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FEATURES

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PERSPECTIVE

Weighing In

Last spring the Arkansas legislature passed a law requiring schools to compute each student's body mass (using the Body Mass Index, BMI) and record it on report cards. The BMI generates a number based on a person's height and weight, and is supposed to indicate something about one's health. However, it's been criticized for not distinguishing between fat and muscle. A few years ago the government revised the index, and 30 million people woke up overweight. According to the Center for Consumer Freedom (www.consumerfreedom.com/game_fatchart.cfm), the new BMI has these people as overweight or obese: Sylvester Stallone, Arnold Schwarzenegger, Bruce Willis, Michael Jordan, and me (5 feet, 7 inches, and 158 pounds).

For *Ideas on Liberty* the issue, of course, is not the questionable validity of the BMI; it's the propriety of a law requiring agents of the state, government teachers, to keep track of the body mass of students who are compelled to attend school.

At FEE it's our policy not to tell the government how to run its schools. We just think no one should be forced to attend or pay for them. Nevertheless, the Arkansas law is instructive. Education historians have long known that government did not get into education because the private sector couldn't handle it. The education market was vibrant and accessible to rich and poor in the days before "public education." Government got itself involved because it was the obvious way to conduct grand social engineering. The American architects of the Prussian-inspired "common school" promised to create a new and improved society—to eradicate crime and sin—by replacing the influence of vicious, slothful parents with that of enlightened state-trained educators. Physical fitness was part of the program, along with a curriculum of social studies that portrays expanding government power as benign and the voluntary sphere as ever threatening.

This matter confirms another warning of those (notably Thomas Szasz) who see danger in the union of health and state. "We are facing a crisis in this country and in Arkansas with obesity," State Senator Sue Madison said. "I realize this is seeming like a huge invasion of privacy but there is a concern because of the health crisis and to some extent that crisis will be [borne] by the taxpayers in the future."

Everyone who believes that government can pay for medical care without serious consequences for liberty can now take stock. All kinds of restrictions on our freedom and privacy—and all impositions on our children—can be defended as ways to save the taxpayers money. Fiscal responsibility has been enlisted in the cause of statism and collectivism. That was the rationalization for the states' suits against the tobacco industry. It will be used to justify suits against fast-food restaurants and who knows what else?

The moral: there is no innocuous use of aggressive force.

* * *

Spam may be okay for breakfast, but few people want it flowing into their computers all day. Must we look to government to save us? No, says Christopher Westley.

Ludwig von Mises, in a 1946 reprint, analyzes the effect of the Great German Inflation on business.

For some strange reason, the people who make life-saving drugs are under assault. Doug Bandow asks us to consider what things would be like without the pharmaceutical companies.

When one thinks of Austrian economics one thinks of Ludwig von Mises, the great theorist and an adviser to FEE founder Leonard E. Read. In the second installment of a classic reprint, legendary economic journalist Henry Hazlitt explores the contributions of Mises and later generations of Austrian writers.

The term "rent-seeking" is often used in discussions of public policy from a free-market perspective. Sanford Ikeda contributes a primer on subject.

The U.S. Supreme Court had handed down landmark decisions on affirmative action at state colleges and universities. George Leef provides a tour of the court's reasoning.

Even though little is known about what causes climate change, an awful lot of people "know" what to do about it. Christopher Lingle advises caution.

A group of critics of laissez faire called themselves "distributists." Concerned with the insecurities in the marketplace, they offered a philosophy with some surface appeal. Thomas Woods goes beneath the surface.

Columns this month: Richard Ebeling looks back at the German hyperinflation. Robert Higgs examines the federal government's venture into the shipping industry. Donald Boudreaux looks at population fallacies. Walter Williams praises the social role of profit. And William Thomas, hearing the argument that Africa's future depends on handouts from wealthy Americans, replies, "It Just Ain't So!"

This month's book reviewers meditate on Adam Smith, the income tax, money, and the war on terrorism.

—SHELDON RICHMAN

From the President

by Richard M. Ebeling

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The Great German Inflation

Eighty years ago this month, on November 15, 1923, the Great German Inflation came to an end when the monetary printing presses were finally shut down. The German people had gone through nine years of ever-greater monetary expansion, ever-more soaring prices, the financial destruction of much of the society's middle class, a massive misdirection and squandering of the country's productive capital in an illusionary economic boom, and the ruin of much of Germany's social fabric. The inflationary madness ended in a virtual total collapse of the German mark.

The German inflation began—as many other inflations have begun throughout history—through the government's turning to the printing press to finance its war expenditures. Almost immediately after the start of World War I, on July 29, 1914, the German government suspended all gold redemption for the mark. Less than a week later, on August 4, the German Parliament passed a series of laws establishing the government's ability to issue a variety of war bonds that the Reichsbank—the German central bank—would be obliged to finance by printing new money. A new set of Loan Banks was created to fund private-sector borrowing, as well as state and municipal government borrowing, with the funds for the loans simply being created by the Reichsbank.

During the four years of war, from 1914 to 1918, the total quantity of paper money created for government and private-sector spending went from 2.37 billion to 33.11 billion marks. By an index of wholesale prices (with 1913 equal to 100), prices had increased more than 245 percent (prices failed to increase far more due to wartime controls). In 1914, 4.21 marks traded for one dollar on the foreign exchange market. By the end of 1918, the mark had fallen to 8.28 to the dollar.

But the worst was to come in the five years following the war. Between 1919 and the end of 1922 the supply of paper money in Germany increased from 50.15 billion to 1,310.69 billion marks. Then in 1923 alone the money supply increased to a total of 518,538,326,350.00 billion marks. By the end of 1922 the wholesale price index had increased to 10,100 (still using 1913 as a base of 100). When the inflation ended in November 1923, this index had increased to 750,000,000,000,000. The foreign-exchange rate of the mark decreased to 191.93 to the dollar at the end of 1919, to 7,589.27 to the dollar in 1922, and then finally on November 15, 1923, to 4,200,000,000,000.00 marks for one dollar.

During the last months of the Great Inflation, according to Gustav Stolper, "more than 30 paper mills worked at top speed and capacity to deliver notepaper to the Reichsbank, and 150 printing firms had 2,000 presses running day and night to print the Reichsbank notes."

Richard Ebeling (rebeling@fee.org) is the president of FEE. His latest book is Austrian Economics and the Political Economy of Freedom *(Elgar).*

But these statistical figures do not tell the human impact of such a catastrophic collapse of a country's monetary system. In his book, *Before the Deluge: A Portrait of Berlin in the 1920s* (1972), Otto Friedrich writes that "By the middle of 1923, the whole of Germany had become delirious. Whoever had a job got paid every day, usually at noon, and then ran to the nearest store, with a sack full of banknotes, to buy anything that he could get, at any price. In their frenzy, people paid millions and even billions of marks for cuckoo clocks, shoes that didn't fit, anything that could be traded for anything else." The price of a cup of coffee would double in the time that a customer took to drink it in a café.

Food supplies became both an obsession and a currency. The breakdown of the medium of exchange meant that the rural farmers became increasingly reluctant to sell their agricultural goods for worthless paper money in the cities. Urban dwellers streamed back to the countryside to live with relatives in order to have something to eat. Anything and everything was offered and traded directly for food to stave off the pangs of hunger.

Illusionary Boom

The inflation generated a vast and illusionary economic boom. In his classic study, *The Economics of Inflation* (1931), Constantino Bresciani-Turroni detailed how the inflation distorted the structure of prices and wages, generating paper profits that created a false conception of wealth and prosperity. Austrian economist Ludwig von Mises was the first one to emphasize this aspect of the inflationary process. (See Mises's 1946 analysis on page 10.) As the selling price of a manufactured good was pushed far above the cost of production, profits appeared huge. But when the manufacturer went back into the market to begin his production process again, he found that the costs of resources and labor had also dramatically increased. What had looked like a profit was not enough to replace the capital used up earlier.

The distorted relative-price signals during the inflation resulted in misallocations of capital and labor in various investment projects that were found to be unsustainable and unprofitable when the monetary debauchery finally came to an end. Thus a "stabilization crisis" followed the inflation, as capital and investment projects were left uncompleted because of a lack of available real resources, and workers faced a period of unemployment as they discovered that the jobs the inflation had drawn them into had now disappeared. The consumption of capital and the misuse of resources and labor during the years of inflation left the German people with a far lower real standard of living, which only years of work, savings, and sound new investment could make up for.

Unfortunately, Germany's economic recovery in the middle and late 1920s turned out to be an illusion as well. A game of financial musical chairs was played out, in which Germany borrowed money from the United States to pay off reparations to the victorious Allied powers, as well as to fund a vast array of municipal public-works projects and government-sponsored business investment activities. These all came crashing down, too, when the boom of the 1920s turned into the Great Depression of the 1930s. It also set the political stage for Adolf Hitler's rise to power in 1933.

The current confidence that inflation seems to be a nonexistent or minor problem is an illusion also. The same political ideas and institutions that resulted in such monetary madness in the past still exist in the world today. Only a change in political-economic ideas can assure that it does not happen again. □

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Massive Foreign Aid Is the Solution to Africa's Ills?

It Just Ain't So!

President Bush traveled to Africa in July. Those sympathetic to the President might say he went to show his charitable concern for the problems of Africa and his sincere care for the downtrodden of the world. But a less rose-tinted view might have shown an unprincipled but skillful political machine bolstering its image among centrist "liberals" and gamely trying to chip away at the Democratic Party's lock on black voters.

Whatever the motivations of the administration, the trip brought the partisans of American engagement in Africa out into the media spotlight. The president had thrown a bone to the foreign-aid community with his surprising endorsement of a $3 billion-a-year package of AIDS-fighting measures for Africa in his State of the Union address. Far from sated with this forced donation from U.S. taxpayers, the international aid bureaucracies have finally gotten a taste of red meat, and they want more.

How much more? One of the most notable calls for aid for Africa that emerged from this time was "A Rich Nation, a Poor Continent," an op-ed by economist Jeffrey Sachs in the *New York Times*. Sachs sketches the truly terrible conditions in which many Africans live: life expectancy "is less than 50 years in most of Africa, and less than 40 years in some of the AIDS-ravaged countries. Until the pandemics of AIDS, tuberculosis, malaria and other killer diseases are brought under control in Africa, economic development and political stability will remain crippled."

Having been a counselor on conversion to capitalism to ex-communist governments (most notably Russia), Sachs is now director of a sustainable-development center called "The Earth Institute" at Columbia University. He is also an adviser to UN Secretary General Kofi Annan. He has become a leading opponent of the free market and a cheerleader for foreign aid. His thinking seems to follow this general line: Capitalism and technology are good things, but any real progress in the world calls for international governmental solutions. In the case of epidemic disease in Africa, Sachs's preferred solution is massive funding for the Geneva-based "Global Fund to Fight AIDS, Tuberculosis and Malaria," to the tune of up to $8 billion per year from the United States alone.

An aunt of mine who was an unreconstructed New Dealer used to say to me: "The problem with the poor is that they don't have money." This seems to be Sachs's view of the needy in Africa: the only thing that keeps them sick is a lack of medicine, and they only lack medicine because they are poor. Sachs puts it this way: "If rich countries contributed a total of around $25 billion per year [to fight disease in the Third World], the increased investments in disease prevention and treatment could prevent around eight million deaths each year in poor countries throughout the world."

My aunt was right that the poor lack money. Any poor person could be made richer—at least temporarily—by a handout. And Sachs is right that in African countries where AIDS runs rampant, the sick lack medicines and too many don't practice safe sex. Enough medicine and education could have a real impact, extending lives and encouraging people to act more prudently.

But Sachs is wrong to think that Africa's problems are essentially medical or financial. He is wrong to emphasize charity at the expense of focusing on the real needs of Africa: rational culture, justice, and capitalism. And he, along with the Bush administration, is wrong to think that wealthy countries or wealthy people bear a responsibility for the health or welfare of others to whom they are unconnected by any significant ties.

My aunt ignored the fact that lasting poverty has roots in culture and incentives. Handouts don't eliminate poverty; too often they help entrench the habits that perpetuate poverty. For his part, Sachs ignores the fact that Africa's crisis has roots in gangster politics, irrationalism, and collectivism. No African country ranks among the 35 freest in the world, as objectively measured in *Economic Freedom of the World 2002*. In fact, several countries in Africa are among those with the least economic freedom and the most capricious legal environment. These include Zimbabwe, Guinea-Bissau, and both Congos. It is no accident that these are some of the poorest and most miserable countries in the world. It is misgovernment—not AIDS or any other disease—that has ruined these countries. When Sachs urges support for the Global Fund, he is calling, in effect, for the support of a new hyper-bureaucracy of foreign-aid experts and for open-ended support of the very regimes that are to blame for Africa's crisis. It precisely to accommodate corrupt and ineffective regimes that the Global Fund is at pains to describe itself as a funding supplement to existing government programs.

A Matter of Morality

Ultimately the case here is moral. Sachs wants the top 400 earners in the United States to give up 10 percent of their income to the Global Fund. He argues "our world is dangerously out of kilter when a few hundred people in the United States command more income than 166 million people in Africa."

