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Ideas On Liberty

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From the President

by Richard M. Ebeling

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Globalization and Free Trade

Freedom of trade is really a very simple concept. Each individual should be at liberty to buy from and sell to whomever he wishes on mutually agreed-upon terms. Whether the partners to this trade live next door to each other or are separated by thousands of miles should make absolutely no difference to the logic of the idea.

For thousands of years most people lived, worked, and died within a small radius of the place where they were born. Households and small communities went about the business of life with a high degree of local self-sufficiency. Of course, there was always a limited amount of what today we would call "international" trade even among the ancient Greeks and Romans. But, for most people, goods produced in faraway lands were unavailable because of the natural difficulties of transportation, or were too expensive.

This began to change during the last 200 years. Railways and steamships made traveling easier and less expensive in the nineteenth century. Modern engineering shortened the distances between different parts of the world as tunnels were built through mountains, bridges spanned wide and powerful rivers, and canals were dug across strips of land connecting continents.

But most important, the nineteenth century saw the triumph of classical-liberal ideas—ideas that emphasized individual liberty, private enterprise, limited government, and free trade. It was the lowering of political barriers separating peoples and regions that enabled the feats of technology and engineering to bring the world closer together, and allowed men on the five inhabited continents to trade with each other.

Now people could purchase resources and raw materials that before had been far beyond their geographical and financial reach, and invest their capital and labor wherever it seemed most profitable and advantageous. Moreover, the growing number of different finished goods manufactured with those resources could be sold to tens of millions of people everywhere around the planet.

Even with the collectivist forces of the twentieth century, which reimposed political barriers to trade through central planning, regulation, and protectionism, the impulse toward the internationalization of production and trade has continued up until our own time. But the two world wars and the reactionary attempts to coercively establish socialist systems on many parts of the globe created perverse imbalances in the extent and speed of economic development in various countries and continents.

Because the United States was exempt in the twentieth century from the direct physical destruction of war that impacted so many other nations, and because experiments with socialist and interventionist ideas were implemented less pervasively in America than in

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many other parts of the world, U.S. economic development and growth dwarfed the rest of the planet in the immediate decades after 1945. America, therefore, had an absolute and a comparative advantage in a wide variety of agricultural and manufactured goods. The American people consumed a large proportion of the world's output because they produced a huge amount of it.

But over the last six decades more and more of the rest of the world have been catching up. During the late 1940s and 1950s, European and Japanese reconstruction overcame the destruction of World War II. In the 1970s and 1980s a small but growing number of countries in East Asia moved toward more market-oriented economics. In the 1990s the crushing weight of socialist central planning was lifted from many countries in Eastern Europe, Asia, and South America. As a result, a growing number of these countries began to rapidly industrialize, increase their production and productivity in agriculture, and improve the quality of their "human capital" through more and better education for millions.

Changing Patterns of Trade

This process of economic development and growth around the world has inevitably been changing the patterns of trade and the comparative advantages of many of the nations that have been or are becoming to a greater extent America's trading partners. Labor and manufacturing specializations that the United States has long been dependent on for employment, income, and profits are now shifting to other parts of the globe. Once peoples and markets on continents outside North America began to become relatively freer and less collectivist—though certainly not laissez faire, unfortunately—these changes in the structure of the international division of labor were inevitable.

But besides their inevitability, the changes also are opening healthy and desirable opportunities for hundreds of millions of people to finally raise themselves out of the poverty that has been the lot of mankind for all of human history. We should hail this as one of the greatest moments in the thousands of years of man's time on this earth.

The United States' place in the global division of labor is also changing. Goods and services that were long taken for granted as being "Made in America" are and will increasingly be available to the American people at lower cost and in better quality and greater quantities from suppliers in other parts of the world. This will require U. S. industry and agriculture to shift over time into a number of different lines of investment and employment. Capital will have to be used in different ways, and workers will have to learn new skills in order to supply the exports that will pay for these better, cheaper, and more plentiful imports. The structure of prices and wages, as well as the relative incomes of some American workers, will have to change to reflect the new and more productive global economy.

By bringing about these changes with competitive flexibility and optimism about a better and wealthier world in the 21st century, the American people will not only participate in a potentially more prosperous future, but will also set the pace for the rising standard of living that can belong to us and countless others around the globe.

The path to this bright economic future is a policy of free trade. Governments—including the U.S. government—do not have the wisdom or ability to guide or assist this process. They can only hinder it with controls and restrictions that slow down progress and serve special interests who don't want to face the future.

The best way for mastering the global challenges and opportunities of our new century is to allow each individual to use his own knowledge and ability in the competitive market, free from the controlling hand of government. Freedom will enable us triumphantly to find our way in the new global economy. □

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PERSPECTIVE

Tax "Breaks" Aren't Subsidies

When is a subsidy not a subsidy? When it's a reduction in taxes. There's a baffling amount of confusion over what should be a simple matter. Tax reductions, credits, deductions, and exemptions are frequently mistaken for subsidies. This shouldn't be. Morally they are worlds apart.

A subsidy is a cash grant from the government. If you've ever seen those cacophonous television commercials with Matthew Lesko, you know what a subsidy is. At his website (www.lesko.com) you'll be told, "Get free money from the government just like the people you've seen on TV!" Elsewhere it says, "Everyone qualifies for something. Even millionaires are eligible."

These and other subsidies are direct transfers from the taxpayers to the beneficiaries. Obviously, money provided in subsidies is unavailable to be used by the taxpayers who earned it in the first place. (The government could create the money out of thin air, but that's another column.)

There are also less-direct subsidies. For example, when the government guarantees a loan, it causes money to be lent to one person rather than another (who doesn't have a guarantee). If the loan is not repaid, the government is committed to transferring money from the taxpayers to the lender. A tariff or import quota is also an indirect subsidy. Rather than giving cash to a domestic firm, the government limits foreign competition and helps boost prices. It's like giving out cash, only it doesn't show up in the federal budget.

In all these cases, government intervention enables people to obtain money they were not entitled to; the flip side is that someone else is deprived of money he is entitled to, or that he would have had legitimate access to.

In contrast, when someone is given any kind of "tax break," he keeps money he is entitled to. It doesn't matter if that person is "rich" and doesn't "need" the money. (Some people believe this should disqualify anyone from a tax cut.) Entitlement to the money one makes has nothing to do with need or how much one already has—at least not according to America's founding philosophy. Thus if a person retains some of his own money because of a government action, we should not condemn this as a subsidy.

Subsidies should be opposed. Opportunities to keep one's own money should not.

Needless to say, government can create great mischief by determining who can and cannot keep his own money. If mortgage interest is tax-deductible but rent is not, government encourages home buying. It is not the government's function to decide the best way to live and then to use the tax system to manipulate people into living that way. If given a free hand, there's no limit to what government can foist on us through tax credits and deductions. In fact, anything it can do through outright regulation it could probably do by amending the tax code. The benefit "given" to producers of ethanol is a lower fuel tax at the pump. Providing "tax breaks" can be "interventionist," in the sense that they can be designed to bring about ends selected by politicians and bureaucrats.

But that is no reason to oppose them, although it's sometimes tempting. No one should be begrudged the opportunity to keep his own money. In the face of a discriminatory tax cut, we should point out that it ought to apply to everyone (who pays taxes), and not just a narrow group of taxpayers. Efforts to widen exceptions may not succeed, since that would defeat the politicians' purpose, which after all is to manipulate private behavior. But at least we can pound home the point that it's better for people to spend their own money for their own objectives.

* * *

Who would have thought that, in this day of globalization and high technology, it would be so difficult to cash a check drawn on a bank in England? Robert Wright relates a personal experience.

The twentieth century was wracked by war, and the new century shows no signs being any different. Many theories of the causes of war have been propounded, but none surpassing that of Ludwig von Mises.

The Census Bureau reports an increase in the poverty rate. Are the statistics to be trusted? Robert Murphy takes a look.

In the nineteenth century, the American people got fed up with rent-seeking corruption in state government and did something about it through the constitutional process. James Rolph Edwards is looking to see if the same will happen at the national level.

When someone suddenly needs medicines and medical supplies, the benefits of the market economy shine. Ralph Hood found this out personally.

The Food and Drug Administration has thwarted attempts to import pharmaceutical drugs from Canada and elsewhere. Is there a good reason for this? Adam Summers doesn't think so.

An economic "miracle" has been taking place in western Europe. Can you guess in which country it is occurring? If not, Karl Sigfrid will tell you.

If the environmental lobby has its way, no chemical or technology could be used unless it was proved absolutely safe in advance. If this sounds unreasonable, Jim Peron agrees.

Our columnists have been busy. Richard Ebeling praises world trade. Donald Boudreaux debunks the trade-deficit scare. Burton Folsom commemorates the "veto president." Charles Baird sees bad labor news in New Zealand. And E. C. Pasour, Jr., reading the assertion that U.S. farm subsidies don't harm developing countries, responds, "It Just Ain't So!"

Books subjected to review in this issue are about the American empire, the history of markets, ideas that dominate our age, and psychiatric slavery.

—SHELDON RICHMAN

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Ending Farm Subsidies Wouldn't Help the Third World?

It Just Ain't So!

Talks by the 146 members of the World Trade Organization (WTO) collapsed last fall over trade-liberalization disputes between rich and poor countries. The biggest bone of contention was the extent to which the "first world"—mainly Europe, the United States, and Japan—were willing to slash their huge farm subsidies. More than 20 developing countries, including Brazil, India, and China, banded together to fight the aid to rich-country farmers.

Writing in the *New York Times* just before the talks collapsed, author Michael Lind acknowledged that farm subsidies in advanced nations exploit their own consumers and taxpayers ("The Cancún Delusion," September 12). However, he discounted their harmful effects on farmers and economic development in poor nations.

Yet farm subsidies in rich countries depress market prices for farm products and induce poor countries in Africa and elsewhere to import food that local farmers could otherwise produce more efficiently. Farmers in poor countries are rightly concerned about the effects of the subsidies.

Consider cotton. The United States spends some $2.5 billion a year and the European Union about $700 million in subsidies to cotton farmers. The historically low cotton prices are wreaking havoc for domestic producers in poor countries.[1] Cotton subsidies in Mississippi drive cotton farmers in West Africa out of business. African countries pleaded unsuccessfully with the WTO to end all cotton subsidies, but they are only the tip of the agricultural-subsidy iceberg.

U.S. farmers annually receive more than $20 billion from the government, and EU subsidies are even larger—45 billion euros a year.[2] These payments for beef, cotton, wheat, and other products spur production, depress product prices on world markets, and make it more difficult for farmers in developing countries to compete. American farmers produce twice as much wheat as the country uses, but federal subsidies help protect them from world market-price signals. Washington then uses food aid and other export programs as a safety valve to cope with overproduction.

Both the EU and the United States maintain programs to *directly subsidize* exports of farm products. The EU spends about $3.3 billion per year doing this. That gives EU goods an artificial advantage in international markets and works against the interests of producers in poor countries.[3]

Direct export subsidies have long been a prominent feature of U.S. farm programs. Public Law 480, enacted in 1954, is still going strong. It was instituted to rid government warehouses of surplus wheat, corn, cotton, and other farm products acquired through price-support programs. Dubbed "Food for Peace" to burnish its desired altruistic image, PL 480 provides easy credit and donates food to people throughout the world in response to famine and other emergencies.

Farmers in poor nations are especially critical of U.S. food aid for humanitarian purposes. Unlike the EU, which for the most part donates cash to buy food from producers in stricken countries, the United States buys food from American farmers. The Department of Agriculture (USDA) estimates the total value of U.S. food aid to be about $1.5 billion this year.[4]

Law Changes

The nature of U.S. food-aid programs has changed as the nature of farm subsidies has changed. In 1996 Washington stopped storing cotton, grain, and other products as a way to support farm prices and raise farmer incomes. Though food aid is no longer an adjunct of price-support programs, it continues as Washington buys the crops directly from the U.S. market.

The operation of U.S. food-aid programs demonstrates the difficulty of linking them to farm policy. Local farmers in Ethiopia, for example, see commodities purchased from American farmers—some $500 million this year—arriving as humanitarian aid as tons of their wheat, sorghum, and beans remain unsold in Ethiopian warehouses.[5] U.S. food aid not only breeds a welfare mentality in the recipients (just as domestic welfare programs do), like all other first-world farm subsidies, it also works against the interests of third-world farmers.

Food-aid programs have been augmented over the years by a variety of other dumping schemes. Washington now provides U.S. exporters guarantees against default on loans used to purchase U.S. agricultural commodities, reimbursement of trade groups and private companies for promotional activities overseas, and subsidies for exports of dairy products and other farm commodities. Recipients of export subsidies include Sunkist Growers, Dole Foods, and Gallo Wines. The value of all direct export subsidies—by USDA estimate—will exceed $6 billion this year.[6]

Indirect subsidies in wealthy countries also damage producers in low-income countries. The U.S. sugar program, for example, holds domestic sugar prices above the world price through import quotas. It also reduces opportunities for sugar producers in low-income countries. Indirect export subsidies are just as harmful to producers in low-income countries as the direct subsidies associated with the production of beef, corn, cotton, rice, wheat, and other commodities in first-world countries.

Farmers in the United States become irate when low-cost imports undercut domestic prices. Farmers in low-income countries are just as concerned about the effects of subsidized agricultural imports on their markets. It is ironic that one arm of the U.S. government provides assistance for economic development in poor countries while another subsidizes farm exports that stifle development.

The developing countries did not go to Cancún with clean hands—they have higher trade barriers overall than richer countries, but their agricultural protection generally is lower. (Poor countries often keep food prices artificially low and tax agricultural exports at high rates.) Ending first-world farm subsidies, as Lind suggests, would greatly benefit consumers and taxpayers in rich countries. However, ending policies that distort world trade in agricultural products—contra Lind—also is critical to poor countries.

—E. C. PASOUR, JR.
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1. Neil King, Jr., and Scott Miller, "Disputes Between Rich and Poor Kill Trade Talks," *Wall Street Journal*, September 15, 2003, p. A18.
2. Roger Thurow and Scott Kilman, "As U.S. Food-Aid Enriches Farmers, Poor Nations Cry Foul," *Wall Street Journal*, September 11, 2003, pp. A1 & A8, "Cancún's Silver Lining," *Wall Street Journal*, September 16, 2003, p. A16. Under the 2002 farm bill, part of the subsidy to U.S. farmers is partially "decoupled" from current production. If fully decoupled, the subsidy would remain the same, regardless of the amount of the product produced and would not spur production.
3. King and Miller.
4. See export subsidy data for fiscal years 2002–2004 for the USDA's Foreign Agricultural Service at www.usda.gov/budget/.
5. Thurow and Kilman, p. A8.
6. See www.usda.gov/budget/.

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Cashing a Cheque in the Third Millennium A.D.

by Robert E. Wright

Several years ago I exported some of my intellectual services to a small publisher in London. I thought nothing of contracting in pound sterling. After all, I reasoned, as early as 1700 A.D. I could have quickly sold a claim on a London bank at the going rate of exchange simply by standing on the corner of Second and Chestnut Streets in Philadelphia, or Broad and Wall in New York, or any number of other places in colonial America. How times change, and not always for the better!

