problem of the lonely hearts among us is that they can't find someone to use them.

Specialization is said to occur when people produce more of a commodity than they consume or plan to consume. Specialization can occur on an individual, regional, or national basis. Here are examples of each. Detroit assembly-line workers produce more crankshafts than they consume or plan to consume. California citrus growers produce more navel oranges than they consume or plan to consume. Brazilian coffee growers produce more coffee than they consume or plan to consume.

There are two requirements for specialization. There must be an unequal endowment of resources and trade opportunities. The unequal-endowment part means that an individual has the skills or a region or nation has land, labor, capital, and entrepreneurial talent whereby he or it can produce certain things more cheaply than can another individual, region, or nation. For example, while it's possible to grow wheat and corn in Japan, it would be an expensive proposition. Why? Because crops like wheat and corn use a lot of land and Japan is relatively land poor. That means Japanese land is relatively expensive. By contrast the United States is land rich, hence grain production is relatively cheap. Therefore, it makes sense for the United States to take advantage of what it can do more cheaply—specialize in grain production—and for Japan to specialize in what it might produce more cheaply—say, camera lenses.

For specialization to occur there must be trade opportunities. It wouldn't make sense for U.S. farmers to produce more grain than they consume or plan to consume if they couldn't trade it. Neither would it make sense for Japanese producers to produce more camera lenses than they consume or plan to consume if they couldn't trade.

Imagine that the Japanese government imposed trade restrictions on U.S. grain imports. Japanese farmers could charge monopoly prices and enjoy higher income, and Japanese consumers would pay higher prices. Would you deem it an intelligent response for the U.S. government to retaliate against Japan's trade restrictions by imposing trade restrictions on Japanese camera lenses, allowing American lens producers to charge monopoly prices and American consumers to suffer higher prices? Put another way, is it smart for the U.S. government to harm American consumers because Japan harmed its consumers?

Making People Dependent

Specialization and trade make people dependent on one another for their everyday wants. How many of us make our own eyeglasses, cars, houses, clothing, and food? We get all those goods by specializing in what we do well and trading with others for what they do well. Through specialization and trade, we might call it "outsourcing," we enjoy goods as if we actually produced them. In fact, specialization is an alternative method of production. By the way, anyone calling for independence individually, regionally, or nationally is asking us to be poorer. It makes no difference whether they're calling for energy independence, clothing independence, or coffee independence.

Let's look at just a few misleading statements about international trade. The United States trades with Japan. Does anyone really think that it is the U.S. Congress that trades with their counterparts in the Japanese Diet? It's really individual Americans trading with individual Japanese through intermediaries. What about fair trade? If you purchase a Japanese-made camera lens on voluntary and mutually agreeable terms, you'd probably conclude that it was a fair trade, or else you would have kept your money. An American camera-lens producer might call that trade unfair because he couldn't sell you his lens at a higher price. Economic theory can't answer a subjective question like whether it would be fairer if you had to pay a higher price; it can say that a higher price would result in your having fewer dollars for other things.

The next installment of this series will focus on one of the most important economic concepts—costs.