The world *is* out of kilter, but not in the way Sachs means. Americans who have earned great wealth through their productivity are not vultures who prey on the poor. The world's poor are generally poor or sick or hungry for reasons that have nothing do with the businesses that make Americans rich. In fact, having nothing to do with American-style capitalism tends to keep people poor, and it is corrupt, intrusive governments that keep them out of contact with the free market. (It is no accident that some of the best health care in Africa is that provided by big corporations for their local employees.) What is out of kilter is the political culture of Africa, not the fact that Americans and other mostly free people can acquire or possess great wealth.

There is nothing wrong with people giving some of their money away to help others. But when they do so, be they richer or poorer, they should make sure that they are really helping those in need, and not just throwing good money after bad into the pit of cultural and political corruption. The rich certainly do not owe the world an apology for what they have, and they are not responsible for all the terrible problems that people find themselves in. The health situation in Africa is a terrible shame. But the shame is not America's.

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The Economics of Spam

by Christopher Westley

What's the matter with the Internet? I used to love it, at least the part of it that brought e-mail. One of the highlights of my day used to be Outlook Express's friendly tone announcing that another e-mail had arrived in my inbox. Then I would stop what I was doing to see which friend or colleague was checking in, or what requested information had arrived.

Those were my glory days of e-mail. I miss them. Nowadays, it seems that for every ten e-mails I receive, eight are unsolicited sales pitches, also known as spam. And of those eight, half offer samples of crude and dehumanizing porn. As a result, I never check my e-mail when my children are nearby.

Though I once wrote in praise of e-mail, I now consider it a mixed bag. A couple of my friends have forsworn it entirely, having decided that the costs outweigh the benefits, and it is hard not to agree that they have a point. There have always been the good and the bad aspects of e-mail, but it seems that lately, based on my own inbox and my ever-growing list of filtered terms, the bad aspects seem to be trumping the good.

My experience reflects the national trend. According to the *Wall Street Journal*, the amount of spam as a proportion of all e-mail on the Internet increased by 350 percent between the summer of 2001 and the summer of 2002. It is now approaching 50 percent of all e-mail traffic. Spam makes up 70 to 80 percent of all incoming e-mail to America Online's servers and 40 percent to Earthlink's network.

The economics of spam explain its pervasiveness. Once a spamming system is set up, the marginal cost of sending an unsolicited e-mail is virtually zero. As a result, the smallest of response rates can make the process profitable. The rule of thumb is that while old-fashioned junk mail sent via the post office requires a response rate of 1 in 100 to be profitable, spam mail requires a response rate of 1 in 100,000. This greatly increases its appeal as a marketing tool.

For instance, a recent story in the *Fort Worth Star-Telegram* reported on an Internet marketer who mailed ten million e-mails a day offering eavesdropping software for $40. His annoying efforts result in 50 orders a day, allowing him to earn $700,000 a year. Not bad for a response rate of only 0.000005 percent. Following the law of supply, his success only signals other spammers to enter the industry, which is an extremely easy process. Anyone with a computer and an e-mail account can enter.

The result is a reduction in the appeal of an otherwise remarkable medium. After all, how many people would watch TV if the networks only showed commercials? The disgust is growing, and the politicians are listening, as evidenced by a recent "Spam Forum" conducted by the Federal Trade

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Commission and several bills working their way through both houses of Congress. This is a bad combination of events.

It is bad because solutions to problems such as these are ineffective, cannot be legislated, and will result in enriching offshore enterprises. In the aftermath of 9/11, the government has made clear its desire to regulate many forms of communication, particularly e-mail. The spam explosion provides a useful foil to justify such regulation on the basis that spam is simply another variant of market failure requiring state oversight.

Besides being incompatible with a free society, these responses are also incompatible with market theory that teaches us that the world in which we live is dynamic, not static, and that it takes time for resources to respond to problems that may hinder society. The market does not fail when the price of gasoline spikes, causing us to reallocate our gasoline usage until entrepreneurs respond to the change in price by redirecting resources to gasoline production. Indeed, it is the government that fails when it intervenes in this process, frequently causing the problems to persist needlessly.

For the same reason, we needn't assume that the current spam scourge must necessarily be the norm, thus overruling whatever advantages we otherwise might have from e-mail and justifying government intervention. In fact, there is no way anyone can know how the nature of e-mail will change over the next five years. But the assumption that today's bad conditions will persist indefinitely certainly does not square with practical experience in most every sphere of life. Although the modern state depends on such assumptions, they go beyond naiveté to enter the realm of the nonsensical.

Problems Create Solutions

Indeed, the problems themselves create the necessary conditions for entrepreneurs to offer various solutions. One can envision the problems resulting in the creation of private *intra*nets, in which spammers pay for the right to solicit their wares. In fact, their payment could result in zero-price e-mail and web access for the non-marketers who use the system, thus funding it much like broadcast television networks. The provider of such intranets could regulate who spams and how much. Such a solution is technologically feasible now, although not yet practical. But if the costs continue to increase, market conditions could easily change to allow such a system to come about.

There are also many unique and clever ways that markets are responding to spam problems today. One company, SpamArrest (http://spamarrest.com), intercepts all e-mail that is sent to its subscribers, requiring senders to visit a web page and click a box allowing the e-mail to be sent to its final destination. The genius of this process is that it requires senders to follow through on their e-mails by doing something only humans can do. Such efforts would place a serious crimp in the work of the e-mail marketer mentioned above.

Other companies offer free services such as SpamGourmet's (www.spamgourmet.com). They allow subscribers to submit faux e-mail addresses to companies that are likely to try to sell them to e-mail marketers. The users specify how many e-mails they wish to receive in response, after which they are "eaten." Since the firms never see users' real e-mail addresses, they never make it on e-mail marketing lists.

There are a myriad of other approaches too numerous to list here. The fact that no one will use e-mail if current trends continue is enough to guarantee that some solutions will be found. Just as markets provide sufficient regulation to maximize transactions, so will they provide tools necessary for e-mail services to maximize satisfied customers. As long as the state does not intervene in this corrective process, the glory days of e-mail will return. It will be as safe, effective, and beneficial as it was in years past.

Now excuse me while I clear out my inbox. ☐

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Business Under German Inflation

by Ludwig von Mises

Paper money inflation and credit expansion never fall upon a people like an act of God. They are always the outcome of a deliberate policy. The governments and the parties in power take recourse to inflation because they consider it as a blessing or at least a minor evil when compared with the effects either of cutting down public expenditure or of choosing other methods of financing. This applies to both peace and to war. Inflation as such does not contribute anything to winning battles. It does not produce arms and other equipment. It is merely one of the methods available for financing the huge expenditure caused by war. The other methods are taxation and borrowing from the public (and not from the commercial banks). If a government prefers inflation, it must not plead as an excuse that there was no other way left.

Of course, the term inflation has fallen into disrepute. All governments and all political parties emphatically announce that their main concern is to fight this dreadful thing called inflation. In fact they are not fighting inflation, but only its symptoms and necessary consequences, namely the rise in prices. And this struggle is doomed to failure precisely because it is merely a tampering with symptoms. Nothing is done to end the root cause, i.e., the increase in the quantity of money and the expansion of credit.

The truth is that the propensity to inflate is nowadays greater than it ever was before. It is only that the advocates of inflation and credit expansion have resorted to new terminology. They call the thing expansionism, an easy money policy, unbalanced budgets, or functional finance. The British paper which inaugurated in 1943 the action which resulted in 1944 in the Bretton Woods agreement explicitly declares that the aim of the new international institution is to bring about "an expansionist pressure on world trade." It expects that this expansionist policy will perform "the miracle . . . of turning a stone into bread."

The idea that monetary and credit expansion make business good, create "full employment," and bring general prosperity was the essence of the ideas of Mercantilism. The fallacies implied were utterly exploded by the economists whom the Prussian Historical School and their modern followers, Keynesians and the American advocates of unbalanced budgets, disparage as orthodox. A new systematic analysis and thorough refutation of the defects of the doctrine of expansionism certainly is not needed. Those interested in such a critical examination are referred to the writings of Professor B. M. Anderson, of the late Professor Edwin Kemmerer,[1] and of many other brilliant American economists. The goal of this article is

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Ludwig von Mises (1881–1973) was the foremost Austrian economist of the twentieth century, an adviser to FEE, and the author of Human Action. *This is the major part of an article originally published in the* Commercial and Financial Chronicle, *March 7, 1946.*

A 20,000,000 mark (August 1923)

merely to stress an aspect of the problems involved which is often neglected. It seems expedient to exemplify the issue with the case of the German inflation of 1914–1923, the classical expansionist experience of our century.

A Mark Is Always a Mark

Among the gravediggers of the German people's prosperity and the German currency, Friedrich Bendixen occupies an eminent place. He was a bank manager and the author of many books and articles dealing with monetary matters. His prestige and his influence on the course of the Reich's financial policy were enormous.

When in the first World War the mark's purchasing power declined and concomitantly foreign exchange rates went up, Bendixen trumpeted that this was a rather fortunate event. For, he said, it made it possible for the Germans to sell their holdings of foreign securities at a profit.

Let us consider an example. A German owned on the eve of the war a Dutch security which was traded on the bourse of Amsterdam at 100 guilders, at that time by and large the equivalent of 240 marks. The price of the stock dropped and the German sold it at 90 guilders. This involved in gold a loss of 10 percent. But in the meantime the price of the guilder in Berlin had risen from 2.40 to 3 marks; 90 guilders represented now 270 marks. The German capitalist made in marks an apparent gain of 30 marks or 12.5 percent. However, the average Germans and their spokesman Bendixen were not shrewd enough to see things in the right light. With them a mark was still a mark. They smilingly pocketed an alleged gain.

The same phenomenon presented itself in every branch of international economic relations. The champions of expansionism assign to rising foreign exchange rates the power of stimulating export trade. It was this idea that impelled many European countries in the inter-war period to devalue their domestic currencies.

Such a devaluation at one stroke makes foreign exchange rates rise. But domestic commodity prices and wage-rates lag for some time behind the rise in foreign exchange rates. In the interval, before the price structure on the domestic market becomes adjusted to the new state of monetary conditions, some export projects, which were unprofitable before, appear seemingly profitable. The exporter makes an apparent profit—in domestic currency—although he may sell at a lower price in foreign currency. But what really goes on is that he gives the domestic products away at a price which enables him only to buy a smaller quantity of foreign products. It is true, the nation whose currency has been devalued exports more during this interval, but it gets in exchange only less or, at least, not more than previously for a smaller quantity exported.

This is what the economists have in mind when speaking of "apparent" gains. These gains are the result of false reckoning and self-deception.

The Huge Inflationary Profits of Business

It is asserted again and again that German business flourished in the years of the great inflation. In fact, the annual reports of the big German corporations and the big German banks showed fat profits, and high dividends went to the stockholders. (The German banks were not merely banks, but at the same time holding companies owning a controlling part of the common stock of many manufacturing corporations.)

However, these gains were often apparent only, a mere product of the fact that the businessman's economic calculation employed the mark as a common denominator. When translated into a less fluctuating foreign currency, for instance, into dollars, they revealed themselves frequently as losses.

It did not matter for German business whether prices in gold and in dollars were rising or falling. Prices in marks were rising whatever the movement of prices on the world market was. The sale of the products and inventories netted big paper profits because prices in marks were soaring ceaselessly.

A second source of paper profits was provided by insufficient writing off of depreciation. The goal of laying aside a portion of the annual earnings in a depreciation fund is to provide the means for the replacement of industrial equipment worn out in the process of production. Failure to provide such funds adequately makes the profits appear larger than they really are. If such apparent surplus profits are dealt with as if they were real profits, the result is capital consumption. As German business was slow in discarding the old custom of writing off annually a fixed percentage of the original costs of equipment, it virtually reduced the amount of capital invested.

With the rapid progress of inflation more and more businessmen began to comprehend that their methods were suicidal. They started what was called "the flight into real values" (*Flucht in die Sachwerte*). They began to reinvest the apparent profits in their plants. It did not matter for them whether these investments were reasonable or not. Their only concern was to get away from the mark at any cost. Later events have evidenced that a great part of the investments made in the years of the inflation by the German banks and the independent business concerns were malinvestments. German business emerged from the trial of the inflation period financially weakened. The big German banks were already in 1924 on the verge of insolvency.

Of course, the Germans, steeped in the monetary fallacies of Bendixen and Knapp,[2] were not aware of this fact. Neither were the foreign bankers and investors shrewd enough to judge correctly the plight of the German big banks and of many of the big German business concerns. In the twenties foreign loans to the Reich, the member states, the municipalities and to the banks and big business amounted to about 20 billion Reichsmarks. Besides, foreigners invested $5 billions directly in German business. This huge inflow—against which reparation payments of about $10.8 billions had to be held—disguised for a few years the frailty of the big banks. When the depression ended foreign lending to Germany, the collapse of the banks could no longer be delayed. It occurred in 1931 as the payoff both of inflation and of ignorance of fundamental economic issues.