In partial payment for my services to the publisher, I received a "cheque" for £2,000 in early November 2003. I knew that I was in trouble the moment my credit union refused to touch it. I was more than a little surprised that the teller had never seen a "funny L" before, and was stunned that his supervisor seemed only dimly aware that other nations use currencies other than the U.S. dollar. But don't get me wrong, I still love my credit union. It is very good, and cheap, at what it does—accepting my dollar-denominated deposits and paying my drafts.

On the recommendation of a friend, I next went to a big commercial bank—one of those North Carolina banks that have recently invaded the northeast. The tellers there were equally clueless, but the eyes of one of the bank's 12,567 vice presidents lit up when I told her that I had sterling to sell. Until, that is, she learned that I didn't have an account with her bank. I flirted with the idea of opening an account just to get her to cash my cheque. But then I learned that—get this—the bank charges a fee for closing an account! I was escorted to the door—literally—when I had the audacity to suggest that they cash the cheque anyway.

The reason? The bank claimed that it could not trust me because it could not discern the difference between a widely published business-school professor who lives a block away and a check-kiting miscreant. That line might have been easier to swallow had not this same bank regularly inundated my mailbox with pre-approved credit-card solicitations.

That line of thought, angry as it was, led me to approach my credit-card issuers. Though my total credit line was enough to buy a small country, not one of my sundry "gold" and "platinum" card issuers would accept the check on open account. If I were using my charge card in London those same companies would have sold me sterling at the best retail exchange rate available. But they wouldn't buy sterling from me at any rate, though the credit risk was no higher than if I had purchased £2,000 of warm beer, fish, and chips in London pubs. (Were I the rogue the southern bank thought I

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might be, I should buy that small country, move there, and tell my card issuers to take a hike.)

My next idea, a "brilliant" one as the Brits would say, was to negotiate the cheque privately. I had a buyer, but he eventually balked at the size of the instrument. He wanted to have fun on his vacation to England, but not that much fun. I contemplated putting the thing up for auction on e-Bay but thought better of it because if the cheque happened to bounce, my e-Bay reputation rating would have been shot.

As Thanksgiving approached, I decided to tap a contact at the Federal Reserve. She said that she regularly sent people in my predicament to a firm called Thomas Cook. "But be careful," she said, "because we [that is, the Fed] don't regulate them." "That's just the ticket," I thought to myself.

It took me some time to find Thomas Cook—it is now called Travelex. I left the place feeling like I had struck a deal with Mephistopheles himself. I endorsed the cheque to Travelex in return for its promise to pay me some unspecified number of dollars at some unspecified date in the future. But all's well that ends well. I ended up receiving a check for $3,196.65 in mid-December. The wholesale exchange rate in the first half of December ranged from about $1.72 to $1.745 per pound.[1] So I took a "haircut" of a couple of hundred bucks and was out my money about three weeks, but all in all it wasn't so bad. More cheques are on the way, so I hope the Fed continues *not* regulating Travelex.

Overregulated Monstrosity

The entire frustrating incident reminded me that our unfettered early financial system was in many ways superior to today's overregulated monstrosity. Sure, we have computers now, but apparently financial institutions do not make very efficient use of them. Why, in the third millennium A.D., it still takes days—up to a week I am told—for nonlocal checks to clear is beyond my comprehension.

I suspect that ultimately the regulators are to blame. Regulations have a way of becoming minimum standards. As such, they are almost means of collusion, a way of shielding a race right to the bottom. Take, for instance, Fed Reg CC, which *allows* banks to hold checks deposited into new accounts for longer than the usual period.[2] (§229.19 (c) (1) stipulates that nothing in the regulation prohibits "a depositary bank from making funds available to a customer for withdrawal in a shorter period of time than the time required by this subpart.") Rather than state that, bank employees often tell new accountholders that regulations *mandate* that they hold checks deposited into new accounts. Truth be told, given the technology now available, banks should be able to clear checks, domestic if not international, the same day, be the account holder an old customer or not.

My fear is that regulations like CC stifle competition and innovation to such a degree that they will in the end prove more than just annoyances. The United States is rapidly losing jobs, now even good white-collar jobs, to foreigners. That ultimately will be a good thing, provided the U.S. economy is not regulated to the point that it cannot create even better jobs in advanced sectors like finance. □

1. www.oanda.com/convert/fxhistory.

2. www.federalreserve.gov/regulations/title12/sec229/12cfr229_01.htm.

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The Economic Causes of War

by Ludwig von Mises

War is a primitive human institution. From time immemorial men were eager to fight, to kill, and to rob one another. However, the acknowledgment of this fact does not lead to the conclusion that war is an indispensable form of interpersonal relations and that the endeavors to abolish war are against nature and therefore doomed to failure.

We may, for the sake of argument, admit the militarist thesis that man is endowed with an innate instinct to fight and to destroy. However, it is not these instincts and primitive impulses that are the characteristic features of man. Man's eminence lies in his reason and in the power to think, which distinguishes him from all other living creatures. And man's reason teaches him that peaceful cooperation and collaboration under the division of labor is a more beneficial way to live than violent strife.

I do not want to dwell on the history of warfare. It is enough to mention that in the eighteenth century, on the eve of modern capitalism, the nature of war was very different from what it had been in the age of barbarism. People no longer fought one another with the aim of exterminating or enslaving the defeated. Wars were a tool of the political rulers and were fought with comparatively small armies of professional soldiers, mostly made up of mercenaries. The objective of warfare was to determine which dynasty should rule a country or a province. The greatest European wars of the eighteenth century were wars of royal succession, for example, the wars of the Spanish, Polish, Austrian, and finally the Bavarian successions. Ordinary people were more or less indifferent about the outcomes of these conflicts. They were not much concerned about the question whether their ruling prince was a Habsburg or a Bourbon.

Nevertheless, these continuous struggles placed a heavy burden upon mankind. They were a serious obstacle to the attempts to bring about greater prosperity. As a result, the philosophers and economists of the time turned their attention to the study of the causes of war. The result of their investigation was the following:

Under a system of private ownership of the means of production and free enterprise, with the only function of government being to protect individuals against violent or fraudulent attacks on their lives, health or property, it is immaterial for the citizens of any nation where the frontiers of their country are drawn. It is of no concern for anyone whether his country is big or small, and whether it conquers a province or not. The individual citizens do not derive any profit from the conquest of a territory.

Ludwig von Mises (1881–1973) was the foremost Austrian economist of the twentieth century, an adviser to FEE from the time of its founding in 1946, and the author of Human Action, Socialism, *and* The Theory of Money and Credit. *This is the major part of a lecture delivered in Orange County, California, in October 1944.*

It is different with the princes or ruling aristocracies. They can increase their power and their tax revenues by expanding the size of their realms. They can profit from conquest. They are bellicose, while the citizenry is peace-loving.

Hence, the old liberals concluded there would be no more wars under a system of economic laissez faire and popular government. Wars would become obsolete because the causes for war would disappear. Since these eighteenth- and nineteenth-century classical liberals were fully convinced that nothing could stop the movement toward economic freedom and political democracy, they were certain that mankind was on the eve of an age of undisturbed peace.

What was needed to make the world safe for peace, they argued, was to implement economic freedom, free trade and goodwill among the nations, and popular government. I want to stress the importance of both of these requirements: free trade at home and in international relations, and democracy. The fateful error of our age has consisted in the fact that it dropped the first of these requirements, namely free trade, and emphasized only the second one, political democracy. In doing so, people ignored the fact that democracy cannot be permanently maintained when free enterprise, free trade, and economic freedom do not exist.

President Woodrow Wilson was fully convinced that what was needed to make the world safe for peace was to make it safe for democracy. During the first world war it was believed that if only the German royal house of the Hohenzollern and the privileged German landed aristocracy, the *Junkers*, could be removed from power, a durable peace could be achieved. What President Wilson did not see was that within a world of growing government omnipotence this would not be enough. In such a world of growing government power, there exist economic causes of war.

Does the Citizen Profit from Conquest?

The eminent British pacifist, Sir Norman Angell, repeats again and again that the individual citizen cannot derive any profit from the conquest of a province by his own nation. No German citizen, says Sir Norman, profited through his nation's annexation of Alsace-Lorraine as a result of the Franco-Prussian War of 1870–1871. This is quite correct. But that was in the days of classical liberalism and free enterprise. It is another thing in our day of government interference with business.

Let us take an example. The governments of the rubber-producing countries have entered into a cartel arrangement in order to monopolize the market for natural rubber. They have forced the planters to restrict production in order to raise the price of rubber far above the level it would have attained on a free market. This is not an exceptional case. Many vital and essential foodstuffs and raw materials have been subject to similar policies implemented by governments around the world. They have imposed compulsory cartelization on numerous industries, as a result of which their control was shifted away from private entrepreneurs to the hands of government. Some of these schemes, it is true, have failed. But the governments concerned have not abandoned their plans. They are eager to improve the methods applied and are confident that they will be more successful after the present second world war.

There is a lot of talk nowadays about the necessity for international planning. However, no planning, whether it be national or international, is required to make planters grow rubber, coffee, and any other commodity. They embark upon the production of these commodities because it is the most advantageous way for them to make a living. Planning in this connection always means government actions for the restraint of output and the establishment of monopoly prices.

Under such conditions it is no longer true that a nation may not appear to derive a tangible profit from a victorious war. If the nations dependent on the importation of rubber, coffee, tin, cocoa, and other commodities could force the governments of the producing countries to abandon their monopolistic practices, they would improve the economic welfare of their citizens.

To mention this state of affairs does not imply a justification for aggression and conquest. It only demonstrates how utterly mistaken are pacifists like Sir Norman Angell, who base their arguments in favor of peace on the unstated assumption that all nations are still committed to the principles of free enterprise.

Sir Norman Angell is a member of the British Labour Party. This party stands for the outright socialization of business. But the members of the Labour Party are too dull to realize what must be the economic and political consequences of the socialization of business.

The Case of Germany

I want to explain these consequences by referring, first of all, to the situation in Germany.

Like all other European nations, Germany is poor in natural resources. It can neither feed nor clothe its population out of its own available domestic resources. Germans must import huge quantities of raw materials and foodstuffs, and must pay for these badly needed imports by exporting manufactures, most of which are produced out of those imported raw materials. Under free enterprise, Germany brilliantly adjusted itself to this circumstance. Sixty or seventy years ago, in the 1870s and 1880s, Germany was one of the world's most prosperous nations. Its entrepreneurs succeeded extremely well in building up very efficient manufacturing plants. Germany's industry was foremost on the European continent. Its products triumphantly swept the world market. The Germans—all classes of the German population—became more prosperous from year to year. There was no reason to alter the structure of German business.

But most of the German ideologists and political writers, the government-appointed professors and the socialist party leaders, as well as the government bureaucrats, did not like the free-market system. They disparaged it as capitalist, plutocratic, bourgeois, and as Western and Jewish. They lamented the fact that the free-enterprise system had incorporated Germany into the international division of labor.

All these groups and political parties wanted to substitute government management of business for free enterprise. They wanted to do away with the profit motive. They wanted to nationalize business and to subordinate it to the commands of the government. This is a comparatively simple thing in a country that by and large can live in economic self-sufficiency. Russia, occupying one-sixth of the earth's surface, can do without almost any imports from abroad. But it is different with Germany. Germany cannot eschew imports and consequently must export manufactures. This is precisely what a government bureaucracy can never achieve. Bureaucrats are only able to flourish in sheltered domestic markets. They are not fit to compete on foreign markets.

Most people in Nazi Germany today want the government to control business. But the fact is that government control of business and foreign trade are incompatible. A socialist commonwealth must aim at autarky. This is where aggressive nationalism—once referred to as Pan-Germanism, and today called National Socialism—comes into the picture. We are a powerful nation, the National Socialists say; we are strong enough to crush all other nations. We must conquer all those countries whose resources are essential for our own economic wellbeing. We need autarky and therefore we must fight. We need *Lebensraum* (living space) and *Nahrungs freiheit* (freedom from a scarcity of food).

Both terms mean the same thing, the conquest of a territory so large and rich in natural resources that the Germans could live without any foreign trade at a standard of living not lower than that of any other nation. The term *Lebensraum* is fairly wellknown abroad. But the term *Nahrungs freiheit* is not. *Freiheit* means freedom; *Nahrungs freiheit* means freedom from a state of affairs under which Germany must import foodstuffs. It is the only "freedom" that matters in the eyes of the Nazis.

Both the Communists and the Nazis agree that the essence of what *they* mean by democracy, liberty, and popular government lies in the establishment of full government control of business. Whether one calls this system socialism or communism or planning is immaterial. Regardless of what it is called, this system requires economic self-sufficiency. But while Russia can, by and large, live in economic self-sufficiency, Germany cannot. Therefore a socialist Germany is committed to a policy of *Lebensraum* or *Nahrungs freiheit*, that is, to a policy of aggression.

The pursuit of a program of government control of business must finally result in a rejection of the international division of labor. From the viewpoint of Nazi philosophy, the only proper mode of international relations is war. Their most eminent men take pride in referring to a dictum of Tacitus. This Roman historian, almost two thousand years ago, said that the Germans consider it shameful to acquire by hard work what could be acquired by bloodshed. It was not a slip of the tongue when Kaiser Wilhelm II, in 1900, raised the Huns as a model for his soldiers. It was the encapsulation of a conscious policy.

Dependent on Imports

Germany is not the only European country depending on foreign imports. Europe—excluding Russia—has a population of about 400 million people, more than three times the population of the continental United States. But Europe does not produce cotton, rubber, copra, coffee, tea, jute, and many essential metals. And it has a quite insufficient production of wool, fodder, cattle, meat, hides, and of many cereals.

In 1937, Europe produced only fifty-six million barrels of crude petroleum, as compared with the U.S. production of 1,279 million barrels. Besides, almost all of Europe's petroleum production is located in Romania and in eastern Poland. But as a result of the present war, these areas will come under the control of Russia. Manufacturing and exporting manufactures are the essentials of Europe's economic life. However, exporting manufactures is almost impossible under government control of business.

Such is the stark reality which no socialist rhetoric can conjure away. If the Europeans want to live they must cling to the well-tried methods of free enterprise. The alternative is war and conquest. The Germans have tried it twice and failed both times.

However, the politically most influential groups in Europe are far from realizing the indispensability of economic freedom. In Great Britain and France, in Italy and in some smaller countries there is a powerful agitation for full government control of business. The case for economic freedom is almost a hopeless cause with the governments of these countries. The British Labour Party and those British politicians who wrongly still call their party the Liberal Party look upon this war not only as a fight for their nation's independence, but no less as a revolution for the establishment of government control of business. The third British party, the Conservative Party, by and large sympathizes with these endeavors. The British want to defeat Hitler, but they are eager to adopt his economic methods for their own country. They do not suspect that state socialism in Great Britain spells the doom of the British masses. Britain must export manufactures in order to buy raw materials and foodstuffs from abroad. Any drop in British exports lowers the standard of living of the British masses.