> The belief that a sound monetary system can once again be attained without making substantial changes in economic policy is a serious error. What is needed first and foremost is to renounce all inflationist fallacies. This renunciation cannot last, however, if it is not firmly grounded on a full and complete divorce of ideology from all imperialist, militarist, protectionist, statist, and socialist ideas.
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> —LUDWIG VON MISES
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> "Stabilization of the Monetary Unit—From the Viewpoint of Theory" (1923), reprinted in *On the Manipulation of Money and Credit*

One of the reasons why public opinion misconstrued the economic consequences of the German inflation was the emergence of a class of inflation profiteers.

The profiteers were those speculators who were quicker to realize the true meaning of the inflationary boom than were the managers of the banks. The interest rates charged by the banks, although high when compared with normal conditions, were ridiculously low when compared with the stock exchange profits a speculator could earn on a market at which prices skyrocketed on account of the inflation. No matter what stock he bought, the speculator netted a gross profit which exceeded by far the interest he had to pay to the lending bank. As long as the inflation went on there was no risk for him in embarking upon bull transactions with borrowed money.

Germany Financially Wrecked by the Inflation

The inflation favored the debtors at the expense of the creditors. It made a very small group of smart speculators rich. It impoverished the immense majority of the nation.

The losses of the losers by far surpassed the total amount of the gains of the profiteers. The per capita wealth of the Germans was reduced, in spite of the fact that they had succeeded in unloading a part of their losses on the shoulders of foreign capitalists, especially American and Swiss.

The excess of inflation losses over inflation gains stemmed from three different sources: The nation consumed more than it produced: it lived on its capital. The greater part of the apparent profits was eaten up either by the speculators and businessmen themselves or by the Government which collected under the misleading label of income and corporate taxes funds which were in fact taken away from the capital invested. The wastefulness of municipal administration was so outrageous that even Schacht[3] could not help criticizing it. Many labor unions succeeded in raising nominal wage rates above the rise in commodity prices. They booked the resulting rise in real wage rates as "social gains." In fact, these workers shared in the capital consumption. They thus contributed to a later fall in the productivity of labor and thereby of market wage rates.

Germany dumped cheap exports on the world market. It happened again and again that German manufactures, produced out of imported raw material, were exported at prices which—when calculated in dollars—did not even cover the price of the raw materials contained. Yet, the German exporter was convinced that he had made a good deal.

A great many of the investments made during the critical years were malinvestments. . . . ☐

1. See Benjamin M. Anderson, *Economics and the Public Welfare: A Financial and Economic History of the United States, 1914–1946* (Princeton: D. Van Nostrand Company, Inc., 1949) and Edwin W. Kemmerer, *The ABC of Inflation* (New York: McGraw-Hill, 1942).
2. Georg Friedrich Knapp, author of *The State Theory of Money* (1924 [1905]).
3. Hjalmar Horace Greeley Schacht, German financier who held a number of positions in German government, 1923–1943, including president of the Reichsbank and minister of economy.

IDEAS ON LIBERTY
NOVEMBER 2003

Healers Under Siege

by Doug Bandow

The Food and Drug Administration has approved a drug to combat non-Hodgkin's lymphoma. That's good news for cancer patients in America and around the world. But you wouldn't know it, given the vicious political campaign being directed against the pharmaceutical industry.

America's drug makers are under attack. Congressmen would like to cut prices, and the expansion of Medicare will encourage Uncle Sam to regulate drug access and prices directly.

State legislators are debating their own draconian price-control schemes. The media, such as the PBS show "Frontline," have targeted the drug makers. Trial attorneys, left-wing activists, and state attorneys general are filing lawsuits charging pharmaceutical firms with everything from racketeering to fraud.

This assault is not new. Drug companies have been under pressure for a decade. When the Clinton administration attempted to nationalize American health care, it sought to demonize the drug makers, as well as most doctors and hospitals.

Unfortunately, years of demagoguery advanced for political profit are having an impact. Public opinion of the industry has been falling sharply.

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While the American people have yet to agree with Al Gore's grotesque comparison of the drug makers to the tobacco companies and "big polluters"—there is little that he would not say to win a vote—they are increasingly turning on an industry that has done so much to improve their lives. Harris Interactive reports that those who believe the drug makers are doing a good job of serving consumers fell from 79 percent to 57 percent from just 1997 to 2001.

Yet new pharmaceuticals are responsible for almost half the reduced mortality from different diseases between 1970 and 1991. Columbia University's Frank Lichtenberg figures that every new drug approved during that time saves over 11,000 life-years annually. And the benefits continue. He estimates that fully 40 percent of the increase in average life span between 1986 and 2000 is due to new drugs.

"Three decades ago medical technology was rather primitive by today's standards," says Dr. E. M. Kolassa of the University of Mississippi School of Pharmacy. "Today, physicians have at their disposal medications and technologies that provide for the immediate diagnosis and treatment of most of the disorders that affect modern man."

Hundreds of new drugs are in development for cancer, heart disease, strokes, Alzheimer's, infectious diseases, and AIDS. Consider the last: Two decades ago there was no treatment for AIDS. By 1987 there was one drug, AZT. Now there are 74 anti-

> *The real cost of pharmaceuticals is not making the pill that patients swallow. It's the research that goes into developing the pill—as well as the other 9,999 substances that never made it to market. The pill's price also has to cover the cost of running the company and complying with burdensome FDA requirements.*

AIDS drugs available and another 100 in development.

Similarly, pharmaceuticals offer the best hope of combating any future outbreak of SARS, which has killed over 700 people. In fact, the quickest solution is to find an existing medicine that works. Laboratories are currently screening some 2,000 approved and experimental drugs to see if they are useful in fighting SARS. Gurinder Shahi, a doctor in Singapore, explains: "Given how little we know about SARS and the reality that it is killing people, it is justified for us to be daring and innovative in coming up with solutions."

Daring innovation is most likely to come in a competitive, profit-driven market. After all, today's medicines exist only because there is a bevy of sophisticated pharmaceutical companies devoted to finding drugs to heal the sick.

Isn't this serving consumers well?

Ah, but prices are high. Too high, in the view of myopic, vote-seeking politicians. "There's no question that prescription drugs cost too much in this nation," claims Senator Jim Jeffords of Vermont.

Why, yes. They only save lives. Extend our life spans. Moderate our pain. Control our nausea. Eliminate our need for surgery. Treat our allergies.

Why should we have to pay for such products? The outrage. The horror. Drugs should be free. Or at least a lot cheaper.

If Life Were Different

It would be nice if they were, of course, but people who believe prices can be lowered legislatively are living in the world as it ought to be. Everyone ought to be rich and beautiful. Everyone ought to be paid a million dollars a year for working ten hours a week. Everyone ought to have a Mercedes at a Yugo price. Everyone ought to have a mansion for the price of a shack. And everyone ought to have all of the pharmaceuticals now available, but for less money.

Unfortunately, pharmaceuticals do not appear outside company doors every morning as manna from heaven appeared in the Promised Land for the ancient Israelites. Instead, firms review numerous plausible substances: of every 5,000 to 10,000 checked, 250 make it to animal testing. About five reach human trials.

Only one gets past the Food and Drug Administration (FDA) onto the market. That *one* has to pay for the research costs of the other 5,000 to 10,000. It isn't easy.

Thus the real cost of pharmaceuticals is not making the pill that patients swallow. It's the research that goes into developing the pill—as well as the other 9,999 substances that never made it to market. The pill's price also has to cover the cost of running the company and complying with burdensome FDA requirements.

The Tufts Center for the Study of Drug Development estimates that companies spend nearly $900 million over a ten- or 15-year period to develop each drug. America's major research firms alone spent $32 billion on R&D last year.

Nevertheless, some politicians would control prices directly. For instance, legislators in Maine want to impose prices they think are fair, and are threatening retaliation if any company tries to pull out of the market in response. Washington State already demands superdiscounts for some of its programs.

But government can only confiscate the drug makers' existing inventory. It can't force them to keep making drugs to be confiscated in the future.

Adopting Canadian- or European-style controls will result in a Canadian- or European-style drug industry and patient access. These countries do their best to free ride on America, but their pharmaceutical industries are weak and getting weaker.

Moreover, their ill citizens have far less access to important medicines. A group called Europe Economics points out that patients often wait years for life-saving products.

Still, America's political air is filled with other alleged panaceas, such as reimportation of drugs from Canada. Yet prices are lower there because the government imposes price controls and litigation costs are less. (The country is not full of profit-minded tort attorneys.) Imposing Canadian (or Mexican, or Afghan) prices in the United States would mean the drugs would not be developed in the first place.

Politicians also are pushing a range of use restrictions—formularies, reference pricing, and more. Yet every attempt to stop people from using new medicines endangers their health and threatens to increase health costs elsewhere. For instance, Frank Lichtenberg estimates that replacing 1,000 older prescriptions with newer drugs raises pharmaceutical costs by $18,000, but cuts hospital costs by $44,000.

Everyone in America has a stake in lowering health-care costs. But they also have a stake in maintaining quality health care. If the pharmaceutical industry succumbs to the demagogic campaign against it, we will all suffer the painful consequences. □

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Oblivious to the Obvious

"Ironically, the birth of a child is registered as a reduction in national income per head, while the birth of a farm animal shows up as an improvement."
—PETER BAUER (1991)

Each passing year makes me more and more aware of human beings' astounding capacity for overlooking the obvious. I have in mind here not those parts of reality that can be understood only with specialized training—say, professional economists' knowledge that the elasticity of a demand curve isn't its slope. Nor do I have in mind aspects of reality that can be known only through experience—say, the reality that French chardonnays taste very different from California chardonnays, or that the Boston Red Sox are destined never again to win a World Series.

Instead, I refer here to aspects of reality that are vivid, overwhelming, and plainly in everyone's sight. Nevertheless, many people remain oblivious to this reality.

My chief example is the continuing, widely held belief that population is the enemy of material prosperity. Newspapers, magazines, and water-cooler conversationalists routinely pronounce, as if it were as palpable as gravity, that a large and growing population of human beings implies widespread poverty and misery. Foundations—including the world's richest, the Bill and Melinda Gates Foundation—devote billions of dollars to the cause of population "control."

Population Connection (formerly Zero Population Growth), a chief proponent of policies to limit population growth, announces on its website: "We want people everywhere to join our cause so that, together, we can make the world better, safer, and less-crowded." U.S. Representative Carolyn Maloney of New York says that slowing population growth is required if we are to "stop hunger and preserve our world's resources."

But no evidence exists to support a belief in the dangers of large or growing populations. Indeed, all the evidence, most of which is plainly in view of everyone, is that more people mean *more* prosperity for everyone.

Probably the richest 23 contiguous square miles on the planet is Manhattan. It is also a speck of earth that is among the world's most densely populated, with each square mile, on average, packed with 67,000 residents. More than 1.54 million people live on Manhattan and some 2.12 million people work there—all amidst the millions of visitors who flock to that island every year.

According to conventional belief, Man-

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hattanites should be among the earth's most destitute and wretched peoples. Yet despite the fact that Manhattan has no forests, farms, pastures, fisheries, or mines, per-capita income there is a sky-high $73,000.

Compare Manhattan to the 46,907 square miles that are Mississippi, a state boasting a great deal of fertile farm land, bountiful lakes and rivers, and thick forests. Mississippi is also blessed (if conventional belief is valid) with a human-population density less than 1/1000th that of Manhattan (61 Mississippians per square mile compared to 67,000 Manhattanites per square mile). According to conventional belief, Mississippians should be much wealthier than Manhattanites. But instead they're much poorer. Per-capita income in Mississippi is less than $16,000, a mere 22 percent of that of Manhattan.

Also according to this same conventional belief, Russia should be among the wealthiest countries on earth. It has vast forests, rich mineral deposits, plentiful inland and coastal waters, and great expanses of arable land—and its population density is only a third that of Mississippi: 22 people per square mile. But per-capita income in Russia is a meager $7,700.

Manhattan is far richer than Mississippi and Mississippi is far richer than Russia.

Here are two additional examples. Each square mile of Hong Kong holds, on average, 15,966 residents; per-capita income there is among the world's highest at $24,506. In stark contrast, Ethiopia is sparsely populated, with each square mile holding, on average, 157 people. Ethiopia's per-capita income is among the world's lowest at $600.

Does Wealth Cause Poverty?

Don't think that the wealth of the developed world comes at the expense of the less-developed world. Empirical study upon empirical study shows that the poorest parts of the world are those without substantial contacts with advanced commercial societies. The greater a people's contact with commercial society, the wealthier they become.

A high density of human population clearly does not cause poverty; a low density of human population clearly does not make people prosperous. Manifest evidence of these facts surrounds us. And yet the prevailing belief of many people—including top officials in governments, at the United Nations, in academia, and in foundations—is that higher population densities entail lower material welfare for the average person.

Why? This is not, after all, a case in which the evidence is ambiguous, complex, or sparse.

One reason for the continuing obliviousness to the obvious fact that prosperity is not threatened by dense human population is the stubborn failure to recognize the crucial insight that the ultimate resource is the human mind.

Wealth is not automatically produced by nature and then "distributed" for consumption to passive peoples. Wealth—*all* wealth; every bit of it—requires for its creation active and rational human involvement. Without creative human minds and effort, no wealth would exist. Even the most fertile land would yield no crops; rivers and oceans would yield no fish; forests would yield neither lumber nor game animals. No minerals, no chemicals, no cloth, no shelter, no paper, no steel, no medicines, no wine, no M-Life—nothing—would exist without human creativity, effort, and peaceful interaction.

It follows that more creative human beings mean more, not less, prosperity. And as all the great economists from Adam Smith through F. A. Hayek, Peter Bauer, Julian Simon, and Vernon Smith repeatedly remind us, humans are remarkably creative and productive only when, and always when, they are free to bargain and exchange with each other.

So places such as New York City and Hong Kong are wealthy because they are densely populated with free people. Places such as Ethiopia and Russia are poor because they have so few free human minds. No fact is more sure and more obvious. ☐

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Understanding "Austrian" Economics, Part 2

by Henry Hazlitt

After the passing of its three founders—Carl Menger, Friedrich von Wieser, and Eugen von Böhm-Bawerk—Austrian economics fell for a long time into eclipse. It was not so much refuted as neglected. English-speaking economists began devoting themselves to such matters as mathematical treatment of problems of "general equilibrium." The Austrian view was revived mainly by one man, an Austrian by birth as well as an "Austrian" by conviction—Ludwig von Mises (1881–1973). He made his influence felt both by his written works and by his oral teachings. Among his early distinguished students and followers were Gottfried Haberler, Fritz Machlup, Oskar Morgenstern, Lionel (subsequently Lord) Robbins, and, most influential of all, F. A. Hayek.

Ludwig von Mises was prolific, but his principal contributions were made in three masterpieces. These were *The Theory of Money and Credit,* first published in German in 1912, *Socialism: An Economic and Sociological Analysis,* also first published in German in 1922, and *Human Action,* which grew out of a first German version appearing in 1940, but was not published in Mises's own rewritten English version until 1949.

Mises on Human Action

Though there is now a gratifying number of able young American economists writing in the Austrian tradition, *Human Action* still stands as the most complete, powerful, and unified presentation of Austrian economics in any single volume. Mises always generously acknowledged his indebtedness to his predecessors. He recalled in a short autobiography (*Notes and Recollections,* 1978) that around Christmas 1903 he read Menger's *Principles of Economics* for the first time. "It was the reading of this book," he wrote, "that made an 'economist' of me."

It would carry me to too great length to itemize and explain all the contributions to economics that Mises made, and I will content myself with mentioning only two. He was the first to prove that it was impossible for socialism to undertake "economic calculation"; and he made one of the most important contributions of any economist toward solving the problem of "the trade cycle."

Because Mises so uncompromisingly rejected government interventionism in all its forms, he acquired the reputation of a "laissez-faire extremist" during most of his lifetime, and was scandalously neglected by the majority of academic economists. But because Hayek elaborated his own ideas in a more conciliatory form, his writings

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attracted more attention from the academic world, and he leapt into prominence in 1931 with his own contribution to the theory of the trade cycle, *Prices and Production,* along lines similar to Mises's. The result is entitled to be called the "Mises-Hayek" theory.

Hayek is also a prolific writer, but though he has written volumes on money, on the trade cycle, on inflation, and on *The Pure Theory of Capital* (1941), he has never attempted a comprehensive book on economic principles. Of late years he has turned his attention mainly to the realms of politics, ethics, and law, and has written profound and widely discussed treatises on *The Constitution of Liberty* (1960) and a three-volume work on *Law, Legislation and Liberty,* completed in 1979. He has been more widely influential in his own lifetime than was Mises, and was awarded the Nobel Prize in Economics in 1974.

Today's zealous group of younger "Austrian" economists, though all acknowledging their great debt to Mises, do not treat his *Human Action* as the final word on the subject, but are exploring a whole range of economic problems with a new vigor. Murray Rothbard [1926–1995], a student of Mises, produced a two-volume treatise, *Man, Economy, and State* (1962), along Misesian lines, with notable clarity of exposition, and making important contributions of his own, pointing out the fallacies, for example, in the prevailing theories of "monopoly price."

Israel M. Kirzner (b. 1930), professor of economics at New York University, another former Mises student, although he has not undertaken a comprehensive book of "principles," has explored individual problems in five separate volumes: *The Economic Point of View* (1960), *Market Theory and the Price System* (1963), *An Essay on Capital* (1966), *Competition and Entrepreneurship* (1973), and *Perception, Opportunity, and Profit* (1979). His work is distinguished by great scholarship, systematic thoroughness, and precision of statement. He has brought further illumination to every problem he has dealt with.

Finally, no reference to individual writers would be adequate that did not include Professor Ludwig M. Lachmann [1906–1990]. Though he is one of the most original and profound among living Austrian economists, his work has not yet nearly achieved the recognition it merits. Among his principal books are *Capital and Its Structure* (1956; republished in 1978), *The Legacy of Max Weber* (1971) and *Capital, Expectations, and the Market Process* (1977). His writings are notable for their emphasis on the role of expectations and for their thoroughgoing application of a "radical subjectivism."


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Ludwig Lachmann (1906–1990)

Restrictions of space permit me merely to list the names of half a dozen of the now-increasing group of important "Austrian" economists: S. C. Littlechild, Gerald P. O'Driscoll, Jr., Mario J. Rizzo, Hans Sennholz, Sudha R. Shenoy, and Lawrence H. White. But so arbitrarily short a list must omit a number of names unjustly.

The "Austrian" economists, more consistently than those of any other school, have criticized nearly all forms of government intervention in the market—especially inflation, price controls, and schemes for redistribution of wealth or incomes—because they recognize that these always lead to erosions of incentives, to distortions of production, to shortages, to demoralization, and to similar consequences deplored even by the originators of the schemes. But personal value judgments of government policy are of course not an essential part of Austrian theory.

The present vigorous Austrian School is not content merely to keep re-expounding the principles developed by Menger and Mises, but is addressing itself constantly to new problems, or a more thorough probing of old ones. This is dramatically evident in a recent volume, *New Directions in Austrian Economics* (1978), edited by Louis M.

Spadaro, with contributions from eleven writers. Professor Spadaro himself, in his concluding essay, outlines some of the still unresolved problems that Austrians ought to explore. In some sense, however, practically all eleven contributions do the same thing.

I have heard it said (by an economist of another school) that there is no such thing as Austrian economics; there is only good economics or bad. But in the same way we could say that there is no such thing as Ricardian economics, Marxist economics, Keynesian economics, and so on. This sort of statement, though true in one sense, is false in another. It is fallacious in implying that if anything is classified in accordance with one characteristic, it cannot be classified in accordance with any other. It is like saying that there are no such persons as Americans or Japanese; there are only men and women. Those who call themselves "Austrian" economists give themselves this label because of its historic origins; but they happen also to believe that its fundamental theses are true, and offer more promise than any other for further progress in economic science.

Perhaps something should be said about the chief differences today between Austrian economics and what we may call "orthodox" or "mainstream" economics. The difficulty here is that "mainstream" economics itself would be hard to define. Economists are still divided into a number of recognizable "schools"—neoclassicists, Keynesians, the Chicago school, the Lausanne school, and so on. The limits of space forbid me to go into the distinguishing doctrines of each of these schools. But one outstanding difference of the Austrians from all of these lies in their method of reasoning. The Austrians emphasize methodological *individualism.* That is, they not only begin by emphasizing human actions, preferences, and decisions, but *individual* actions, preferences, and initiatives. Mainstream economists are concerned with "macroeconomics," with averages and aggregates; and those of the Lausanne school, trying to reduce economics to an "exact" science, and therefore seeking to quantify everything, are obsessed with complicated mathematical equations that try to stipulate the conditions of "general equilibrium."

Equilibrium a Useful Concept, Though Never a Reality

Now "general equilibrium" is defined by these economists (when it ever is) in highly abstract and obscure phrases; but for laymen it might be defined as a condition in which all the tens of thousands or millions of commodities and services are being turned out in the exact quantities and proportions in which they are relatively wanted by producers or consumers, so that there are no "shortages" or "surpluses." All prices reflect costs, and there is no more profit in making one commodity than any other. (In fact, there is no "pure" profit at all.) These economists admit that at any moment this condition does not exist, but they contend that there is a constant long-run *tendency* toward equilibrium, because when there is an unusual profit in turning out some one product, producers will turn out more of it, and when there is a loss in turning out some other product, producers will make less of it, or transfer to making something else.

Now the concept of equilibrium (or much better, the Mises concept of an "evenly rotating economy") can have great usefulness as a tool of thought. We are often better able to analyze the problems of change if we begin with the fictitious assumption of a state of affairs in which certain changes are hypothetically eliminated. But this is a purely imaginary construction, a useful fiction. It should never be confused with reality.

While a true "equilibrium" between the marginal cost of production and the market price of any one commodity is a condition that is seldom reached, even momentarily, a "*general* equilibrium" in the relative production, supply price, and demand price of *all* commodities and services is a condition that is *never* reached, even for an instant of time.

The concept itself is extremely nebulous. Neoclassical economists seem obsessed today with setting up complicated algebraic equations stipulating the conditions of equilibrium or functional relations under "perfect competition" and the like, but it is difficult to specify precisely what their x's and y's stand for. They cannot refer to physical quantities, because you cannot add apples to horses, or a ton of gold watches to a ton of sand. One might add or compare quantities times prices, but what would be the meaning of the total, or any of the parts that make it up? The price, even of one commodity, differs from hour to hour, place to place, and transaction to transaction. The value of the currency itself fluctuates and constantly changes its exchange ratio with commodities. If we simply add or compare "values," then we must recognize that values are purely subjective. They are impossible to measure or to total because they differ with each individual.

If we pass over these fundamental difficulties, where do we arrive? Even if we assume that there may be a persistent long-run *tendency* toward general equilibrium, we must admit that there is also a persistent short-run and long-run tendency toward the persistence of *disequilibrium.*

This is not only because there is a tendency of entrepreneurs, in increasing or reducing production in response to market and profit signals, to overshoot the mark, but because individual entrepreneurs, so far from making merely automatic responses, are constantly gaining new knowledge, alert to new opportunities, changing methods and reducing production costs, improving products, innovating—turning out entirely new products or inventions. And consumers too are constantly learning, changing tastes, and demanding new products to meet new wants. So Austrian economists seldom speak of market equilibrium, but of the market *process.*

My own suspicion is that the enormous attention now being devoted to stipulating the mathematical conditions of "general equilibrium" is a pursuit of a will-o'-the-wisp, of questionable help in solving any real economic problem.

But space forbids me to go into too many detailed contrasts. Let me sum up briefly the main Austrian theses once again, this time not in my own words or in Menger's, but in those of two prominent living [1981] "Austrians."

Israel Kirzner

"Beginning in the 1870's in Vienna, Austria," writes Professor Kirzner, "the school was distinguished by its emphasis on the *subjective* elements in economic analysis, on the significance of *time* in production processes, and on the role of *error and uncertainty* in economic phenomena" (his italics).

The summarization by Professor Lachmann is remarkably similar: "The first, and most prominent, feature in Austrian economics is a radical subjectivism, today no longer confined to human preferences but extended to expectations. . . . Secondly, Austrian economics displays an acute awareness of the many facets of time that are involved in the complex network of interindividual relations. . . . In the subjective revolution of the 1870's the first step in the direction of subjectivism was taken when it was realized that value, so far from being inherent in goods, constitutes a relationship between an appraising mind and the object of its appraisal" (*New Directions in Austrian Economics*, pp. 1–3).

All the rest of Austrian economics follows from these basic insights. Let me conclude with my own opinion that any economic analysis that fails to embody such insights cannot be entirely sound.

Recommended Reading

Those who have no previous acquaintance with Austrian economics, and would like a short and simple text written along Austrian lines, might begin with *Essentials of Economics* by Faustino Ballvé (126 pages;

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Murray Rothbard (1926–1995)

Irvington-on-Hudson, N.Y.: Foundation for Economic Education). A more advanced . . . introduction (1979), specifically explaining the Austrian point of view, is *The Fallacy of the Mixed Economy,* by Stephen C. Littlechild [out of print].

Surprisingly, the original *Principles of Economics,* first published in 1871 by Carl Menger, the founder of Austrian economics (328 pages), still makes an excellent, very readable, and not too technical introduction to the school's basic principles.

Of course, *the* authoritative and most complete work on modern Austrian theory is *Human Action*, by Ludwig von Mises (907 pages, first published in 1949 [fourth edition, FEE, 1996]). Some may find this difficult reading. A very clear two-volume work written thirteen years after *Human Action* by a student of Mises is Murray N. Rothbard's *Man, Economy, and State* [Ludwig von Mises Institute, 987 pages].