Conditions in France and Italy and in most other European countries are similar to those in Great Britain.

In supplying the domestic consumer with various necessities a socialist government is sovereign. The citizen must take what the government gives him. But it is different with any export trade. The foreign consumer buys only if both the quality and the price of the commodity offered for sale are attractive to him. In this international arena of serving foreign consumers, capitalism has shown its greater efficiency and adaptability. The high level of prewar Europe's economic well-being and civilization was not the outcome of the activities of government bureaus and agencies. It was an achievement of free enterprise. Those German cameras and chemicals, those British textiles, those Paris dresses, hats and perfumes, those Swiss watches, and Vienna leather fancy goods were not the product of government-controlled factories. They were the products of entrepreneurs indefatigably intent upon improving the quality and lowering the price of their merchandise. Nobody is bold enough to assume that a government agency could successfully replace the private entrepreneurs in this function.

Privately conducted foreign trade is the private affair between private firms of various countries. If some disagreements result, they are the conflicts between private firms. They do not create conflicts in the political relations between nations. They concern a Mr. Meier and a Mr. Smith. But if foreign trade is a matter of government, such conflicts are transformed into political issues.

Suppose the Dutch government prefers to buy coal from Great Britain rather than from the German Ruhr. Then the German nationalists may think, Why tolerate such behavior on the part of a small nation? It took the Third Reich precisely four days to smash the armed forces of the Netherlands in 1940. Let us try it again! Then we will enjoy all the products of the Netherlands, but without having to pay for them.

"Fair" Distribution of Resources

Let us analyze the frequently expressed demand of the Nazi and Fascist aggressors for a new and fair distribution of the natural resources around the globe. In a world of free enterprise, a man who wants to drink coffee and is not himself a coffee planter must pay for it. Whether it is a German or an Italian or a citizen of the Republic of Colombia, he must render some services to his fellowmen, earn a money income and spend part of it on coffee he desires. In the case of a country that does not produce coffee within its own borders, this means exporting goods or resources to pay for the coffee that is imported. But Messrs. Hitler and Mussolini do not imagine such a solution to the problem. What they would want is to annex a coffee-producing country. But since the citizens of Colombia or Brazil are not enthusiastic about becoming the slaves of either the German Nazis or the Italian Fascists, this means war.

Another striking example is provided by the case of the cotton industry. For more than a hundred years, one of the main industries of all European countries was the spinning of cotton and the manufacture of cotton goods. Europe does not grow any cotton. Its climate is unfavorable. But the supply was always sufficient, with the only exception being the years during the American Civil War in the 1860s, when the conflict interrupted the supply of cotton from the Southern States. The European industrial countries acquired enough cotton not only for the needs of their own domestic consumption, but no less for undertaking a considerable export trade in cotton goods.

But in the years just preceding the start of the second world war, conditions changed. There was still an ample supply of raw cotton on the world market. But the system of foreign exchange controls that was adopted by most European countries prevented private businessmen from buying all the cotton they needed for their production processes. Hitler's contribution to the decline of the German cotton-goods industry consisted in restricting their production and making them discharge a large part of their workforce. Hitler did not worry much about the fate of these discharged workers. He sent them to work, instead, in the munitions factories.

As I already point out, there are no economic causes for armed aggression within a world of free trade and free enterprise. In such a world, no individual citizen can possibly derive any advantage from the conquest of a province or a colony. But in a world of totalitarian states, many citizens may come to believe in an improvement of their material well-being from the annexation of a territory rich in resources. The wars of the twentieth century have been, to be sure, economic wars. But they have not been caused by capitalism, as the socialists would have us believe. They are wars caused by governments aiming at complete political and economic omnipotence, and have been supported by the misguided masses of these countries.

The three main aggressor nations in this war—Nazi Germany, fascist Italy, and Imperial Japan—will not attain their ends. They have been defeated, and they know it already. But they may try it again at a later date, because their counterfeit philosophy—their totalitarian creed—does not know of any other method of trying to improve the material conditions of the people other than war. For the totalitarian, conquest is the only viable political means to attain their economic ends.

Economic Mentality

I do not say that all wars of all nations and in all ages were motivated by economic considerations, that is, by the desire to make the aggressors rich at the expense of the defeated. There is no need for us to investigate the root causes of the crusades or the religious wars of the sixteenth and seventeenth centuries. What I want to say is that in our age the great wars have been the outcome of a specific economic mentality.

The second world war is certainly not a war between the white and the colored races. No racial differences separate the British, Dutch, and the Norwegians from the Germans, or the French from the Italians, or the Chinese from the Japanese. It is not a war between Catholics and Protestants. After all, there are Catholics and Protestants in both belligerent camps. It is not a war between democracy and dictatorship. The claim of several of the United Nations (Soviet Russia in particular) to the appellation "democratic" is rather questionable. On the other hand, Finland (which is allied with Nazi Germany) is a country with a democratically elected government.

My argument that recent wars have been motivated by economic considerations is not meant to be a justification of the aggressor's policies. Viewed as an economic means for the attainment of certain economic benefits, the policy of aggression and conquest is self-defeating. Even if technically successful in the short run, it would never attain in the long run the ends at which the aggressors are aiming. Under the conditions of modern industrialism, there cannot be any question of a social system such as the Nazis plan under the name of a "New Order." Slavery is not a method for industrial societies. If the Nazis had conquered their adversaries, they would have destroyed civilization and brought back barbarism. They would certainly not have erected a thousand-year New Order, as Hitler promised.

Thus, the main problem is how to avoid new wars. The answer is not to be found in setting up a better League of Nations; neither is it a question of the establishment of a better World Court, nor even in the implementation of a World Police Force. The real issue is to make all nations, or at least the most populous nations of the world, peace-loving. This can be achieved only by going back to free enterprise.

If we want to abolish war, we must remove the causes of war.

The great idol of our time is the State. The State is a necessary social institution, but it should not be deified. It is not a god; it is a device of mortal men. If we make it an idol, we must sacrifice to it the flower of our youth in coming wars.

What is needed to make a lasting peace is much more than new offices and a new court for the League of Nations in Geneva, or even a new international police force. What is needed is a change in political ideologies, and a return to a sound free-market economic system. □

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A Deficit of Understanding

"Nothing, however, can be more absurd than this whole doctrine of the balance of trade."

—ADAM SMITH
The Wealth of Nations

Here's some sound advice: don't worry about the trade deficit.

The pundits' and politicians' hysteria over the trade deficit is rooted in confusion. The fact is, a trade deficit is unlikely to be a problem. Let's see why all the fuss about it is pointless.

Begin by recognizing that most people who haven't studied international economics don't know what the trade deficit is. The term itself is used on different occasions to refer to two different things. One is trade in merchandise. A country runs a deficit in merchandise trade if the dollar value of the tangible goods that it imports exceeds the dollar value of the tangible goods that it exports. But so what? Despite the fetish that many people have for manufacturing, there's nothing economically special about tangible goods and, hence, nothing meaningful about measurements of imports and exports of merchandise.

Consider two examples.

- Americans import $1 million of foreign cars and, in exchange, export to foreigners $1 million worth of software engineered in Silicon Valley. The software is delivered to foreigners by loading it onto computer diskettes and then shipping these diskettes abroad.
- Americans import $1 million of foreign cars and, in exchange, export to foreigners $1 million worth of software engineered in Silicon Valley. The software is delivered to foreigners by having them download it online.

Economically, no relevant difference separates these two examples. In both, foreigners use their dollars to buy American software-engineering services. But while in the first example America's merchandise-trade account is balanced, in the second, America has a merchandise-trade deficit.

A measurement so sensitive to such economically irrelevant factors as the *form* taken by exports and imports is unworthy of serious attention.

A better trade-measurement figure is the current account, which measures trade in goods *and* services. Not incidentally, the current account is balanced in both of the above examples.

Nevertheless, the picture of international trade offered by the current account is incomplete. As its name suggests, it excludes

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investment decisions. These are made principally with a view to future periods, not just the current one. International investments, therefore, are measured in a different account, the capital account.

What can a foreigner do with dollars he earns from selling something to Americans? He can spend them on U.S.-made goods or services. If he does so, America's current account moves closer into balance. But he often invests his dollars. He can buy stock in American corporations, U.S. Treasury notes, Texas real estate, and so on.

If he invests his dollars, he contributes to an American current-account deficit. Importantly, however, he also contributes to an American capital-account surplus.

Accounts Cancel Out

The accounting rules that govern the computation of the capital and current accounts guarantee that, in economies with floating exchange rates, these two accounts cancel each other out. They are *defined* so that, together, they add up to zero.

For example, if the U.S. current account is in a deficit of $138,671,255,142, then the U.S. capital account is in a surplus of $138,671,255,142. Keep this fact in mind when you next hear a network anchorman bemoan the size of "the" trade deficit. He could just as truthfully report on the size of "the" surplus.

Several other features are worth noting about a capital-account surplus (or current-account deficit).

First, a larger U.S. capital-account surplus generally means brighter U.S. economic prospects. Not only is large and growing foreign investment in the United States evidence that investors worldwide believe the American economy's prospects to be rosy, but also the inflow of investment funds creates valuable assets, such as more machines, more factories, and increased research and development. This raises the productivity of labor (causing wages to rise), improves work conditions, and generates greater output. Americans' standard of living increases.

To press for reducing America's current-account deficit is to press for reducing the capital-account surplus—which, if achieved through protectionist measures, will mean reduced investment in the U.S. economy. That's no recipe for enhancing the prospects of American workers and consumers.

A second fact is that, despite the assertions of Warren Buffett and a herd of politicians, a trade deficit is not a species of debt.

I'm writing this column on a Sony computer. I bought the computer outright from Sony (a Japanese company) with dollars that I earned from working. I now own a valuable computer; Sony now owns more dollars. No debt was created in this transaction.

Whether or not Americans become indebted to Sony as a consequence of this transaction depends on how Sony and Americans afterward choose to interact commercially with each other. Sony can spend its dollars in countless other ways that both increase America's current-account deficit *and* create no debt owed by Americans to foreigners.

If Sony buys shares in Microsoft, no debt is created, even though this series of transactions raises the U.S. current-account deficit. Likewise if Sony uses these dollars to purchase American real estate, or if Sony holds its dollars as cash reserves.

Debt enters this picture only if Sony uses its dollars to buy corporate or government bonds. Bonds, of course, are I.O.U.s.

Even when foreigners spend all their dollars on American debt instruments—that is, loan their dollars to Americans—nothing is necessarily amiss. Americans issuing the bonds do so voluntarily, and foreigners buying the bonds do so voluntarily.

Whether or not such indebtedness is good or bad depends on a variety of factors, none of which is the nationality of the lender. In my next column, I explain why. □

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What's Wrong with the Poverty Numbers

by Robert P. Murphy

Last fall the U.S. Census Bureau released its annual report on poverty in the United States. The report indicated that the number of people below the official poverty line had risen from 32.9 million in 2001 to 34.6 million in 2002. Worse, the official poverty rate had risen from 11.7 percent in 2001 to 12.1 percent the following year.[1]

The response to the grim news was predictable. "Everyone's taking a bump down, and you haven't seen the worst of it," declared Syracuse University economist Tim Smeeding. (I just got my degree and landed a job teaching economics. My salary is more than double my stipend in graduate school; I guess I'm not a somebody to Professor Smeeding.)

Self-proclaimed advocates for the poor pounced on the statistics—particularly the estimated 400,000 more children living in poverty—to prove the need for bigger government budgets. Others were quick to point fingers over the news: "The Bush administration has continued to pander to the wealthy through millionaire tax cuts while having no real plan for low- and middle-income Americans," declared AFL-CIO president John Sweeney.

Although the Census report and the associated media commentary have the appearance of scientific rigor, one cannot help but suspect that the entire enterprise is driven more by politics than by disinterested curiosity. The annual release of the Census data provides a wonderful avenue for media statements by those whose entire profession involves "advocacy" for the poor—those who make a living off the growth industry in wealth redistribution. No matter *what* the Census reports, such professional Robin Hoods can and will always proclaim the urgent need for additional tax money. If the official poverty rate goes up in a given year, then obviously the press releases point to this dire fact as proof of the emergency.

However, even if the official poverty rate *drops* in a given year, the advocate for the poor still benefits from the Census announcement. This is because he can always claim, "Although we are making progress in the War on Poverty, we can't relax our vigilance." Furthermore he can criticize the statistical method used by the Bureau (see below) and claim that the official poverty rate underestimates the problem. To give a concrete illustration: According to the data contained in the Census report (p. 22), the official poverty rate declined every single year from 1983 to 1989 (15.2 to 12.8 percent). Does anyone think that during those years the AFL-CIO spokespeople issued annual statements of praise for President Reagan's compassionate supply-side tax policies?

The Census figures are dubious on purely

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> *No matter what the Census reports, professional Robin Hoods can and will always proclaim the urgent need for additional tax money.*

technical grounds. Most obvious, the Census collects its data on income by asking a (hopefully representative) sample of Americans to fill out a survey. Although the report itself claims that "[r]espondents provide answers to the best of their ability" (p. 1), one wonders how the bureau can possibly know this. (Presumably there is not an additional box declaring, "Check here if the above estimates of your income are truthful.") In any event, those relying on the Census data should keep in mind that these income figures are estimates given by the respondents themselves, *not* some official measure, such as their W2 forms.

Even if we assume that the self-reported levels of income are accurate, such statistics are still not sufficient to get a true measure of poverty by any common-sense definition. As a Heritage Foundation report documents, many of the officially "poor" in America enjoy expensive durable consumer goods.[2] Thus a household's income in any given year may not reflect its members' actual consumption in the broadest sense. For example, the Heritage report cites the Department of Commerce's *Housing Survey for the United States in 1995*, which showed that 41 percent of "poor households" owned their homes (the median value of which was $65,000), 69.7 percent had a car or truck, 99.3 percent had a refrigerator, and 66.3 percent had air-conditioning. In addition, 97.3 percent had a color television, while 49.1 percent had *two or more* color televisions.

Income Statistics Incomplete

Even setting aside the problem of durable consumption goods (which may provide a flow of benefits even when money income is low), the Census income statistics are objectionable on their own terms, because they measure only pre-tax income, and exclude noncash government entitlements (such as public housing, Medicaid, and food stamps). To hear that someone only makes $5,000 a year conjures up images of the barest survival, until we realize that the taxpayers may be footing his room and board.

Of course, the poverty advocates may cite such cases as proof of the importance of food stamps, public housing, and other government provisions. But this simply assumes that people do not respond rationally to the existence of such generous handouts. After all, far more parents would patronize private schools if there were no "free" government alternatives; current retirees would have invested far more in pension plans if they had not counted on Social Security payments; and private donations to charities would be far higher if the government did not spend (and tax) billions of dollars annually to "help the poor." In the same way, simply because many people choose to earn little money when the government makes that way of life feasible does not prove that such people are *incapable* of working to support themselves.

In addition to the omission of noncash benefits, another flaw is that the Census figures do not reflect geographical differences in the cost of living. To its credit, the Census report discloses these and other shortcomings (p. 15), and includes an entire section on alternative measures of poverty.

There are dozens of plausible measures of income, each including some factors while excluding others, and differing in the treatment of medical expenses, child-care expenses, and so on. There is really no way to single out one of the measures as "cor-

The media obsession with static figures causes us to fret about ways of helping "the poor," when a more accurate picture would have us concentrating on ways to accelerate the upward mobility of those who leave the ranks of "the poor" all the time.

rect," and that's the point: If one wants to paint a picture worse than the official statistics, one can construct measures that imply a higher rate of poverty. This is certainly the case for Arloc Sherman, a senior researcher for the Children's Defense Fund, who said, "When we mismeasure not only how many Americans are poor, but who they are, we misunderstand their plight . . . [which] makes it easier to ignore them."

On the other hand, someone can just as easily argue that the official poverty rate overstates the problem. I found the income measure "MI-Tx+NC" to be compelling; this statistic computes the relevant income as money income plus capital gains (or losses), minus income and payroll taxes, plus the value of all noncash transfers (such as food stamps). Using this definition of income (rather than the official measure of pre-tax income) with the same official thresholds of poverty, the poverty rate in 2002 was only 9.4 percent, compared with the "official" rate of 12.1 percent (p. 19).

Bruce Bartlett, senior fellow at the National Center for Policy Analysis, has made similar observations regarding the shortcomings of conventional poverty statistics.[3] For example, Bartlett writes that "consumption by households in the lowest 20 percent of the income distribution averaged $13,957 in 1993, while their income averaged only $6,395. Insofar as consumption is a truer measure of living standards, many low-income Americans are far better off than their income alone would suggest."

Low Incomes, Substantial Assets

How can these people consume so much more than their official income? Besides the in-kind benefits (such as food stamps and public housing) and the possibility of underreporting that we have already considered, Bartlett raises another issue: "[A] large percentage of those with low money incomes are the elderly. Many have low expenses and may have substantial assets." For example, Bartlett points out that many elderly own their own homes, and thus have no mortgage or rental payments to make. Because of this, they can still "consume" a flow of housing services without reducing their money income. Someone who owns his home can live comfortably on a far lower money income than a younger person who has not had time to accumulate such assets.

Beyond the technical problems described above, the Census approach invites misleading reports by the media. To calculate the number of people in poverty in a given year, and then compare the figure with previous years, gives the impression that we are referring to *the same group of poor people*. For example, the October 22, 2003, *New York Teacher* stated, "More than 1 million Americans sank into poverty . . . the U.S. Census Bureau reported in September."

To understand the problem with such statements, imagine that we are measuring the number of people in a public swimming pool. Suppose that at noon on June 15, we count 50 people in the pool. We then return at noon on August 15, and now count 250 people in the pool. Would it really be accurate to then report, "In the last two months, 200 Americans sank into pool water"?

The pool analogy is not as silly as it first sounds. The official poverty rate merely gives us a snapshot of how many people were earning less than the official income threshold at the time of the survey. But if we turn to the Survey of Income and Program Participation (SIPP; the results of which are summarized on pp. 14–15 of the Census report), we have access to data from longitudinal surveys that periodically interview the same respondents over several years.

Although the following quotes are contained in the Census report itself, you will not see them trumpeted in the media: "According to the 1996 SIPP panel, a little over half of the [poverty] spells lasted 4 months or less (51.1 percent), and about four-fifths (79.6 percent) of spells were over within 1 year." The Census report goes on to say, "About 34.2 percent of all people were in poverty for at least 2 consecutive months from 1996 through 1999, but only 2.0 percent were in poverty every month of that 4-year period."

In short, people have variable incomes; someone might be officially in poverty when he fills out a survey, but that doesn't mean he is condemned to membership in the underclass. The media obsession with static figures causes us to fret about ways of helping "the poor," when a more accurate picture would have us concentrating on ways to accelerate the upward mobility of those who leave the ranks of "the poor" all the time.

Lest I give the wrong impression, let me assure the concerned reader that poverty is indeed a vexing social problem, even in the wealthy United States. There are undeniably people whose material standard of living is shocking, and the government can definitely take steps to ameliorate the situation. Most obvious, governments at all levels could cut (or abolish!) income and sales taxes, which would allow the poor man's dollar to go that much farther. They could also reduce (or eliminate!) the contradictory and pointless regulations that stifle entrepreneurship and thus retard economic development of "depressed" areas. More than any official (and ineffective) "jobs program," the radical move to legalize drugs, abolish the minimum wage, and at long last end the failed government experiment in so-called public schooling would revitalize the nation's inner cities almost overnight.

There is one last governmental policy reform we should mention—and one perhaps that would prove more effective in raising the incomes of America's poor than all of the above items put together: Perhaps our society would experience a tremendous reduction in poverty if only our federal government *would stop spending billions of dollars subsidizing it.* Currently the government tells its citizens: "Tell you what. If you agree to make under $10,000 or so a year, we'll give you a bunch of money and other goodies." As Murray Rothbard put it, we can have as many poor people as we're willing to pay for.

Alas, it is not likely that the public—not to mention the professional advocates for the poor—will support such bold reforms anytime soon. Consequently, those in poverty would do well to take matters into their own hands. As the Census report itself declares, "Those who worked in 2002 had a lower poverty rate than those who did not—5.9 percent compared with 21.0 percent. . . . Among full-time year-round workers, the poverty rate was much lower. . . ." (p. 8).

And there you have it, backed up by cutting-edge statistical investigation: If you want to reduce the likelihood of finding yourself in poverty, get a job. And if you *really* want to minimize the probability of being poor, get a full-time job and *keep* it. □

1. Bernadette D. Proctor and Joseph Dalaker, U.S. Census Bureau, Current Population Reports, P60–222, *Poverty in the United States: 2002*, U.S. Government Printing Office, Washington, D.C., 2003.

2. Robert E. Rector, et al., "The Extent of Material Hardship and Poverty in the United States." Heritage Foundation, WebMemo no. 187, www.heritage.org/Research/Welfare/wm187.cfm, September 1, 1999.

3. Bruce Bartlett, "How Poor Are the Poor?" National Center for Policy Analysis, Brief Analysis no. 185, undated, www.ncpa.org/ba/ba185.html.

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There's Still Work to Do

Free trade is again under assault. If there is one reason for the perennial attack it is likely the one Frédéric Bastiat made so much of: the failure to look for what is "unseen." The costs of free trade (temporary job loss, closed firms) are easily traced to the free movement of goods, services, and capital. The benefits (lower-priced goods, new products, new job opportunities), though great and impossible to produce any other way, are not readily traceable to that movement.

Three things are overlooked in most discussions critical of free trade: We're not in the Garden of Eden; national boundaries, economically speaking, are unimportant; and the mixed economy creates problems that appear attributable to international trade.

Laments about job losses from foreign competition implicitly assume that we have all the goods and services we could possibly want and so there is no more work to do. The only question is who will do it. We might wish that were the case. Economists talk about the disutility of labor, meaning work is *work*. We do it because we want things. If those goods were superabundant and could be had without effort, we might spend our time other ways.

But those goods aren't superabundant. They're scarce. To get one thing we have to give up something else. We make shoes and swap them (indirectly) for hamburgers. This sheds a different light on the adjustments that occur with free trade. When something can be had cheaper from abroad, labor, capital, and resources are freed up for other things. What other things? More of what we already have and things that people, except for a few perceptive entrepreneurs, have never even dreamed of. Thanks to free trade, we can now afford those things.

Bastiat illustrated the point with his tale about Crusoe and the plank that washes ashore. Crusoe had intended to make a plank. Should he destroy the free one in order to protect the plank-making job he anticipated? Or should he welcome the good fortune because now the hours earmarked for plank-making are free for coconut-gathering, hammock-weaving, or leisure? The answer is obvious.

This is not to ignore that the changes ignited by free trade can be painful to particular individuals. Losing a job and having to train for a new one, perhaps at lower pay, are unpleasant experiences, financially and psychologically. Unfortunately, the alternative to change and adjustment is government-enforced stagnation for all. This understates the case. Import restrictions intended to protect jobs inevitably reduce foreigners' export-buying power; that costs Americans well-paying jobs. The restrictions also tend to provoke protectionist retaliation, which harms still more Americans. Living standards just don't stagnate; they drop.

The blasts against free trade mistake world economic activity for the Olympics, in which only one nation can win the gold medal in each contest. But economic activity

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is not like a sporting event. People enter into exchanges because each person anticipates a gain. Why should it matter if one stands north of a national boundary and one stands south, rather than on the same side?

As Murray Rothbard wrote in *Power and Market*: "Economists have devoted a great deal of attention to the 'theory of international trade'—attention far beyond its analytic importance. For, on the free market, there would be no separate theory of 'international trade' at all. . . . 'Nations' may be important politically and culturally, but economically they appear only as a consequence of government intervention, either in the form of tariffs or other barriers to geographic trade, or as some form of monetary intervention."

Rothbard employed the *reductio ad absurdum* against the opponents of free trade. He asked, Why stop at national boundaries? If Buy American is well advised, why not Buy Pennsylvanian? Or Buy Scranton? Or Buy Elm Street? Indeed, the logic ought to apply to each household or person. Anyone who refused to "import" goods and services from others would surely never find himself unemployed. And his trade account won't be in deficit either. But he'll have a dismal standard of living.

People who appreciate that America is rich in part because its large land mass is a free-trade zone should also see that pushing the boundaries of that zone ever outward can only be a good thing.

Self-Inflicted Wound

Trade benefits the parties to it. It is true that if an American buys a good from a Pakistani, he's not buying that good from another American. But with the money he saves by paying less for the Pakistani good he can buy other American-made goods or invest in new production. Moreover, the Pakistani now has dollars with which to buy American-made goods or to invest in American enterprises. So even people who want to continue to think about trade in national terms should see that restrictions cannot help "America," but rather only one group of Americans at the expense of all the rest.

The economist Paul Craig Roberts asserts that the case for free trade depends on immovable capital, which activates the law of comparative advantage, according to which more-efficient people profit from trading with less-efficient people. Since capital is highly mobile now, Roberts says, the conditions justifying free trade no longer apply. He fears that high-tech service jobs, such as computer programming and radiology, will be "outsourced" en masse to low-wage Asians at the expense of high-wage Americans.

Yet it's hard to see why this would mean there will be no lucrative work for Americans. (We're not in the Garden of Eden.) Foreigners will still find it in their interest to specialize in the things where they have a relative advantage and buy the rest elsewhere. In other words, the law of comparative advantage lives!

One thing is sure: they won't sell to us if there's nothing of value to buy from us. Nominal incomes in the United States may decline, but less-expensive products and services from abroad will make real incomes attractive. (I recall an old English political poster that said: "Incomes buy more under free trade.")

Roberts may be right that political stability and increasing education in the developing world, as well as technological advances like the Internet, are producing new competition for high-paid Americans; but are those developments to be feared? What is apt to make us richer: a more elaborate division of labor using scarce capital more efficiently, or third-world chaos, repression, ignorance, and technological primitivism?

Finally, the doomsday scripts written by the free-trade skeptics confuse the effects of trade with those of pervasive government intervention in the economy. Yes, free trade requires people to make adjustments. Here's how the government can help: cut spending, slash and repeal taxes, abolish regulations, and move to market-based money. There's no better way to ease any harsh consequences from world trade. □

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How Nineteenth-Century Americans Responded to Government Corruption

by James Rolph Edwards

From its origin as a distinct secular scientific discipline with the French Physiocratic school in the middle of the eighteenth century, and the British classical school that followed, economics had a pro-market, limited-government orientation. Indeed, intellectual historians and political philosophers often refer to it as "economic liberalism," in contrast with the classical liberal *political* philosophy of natural rights, human equality, and constitutionally limited government, which emerged somewhat earlier. Complementing that political philosophy, the teachings of the economists are known to have helped institutionalize liberal regimes and policies based on private property and voluntary exchange.

The effects of such regimes and policies were startling, first in Britain and then in America. Centuries of medieval stagnation gave way, and for the first time in recorded history, continuing economic growth with rising real incomes for *ordinary* persons became the norm. In the eighteenth century, real income had stagnated in the American colonies under British mercantile policy. Over the nineteenth century, however, closely following ratification of the Constitution in 1788, real incomes in America grew at an average annual rate 50 times above that experienced in the Old World during the sixteenth and seventeenth centuries. Average life spans rose rapidly, and life-changing inventions and innovations of all kinds emerged at a dazzling pace.

Fairly early in the twentieth century, however, most economists in America succumbed to the interventionist perspective of political progressivism and welfare liberalism. In this "public interest" perspective, the regime of private property and voluntary exchange was and is believed to be subject to massive and frequent market failures—externalities, monopolies, corporate exploitation of workers, and so on—which are assumed to require interventions by public-spirited government officials in the form of taxation, subsidies, or administrative regulation.[1] For decades economic analysis focused strongly on the nature of market failures and on regulatory prescriptions. Government intervention expanded apace, progressively restricting economic freedom.

However, a reversion of opinion by many economists back toward the classical-liberal roots of the profession began in the 1960s and accelerated in the 1970s due to three developments. The first was the increased

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professional influence of Milton Friedman and the Chicago school of economics, which had a strong free-market orientation. The second factor was that economists had, by that time (the 1960s), several decades of regulatory practice to observe and analyze. The picture emerging from careful studies was *not* one of social problems being cured by beneficent regulators. The third factor was the resurgence of the Austrian school, which had always defended free markets and opposed statist interventionism, but which had almost disappeared in the 1940s.

Oddly (or perhaps not so oddly), this resurgence of skepticism among economists about the political motivations for and beneficial character of government intervention overlapped a new burst of regulatory activity in the late 1960s and early 1970s. In that period the Johnson and Nixon administrations established the EPA, OSHA, NHTSA, CPSC, and many additional regulatory agencies with enormous budgets and vast powers. Since then, evidence has continued to accumulate that regulation normally does more harm than good. If regulatory activities were in fact solving social problems and overcoming market failures by acting to end racial discrimination, business monopoly, labor exploitation, externalities, unsafe working conditions, and the like, they should have *increased* productivity and economic growth.[2] Instead, after 1972, productivity growth fell below its historic 2 percent long-run annual average, and stayed below it for over 20 years, in an episode economists termed the Great Productivity Slowdown. Richard K. Vedder has shown empirically that increasing regulation was a primary cause of the slowdown and that we suffered staggering losses in real income as a result.[3]

Politics of Intervention

Suspicion among economists over the motives for regulatory intervention emerged not only because the forms and effects of regulation diverged from economists' models and predictions, but also because firms were often observed *seeking* regulation, rather than opposing it. Major firms in the trucking industry, for example, had lobbied for passage of the National Motor Carrier Act of 1935, bringing the industry under regulatory control of the Interstate Commerce Commission, which had been created in 1877 to regulate the railroads. And in 1938 the airlines lobbied Congress to pass the Civil Aeronautics Act, establishing a government-enforced cartel over the air-passenger industry.[4]

George Stigler was among the first economists to wonder whether, given that economic agents often demand regulation, something like market exchange was occurring between those parties and legislators. He was a pioneer in attempting to model supply and demand in such a market.[5] A student of industrial organization and cartels, Stigler was aware that private cartels are unstable: The fixing of a price above the competitive level motivates members of the cartel to undercut the fixed price for personal gain. Also, the high price attracts outside competitors into the market, adding to supply and making it impossible to maintain the cartel price. He also knew that entry can be prevented, and cartel arrangements enforced, if the cartel can persuade the government to use its coercive legislative and police powers in those efforts.