For the reader interested in the latest developments in Austrian economics I can highly recommend two books: One is *The Foundations of Modern Austrian Economics,* edited by Edwin G. Dolan, which contains contributions by half a dozen writers [1976, 238 pages, out of print]. The other is *New Directions in Austrian Economics,* edited by Louis M. Spadaro (1978), 239 pages, with contributions by eleven writers [out of print].

Most of these foregoing books have already been mentioned in the text. The reader may also profitably consult others mentioned there, especially the volumes by Kirzner and Lachmann. □

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IDEAS ON LIBERTY
NOVEMBER 2003

Rent-Seeking: A Primer

by Sanford Ikeda

Readers of *Ideas on Liberty* often come across references to the term "rent-seeking." Usually from the context it's plain that it refers to something undesirable, but what exactly is it?

The idea of *rent* is an old one in economics. In mainstream economics it refers to a payment to the owner of a fixed factor of production over and above its "opportunity cost," that is, what it could fetch in its next most profitable use. In the case of land, for example, any payment to the owner of a particular parcel beyond the cost of, say, clearing and leveling it or for its "permanent and indestructible qualities" was traditionally considered rent.[1]

There are those, including nineteenth-century social critic Henry George, who believe that such payments are wasteful because (1) they could have been spent to bring other goods into existence, such as houses or food, instead of being used merely to transfer ownership of an already existing commodity from one person to another, and (2) they do nothing to increase the supply of the fixed factor. Does this mean that the pursuit of rent is a bad thing because it's wasteful? No, not in this case.

Let's examine the first argument. A pure rental payment for a fixed factor such as land, whether it's paid in increments over time or all at once in a lump sum, doesn't merely move a product around from one person to another. (In fact, land doesn't even do that because it isn't movable, except near places like the San Andreas fault, where occasionally it is.) But what rent does help to do is encourage the transfer of land ownership from a less-profitable use to a more-profitable use—from, say, a housing development to agriculture, if growing crops will fetch a higher profit than building houses on the land. In this way, the transfer, and thus the rental payment, is part of a process that increases *wealth*.

Here it's important to realize that *production* in economics has nothing necessarily to do with the physical transformation or movement of things, but rather with the *creation of value*, which is subjective in nature. For instance, if John and Mary, without either one using force or fraud, trade ownership of an apple and an orange, both necessarily expect to feel subjectively better off as a result (or else at least one of them wouldn't agree to the trade) because each will be giving up something he or she values less for something he or she values more. The net gain in subjective value that each one feels constitutes newly created wealth. In developed societies this is how most wealth is produced, by free trade.

Likewise, the consumers of food generate for the landowner a greater excess of revenue over cost than do potential consumers of the houses that could have been built on

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the land. Rent is a fixed payment to the owner for using the land in a more valuable way, in terms of willingness to pay.

How does anyone know which use is most valuable in this sense? No one can know for certain, but the entrepreneur-owner of the land has a strong incentive to decide correctly who should have the ultimate use of it, consumers of food or of housing, because he stands to earn a profit for making the right choice and suffer a loss for the wrong choice. *Resources that entrepreneurs spend in seeking rent, insofar as they improve their chances of making wealth-increasing decisions, are not wasteful.*

The second argument against rent is that rents don't increase the supply of land. However, economists think dynamically (or at least they should), and that means taking into account what happens over time as the unknowable future becomes the partially known present. From this perspective it's possible to view the rent that a particular tract earns for its owner as something that could very well induce other profit-seeking entrepreneurs to invest in the clearing or filling in of more land when working space becomes scarce enough. That is, *rent can serve as an incentive to produce more space in which further valuable work can take place.*

So, from the point of view either of efficiently allocating existing working space or of creating new working space, rent aids in the creation of wealth.

Rent-Seeking Defined

Where then does the bad connotation of rent-seeking come from?

Gordon Tullock, one of the pioneers in the theory of rent-seeking, has defined it as "the use of resources for the purpose of obtaining rents for people where the rents themselves come from some activity that has some negative social value."[2]

We've seen how rents generated in the free market have a positive "social value," insofar as we can agree that creating wealth is a good thing.[3] Thus no negative connotation would attach to free-market rent-seeking, that is, spending resources to acquire land rent or any other privately acquired rent. Tullock is referring to those activities that destroy wealth. Nevertheless, people sometimes feel uncomfortable with the free market because they're unable to differentiate profit-seeking from (bad) rent-seeking.

According to the principle of human action that Ludwig von Mises used as the starting point of economics, *man acts in order to improve his situation as he sees it.* One of the important lessons taught by Mises, and later many of the adherents of the Public Choice school of political economy, who follow in the footsteps of Tullock and James Buchanan, is that while the principle of human action is universal, the particular actions chosen, and the consequences that follow from them, depend crucially on the "rules of the game."

If the rules say that the acceptable way to improve your situation is to provide a product or service that consumers would be willing to pay more for than the opportunity cost of the resources used, then that's what you'll tend to do. In that case, if you're correct, and if you can out-compete your rivals in the market for those consumers' dollars, then your actions will have added wealth to society. This is profit-seeking.

On the other hand, if the rules say that it's okay to use *political means*—the government's authority to initiate violent aggression and fraud—to contrive rents by preventing others from competing with you or by forcibly taking the wealth of others, people will naturally tend to spend valuable resources trying to gain access to them. This is rent-seeking.

But unlike profit-seeking, rent-seeking doesn't create wealth, it merely transfers it from one party to another. Whoever wins rents by using political means may be better off, but others, potential competitors, but more importantly consumers, will be made decidedly worse off. The latter will pay higher prices, get poorer quality, or have fewer choices because political means are quite effective in discouraging rival entrepreneurs. The results of rent-seeking also stifle the competitive discovery process, so that consumers are less likely to become aware of more efficient methods or better providers.[4]

Thus the resources that competitive rent-seekers spend in their quest for these politically created rents are indeed wasted because they are used to produce an outcome in which nothing of value is created. Indeed, rent-seeking of this kind destroys wealth.

Rent-Seeking Versus the Rule of Law

So far we've seen that rent-seeking is undesirable because it's wasteful. In addition, however, because it usually takes the form of restrictions on competition or on the use of property rights, the desire to gain rents through political power distorts the operation of the market process. Such distortions, especially as they impinge on interest rates and the prices of goods and services, make it harder for consumers and producers to plan for the uncertain future, increasing their chances of error.

But an even more serious problem at the level of social norms is that rent-seeking tends over time to encourage growing numbers of ordinary people to engage in it, trying to acquire political power either to gain advantages over the less powerful or as redress against the mounting advantages and political power of others. It thereby sets into motion a troubling dynamic that over time progressively erodes respect for the rule of law, limited government, and private property.

The rule of law binds the government by rules that are fixed and announced beforehand, and are not intended to benefit or harm any particular persons or groups. For example, a rule that forbids anyone from engaging in fraudulent advertising is in accord with the rule of law, whereas a rule granting a monopoly privilege to a particular firm or union is not. Like private property, the rule of law serves to protect individuals against arbitrary government interventions, and as such it's one of the pillars of personal liberty, limited government, and the free market.

Rules of the game that beget rent-seeking are clear violations of the rule of law because they arbitrarily privilege some at the expense of others. This in turn gives people an incentive to spend resources either to associate themselves with the winners or distance themselves from the losers. The desire to capture politically generated rents is a fundamental motive for interventionist breaches of the rule of law. At the same time, rent-seeking tends to prevail to the extent that citizens permit government to violate the rule of law. A politico-economic system that strictly observes the rule of law would perforce ban rent-seeking.

The difference between profit-seeking and rent-seeking is akin to that between peaceful trade and armed robbery. Both require time, energy, and skill, but one creates wealth while the other destroys it; one encourages peaceful cooperation, the other undermines it. □

1. Ludwig von Mises and Murray Rothbard defined rent differently, as simply the payment for the services of any durable commodity. Since this primer is concerned with explaining the meaning not of rent itself but of rent-seeking, which is based on mainstream-economics concepts, it would not be appropriate to address these differences here. On this see Ludwig von Mises, *Human Action*, 4th rev. ed. (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996 [1949]), pp. 635–37, and Murray N. Rothbard, *Man, Economy, and State* (Los Angeles: Nash, 1970 [1962]), p. 249.

2. Gordon Tullock, Gordon Brady, and Arthur Seldon, *Government Failure* (Washington, D.C.: Cato Institute, 2002), p. 43.

3. Tullock uses the term "social" value, but he is simply referring to the new wealth that each individual experiences, viewed as a whole. If economists try to suggest anything more than this by the term, they're probably making a big mistake.

4. Any attempt to compete with those protected by such privilege is a challenge to the power of the state. As a matter of fact, because political rent-seekers rely on the government's authority to initiate aggression and fraud their gains essentially come from robbery at gunpoint.

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Canute's Courtiers Were Wrong

Shortly after the northeast blackout a *New York Times* headline blared: "Under Deregulation, Montana Power Price Soars." The story explained that "Montana residents used to pay some of the lowest rates for power in the Northwest, but now, some lawmakers lament, they pay among the region's highest. What happened? Mainly deregulation."

The story went on: "Montana Power executives argued six years ago that state residents would benefit from paying competitive rates for electricity and natural gas. As market rates have gone up, though, the residents have had to bear the cost, critics of deregulation say."

Although the article acknowledged that "So far Montana has not experienced the kind of supply problems that plagued California in recent years," the strong impression was left that rising prices are a grave indictment of deregulation.

The historic blackout again demonstrated that the word "deregulation" is subject to as many interpretations as a Rorschach inkblot. California is said to have embraced deregulation, but this is true only if the word means something other than the removal of regulation. In Montana, legislation was passed in 1997 to allow a choice of retail electricity providers. Retail prices were frozen for two years, and electricity co-ops, which serve half the state's homes, were allowed to opt out of the new arrangement. All but two did so. When the price freeze expired, prices rose, which has upset customers. An organization of single mothers even sued the state in federal court, claiming the legislation is unconstitutional because, the *Missoulian* reported, it "caused or will cause huge power rate increases that deprive the women of the basic necessities of life." (A district court judge dismissed the suit.)

Rather than dwell here on the misleading use of the word "deregulation," let us focus on the proposition that rising retail prices per se indicate that that something is amiss. This belief rests on a usually unspoken, but nevertheless consequential premise that prices ultimately are arbitrary and can be controlled by government with impunity.

This in turn is part of a deeper fallacy: the proposition that economic laws do not exist and that the belief that they do is a superstition limiting man's collective power to arrange his social life. It's an old misconception, a throwback to pre-economics. As Ludwig von Mises wrote in *Epistemological Problems of Economics,*

> When men realized that the phenomena of the market conform to laws, they began to develop catallactics and the theory of exchange, which constitutes the heart of economics. . . . The development of economics . . . did more to transform human thinking than any other scientific theory before or since. Up to that time it had been believed that no bounds other than those drawn by the laws of nature circumscribed the path of acting man.

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> It was not known that there is still something more that sets a limit to political power beyond which it cannot go. Now it was learned that in the social realm too *there is something operative which power and force are unable to alter* and to which they must adjust themselves if they hope to achieve success, in precisely the same way as they must take into account the laws of nature. [Emphasis added.][1]

Thus economics—the identification of the regularities that constitute the market process—stood in the way of the sheer will of the ruler. He could command, but if he contravened the laws of economics he could not bring about the results he wished. "Thus," Israel Kirzner wrote, "the idea that there exist in society 'laws' which operate regardless of the will of the rulers was a genuinely revolutionary idea."[2] And, Mises added, "Whoever wished to combat liberal economic policy was compelled to challenge the character of economics as a science. Enemies arose against it for political reasons."[3]

"A Prodigiously Ingenious Mechanism"

The German Historical School of the late nineteenth century was one of those opponents of liberalism that rejected economics. It held that only specific historical episodes could be described, and that no universal laws regarding human action existed. Carl Menger, founder of the Austrian school, defended economics against the historicists. Mises did the most to systematize the "science of human action" (which he called "praxeology") and to free it from its earlier tentative empirical mooring. But one can find hints of the Misesian approach in the writings of Frédéric Bastiat and others. Bastiat saw spontaneous regularity all around. "We should be shutting our eyes to the facts if we refused to recognize that society cannot present such complicated combinations in which civil and criminal law play so little part without being subject to a prodigiously ingenious mechanism. This mechanism is the object of study of political economy."[4]

What does this theorizing mean? It means that regardless of motives, if the government puts a ceiling on prices, there will be unsatisfied demand—shortages (other things being equal). If the government puts a floor under prices, there will be unsold goods—surpluses (again, other things equal). If a minimum wage is legislated, there will be surplus labor—unemployment. It's the law.

The story of the control of electricity prices is classic. For the last few decades, the demand for electricity has been rising. Think about how many new uses people have for electricity: computers, modems, VCRs, DVD players, cordless telephones, video-games, and more. But while this demand was rising, regulators often thwarted the industry's ability to meet that demand with greater supply. Meanwhile, retail prices were strictly controlled by the authorities.