Political officials will not grant and enforce such a legal cartel arrangement for nothing, however. Private interests seeking monopoly or cartel gains at the expense of their competitors and the public will have to pay the politicians for granting them. The payments assume diverse forms, such as campaign contributions, wining and dining by lobbyists, literal bribes, speaking fees, and the promise of jobs after their political careers end. In essence, the politicians operate an auction market where various interests bid for redistributive legislation. Obviously, this may take many forms beyond the literal regulatory cartelization legislation stressed by Stigler. Examples include efforts by firms and other private interests to obtain such things as targeted income transfers, farm price supports, tariffs on imports competing with domestic products, and so on.

The key social problem associated with

private efforts to obtain redistributive legislation (termed "political rent-seeking") was made clear by Gordon Tullock, in another breakthrough paper.[6] Scarce resources (money and lawyers' and lobbyists' time, among other things) that are used in such efforts are diverted from more productive uses, and the real output they would have otherwise generated is lost. Indeed, Tullock demonstrated that when rent-seeking is competitive, the entire discounted present value of the prospective future gains being sought through redistributive legislation will be expended as rent-seeking costs. Redistributive politics is thus a negative-sum game. There are winners and there are losers, but the sum of the losses exceeds the sum of the gains, and the members of society as a whole are made poorer than they otherwise would be.[7]

Recently there has been another breakthrough in describing the interaction between political authorities and private interests. Economist Fred S. McChesney of Northwestern University noticed that many payments by private parties to legislators could not be explained as efforts to obtain economic rents at public expense through legislation. Instead, the parties making the payments were simply attempting to *protect* wealth and income they *already* possessed from being reduced or eliminated by costly legislation targeted at them. The basic insight here seems obvious: Politicians who have the power to grant special benefits, and can generate payments from private interests seeking to be the beneficiaries, *will also have the power to impose legislative harms* and can generate payments from private parties by threatening to do so.[8] McChesney calls this process "rent extraction," or legislative extortion.

This can take many forms, including threats to impose excise taxes or costly regulation (including price controls), or even threats to deregulate industries previously cartelized through regulation. Officials in federal, state, and local regulatory agencies can also engage in rent-extraction by such practices as threatening to withhold licenses required to do business or to initiate antitrust prosecutions. It is notable, for example, that Bill Gates gave little in political contributions before the Microsoft prosecution and has given very much since it began.

McChesney stresses that, just as with political rent-seeking, there are real costs associated with rent-extraction. First, the risk that government officials will use their legislative or administrative power to reduce private returns on invested capital diminishes the incentive private entrepreneurs have to invest in the first place. In addition, there are transactions costs (including bargaining and information gathering) incurred in the process. Also, risks of rent-extraction motivate some economic agents to hide their resources to avoid political extortion, and there are deadweight costs associated with doing so.

Public Choice economists have long argued that minimizing rent-seeking behavior and its associated costs requires constitutional reforms restricting the power of legislators to grant special favors. Few people will waste time or money trying to influence a legislator who has no power to grant them a subsidy or protected position in the market. McChesney likewise recognizes that limiting government authority to its minimum legitimate functions would minimize rent-extraction. Who would make extortion payments to politicians lacking power to carry out their threats?

A Look Back

The immediate question becomes whether such constitutional reforms are feasible. History provides a fairly unambiguous answer, because such reforms have been applied, and have worked, in the past. The fact that the U.S. Constitution placed so many prescriptive (Article I, section 8) and proscriptive (including Article I, section 9, and the Bill of Rights) limits on the legislative power of Congress is a primary reason so little interventionist activity was engaged in at the federal level before the Civil War. State officials, in contrast, were under much less constraint and engaged in a great deal of rent-seeking and rent-extracting economic intervention. When the effects of such activities became clear to the public, however, constitutional reforms were applied at that level of government also. Oddly, this history is little known.

One of the first political parties in the United States, the Federalists, was a mercantilist party advocating central banking, internal excise taxes, and federal funding of the building of canals and turnpikes.[9] Its Jeffersonian opponents in Congress, citing a lack of constitutional authority, predicting that fraud and collusion would result, and stressing the regional redistributions likely to be generated by any particular transportation subsidy, largely frustrated the Federalist program of "internal improvements." At the state level, however, constitutional provisions were less restrictive and the case for canal and turnpike subsidies seemed initially more compelling.[10]

State officials wanted to subsidize grandiose canal and turnpike projects precisely in such instances where market entrepreneurs were unwilling to venture because of likely unprofitability. The officials easily assumed—usually falsely—that subsidies would make those projects profitable. In some cases, such as the Erie Canal, built by New York state with borrowed money and revenue from an excise tax on salt between 1817 and 1825, that appeared to be true. The Erie made money, though its profitability was mostly due to the state's suppressing of competition from other canals and railroads built along segments of its route.

The apparent success of the Erie, however, motivated New York and other states to subsidize many other projects. These subsidies, often in the form of state stock or bond purchases to capitalize franchised private builders, were associated with massive and repeated rent-seeking corruption, generating political scandals that outraged the public in state after state. Worse, most of the projects lost money, and the financial conditions of the states heavily involved in such projects consequently deteriorated, putting many of them in serious trouble.

Grain boat on the Erie Canal.

Problem Exacerbated

The development of the steam railroad engine and rapid expansion of the railroad industry after 1830, though an enormous stimulus to economic growth through reduced transport cost between locales not capable of being connected by waterways, in some ways exacerbated the problems of the state governments. For one thing, the railroads, like the turnpike and canal corporations before them, had to obtain incorporation charters or permits from the governments. In return, state authorities frequently extracted rents. Canal and turnpike companies lobbied state legislators to prevent competing railroads from being built. This motivated counter-lobbying from the railroads, further enriching the legislators, but wasting scarce resources.[11] In many cases, the legislators offered subsidies to the railroad bidding highest for the legislative franchise to build a particular route. Consequently, many railroads were built to obtain the subsidies, not to profit from operations. Such roads were often not completed, or otherwise lost money, leaving the states further in debt.

By the early 1840s the citizens in many states had had enough of scandals and financial crises generated by "internal improvement" subsidies. Around 1842, under pressure from angry citizens led by Jacksonian reformers, Indiana, Illinois, and Michigan all amended their constitutions to forbid or restrict their legislatures from providing subsidies to private corporations. They were followed in 1845 by Louisiana, in 1846 by New York, in 1850 by Kentucky, in 1851 by Maryland and Ohio, and in 1857 by Missouri and Pennsylvania. On top of this, under the same public pressures, many states had begun passing general incorporation laws, allowing virtually any group of aspiring business associates to incorporate. This removed state power to extract rents from private parties to obtain or retain incorporation, and also made corporations truly private, rather than quasi-public, business entities.[12]

These events significantly contracted the boundaries of the public sector relative to the private sector, providing crucial conditions for rapid economic growth to occur in the remainder of the nineteenth century.

This massive public revulsion and wave of constitutional and legal reform had important national implications. Mercantilist interventionism had been dealt an enormous blow, and, with it, so had a major political party. Since 1834, the mercantilist party in the United States had been the Whigs, who favored public infrastructure subsidies, paper money, and high tariffs. Their opponents were the Jacksonian Democrats, who had a classical-liberal ideology favoring low tariffs, hard money, and opposition to government economic interventions. The rejection of mercantilism by the public was to no small extent a rejection of the Whigs. This and other factors caused the Whig party to break up and be replaced by the Republican party after 1854.[13]

What followed then, we all know: a civil war over tariffs and slavery that badly injured the South and, with the Southern Democrats out of Congress, a new wave of statist and mercantilist policy under the Republicans, including the corrupt and unnecessary federal subsidization of the first transcontinental railroads.[14] These traumatic events seem to have overshadowed and reversed an enormous victory for those who favored limited government and opposed corrupt rent-seeking and rent-extraction, which occurred over the two decades prior to the war. □

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1. See, for example, Leverett S. Lyon and Victor Abramson, *Government and Economic Life: Development and Current Issues of American Public Policy* (New York: Brookings Institution, 1940).

2. For the logic of this claim, see James Rolph Edwards, *Regulation, the Constitution, and the Economy: The Regulatory Road to Serfdom* (Lanham, Md.: University Press of America, 1998), pp. 166 and 169–70.

3. Richard K. Vedder, "Federal Regulation's Impact on the Productivity Slowdown: A Trillion Dollar Drag," CSAB Policy Study Number 131, July 1996.

4. See William A. Jordan, *Airline Regulation in America: Effects and Imperfections* (Westport, Conn.: Greenwood Press, 1979 [1970]).

5. George Stigler, "The Theory of Economic Regulation," *Bell Journal of Economics and Management Science*, Spring 1971, pp. 3–21.

6. Gordon Tullock, "The Welfare Costs of Tariffs, Monopoly, and Theft," *Western Economic Journal*, June 1967, pp. 224–32. For a description of rent-seeking see Sanford Ikeda, "Rent-Seeking: A Primer," *Ideas on Liberty*, November 2003.

7. This is so not just because of the rent-seeking cost, however, but also because of the overhead costs of administering the transfers or regulating the cartel, the deadweight costs of taxation to finance such activities, and so on.

8. Fred S. McChesney, *Money for Nothing: Politicians, Rent Extraction, and Legislative Extortion* (Cambridge Mass.: Harvard University Press, 1997).

9. It is important to know that the late medieval European monarchies were mercantilist, rent-seeking societies, replete with franchised monopolies, cartels, and trade restrictions. Mercantile practices had to be largely *eliminated* for free societies with efficient market systems to emerge. The motives for mercantile policies never quite disappear, however.

10. The standard source here is Carter Goodrich, *Government Promotion of Canals and Railroads* (New York: Columbia University Press, 1960). Goodrich's bias, however, is easily shown. Repeatedly implying that state and federal subsidies were beneficial on net, he never once even mentions James J. Hill, who built the Great Northern Transcontinental railroad in the 1890s without a cent of either federal or state subsidy, an achievement that dwarfs the building of the Erie Canal.

11. Stewart H. Holbrook, *The Story of American Railroads* (New York: Crown Publishers, 1947), p. 231, describes these conditions well.

12. Robert Hessen, *In Defense of the Corporation* (Stanford Cal.: Hoover Institution, 1979), pp. 29–30.

13. The failure to recognize the nature and importance of these events leads historians to vague and convoluted explanations for the demise of the Whig party. See, for example, Michael F. Holt, *The Rise and Fall of the American Whig Party* (New York: Oxford University Press, 1999), chapter 26.

14. See Burton W. Folsom, *The Myth of the Robber Barons* (Herndon, Va.: Young America's Foundation, 1991), chapter 2.

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Government Control of Medicine: Thanks, But No Thanks

by Ralph Hood

Several years ago my doctor informed me that I have diabetes. I was, of course, horrified. What did I know about diabetes? He gave me info and directions, but I was overwhelmed. Then he handed me a box full of coupons and a list of what to buy at the drugstore.

At the drugstore I stood befuddled at the display counter, confused and addled. Then, slowly, something became evident. In front of me was a whole section filled with nothing but supplies for diabetes control. I was not out on a limb by myself; I was part of a market! People were trying to help! On that counter was everything my doctor had told me to get, complete with instructions, and I had coupons for all of it! Free coupons! These companies were competing to help me with my diabetes. Not only did they do the research and produce the supplies; they also paid their employees to take the information and coupons to my doctor so he could pass them on to me. Other employees called on drugstores and drug wholesalers to arrange distribution. All of that, just to get solutions to my problem delivered to my corner drugstore.

Ain't the free market wonderful?

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Since then, that drugstore counter has changed. Many improvements for diabetics have come to me, totally unsolicited, via that counter. I open a magazine or watch TV, and ads introduce me to the latest tools, procedures, and medicines. I don't do research or seek answers. Instead, manufacturers seek me out; they provide answers and products.

I belong to a wonderful, loving church, but that church has never provided help for my diabetes. Over the years I have contributed in my small way to many charities. Plaques cover my office walls thanking me for services provided to civic clubs, schools, charities, associations, and service organizations. They are wonderful organizations, one and all, but not a one of them has offered a new way to test my blood sugar.

The market—that wonderful American free market—has.

Oh, yes, I explain to my liberal friends, I realize they are not doing it out of the kindness of their hearts. I know they seek to profit from my illness. But, as Adam Smith put it lo so many years ago, they can't get that profit without finding a solution to my problem. Not only that, they must find it faster, better, and cheaper than other companies. The invisible hand is alive and well.

No, I do not wish the government would provide the same services and products "free." The market does it so much faster for so little cost. Besides, the government doesn't do *anything* free.

I trust the market to work like crazy to find even newer and better solutions, and it does. I used to check my blood sugar with finger pricks, and it hurt like hell. Today, a new device works painlessly on my arm. The market is working frantically to provide a bloodless checking system, and I expect it to be available and affordable any day now.

The market even helps me lower the cost of treating diabetes. Thanks to new information, products, and services, I have cut my use of insulin in half, and still get better results.

One thing does worry me: There seems to be a growing movement to increase government controls in health services. Please Lord, let them stay out of the way. □

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The New Drug War

by Adam B. Summers

Seeking to combine the failures of the War on Drugs and the War on Poverty, the U.S. government has now embarked on the War on (Expensive) Prescription Drugs. You see, grannies crossing the northern border in search of cheaper prescription drugs are causing fits at the Food and Drug Administration (FDA).

U.S. District Judge Claire Eagan last November granted the FDA and Justice Department's request for a preliminary injunction shutting down the company doing business as Rx Depot and Rx of Canada. The company operated 85 stores nationwide and served as the middleman for consumers wishing to benefit from cheaper prescription-drug prices outside U.S. borders. The decision has thrown a monkey wrench into the plans of several state governments—including those of Illinois, Iowa, Michigan, Minnesota, New Hampshire, and Wisconsin—that have been considering importing drugs to ease their tight budgets by lowering the costs of state employee health-care programs.

What began as a few busloads of senior citizens entering Canada to keep their health-care costs down has ballooned to an $800 million business, as an estimated 1 million to 2 million Americans now get their drugs from our northern neighbor. Consumers are realizing that they can save up to 85 percent on the same drugs sold in the United States. One heart-transplant patient and Rx Depot customer, for example, testified at a hearing during the case that he saved $9,000 per year by using the company's services.

The problem is that the U.S. government, in its infinite wisdom, has deemed it a crime to purchase and import prescription drugs, even if they are the same drugs manufactured in the United States and approved by the FDA. The government's argument, according to FDA Commissioner Mark McClellan, is that the "FDA's job is to assure drug safety in the United States, and unapproved, imported drugs are illegal because FDA does not have the resources under current law to assure their safety." He added, "[Consumers] are buying under buyer-beware conditions." Heaven forbid people purchase prescription drugs without the government's approval, as they do countless other products!