Prices are signals. They communicate vital information about the state of resources, goods, and services. Changes in those signals indicate changes in prevailing conditions—and stimulate remedial action: conservation by consumers and new supplies and alternative products from entrepreneurs. The idea that anything good can come from distorting or squelching those signals is astounding in its lack of wisdom. It's equivalent to believing that a person with a fever can be helped by placing his thermometer in ice water. Yet that is the policy that has often been followed with electricity (and so many other things).

The would-be regulators may not want to hear it, but King Canute the Great's courtiers were wrong. He couldn't really "command the tides of the sea to go back." □

1. Ludwig von Mises, *Epistemological Problems of Economics* (New York: New York University Press, 1976 [1960]), p. 3.
2. Israel M. Kirzner, *Ludwig von Mises* (Wilmington, Del.: ISI Books, 2001), p. 72.
3. Mises, p. 4.
4. Frédéric Bastiat, *Economic Harmonies* (Irvington-on-Hudson, N.Y.: Foundation for Economic Education, 1996 [1870]), p. 5.

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Grutter v. Bollinger: A Constitutional Embarrassment

by George C. Leef

"All animals are created equal—but some are more equal than others." So goes the crucial line in George Orwell's classic *Animal Farm*. The Supreme Court's recent decision in *Grutter v. Bollinger* makes one think of that line, since it gives constitutional approval to the policies used at many colleges and universities that group applicants by race and treat certain groups as "more equal than others." Racial preferences can't be used too overtly, the Court said, but they are acceptable, and if one takes the rhetoric of the decision seriously, it would seem that the nation would be in a terrible state if colleges and universities didn't use them.

Grutter has been wildly cheered by most of the higher education community and social interventionists generally. By "social interventionists," I refer to those who believe that virtually every aspect of society can be improved by the application of their wisdom, whether it's the housing market, health care, preparation for retirement, or anything else. Social interventionists are never content to leave processes alone if they can take over and direct them. When it comes to universities, student admissions can't just be left up to a simple rule like "admit the academically best students possible." Instead, social interventionists delight in trying to engineer a student body that is "diverse" and have convinced themselves that doing so is both noble and immensely beneficial.

The Problem of Government Education

I would not care in the least if any private college or university wanted to use racial preferences to assemble a student body that it regarded as having the ideal mix of people. They should be free to discriminate on the basis of race—or religion, musical tastes, family background, political views, acceptance of vegetarianism, or anything else—if they want to. The trouble occurs when government-funded institutions adopt such preferences. We can blissfully ignore the choices of private institutions that can neither tax nor control us. When dealing with government, however, people cannot escape its power and are entitled to expect that they will not be treated differently from others, or compelled to support institutions that do.

This is one of the vast number of controversies that would never arise if government did not undertake activities that go outside

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its proper sphere of protecting individual rights. Governments do not need to run colleges and universities. Voluntary action is quite capable of providing us with all the various educational opportunities we might desire. If the market for education were allowed to function and the government exited the field, the heated political disputes over admissions, textbooks, curriculum, and so on, would cease. The discrimination-in-admissions battle is just one more reason why the entire government education empire should be privatized.

As long as we have government-run universities, however, we should hold them to the law. The Fourteenth Amendment forbids the states from denying any citizen the equal protection of the laws. Enacted just after the Civil War in an attempt to head off a regime of official discrimination against former slaves and free blacks, the Fourteenth Amendment has come to mean generally that government may not treat some citizens better or worse than others based on irrelevant characteristics, such as ancestry. When a government college or university adopts a policy that establishes different admission criteria for applicants depending on what their race is (or is *claimed* to be—people learn to game the system by saying that their lineage to a distant ancestor puts them in a favored group), it is certainly not treating all people as legal equals.

"Diversity Is Educationally Beneficial"

So how did the Supreme Court evade the equal-protection clause to arrive at the conclusion that racial discrimination in university admissions is permissible, provided that it's done in an "individualized" manner? (In the companion case, *Gratz v. Bollinger*, the Court held that the University of Michigan's undergraduate admissions policy was impermissible because it automatically gave black, Hispanic, and American Indian applicants 20 points toward the 150 needed. That was too much favoritism. So the meaning of the two cases is that racial preferences are all right, but don't be so blatant as to use a point system.)

Justice Sandra O'Connor's opinion wheeled out one of the most frightful concepts in constitutional jurisprudence—compelling state interest. When government wants to do something that the Constitution forbids, it argues that there is a "compelling state interest" that the Court should recognize, and that it's permissible for government to violate the Constitution because of that interest. Sometimes the Court "interprets" the Constitution to get around unwanted limitations on the power of government, and sometimes it finds that a "compelling state interest" overrides them. The result is the same. Our rights and liberties erode.

In this case, the compelling state interest is the "education benefits" that are supposed to come from having a "diverse" student body. That conclusion, backed up by nothing more than some dubious research and the testimony of university officials who want to be able to discriminate, is the linchpin of the Court's opinion.

The last time the Supreme Court dealt with the issue of racial preferences in admissions was the *Bakke* case in 1978. There, a badly divided Court wound up holding that states could not use racial quotas, but that race might be considered as a "plus factor" in individual instances. A line in Justice Lewis Powell's opinion that preference advocates were quick to seize on was that universities might have an educational interest in having a racially diverse student body. That soon became the new justification for racial preferences. They weren't being used to remedy past discrimination (as the older "affirmative action" argument went), but were being used to obtain the benefits of diversity.

But was there anything to Justice Powell's speculation? To make the "diversity is educationally beneficial" argument work when it was sued by several white applicants who had been rejected despite having significantly stronger academic records than the minority students who were accepted, the University of Michigan needed some evidence. It had one of its faculty members, Professor Patricia Gurin, conjure up a study that arrived at the desired conclusion. There *were* significant educational benefits to having a "diverse" student body, she proclaimed.

Most people would assume, on hearing that conclusion, that the study irrefutably demonstrated that students learn their chemistry, calculus, history, and so on better when the student body is "diverse." Whether that would be a "compelling state interest" is debatable, but the purported benefits were not of that sort. Rather, they were extrapolated from student surveys probing their attitudes on such things as their level of intellectual confidence, whether they have friends of different ethnicities, and whether they're "good listeners." That's all this decision rests on, a very rickety support for a constitutional holding.

The Gurin study has been subjected to withering scrutiny. For example, Professors Thomas Woods and Malcolm Sherman conclude in a paper written for the National Association of Scholars that "there is no evidence that campus racial diversity has any educationally significant effect, direct or indirect, on any of the academic and civic outcome variables that the University of Michigan has discussed."* Moreover, there is evidence pointing the other way that is at least as persuasive—that the fixation on racial quotas in education leads to divisiveness, polarization, and deviation from the university's educational mission.

Nevertheless, Justice O'Connor accepted Michigan's feeble argument whole. Then she magnified those dubious "educational benefits" molehills into a Himalaya Range of social improvement, saying that universities need to be able to racially engineer their student bodies so we can have "cross-racial understanding" and to "cultivate a set of leaders with legitimacy in the eyes of the citizenry."

This is a non sequitur of breathtaking proportions. Are we really to believe that so much hangs on the ability of universities to reject some white and Asian students with stronger academic profiles in order to get more students from racially preferred backgrounds? If schools couldn't or didn't practice such discrimination, would "cross-racial understanding" become unattainable? Would it be impossible to find "leaders with legitimacy"?

How Much "Diversity" Do We Need?

If the reason for believing that educational benefits follow from student-body diversity is weak, the reason for believing that those benefits depend on reaching some particular number of minority students is nonexistent. Suppose that Michigan admitted students solely on the basis of academics. There would still be some racial diversity—and plenty of diversity of other kinds. Students would still interact with a diverse faculty and live in a diverse world. To defend its desire to reach a certain level of "minority representation," the university used what amounted to a quota system. But why not just accept whatever degree of racial diversity would come from admitting the most qualified students?

The university answered there had to be a "critical mass" of minority students so that they wouldn't feel "isolated." For that proposition no evidence exists. Do we know that, for example, black students won't speak up in class unless it contains a certain number of other black students? No. The very idea is both insulting and risible. We aren't talking about first-graders here. We're talking about young adults, and there is no reason whatsoever to assume that young adults from these groups have much to add to the educational environment, but won't add it unless they have several other students "like themselves" in the classroom.

Alas, the absurd "critical mass" argument found favor with a majority of the justices. It is hard to believe that this flimsy justification for discriminatory admission policies is anything other than a constitutional fig leaf, a fiction designed to hide the fact that the Court has decided that preferential policies are a good thing and universities should be allowed to use them, no matter what the Constitution says.

*Thomas E. Woods and Malcolm J. Sherman, "Is Campus Racial Diversity Correlated with Educational Benefits?" National Association of Scholars, April 4, 2001. The executive summary, with a link to the full report, is online at www.nas.org/reports/umich_diversity/umich_execsum.htm.

What is really at the core of the enthusiasm among social interventionists for racial preferences in higher education (and elsewhere) is, I believe, a peculiar feature of their way of looking at the world. That feature is what we may call groupthink, the tendency to evaluate phenomena not from the standpoint of individuals, but of groups. Groupthinkers don't much worry about whether laws and procedures treat individuals fairly. Instead, they worry whenever they see that a group which they perceive as having somehow suffered in the past is not advancing as rapidly as they think it should. Whenever that's the case, groupthinkers don their social interventionist robes and try to make things better.

Because the average incomes of blacks, Hispanics, and American Indians are below the national average, groupthinkers believe that these groups have to be helped. Enabling more of such students to get into top colleges and professional schools, they assume, must be a benefit to the group, so it's a good policy to follow. Never mind that most students who benefit from racial preferences come from fairly affluent families, and never mind that the correlation between having attended a prestige school and success in later life is quite weak. As long as minority-group representation is up at places like the University of Michigan, groupthinking interventionists are happy.

Former Harvard president Derek Bok has said that it just wouldn't do "to have an all-white university." (Chinese, Japanese, Koreans, Indians, and others may be surprised to learn that, for admissions purposes, they're "white.") That statement perfectly symbolizes the groupthink outlook. Bok frets over the group mixture of the student body, apparently believing that the rest of America does, too.

But does the composition of the student body at Harvard or Michigan or anywhere else matter to people who aren't obsessed with group identity? I think not. I strongly doubt that a Mexican landscape worker ever thinks, "American is all right because Harvard has a quota for students with Spanish-sounding surnames" or that a black auto worker ever thinks, "It's a really good thing that Michigan's law school maintains a critical mass of black students." Most of us are interested in ourselves individually, not as group members. If top colleges chose their students just on academic ability, hardly anyone would pay the slightest attention—except, of course, groupthinkers.

Interventionists are good at convincing themselves that their meddling is terribly important. Despite mountains of evidence that programs such as rent control, Social Security, and "public education" are harmful, one almost never hears them say, "That was a bad idea; we should have just left well enough alone." In this case, interventionists are just *certain* that their well-intentioned racial blending on campus is essential for a host of wonderful outcomes. But their protestations that the use of racial preferences is necessary are no more convincing than are interventionist statements on the need to allow them to do other things their way—the "need" for a national health-care system, for example. They habitually exaggerate the benefits of their policies and ignore the costs.

Sir Henry S. Maine observed in his book *Ancient Law* that "the movement of the progressive societies has hitherto been a movement from status to contract." That is, progress required the abandonment of social organization in which a person's rights depended on his class, and adoption of the idea that everyone should be equally free to negotiate for whatever he wants in life. Maine was right. By giving its blessing to government use of racial preferences in education, the Supreme Court has taken a step backward, a reversion toward the time when the law said, "Tell me who you are, and then I'll let you know how you will be treated." That's bad enough, but we also have to worry that *Grutter* will spawn more government action in the future, based on the assessment that the Court may call any foolish interventionist notion a "compelling state interest" if backed up by some dubious "research" and fervent wishful thinking.

All in all, a bad day's work at the Supreme Court. □

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Global Warming: Extreme Weather or Extreme Prejudice?

by Christopher Lingle

Extreme weather is making headlines. Record summer temperatures in Europe and a large number of heat-related deaths in India joined news about severe flooding in Bangladesh, China, and Sri Lanka. And an unusual number of tornados in the United States have been reported.

For its part the UN World Meteorological Organization (WMO) suggests that global warming is linked to these events. It also declared that extremes in weather and climate are setting new records and the number of such extreme events has been rising. (The Bush administration plans to spend $103 million to study global climate change.)

But these reports raise many questions. As the director of the WMO admitted, the results reflect the fact that monitoring and communication of weather conditions are better than ever before. It turns out that the only certainty is that reporting of extremes is more common, even if the extremes are not.

As it is, little attention is paid to the fact that some of the vulnerability to extreme weather arises from changing human population patterns. Over the years, foreign aid and emergency disaster relief encouraged the building of slums or suburban housing in flood plains. Similarly, air conditioning allows more people to live comfortably in areas subject to hurricanes and cyclones.

In its report, the WMO notes that global averages for land and sea surface temperatures in May are the second highest since records began in 1880. However, temperatures in the upper atmosphere were not reported. This is no slight oversight. For global warming to be truly global, atmospheric temperatures would also have to be rising. But there is no evidence that air temperatures have risen to match the reports of rising ground temperatures.

Consider the fact that surface temperatures have been increasingly recorded in urban areas or airports that have much more concrete and asphalt than they had even a few decades back. All other things constant, it would be surprising if temperatures taken in such "hot spots" did not increase.

Such alternative explanations tend to be ignored. And so it has become an article of faith that burning fossil fuels increases greenhouse gases (GHG) that lock in heat and cause global warming.

Contrary to conventional wisdom, scientific understanding of climate change remains quite unsettled. In particular, it is not clear that observed global warming

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trends are significant or relevant to the long-term survival of life on earth. Nor is it clear that attempts to reduce greenhouse gases will offset other factors that influence climate. Indeed, there is a strong correlation between sunspot activity and temperature variations.

In all events, GHGs are not the only possible source of warming trends and not necessarily the most important. Weather and climate patterns depend on influences from oceans and other water systems, the variability of solar radiation, volcanic aerosols, and greenhouse gas emissions, as well as clouds and water vapor, just to name a few.

The UN Intergovernmental Panel on Climate Change (IPCC) considers at least 12 conditions that could change climate. Of these, only greenhouse gases have come under the close scrutiny of the scientific community. Uncertainty over the influence of the other conditions means that they could worsen the warming trend or reduce it or cancel it out completely.

A report released by the United Nations identified a two-mile-thick "Asian Brown Cloud" that is blamed partly on greenhouse gases. However, an examination of the effects of this enormous blanket of haze found that it counteracts global warming by shading land areas that it covers. So, it turns out that sometimes GHGs can induce cooling.

This is not the only beneficial property of GHGs. It is also overlooked that CO_2, one of the most infamous carbon-based GHGs, is actually plant food that is converted into oxygen.

Certain Harm, Uncertain Benefits

Meanwhile, most economic analyses indicate that mandating reductions in greenhouse gases will cause significant harm of which we can be certain, in exchange for uncertain benefits. Our incomplete understanding of the climate system raises questions over the effectiveness of local or regional responses to perceptions about global climate change.

Since global climate history reveals wide fluctuations over the earth's life, it is important to choose an appropriate time frame for reference to allow for reasonable comparisons. Most climate models used by the IPCC cover the last 1,000 years of climate variation. However, most of the data are estimates because surface temperature data have been recorded for only about 150 years. And weather balloon readings have been collected for 30 years, while satellite readings span less than 20 years.

It turns out that greenhouse politics suffers from a tendency to exaggerate. Environmental activists use worst-case scenarios that reflect their own biases to raise funds to support their causes. Politicians have a vested interest in citizens' believing in catastrophic scenarios that make it easier to levy new taxes, since guilt or uncertain risks make them more willing to surrender more of their income.

While the perceptions of the general public are influenced by these biases, rising incomes also lead to increased demand for higher environmental quality. Politicians and bureaucrats have tended to respond by imposing stricter environmental regulations, with violations receiving ever wider media coverage. In turn, there has been a misperception that environmental quality is worsening when it may actually be improving or perhaps remaining unchanged.

Even if global temperatures are rising, we do not really understand why. Neither do we know if nor how soon the worst-case scenarios might occur. Even their ultimate consequences remain uncertain. □

by Robert Higgs

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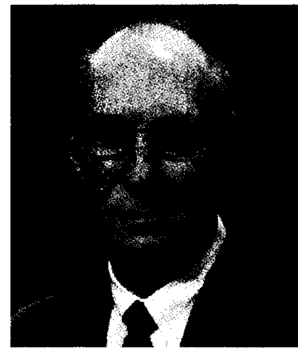
How the Federal Government Got into the Ocean-Shipping Business



Someone who maintains that the relations between government and business in the United States during the past century have been essentially fascistic could find no better example than ocean shipping. Here we observe all the requisite elements of economic fascism: government-authorized and -supervised cartels, the semblance of private property rights without the substance, and the ever-present rationale of preparation for or actual engagement in warfare.

Because many ships historically have been capable of serving both commercial and naval or military purposes, the government always has had an interest in the ocean-shipping business—between 1848 and 1858, for example, the federal government paid three shipping lines more than $11 million in subsidies[1]—but the government's actions in relation to the building and operation of merchant vessels remained ad hoc and transitory prior to World War I. After enactment of the Shipping Act of 1916, however, the government became deeply and permanently involved.

The onset of war in 1914 created an immediate severe shortage of ocean-shipping services, which only grew worse with the passage of time and the sinking, diversion, or internment of ships. Shipping rates increased enormously. Treasury Secretary William Gibbs McAdoo, a leading Progressive with no fear of government intervention, proposed as early as August 1914 that to alleviate the crisis the U.S. government should be authorized to regulate shipping rates and to operate competing vessels on its own account. President Woodrow Wilson strongly supported this plan, writing in September 1914, "The idea in the proposal is not that the government should permanently embark in these things, but that it should do the immediate and necessary thing"—a classic example of diving into quicksand.[2]

The Wilson administration's proposal met substantial opposition in Congress—Senator Elihu Root declared it to be "a measure of state socialism which, if established, will inevitably destroy individual liberty"—and both Wilson and McAdoo devoted much time and effort to gaining its approval.[3] Proponents urged that the government's merchant ships would serve also as naval auxiliaries and thus contribute to national security. In promoting the proposal McAdoo began to emphasize the national-security aspect, having learned from experience, he later wrote, that "people as a rule are far more interested in fighting, and in preparations for fighting, than they are in any constructive commercial or industrial effort."[4]

Finally, whatever had restrained Congress from projecting the government into the shipping business gave way before the combined weight of the extraordinary shipping costs, the lure of lucrative trading opportunities, and the growing national insecurity. After two years of politicking, spearheaded by Wilson, McAdoo, and their fellow Democrats in Congress, a shipping bill was

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passed, and the President signed it into law on September 7, 1916.

This law created the U.S. Shipping Board and empowered it to regulate the rates and practices of waterborne common carriers in foreign and interstate commerce and, through a subsidiary, to acquire, construct, and operate merchant vessels. The subsidiary, known as the Emergency Fleet Corporation, was created on April 16, 1917. During the war, executive orders, amendments to the act, and related legislation greatly extended the government's authority over the ocean-shipping industry. Government agencies gained the power to acquire vessels by requisition, commandeering, and seizure; to assign cargoes and routes; to regulate not only shipping and shipbuilding but also the wages, hours, and working conditions of laborers in those industries; and even to build residential housing, stores, and transport systems for them. By the autumn of 1918 "government control of merchant shipping in American service was absolute."[5]

The Emergency Fleet Corporation's shipyards had just begun to operate at a high rate when the war ended. Interested parties pressed the government to keep building, however, and it did so, in disregard of the long-term consequences, producing far more in 1919 than it had produced in 1918. Altogether, between 1917 and 1922, the government built more than 2,350 ships (hundreds of them nearly worthless wooden vessels) at a cost of more than $3 billion—approximately one-tenth of the entire financial cost of the war.[6]

Ship Sale

The government now found itself in possession of thousands of ships no longer needed for composing, in the words of a wartime slogan, "a bridge of ships" across the Atlantic. The Merchant Marine Act of 1920 authorized selling the ships to U.S. firms on easy terms and provided for subsidies to private operators. It also approved the operation of government shipping lines. The shipping business remained depressed during the interwar years, however, and the government's ventures incurred chronic losses, which the taxpayers had to cover. Many of the ships rested at anchor—rusting monuments to government ineptitude and waste.

No salvation lay just beyond the horizon, however. In 1936 a new Merchant Marine Act authorized the U.S. Maritime Commission to assume the Shipping Board's functions and set in motion another round of government subsidies, ship construction, and cartelization. When World War II began, the War Shipping Administration took complete control of all private shipping operations, while the Maritime Commission plunged into a massive ship-construction program that dwarfed its World War I antecedent, then left the government at the end of the war in possession of a gigantic fleet of unemployed and, for the most part, unemployable vessels, including thousands of poorly constructed, slow-moving Liberty ships.

Statutes enacted in 1950, 1961, and 1984 repositioned deck chairs on the government's shipping Titanic. Nowadays an independent regulatory agency called the Federal Maritime Commission oversees the cartels, while the Maritime Administration (in the Department of Transportation) channels taxpayer money into the pockets of favored parties by means of subsidies to shipbuilders and shipping lines, loan guarantees for construction and repairs in U.S. shipyards, and maintenance of the National Defense Reserve Fleet, among other boondoggles.[7] □

1. Burton W. Folsom, Jr., *Entrepreneurs vs. The State* (Reston, Va.: Young America's Foundation, 1987), p. 14.
2. Wilson to O. G. Villard, September 4, 1914, quoted in Richard Sicotte, "Economic Crisis and Political Response: The Political Economy of the Shipping Act of 1916," *Journal of Economic History*, December 1999, p. 871.
3. Root to C. W. Wilson, February 4, 1915, quoted in ibid., p. 862.
4. William Gibbs McAdoo, *Crowded Years* (Boston: Houghton Mifflin, 1931), pp. 311–12.
5. Edmund E. Day, "The American Merchant Fleet: A War Achievement, A Peace Problem," *Quarterly Journal of Economics*, August 1920, p. 591.
6. Ibid., pp. 592–93; U.S. Shipping Board reports cited by Sicotte, p. 861.
7. See "Maritime Administration" and "Maritime Commission, Federal," in *A Historical Guide to the U.S. Government*, ed. George Thomas Kurian (New York: Oxford University Press, 1998), pp. 379–83.

IDEAS
ON LIBERTY
NOVEMBER 2003

The Fallacies of Distributism

by Thomas E. Woods, Jr.

In certain disaffected pockets of the political left and right, more and more voices can be heard on behalf of an economic and social system known as distributism. According to the celebrated Catholic writers G. K. Chesterton and Hilaire Belloc, who popularized the idea in the early twentieth century, that social system is best in which "productive property" is widely dispersed rather than concentrated. They contend that the market order undermines community life and introduces an intolerable level of insecurity and anxiety into the economic life of the ordinary person. They would, therefore, limit business competition and implement a system of punitive taxation against firms that had attained what these writers considered excessive economic concentration.

I do not for a moment doubt the good will and pure intentions of those who support distributism, and indeed I count some of them among my friends. My own view is that if someone wishes to live in relative self-sufficiency and to retreat, to a degree, from the division of labor, that is his decision. What I wish to do here is to suggest that the purported advantages of distributism, as well as the alleged iniquities of the market, have both been greatly exaggerated.

Let us consider Belloc's fundamental claim for distributism. As he sees it, distributism brings freedom:

> A family possessed of the means of production—the simplest form of which is the possession of land and of the implements and capital for working the land—cannot be controlled by others. Of course, various producers specialize, and through exchange one with the other they become more or less interdependent, but still, each one can live "on his own": each one can stand out, if necessary, from pressure exercised against him by another. He can say: "If you will not take my surplus as against your surplus I shall be the poorer; but at least I can live."[1]

For Belloc, then, the great advantage of distributism is that it gives the household a significant measure of independence. A new introduction to his *Essay on the Restoration of Property* describes his view of "economic freedom" as something that "comes from the possession of sufficient productive property, such that a man need not depend upon his employer for a wage, but has rather to depend upon himself and *his* land, craft, tools, and trade for his sustenance."[2] Belloc acknowledges in passing that of course anyone selling to others is in some way dependent on those others, thereby conceding that risk and uncertainty are unavoidable aspects of life rather than unique to a system of economic freedom. If the price and quality of his goods do not remain sufficiently competitive, he is surely bound to lose business. However, Belloc points out, the family can nevertheless live on its own, even if buyers refuse to purchase its

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surplus goods. They can live on what they themselves produce. At heart, then, Belloc's promise of security amounts to the distributist family's ability in the last resort to retreat altogether from the division of labor and live in a condition of self-sufficiency.

Yet the advantages of the division of labor are so clear that relatively few people have found Belloc's proposal attractive enough to have actually attempted to adopt it. Practically anyone in the United States today who possesses the requisite knowledge and modest capital can acquire farmland and chase after the kind of self-sufficiency Belloc advocated. Producing their own necessities and in possession of the means of production, so to speak, such a family would be utterly independent of employers or anyone else. They would probably also enjoy a standard of living so depressed and intolerable as to throw the rationality of the entire enterprise into question. This certain outcome probably accounts for why the overwhelming majority of people choose to take their chances within the division of labor, balancing the risks from which this earthly life is never entirely secure against the unparalleled wealth and comfort they can enjoy by not retreating into semi-autarky.

Even granting the distributist premise that smaller businesses have been swallowed up by larger firms, that it is always preferable for a man to operate his own business rather than to work for another is by no means obvious. It may well be that a man is better able to care for his family precisely if he does not own his own business or work the back-breaking schedule of running his own farm, partially because he is not ruined if the enterprise for which he works should have to close, and partially because he doubtless enjoys more leisure time that he can spend with his family than if he had the cares and responsibilities of his own business. Surely, therefore, we are dealing here with a matter for individual circumstances rather than crude generalization.