In analyzing the FDA's position that it is necessary for the government to monitor imported drugs (and numerous other food and drug products) for our own safety, let us ignore that, as Rep. Rahm Emanuel has pointed out, "[Importation opponents] cannot tell you a single case they've discovered of anybody getting ill" from Canadian drugs. The government has already conceded the argument and called the law's merits into question by its own actions. As

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FDA witnesses in the Rx Depot case testified, the agency uses "enforcement discretion" in cases where individuals cross the border to purchase small amounts of drugs and bring them back into the country. According to government attorneys, the Rx Depot case was special, however, since it involved a large company making a commission on the sale of large quantities of drugs. But if importing drugs is harmful and illegal, why should the amount or the existence of a middleman make any difference? If the product in question were cocaine, it wouldn't matter if the smuggling was being done by granny or a large cartel. Granny would do time.

Others have argued against drug importation on the grounds that it is "unfair" trade since Canada keeps its drug prices down through price controls. Said Jeff Trewhitt, spokesman for Pharmaceutical Research and Manufacturers of America (PhRMA), "We don't want somebody else's failed government-mandated price-fixing schemes being brought into this country." Indeed, Canada's price-fixing system is anti-free market, but the answer is not to prohibit trade. Every nation has policies that are anti-free market or anti-free trade (including the United States), but to isolate ourselves by halting trade with all of them would surely bring only economic harm.

To be sure, the pharmaceutical industry would stand to lose big if importation were legalized. Thus it should come as no surprise that PhRMA spent roughly $8.5 million lobbying in 2003, much of it against legislation that would have allowed the practice. The industry and its proponents argue that permitting drug importation would lead to smaller profits for U.S. drug makers, which in turn would cause the companies to slash research and development budgets, resulting in a diminution of innovative drugs brought to market. (This may or may not be the case, as firms would still have to introduce new products to compete with one another.)

The Bush administration's answer to rising pharmaceutical prices was to create a "limited" prescription drug benefit under Medicare. Apparently it is the scope of the program—not the cost—that will (initially) be limited; the administration requested, and Congress approved, a Medicare and prescription-drug plan that was supposed to consume $395 billion over the next ten years. Two months after the bill was signed, the cost estimate rose by one third, to $535 billion. Given the government-inertia principle, Americans should expect that "limited" benefit to be universal before too long.

Market Protection

I have a different solution: abolish the FDA and the drug-importation ban altogether. But without the FDA, you might ask, how are we to know that our food and drug products are safe? There are two checks to combat this problem that are built into the free market: reputation and the legal system.

Reputation is perhaps the most important, and least discussed, aspect of doing business. What would happen, for example, if certain state governments stopped licensing exterminators, chiropractors, and barbers? People would be living in bug-infested dwellings and running around with bad backs and bad haircuts? Of course not. People would find a way to manage without government regulation. When looking for a place to get your hair cut, you probably just ask your friends for a good referral. If you happen to get a bad haircut anyway, you simply go somewhere else next time. Herein lies the beauty of the free market: businesses have an incentive to provide the goods and services customers want at the best possible price *and quality*. Bad service is just as much a killer for businesses as high prices.

In cases where a single indiscretion may lead to serious injury or even death, such as unsafe prescription drugs, the legal system provides an additional incentive for businesses to provide high-quality goods and services. If you are injured by a defective product, you can sue the manufacturer for negligence and perhaps fraud. If the stigma of being tried and convicted for selling faulty products is not enough to deter shady business practices, the economic effects of a guilty verdict certainly are. Any company foolish enough to hawk faulty and dangerous goods would quickly be put out of business by legal judgments.

Abolishing the FDA would relieve drug makers and other businesses of costly regulations that make it difficult to bring products to market. As it is, pharmaceutical companies have to spend hundreds of millions of dollars and waste years jumping through regulatory hoops. Any lost profits the drug companies would suffer from importation would at the very least be partially offset by the removal of these burdensome and unnecessary regulations. As the Cato Institute points out, "85 percent of the cost of pharmaceutical development goes to complying with FDA regulations." (See Cato's *Handbook for Congress*, chapter 32, www.cato.org/pubs/handbook/hb105-32.html.) Furthermore, the elimination of FDA regulations would reduce certain "non-monetary" costs—such as the loss of human life—by allowing life-saving and life-enhancing drugs to come to market sooner.

The FDA's attack on the right of consumers to do business with whomever they choose has nothing to do with product safety and everything to do with special-interest politics. The additional government interference sought by the Bush administration will only repeat previous governmental failures. Of course, this will once again provide politicians with a campaign issue and a "crisis," they will claim, that only government can solve. □

Ultimate Victims

The ultimate victims of stifling FDA bureaucracy are patients. New and improved medical products would enhance people's lives in a number of areas, ranging from heart and coronary disease to ligament repair. Tens of thousands of lives could be saved; millions of people could enjoy a higher quality of life; billions of dollars could be saved. Unfortunately, federal regulation stands in the way of these advances. . . .

Paternalism remains a powerful influence in Washington. But it is time for patients and doctors, insurers and hospitals, pharmaceutical firms and device manufacturers, senior citizens and healthy young people to together say "No more." For years the system has seemingly "worked" despite stultifying regulation: highly competitive American firms have led the world in the discovery and marketing of new treatments and cures. But so much more could have been accomplished, and the U.S. government continues to put arbitrary roadblocks in the way of developing, testing, and marketing new drugs and devices. For too long too many people have unnecessarily suffered and died because of the FDA.

—DOUG BANDOW, "Increasing Access to Pharmaceuticals" by Burton Folsom, Jr.

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Grover Cleveland: The Veto President

The courage to say "no" under pressure is a hallmark of sturdy character. For a U.S. president, one test of this courage is the willingness to veto bad bills—bills that spend too much money or that contradict Article I, Section 8, of the Constitution. In that test of character, perhaps no president passed more convincingly than Grover Cleveland (1837–1908), America's 22nd president.

During Cleveland's first term (1885–1889), he vetoed 414 bills, more than twice the total vetoed by all previous presidents. The reason for the onslaught of vetoes was that Congress, in the 1880s and 1890s, decided to give taxpayer dollars to various special interests in return for votes. Cleveland drew a line in the sand and said "no" to subsidy grabs.

In his most famous veto he quashed a $10,000 subsidy for drought-stricken farmers in Texas by pointing out that the Founders wanted private citizens, not government, to aid their fellow men and women in distress. "Though the people support the government," Cleveland said, "the government should not support the people." (See Robert Higgs, "Why Grover Cleveland Vetoed the Texas Seed Bill," *Ideas on Liberty*, July 2003, www.fee.org/vnews.php?nid=5463.)

Over half of Cleveland's vetoes involved pensions to Civil War veterans. Congressmen, especially Republicans, were increasingly trying to funnel taxpayer dollars to unqualified veterans in hopes of capturing "the soldier vote." During the Civil War, Abraham Lincoln and others created the Pensions Bureau, which set up strict rules of eligibility for two groups only: disabled soldiers and the widows and dependents of soldiers killed in the war.

Some of Cleveland's fellow Democrats complained that these rules siphoned government funds from the defeated, and largely Democratic, South to the more Republican North, where most of the veterans lived. But Cleveland argued that the Union won the war and that the disabled Union veterans and the widows of war should be compensated for their sacrifice to the Union. What Cleveland opposed were Republican efforts to expand pension payments to unworthy applicants.

The Pensions Bureau, with advice from local physicians, passed judgment on who qualified for pensions. The problem was that some claimants who failed to persuade the Pensions Bureau turned around and asked their congressmen to include them for full pensions in special appropriation bills. The presidents before Cleveland, fearing the vote of the veterans' lobby, signed all these bills. But Cleveland refused to do so. He reviewed all pension bills, signing some and rejecting others.

For Cleveland, maintaining the integrity of the pension system was a matter of principle and sound government. He refused to allow unworthy or phony claimants to

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extract pensions from hard-pressed taxpayers. One man claimed a pension for an injury incurred on horseback *before* he enlisted in the army; a widow, whose husband fell from a ladder in 1881, claimed a war wound was the real cause of his accident; another veteran wanted a pension for a disease of the eyes, which he insisted was caused by army diarrhea; even deserters tried to capture pensions for their brief stints in the army. Remarkably, Congress supported these claims one after another. Cleveland, however, did not. He piled veto upon veto. He called the pension list a "roll of honor" and wanted to keep it legitimate.

Cleveland's biggest challenge came not from deceitful claimants, but from determined politicians. Senator Henry W. Blair of New Hampshire introduced a bill to give pensions to every veteran disabled for any reason during or after the war. Even old age would qualify as a disability, and local physicians and towns would have financial incentives to certify the hundreds of thousands of veterans certain to apply if the Blair bill became law.

Republicans in the House and Senate almost unanimously supported the Blair bill, but Cleveland shuddered at the thought of doubling the pension rolls with the blitz of applications from allegedly disabled veterans. Others agreed with the President. The Chicago *Tribune* concluded that the Blair bill would "put a serpent of temptation at the ear of every veteran" to feign injuries. General Edward Bragg of Wisconsin denounced the Blair bill as an effort "to pension the rubbish of the United States, and to revive the business of claim agent in Washington."

Raid Postponed

When Cleveland eagerly vetoed the Blair bill, he did not end, but only postponed, the raid on the U.S. Treasury. In 1888 Republican Benjamin Harrison took the White House from Cleveland and opened its doors to the veterans' lobby. Historian John Garraty of Columbia University observed that in doing so Harrison "saw no harm in dispensing federal pensions lavishly to undeserving veterans." The Blair bill again passed Congress, and this time the new President signed it and welcomed the votes he thought he would gain.

Sure enough, during Harrison's term the number of pensioners roughly doubled to almost one million—a fourfold increase in 20 years, or about three pensions per Union casualty almost 30 years after the war had ended. Pension payments approached $150 million and easily became the largest item in the federal budget. Harrison also tried to satisfy the silver industry by signing the Sherman Silver Purchase Act, which required the government to buy 4.5 million ounces of silver per month.

Cleveland's response was to challenge Harrison to a rematch in 1892, and he vigorously attacked the "Billion Dollar Congress" that spread federal largess so freely. American voters could choose between two presidents: One held the record for saying "no" and the other broke the record for saying "yes" to so many interest groups. Cleveland won—becoming the only president to win two nonconsecutive terms.

Cleveland's second term began with a depression, the Panic of 1893. He argued that it was caused by unsound government spending. He immediately got the Sherman Silver Purchase Act repealed and stopped other groups from raiding the federal treasury: No more free seeds for farmers; no more salaried "rainmaker" in the Agricultural Department; no more high tariffs for many northern manufacturers.

Included in Cleveland's fiscal vigilance was another slew of pension vetoes. Cleveland was astonished that with each passing year the pension list grew rather than shrank. "I am unable to understand," Cleveland announced early in his second term, "why frauds in the pension rolls should not be exposed and corrected with thoroughness and vigor. . . . Thousands of neighborhoods have their well-known fraudulent pensioners."

A man of character to the end, Cleveland spent his last days in office in March 1897 vetoing more specious pension claims. He was America's last laissez-faire president. ☐

THE FREEMAN
Ideas On Liberty
APRIL 2004

The Irish Miracle

by Karl Sigfrid

European advocates of the freedom philosophy are rarely enthusiastic about their own continent—a world center for high taxes and overregulated markets. When asked to pick their favorite society, they will usually select Hong Kong or—less often—the United States. Too often, we Europeans forget that we have a free-market success story in our own backyard. During the last 15 years, Ireland— believed by many to be a poor nation of farmers—has transformed into the second wealthiest member state of the European Union (EU). The tax level, measured in actual government consumption, is lower than the tax level in the United States.

Ireland's contrast with the rest of the EU is stark. In the EU, unemployment is close to 10 percent. The tax burden is heavy. The labor market is massively regulated, and social mobility is low. Meanwhile, Ireland has moved in the opposite direction and has even outperformed many of the east Asian tiger economies. The unemployment rate is a third of what it was only a few years ago. Foreign companies stand in line to move in; and to meet the demand for labor, companies as well as the authorities encourage immigration.

It wasn't long ago that the Irish situation was the reverse, with a standstill economy, huge deficits, and an unemployment rate close to 20 percent. In 1987 the average income in Ireland was only 63 percent of that in Great Britain. Ireland was poorer than Spain and only slightly less poor than Portugal and Greece. The public debt had skyrocketed from 65 to 120 percent of GDP. The nominal pay raises were high, but with 20 percent inflation they represented no increase in buying power. All growth took place in the public sector, which ate most of the country's production and still had to be financed with borrowed money.

The economy depended on agriculture and exports to its rich neighbor, Great Britain. Except for that, Ireland had little trade with the world outside. Perhaps because of this isolation, Ireland wasn't modernized and fell further and further behind the rest of Europe. Many Irishmen emigrated to seek their fortunes elsewhere.

The country's transformation into a hitech center and a portal to Europe for foreign investors has more than once been called a miracle. Luckily, it's not a literal miracle, but the result of insightful political ambition. The road that Ireland took is open to any other country that faces similar problems.

While 1987 marked the bottom of a long recession, it was also the year Charles Haughey took over as prime minister and decided that the economic system should be rebuilt from scratch. He even managed to sell his idea to the opposition and to the most important interest groups, including the unions.

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Unlike Margaret Thatcher in Great Britain, who confronted the powerful interest groups, Haughey chose to sit down with them. What would later be called a miracle started with a social contract between the government, the employers, and the unions. The contract included tax cuts and some financial support for those worst off.

The public sector was quickly slimmed, and so the private sector had more room to grow. The economy accelerated. The government cut taxes for corporations and working citizens, while the jungle of regulations was cleaned up. Publicly owned banks were prepared for privatization.

It might seem strange that the unions would support a political agenda with tax cuts and a smaller public sector. In retrospect, however, we can conclude that the Irish employees did the right thing. Nobody was happy with the previous situation. The labor market was anything but flexible, and there was no growth to distribute.

Another important condition for Ireland's economic development was its openness to foreign business. By attracting new categories of businesses that didn't do things the traditional Irish way, Ireland transformed its economy.

Foreign investors only need to deal with one government bureau, the Irish Development Agency. They are also attracted by low corporate taxes; the rate is now 12.5 percent for both foreign and domestic corporations. With 1 percent of the total euro-zone market, Ireland gets a third of the American investments, which makes other countries complain about unfair tax competition.

Magnet for Job-Seekers

The Irish are not the only people who can enjoy the prosperity that has followed investments from such companies as IBM, Intel, Gateway, Fujitsu, and Motorola. From being a nation of emigrants, Ireland is now a country to which people move to find jobs. Approximately 40,000 people immigrate annually, while only half as many leave the country. Businesses active in Ireland advertise in American newspapers to find employees, and there are plenty of opportunities for multilingual Europeans. From 15 percent in 1993, the unemployment rate by 2000 had fallen to less than 4 percent. And unlike other European countries, Ireland doesn't hide joblessness in its statistics. The long-term unemployment rate is down to 1.7 percent.

Christopher J. Fisher

During the last 15 years, Ireland has transformed itself into the second wealthiest member of the European Union.

In 1997 *The Economist* noted that Ireland's per capita GDP had reached the EU average, but the magazine doubted that the progress could continue at the same pace. But that's exactly what has happened. In 2000 the growth rate reached a record 10.7 percent and exceeded the government's own prognosis. Today, Ireland is the second richest country in the EU and the fourth richest in the Organization for Economic Cooperation and Development. That growth is three times as high as that of western Europe as a whole. Rather than trying to stop healthy tax competition from Ireland, the rest of Europe should learn from its example. ☐

THE FREEMAN
Ideas On Liberty
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The Irrational Precautionary Principle

by Jim Peron

Chlorine is a common chemical. It's estimated to be used in the production of 80 percent of all pharmaceuticals. But like most chemicals it can cause problems depending on the dose, what it is mixed with, and how it is used. On one hand, it is used to disinfect drinking water and saves millions of lives every year. On the other hand, it is a component in compounds that are believed possibly to cause cancer or other health problems. When the U.S. Environmental Protection Agency said that a chlorine byproduct presented a cancer risk, officials in Peru stopped using chlorine to disinfect drinking water. The resulting cholera outbreak killed thousands of people.[1]

The Green Left is today pushing a new legal principle that would seem to mandate that governments around the world repeat this disaster. It's called the Precautionary Principle. It means that any new technology or substance should be banned or restricted until it is proven harmless. Of course, life is rarely that simple. Even if chlorine slightly increases the risk of cancer, it dramatically reduces the risk of dying. But the environmentalist doesn't seem to understand this. Joe Thornton, who was an analyst for Greenpeace, has written: "We need to treat organochlorines as a class. There are 11,000 in commerce plus thousands more that are produced as by-products. It would be truly impractical to regulate them one-by-one. . . . It makes sense to treat organochlorines as guilty until proven innocent."[2]

Any such rule that treats all chlorine as the same would be impractical. A ban *might* save a few lives from some forms of cancer, but it would surely cost millions of other lives because of impure drinking water.

The precautionary principle says we shouldn't allow something to happen as long as someone believes it may be a threat and until we can prove that it isn't harmful. A coalition of Green groups enshrined this concept in the Wingspread Statement, which said: "In this context the proponent of an activity, rather than the public, should bear the burden of proof."[3]

Of course, the "public" referred to is not the public at all but the Green groups themselves.

As Jeremy Leggett wrote in *Global Warming: A Greenpeace View*: "The modus operandi we would like to see is: 'Do not emit a substance unless you have proof it will do no harm to the environment.'"[4] The European Commission took the principle to heart. When it banned animal-growth hormones in 1985 it did so not because of any evidence on hand, but because their safety had not been conclusively proven.

Imagine what the precautionary principle would require in day-to-day living. We are faced with choices and tradeoffs every day.

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Doing one thing precludes doing other things. We can't go to the movies on Friday night and at the same time visit the in-laws. But the precautionary principle would strip us of entire classes of options. Normally, if you have to decide whether to do something or not, you weigh evidence and choose accordingly. If you applied the precautionary principle instead, you'd do nothing. You would only go to the movies if you could prove in advance that going was better than not going. But how could you do that?

We've all gone to films that were wonderful experiences, and no doubt we've also been to some so abysmal that we walked out before the end. We are certain that the choice was good *only after the fact*. We can make educated guesses, but we can't prove, in advance, that one option is better than another.

The precautionary principle is tantamount to a coup in legal theory. Say a developer wants to build an apartment and a Green group condemns the plan, saying it's "harmful to the environment." The group would not have to present any evidence to stop the developer. Rather, the developer would have to prove that all possible outcomes from his plan are good. But he could never do that. This would also be true for the inventor, scientist, industrialist, and virtually anyone else who has to deal with the physical world—in other words, all of us. We must remain stagnant until we can prove that any particular action is good under all possible scenarios.

The established principle that puts the burden of proof on those who would block free action is clearly superior to the precautionary principle. The reasons are relatively simple. We can't know the future, and we can't prove a negative. We don't incarcerate people because they belong to a group or class that might commit a crime. But the precautionary principle says that anything that deals with the environment—and that really means everything—is deemed dangerous until proven otherwise.

That principle drives the environmentalist agenda. There is no convincing evidence that biotechnology is dangerous to humans, but the environmentalist lobby posits theories, unsupported by facts, that such a danger might exist. Therefore it demands that biotechnology be proven safe. How? No answer—because there is no answer. One can disprove a positive but not prove a negative.

Treaties Embody Principle

This theory is now embedded in various UN treaties and the proclamations of international bodies:

- The UN's Convention on Biological Diversity states, "[L]ack of scientific certainty should not be used as a reason for postponing measures to avoid or minimise such a threat."
- The UN's Framework Convention on Climate Change states, "lack of full scientific certainty should not be used as a reason for postponing such measures" that prevent actions from being taken.
- The UN's 1992 Rio Declaration states: "In order to protect the environment, the precautionary principle shall be widely applied by States according to their capabilities. Where there are threats of serious or irreversible damage, lack of full scientific certainty shall not be used as a reason for postponing cost-effective measures to prevent environmental degradation."

Author Jonathan Adler notes that the UN's Cartagena Protocol on Biosafety "creates mechanisms whereby national governments will be able to restrict, or even prohibit, the importation of genetically engineered crops." Like many environmental treaties, the preamble of the protocol "reaffirm[s] the precautionary approach" contained in the Rio Declaration. The protocol goes further, however, by explicitly stating that "lack of scientific certainty" about potential risks of biotech products "shall not prevent [a member] from limiting or banning such products."[5] In other words the lack of evidence does not mean something cannot be declared guilty.

The principle first appeared in the 1982 UN World Charter for Nature. The charter said that "Activities likely to pose significant risks to nature shall be preceded by an exhaustive examination; their proponents shall demonstrate that expected benefits outweigh potential damage to nature, and where potential adverse effects are not fully understood, the activities should not proceed."[6]

Inertia thus becomes the primary human state, and everything must be justified in advance because it is deemed harmful until proven beneficial. In addition, proponents must show that no possible alternative is safer.

Understandable Attraction

One can see the attraction of the precautionary principle to the environmentalist lobby. From the start the lobby was long on scare-mongering and short on facts. Even when sufficient time has gone by to test its theories, many claims have failed to be substantiated. No wonder, then, that Joel Tickner, in the newsletter for the Science and Environmental Health Unit, argues for the principle in this manner: "Proving cause takes extensive time and resources."[7] It's much easier to merely assert harm and let your opponents grapple with the impossibility of proving it isn't so.

The environmentalist Institute for Science in Society has admitted that "The precautionary principle is about the burden of proof."[8] Peter T. Saunders of King's College in London even compares the precautionary principle to the burden principle used in the courts: "Just as society does not require a defendant to prove his innocence, so it should not require objectors to prove that a technology is harmful."[9] But this is backwards. In a rational process, the new technology *is* the defendant—innocent until proved guilty—and the objector is the prosecutor with the burden of proof.

At least one prominent advocate of the precautionary principle is candid about his reasons for turning that legal maxim inside out. Boston University law professor George Annas says: "The truth of the matter is that whoever has the burden of proof loses."[10]

Be that as it may, the precautionary principle is appealing to the environmentalists because, in the words of Britain's Social Issues Research Centre, "it prevents scientific debate." The Centre adds: "The burden of evidence and proof is taken away from those who make unjustified and often whimsical claims and placed on the scientific community which, because it proceeds logically and rationally, is often powerless to respond. This is what makes the principle so dangerous. It generates a quasi-religious bigotry which history should have taught us to fear. Its inherent irrationality renders it unsustainable."[11] □

1. Michael De Alessi, "Precautionary Principle Is Risky Gambit," San Francisco Chronicle, July 16, 2003.
2. Quoted in Jonathan Adler, "The Precautionary Principle's Challenge to Progress," *Global Warming and Other Eco-Myths* (Roseville, Cal., Prima Publishing, 2002), p. 274.
3. Available at www.gdrc.org/u-gov/precaution-3.html.
4. Jeremy Leggett, *Global Warming: A Greenpeace Report* (Oxford: Oxford University Press, 1990), p. 459.
5. Adler, p. 282.
6. See www.un.org/documents/ga/res/37/a37r007.htm.
7. Joel Tickner, "Precautionary Principle," *The Networker*, May 1997, www.safe2use.com/data/precaut1.htm.
8. Peter T. Saunders, "Use and Abuse of the Precautionary Principle," Institute of Science in Society, July 13, 2000, www.ratical.org/co-globalize/MaeWanHo/PrecautionP.html.
9. Ibid.
10. Quoted in Ronald Bailey, "Precautionary Tale," *Reason*, April 1999; www.reason.com/9904/fe.rb.precautionary.shtml.
11. "Beware the Precautionary Principle," Social Issues Research Centre, no date, www.sirc.org/articles/beware.html.

BOOKS

America the Virtuous: The Crisis of Democracy and the Quest for Empire

by Claes G. Ryn

Transaction Publishers • 2003 • 221 pages • $34.95

Reviewed by Richard M. Ebeling

In 1988 Robert Nisbet, one of America's most prominent sociologists and conservative social philosophers, published *The Present Age: Progress and Anarchy in Modern America*. He critically evaluated how American society had come increasingly under the control of the central government in Washington, D.C. One of the main forces behind that trend, Nisbet argued, had been U.S. participation in the two world wars.

Before World War I, the American people had been predominantly local and regional in their loyalties and interests. Political decision-making was decentralized, and the federal government's activities were still, for the most part, limited to the narrow responsibilities originally assigned under the Constitution. But both the Woodrow Wilson and Franklin D. Roosevelt administrations expanded the power of the federal government over the states and the people. War played a crucial role in the process. Making the world safe for democracy in World War I, being the global arsenal of democracy in World War II, and acting as the policeman of the "free world" during the Cold War all required the sacrifice of liberty at home.

Taxation and regulation for the war efforts concentrated power, wealth, and decision-making in the federal government. The welfare state reinforced that trend as people grew increasingly dependent on largess from Washington. As a result, American society and culture became more and more "nationalized" in the twentieth century, Nisbet concluded. (See my review of *The Present Age* in *The Freeman*, January 1989, www.fee.org/vnews.php?nid=2019.)

In his new book, *America the Virtuous*, political scientist Claes G. Ryn explains why this trend has continued in the United States, in spite of the end of the Cold War following the demise of the Soviet Union in 1991. What has happened, Ryn argues, is that American foreign policy has been more or less captured by a group of policy analysts and policymakers he labels "the new Jacobins."

The original Jacobins were the radical ideologists of the French Revolution who declared the necessity of remaking man and society for the purpose of creating not merely a better but a perfect world. They waged intellectual and political war against the notion of an invariant human nature and against the historically evolved institutions of society, as well as the cultural and moral foundations on which Western civilization had developed over the centuries. The Jacobins believed in rationalistic blueprints for redesigning the social order. Anything that resisted this cleansing revolutionary reform had to be destroyed in the name of the future utopia.

The new Jacobins, who Ryn explains are better known as "neoconservatives," believe that America is called on to remake the world in the image of a particular conception of democracy and equality. In their view, "democracy" means the abstract god of a political institutional order that reflects the will of the majority, which is mistakenly taken to be synonymous with liberty. Equality means the reduction of all human distinctions to one standard of a national mass man, with all individual, local, and regional differences within the country submerged in a uniform pattern of life.

And just like the earlier Jacobins, the new American Jacobins believe that an intellectual and political elite is needed to educate and guide society to its egalitarian, democratic utopia. In addition, this means that many of the traditional constitutional restraints on the federal government must be set aside so the central government has the power and discretion to bring America to its domestic destiny.

The new Jacobins also insist that this

model of a perfected America is the ideal that the rest of the world should follow. The United States is called on to bring this ideal to the ignorant, backward, and corrupt nations around the globe. And with the same revolutionary zeal of the older Jacobins, this goal is to be accomplished through the force of arms if necessary.

Ryn argues that the tragic events of September 11, 2001, have served as the rationale and catalyst to set this global crusade in motion. The invasions and occupations of Afghanistan and Iraq are the opening military campaigns to bring the "American way of life" to one part of the world not enlightened enough to achieve it on its own. In other words, America's new Jacobins are determined to socially engineer entire peoples and cultures according to the ideal to which they would aspire if only they had the wisdom to see what was good for them. Social bliss is to be brought to them through American bombs and bayonets and U.S.-designed ballot boxes.

But what if millions around the world do not want this gift from America? What if they resent and resist the overthrow and destruction of their own histories, cultures, and institutions—no matter how unenlightened or barbaric they may seem to the new Jacobin elite? Then America is faced with a future of endless wars in the name of creating a global empire of democracy and equality, as defined and dictated by the neoconservatives.

Ryn reminds his readers that the older tradition of freedom and reform in America was based on the idea that social and economic change cannot be imposed from the outside. It must grow within the individuals of other societies and nations. If America follows the path of empire for the supposed good of mankind, the American people will find that their own freedoms and fortunes will have to be sacrificed on the altar of global social engineering. □

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Reinventing the Bazaar: A Natural History of Markets

by John McMillan

W.W. Norton • 2003 • 388 pages • $15.95 paperback

Reviewed by Robert Batemarco

Libertarians and other consistent free-market advocates are often accused of being blinded by ideology. Maybe the shoe belongs on the other foot. According to my scorecard, John McMillan, author of *Reinventing the Bazaar,* cites over 80 cases either of markets solving problems or of governments thwarting consumers. This compares with roughly a dozen where government actions appear to have done more economic good than harm. Although a baseball game that one-sided would be called a laugher, McMillan, a professor of economics at Stanford, concludes with a straight face that we cannot make a general case for minimizing government's role.

Despite this failure to draw conclusions consistent with his evidence, McMillan has written a book that contains much of value. He is a skilled writer who can take recent developments in economic theory and make them easily understandable, even for non-economists. He provides apt examples that bring these theories to life. There can be little argument with his central contention that how well markets are designed is of paramount importance in how well they work. His five conditions for making markets run properly—smooth information flows, well-protected property rights, trust, competition, and minimal third-party effects—are unexceptionable, although his understanding of them is distorted by a misperception all too prevalent in the economics profession, namely, that each condition calls for government action.

Reinventing the Bazaar is informative about the wide variety of auctions and how they work. Auctions are obviously an area of expertise for this author; he used his knowledge of economic theory to help design an auction selling off part of the electromagnetic spectrum. This makes chapter 7 one of the best in the book. In it he explains why some goods are sold by auction while others simply have posted prices. He also describes the differences between open auctions, Dutch auctions, sealed-bid auctions, second-price auctions, simultaneous ascending auctions, reverse auctions, and package bidding, elucidating the strong and weak points of each. In so doing, he shows how entrepreneurs themselves redesign markets.

Also strong are chapters 12 and 15, which show, respectively, the havoc wreaked by socialistic central planning and the ability of markets, even when partly unfettered, to restore health to moribund economies. Alas, *Reinventing the Bazaar* implies we can only see with hindsight the debacle that was socialism, ignoring Ludwig von Mises and others like him who, through rigorous application of economic theory, foresaw that failure was inherent in socialism's nature. Nonetheless, this book's comparison of the attempts of China and Russia to move toward markets both piques our interest and lends support to McMillan's contention that the devil is in the details.

Toward the end of the book, the author tries to ensure that his qualified support of markets not be mistaken for libertarianism. He does this by holding up Ayn Rand as the apotheosis of market theorizing—as if no one else has grappled with these problems.

McMillan's chief target is Rand's philosophical rather than empirical approach. There are two things wrong with this line of attack. The implicit assumption that the facts would never support laissez faire is belied by much of the material in the book. The second error is the ready dismissal of the philosophical and ethical approach to policy questions. Although the author admits that principles can indeed trump costs and benefits, he never acts on that insight. Indeed, it appears to me that ignoring it leads him to struggle with issues like patents. The case-by-case, cost-benefit approach McMillan consistently employs permits him to arrive at no firmer conclusion on that issue than "whether . . . [intellectual property protection] . . . should be strong or weak varies with the circumstances." This is because he never regards such fundamental questions as what constitutes theft of someone else's ideas as having any bearing on the point at hand. Murray Rothbard successfully used this very question to attach clear but defensible limits on the legal protection for intellectual property. (He accepted copyrights but not patents.) This shortcoming pervades McMillan's work, preventing him from drawing a sharp line between what government should and should not do.

Samuel Johnson called second marriages "the triumph of hope over experience." *Reinventing the Bazaar* shows an intimate acquaintance with the experience of government distortion of markets, yet clings to the hope that government can make markets function better. While the facts McMillan presents make this book well worth reading, I would advise readers to draw their own conclusions. □

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The Ideas That Conquered the World: Peace, Democracy, and Free Markets in the Twenty-First Century

by Michael Mandelbaum

PublicAffairs • 2002/2004 • 512 pages • $30.00 hardcover; $18.00 paperback

Reviewed by Gene Callahan

The wonderful thing about Hegelianism as a "theory" of history is that it can be shaped to suit almost any particular political agenda one wishes. If you can formulate a thesis and antithesis so that your political program emerges as the synthesis of the two, then you can read all of history backwards: a story inevitably leading to its stirring climax, the triumph of your ideology.

The Ideas That Conquered the World is such a reading of the past, intended to support what Michael Mandelbaum, who teaches foreign policy at Johns Hopkins and is a senior fellow at the Council on Foreign Relations, calls "the liberal theory of history." However, it is not so much a "theory of history" as a riffling through the last century or two to discover events that lend support to Wilsonian social democracy. Mandelbaum presents a "triad" of policies fundamental to his vision of liberalism: democracy, free markets, and disarmament/collective security. However, he does not coherently articulate the meaning of any one of these elements.

For instance, Mandelbaum asserts that the "liberal" approach to international relations is the "configuration of all . . . military forces so that they are suitable for defense but not for attack." Such a policy has been adopted fully, he says, "only [by] the countries of Europe and North America."

Does Mandelbaum really believe that the military forces of the United States currently are configured only for defense? Since World War II no foreign government has attacked American territory, yet the United States has intervened militarily in other countries over 60 times. One might applaud those interventions as necessary for the good of the liberal world order, but to call them "defensive" seems so to stretch that word as to render it meaningless. If the U.S. invasion of Panama in 1989 can be called "defensive," what war cannot?

Nor does Mandelbaum offer any argument as to why democracy is inherently liberal. He asserts that democracy involves "restraints on the exercise of power by governments," but he does not explain how or why that is so. If democracy simply means that a government should perform only those actions that are approved by the majority of its citizens, as Mandelbaum implies, then democracy only limits government to doing whatever the majority approves, however illiberal that might be.

Mandelbaum's version of "free markets" is a sadly attenuated version of the classical-liberal policy of laissez faire. Rather than recognizing that free markets are what occur when coercion and central planning are absent, he believes that free markets must be "constructed" and "maintained," and that such construction and maintenance are "far more difficult than had been imagined for most of the modern era." He holds that the "status and power" of the World Bank and the IMF are evidence of the triumph of "laissez faire capitalism," despite the fact that their existence springs entirely from a perceived need for centrally planned intervention into the market economy.

Mandelbaum says "the rise of the welfare state . . . made popular sovereignty through universal suffrage compatible with the protection of private property by giving every citizen property in the form of an entitlement to benefits from the state." In other words, "private property" is "protected" by being subject to arbitrary confiscation by the majority of voters. While Mandelbaum asserts that modern social democracies establish zones that are "off limits to the exercise of government power," he gives no indication as to what the boundaries of such "zones" might be. He tries to calm the fears of classical liberals by contending: "In the twentieth century . . . liberty and political equality proved to be compatible in Britain and the United States and throughout the Western core." However, many classical liberals might contend that mass democracy has led to precisely the diminution of liberty that they predicted it would.

While purportedly a supporter of free markets, Mandelbaum does not even seem to realize the fundamental flaw of socialism: the absence of any means by which to calculate economic success. He contends that while the command economy was "not necessarily superior to the market, [it] did work." As evidence, he cites the facts that in socialist regimes "people migrated in large numbers from the countryside to the cities" and "governments built, owned, and managed huge industrial complexes." It is hard to imagine why these are indicators that an economy is "working."

The Ideas That Conquered the World is a salient example of the common tendency to herald whatever trends are currently ascendant, while ignoring any analysis of whether such trends are sustainable in the long run. □

Gene Callahan is the author of Economics for Real People *(Mises Institute, 2002).*

Liberation by Oppression: A Comparative Study of Slavery and Psychiatry

by Thomas Szasz

Transaction Publishers • 2002/2003 •
237 pages • $39.95 hardcover; $24.95 paperback

Reviewed by Brian Doherty

Freeman columnist Thomas Szasz, emeritus professor of psychiatry at the State University of New York Health Science Center in Syracuse, has tirelessly agitated for over four decades—in over 20 books and hundreds of speeches and even in occasional courtroom testimony—in defense of the rights of our culture's most abused group: the so-called mentally ill.

Szasz maintains that mental illness is in fact a metaphorical illness: the illegitimate rhetorical medicalization of behaviors we find disturbing in order to excuse inhuman treatment of the "patient." Turning his opponents' weapon back on them, he embraces—but honestly, not covertly—the extended metaphor as a rhetorical technique. His 1970 classic, *The Manufacture of Madness,* compared our culture's treatment of the mentally ill with the historical treatment of witches (while debunking the popular "liberal" notion that the witches of old were "really" mentally ill).

In *Liberation by Oppression* Szasz uses another illuminating metaphor to revisit his favorite topic, "mental illness" as an excuse for oppression. We now assume the inferiority and practical inhumanity of the mental patient; and this, he posits, can be profitably analogized to the old assumptions about the inferiority and inhumanity of blacks that underlay slavery.

The key idea linking both evils (though our culture sees only one as evil now) is what Szasz calls coercive paternalism. This is the idea that it is acceptable—indeed, admirable—to dominate a class of people because it is ultimately for their own good. Szasz traces the history of arguments for and against slavery and the oppression of the mentally ill and displays the analogous thinking that has justified both tyrannies.

He shows how neither slaves nor mental patients have the freedom to come and go as they please, or have courts respect their rights. He convincingly compares fugitive-slave laws and the Interstate Compact on Mental Health. Defenders of slavery—chattel or psychiatric—depend, as Szasz relates, on frightening myths of the inherent dangerousness of the Negro or the mental patient.

Szasz's choice of central analogy is wickedly incisive. It takes something the modern liberals believe in fervently—the necessity to care for mental patients by force if necessary—and compares it to a racist institution they profess to hate more than anything. If Szasz can make such a person see the similarities he rigorously points out, it will be a rhetorical grand slam indeed.

He does not spend the whole book hammering home that analogy. He also explains in depth how legal changes in the relationship of doctors and psychiatric patients irreparably corrupt any hope of a genuine therapeutic relationship. Now doctors can be held liable for not reporting any potential "danger" they divine from their patients, and patients can sue doctors for not giving them this season's most popular psychiatric "medicines." These legal complications, Szasz writes, transform psychotherapy "from a helping situation into a sting operation."

But perhaps most fascinating for followers of Szasz's career is his addressing the deinstitutionalization of the mentally ill—a public policy for which Szasz is frequently blamed, and whose effects are taken to be self-evidently bad. Szasz thinks that kicking people out of mental institutions after they have had their ability to cope with the outside world stripped by being trapped within them merely compounds the original injustice.

Here, Szasz doesn't take a strict libertarian anti-welfare stance, which would say that if mental patients can't pay for their keep in an asylum, then they have no right to stay there. Szasz thinks that true asylum is a function a civilized society should provide, and that "politicians and philanthropists would have to support it with the appropriate legislation and necessary funds."

"Our society," he adds, "provides no place of refuge for the individual who wants to escape from the world. Instead of offering asylum, the modern mental hospital offers only coercions called 'treatments,' intended to force the patient back into a society in which he cannot, or does not want to, find a place for himself." He examines the current system of forced drugging, outpatient therapy, hospitals, halfway houses, and prisons that now dominates mental health care, and considers "deinstitutionalization" nothing more than "indefinite psychiatric probation."

The book is the product of a man who has passed 80, with a long, courageous, and doubtless somewhat frustrating career of advocacy for liberty and responsibility behind him. Its epilogue ends on a sadly valedictory note that will especially touch long-time fans of Szasz and what he stands for. He quotes Lord Acton, one of his favorite thinkers: "It takes a gentleman to live on terms of hearty friendship and kindness and intimacy with men whose ideas and conduct he abhors and when he well knows that they view with contempt and horror the principles on which he shapes his own character and life."

Szasz then adds: "As I look back on my life, I pride myself on having been able to follow Acton's example, at least in this regard." This is as chilling a discussion of the social role of the advocate of unpopular ideas—such as libertarianism—as I've seen. Still, Szasz ultimately manages to cheer the liberty-loving reader with his sharp, witty polemic whose occasional acid cannot fully overwhelm the sweet love of humanity and freedom that motivates it. □

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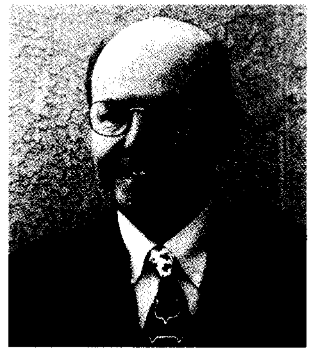

Back Toward Serfdom in New Zealand

In the September 2000 issue of this magazine I reported that the Labour Party in New Zealand, at the behest of labor unions, had repealed the 1991 Employment Contracts Act (ECA), which had abolished compulsory unionism there. In its place was substituted the Employment Relations Act (ERA) to help unions reverse their drastic decline in membership.

It didn't work. When the ECA was repealed in 2000, only around 20 percent of New Zealand workers were covered by collective-bargaining agreements. In December 2003 the figure was still around 20 percent. The special privileges given to union organizers by the ERA were not strong enough to overcome the culture of voluntarism that emerged during the years of the ECA. Distraught union bosses have now instructed their mandataries in the Labour Party to change the law yet again, and in December Labour Minister Margaret Wilson announced a new bill that, she hopes, will accomplish her masters' ends.

From a classical-liberal perspective there are four particularly egregious features of the proposed bill: It disadvantages individual, relative to collective, employment contracts; it imposes drastic new "good faith" requirements on both collective and individual bargaining; it promotes multi-employer collective bargaining; and it forces transfer of terms of employment from one employer to successor employers or contractors.

Unlike American workers, New Zealand workers have a right to decide whether to be subject to a collective agreement between a union and an employer or to negotiate an individual contract. In America, where there is a certified union, all workers are forced to be represented by it and are subject to its collective agreements. That is called "exclusive representation." New Zealand unionists would love to have such monopoly bargaining privileges, but as of yet even the Labour Party has refused to go that far.

Nevertheless, the proposed amendments are a step in that direction. They would make it illegal for an employer (without union permission) to grant workers on individual contracts the same terms of employment that are in the union's collective agreement. Moreover, an employer would be forbidden to offer any better terms of employment to workers on individual contracts because it would be a "breach of good faith" for an employer to do anything to "undermine" any collective agreement. Minister Wilson cited offering better terms in individual contracts as an example of such a breach. So it looks as if the only alternative open to an employer is to offer inferior terms of employment in individual contracts. I suppose if this doesn't work, the next thing they will try is exclusive representation.

Under the proposed amendments all labor-management relations must be conducted under a "duty of good faith," which, in Wilson's words, "means more than the common law obligations of mutual trust and

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confidence." Section 6 of the bill says that the duty of good faith "requires the parties to an employment relationship to be active and constructive in establishing and maintaining a productive employment relationship in which the parties are, among other things, responsive, communicative, and supportive." Wow! That is sufficiently mushy to sustain just about any allegation of breach by any employer who does not cave in to union demands. Once such an allegation is upheld, the Employment Relations Authority can impose terms on employers. It seems that union negotiators have been unable to achieve terms of employment in collective agreements that would really be attractive to workers; so now such terms will be imposed. Moreover, unions are given the right to see to it that employers adhere to this inflated notion of good faith in their bargaining with individual workers who want nothing to do with unions.

Before the enactment of the ECA in 1991, unionism was compulsory in most employments, and wages were often set by "national awards" agreed to by unions and government bureaucrats. The ECA moved negotiations in the labor market to the individual firm level and gave workers a genuine choice of whether to participate in collective agreements or not. Of course, unions prefer to bargain with several employers at once because that prevents individual employers from gaining cost advantages over their rivals who consent to union demands. Economists call a situation where one union (a cartel of workers) bargains simultaneously with all employers in an industry as a group (a cartel of employers) "bilateral monopoly bargaining." In such bargaining it is easy for employers to pass along cost increases to consumers.

Multi-Employer Collective Agreements

Toward that end the proposed bill stipulates that any union can approach any group of employers and propose multi-employer collective bargaining. Each employer who is asked must attend at least one meeting with his fellow employers and the initiating union, and bargain in good faith over the proposal. If no agreement is reached, and the Employment Relations Authority decides there is a breach of good faith, such an arrangement may be imposed.

The proposed bill stipulates that all employment contracts, whether collective or individual, must include provisions that "protect" workers when their existing employer sells or transfers ownership of his business or contracts out any jobs. Moreover, existing employers will have a duty to engage in good-faith negotiations with successor employers over terms of employment for affected employees.

The bill even goes further in the case of a specific list of "vulnerable" workers. Here it is not a matter of negotiation at all. Successor employers must hire vulnerables at terms that are at least as good as they enjoyed before. Failing that, they must negotiate a redundancy agreement or have one imposed on them. This will do wonders for flexibility of organizational architecture in response to frequently changing market conditions in the global economy.

Minister Wilson claims the proposed bill will promote "free choice, flexibility and fairness to all [and] support a more innovative economy." That is risible. The actual effect will be to move New Zealand back toward serfdom. Politicians never learn. □