Deprived of Property

The way distributists portray the situation, the wage earners of today are where they are as a result of forces beyond their control; an ineluctable process of wealth concentration brought about by capitalism has deprived them of the possibility of owning "productive property" and avoiding the dependency that the wage relation implies. But the fact is, many people clearly prefer to be wage earners rather than business owners. Belloc and his followers are free to insult such people by calling them "wage slaves"—the distributists' favorite slur—but they have made an entirely rational choice. And it *is* a choice. As Fr. James Sadowsky observes,

> The fact is that in the nineteenth century, when workers had far less disposable income than their counterparts today, a remarkable number of them became capitalists. It is all too often the *unwillingness* to restrict consumption, a grasshopper attitude, that prevents workers like me from becoming capitalists. In our day we see especially among immigrants from Asia what is, for us, an amazing willingness to defer present consumption. We find these people living initially in conditions that we should judge to be absolutely impossible. Yet before we know it, they are operating successful businesses.[3]

As for the alleged insecurity with which workers must live, those who work for wages in fact enjoy a kind of security that is simply not acknowledged at all by distributists—namely, that the worker receives his pay whether or not the goods toward whose production he contributes ever sell. It may be many months or years before they make it to market at all. During all that time, instead of suffering the anxieties and uncertainties of the independent craftsman or shop owner, the worker consistently earns his wage. He need not wait until—if ever—his product is actually sold in order to reap his benefit.

While Karl Marx claimed that any differential between capitalist profit and wages paid to labor constituted "surplus value" and exploitation, the Austrian economist Eugen von Böhm-Bawerk attributed such differentials to the time factor involved: rather than having to wait, say, the full year that must ordinarily elapse before the product on which he has worked is sold, the laborer can be paid immediately. Since present goods are preferred, other things equal, to future goods, the capitalist is entitled to his profit since he compensates his workers in the present for the production of goods that will be sold only in the future. The worker, on the other hand, prefers a lesser amount in the present to the greater amount he could have received in the future had he been willing to wait that long. He is clearly benefited by the wage relation.[4]

To be sure, the worker does labor under the very real uncertainty that he may lose his job. But this is inevitable due to technological improvements, changing tastes, new methods of production, and the like. The advent of the automobile meant that carriage manufacturers would have to shift into some other line of production. The introduction of fax machines and electronic mail must have cut into the business of couriers and package delivery. The net result of these changes is greater abundance and a higher standard of living, as fewer resources are now necessary to accomplish our ends, thereby freeing up resources for the production of goods that prior to these technological advances we could not have enjoyed.

What would the distributists have us do about these benign phenomena? Shall we establish a board of economic commissars to dictate which improvements will be permitted and which not? No one has a property right in a job. Put another way, no one has a right to demand that society continue to compensate him for performing a task people no longer require, whether he is a laborer or a shop owner. An economy based on the division of labor does not tolerate such a self-centered, anti-social attitude. Instead, it encourages us to satisfy the needs of our fellows.

Life Is Always Uncertain

Moreover, it is profoundly misleading to suggest that the "uncertainty" of the modern worker is a uniquely reprehensible aspect of modern society rather than an inevitable aspect of life that has been with us since the beginning of time. Were peasants in pre-industrial France—who were, it should be recalled, among the freest, most independent peasantry in Europe—free of "hand-to-mouth uncertainty"? (Try telling that to a fourteenth-century mother who has just lost her fourth child before his first birthday, lives one bad harvest away from starvation, and resides in nearly intolerable squalor.) As late as the eighteenth century, all travelers commented on the appalling conditions of the French peasantry and the shockingly dilapidated state of rural housing. The same held true for many who sought employment in a trade. A Norman parish priest described the situation in 1774:

> Day laborers, workmen, journeymen and all those whose occupation does not provide for much more than food and clothing are the ones who make beggars. As young men they work, and when by their work they have got themselves decent clothing and something to pay their wedding costs, they marry, raise a first child, have much trouble in raising two, and if a third comes along their work is no longer enough for food, and the expense. At such a time they do not hesitate to take up the beggar's staff and take to the road.[5]

Taking up the beggar's staff and taking to the road: that is what was left to them. To say, therefore, that the free market led to the destruction of some previously existing, harmonious community life is simply to defy historical testimony. How could "community" exist when people were starving and forced to take to the road for sustenance? In what way is the alleged "independence" of farmers and craftsmen in evidence here? These appalling conditions applied at times to as much as one third of the French population—some eight million people.[6]

Nevertheless, Belloc claims that "the twin evils of Insecurity and Insufficiency" are inevitably associated with capitalism. "The main body of citizens, the Proletariat, are not sufficiently clothed, housed and fed, and even their insufficient supply is unstable. They live in a perpetual anxiety."[7] This was not even true at the height of the Industrial Revolution, let alone in the early twentieth century when Belloc was writing.[8] Practically everyone acknowledges that the free market has created a greater abundance of necessities than previous ages could have dreamed possible. Imagine what the thirteenth-century peasant, the exemplar cited by so many distributists, would have thought of a society in which life expectancy was not 35 but 75, where everyone in society enjoyed dozens of changes of clean clothes, inexpensive food, shelter with amenities like heating and air conditioning—the list could go on a long, long time. The only way one could claim that capitalism actually brought about a retrogression of the physical well-being of the poorest would be if he were entirely ignorant of the conditions of the past.

More to Life

Faced with this point, distributists frequently shift to the rhetorically effective argument that there is more to life than material possessions, and that economic relations should be such that man is enabled to enjoy and cultivate higher tastes and virtues. This is a straw man, of course, since hardly anyone arguing in favor of the market suggests that material possessions are ends in themselves or bring the highest kind of fulfillment. Furthermore, it is precisely the wealth that the market creates and the leisure it makes possible that make the enjoyment of higher things practicable in the first place. A man living at the level of bare subsistence is not likely to be able to cultivate an interest in opera, or Renaissance painting, or nineteenth-century literature.

Indeed, the objection of materialism only reveals the incoherence of the anti-market position, which began as an argument that the market systematically exploited and impoverished the laborer. When the overwhelming weight of the evidence shows this opinion to be ludicrously at odds with reality, the accusation shifts ground. With the superiority of economic freedom all but impossible to deny, and the amazing abundance which we owe to such a social order no longer a matter of serious dispute, we are now told that even to think in such terms reveals an excessive attachment to the things of this world.

The net result of all of the obstacles to prosperity inherent in distributism *must* be a far poorer society. Now Belloc and his followers are free to argue that impoverishment is a small price to pay for economic independence. But they have no right to accuse anyone of moral perversity for remaining unconvinced. Yes, there is "insecurity" in a free society, in that no one has a right to demand that his fellow men continue to pay him for performing a task they have indicated they no longer require. This is a feature of any economic system—unless we guarantee every business owner a share of the market regardless of his abilities, courtesy toward the customer, and responsiveness to the needs of society. At the same time, the "insecurity" of the free society is more than compensated for by the unique security enjoyed by members of such a society vis-à-vis members of a distributist society, in the form of fantastic, unheard-of levels of wealth, the benefits of the division of labor, and the large-scale social cooperation it makes possible. An eleventh-century serf enjoyed a great deal of job security, but few envy him his position.

Every one of the agricultural revolutions through which the Western world has passed since the ninth century has involved the introduction of new farming implements, methods, or fertilizers whose net result has been that fewer people are needed to produce the same amount of output. Naturally, these advances meant the displacement of some people, as the economy adjusted to new circumstances. Would Belloc have permitted any of these agricultural revolutions to occur? After all, they led to a great deal of what Belloc calls insecurity. But they also made possible the sheer survival of far more people, now that food could be more readily produced. The same is true of any innovation that increases the productivity of agricultural labor: it makes possible a considerable increase in population. Can this consideration be weighed against Belloc's desire for stability? We are not told.

Moreover, it is not clear what precisely is so "secure" about deliberately spurning the material benefits of the division of labor, which are not inconsiderable, in favor of the kind of self-sufficiency that Belloc describes. As Belloc and other distributists have said, the self-sufficient man, while certainly benefiting from specialization and exchange with others, can if necessary rely on himself alone for the things he needs. That is certainly true, but that would make Robinson Crusoe one of the most secure men who ever lived, since he was in no danger (until Friday came along, that is) of being lured into the temptations of the division of labor and thereby finding himself in a state of interdependence with his fellows.

The man who relinquishes so many of the benefits of the division of labor, moreover, invites a level of insecurity with which the so-called "wage slave" of capitalism need never be confronted. What does Belloc's isolated farmer do during a drought? By the time normal channels of trade are hastily reopened, it may be too late. What consolation will such a family be afforded by reassuring themselves at such a time that at least they are not "wage slaves"? Who in the present United States suffers from such fears?

Belloc would use state policy to keep large manufacturers in check. But in the marketplace a crucial check already exists against a wealthy manufacturer: he will be able to maintain his wealth only to the extent that he makes prudent investments and continues to satisfy the needs of his fellow man. This is what Ludwig von Mises meant when he said that ownership of the means of production "is not a privilege, but a social liability":

> Capitalists and landowners are compelled to employ their property for the best possible satisfaction of the consumers. If they are slow and inept in the performance of their duties, they are penalized by losses. If they do not learn the lesson and do not reform their conduct of affairs, they lose their wealth. No investment is safe forever. He who does not use his property in serving the consumers in the most efficient way is doomed to failure. There is no room left for people who would like to enjoy their fortunes in idleness and thoughtlessness. The proprietor must aim to invest his funds in such a way that principal and yield are at least not impaired.[9]

What more salutary check against arbitrariness could exist than that? The state, on the other hand, which Belloc proposes to use to establish and maintain his own system, is insulated from the consequences of arbitrariness, since it never has to pass any such market test. In fact, the worse a government agency performs, the higher its budget tends to be the following year. This is one reason so many of us are loath to entrust our well-being to such an institution.

Let us count our blessings. Thanks to industrial society, few of us live in fear of dying of the countless diseases since tamed by medical science. We enjoy sanitary conditions, personal comforts, and opportunities that the greatest kings of Europe could scarcely have imagined. Half of our children do not die by age five. People are free to consider these things trivial or unimpressive if they wish, but the judgment of mankind appears to run in the other direction. □

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1. Hilaire Belloc, *Economics for Helen* (London: J. W. Arrowsmith, 1924), p. 125.
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4. Eugen von Böhm-Bawerk, *Capital and Interest*, 3 vols., trans. George D. Huncke and Hans F. Sennholz (South Holland, Ill.: Libertarian Press, 1959), vol. 1, p. 269; see also Hans-Hermann Hoppe, *The Economics and Ethics of Private Property* (Boston: Kluwer Academic Publishers, 1993), pp. 96–97.
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8. Thomas E. Woods, Jr., "A Myth Shattered: Mises, Hayek, and the Industrial Revolution," *Ideas on Liberty*, November 2001, pp. 42–44.
9. Ludwig von Mises, *Human Action*, Scholar's Edition (Auburn, Ala: Ludwig von Mises Institute, 1998 [1949]), p. 308. I owe this reference to Professor Jeffrey Herbener.

BOOKS

Adam Smith's Marketplace of Life

by James R. Otteson

Cambridge University Press • 2002 • 338 pages • $70.00 hardcover; $26.00 paperback

Reviewed by Robert Batemarco

One of the puzzles confronting students of the history of economic thought is the apparent inconsistency of the two masterworks of Adam Smith: *The Theory of Moral Sentiments* and *An Inquiry into the Nature and Causes of the Wealth of Nations*. In the former, Smith gives an account of how benevolence plays a central role in shaping individuals' moral sensibilities, while in the latter he contends that economic prosperity can prevail with nary a trace of benevolence.

James Otteson, associate professor of philosophy at the University of Alabama, did not find conventional explanations of this disparity satisfactory. Where most students of this issue tried to explain why *The Wealth of Nations* differed from *The Theory of Moral Sentiments,* Otteson looked for what in the latter was the same as in the former. In *Adam Smith's Marketplace of Life*, his willingness to think outside the box led him to identify the common framework that integrates both these works in their parallel adjustment processes.

In the economic order, most readers of *Ideas on Liberty* are more than familiar with Smith's notion that prices are guides to mutually beneficial exchanges and desirable allocations of resources. His vision of automatic adjustment is central to modern economics. In the moral realm, he used a parallel construction to explain people's moral judgments.

Otteson sees Smith starting from the premise that people have an innate desire for their sentiments to correspond with those of others, which he calls "mutual sympathy of sentiments." To accomplish this, people must judge their own actions the way a fair-minded observer with no vested interest in the outcome of those actions would. This is Smith's imaginary "impartial spectator." Following the dictates of this "impartial spectator" is a kind of adjustment mechanism driving us toward a moral consensus in much the same way that following the price system permits markets to clear—the better known "Invisible Hand."

Smith sees this "impartial spectator" as able to permit us to strike a balance between benevolence and self-interest against a backdrop of justice. Whereas justice is the prerequisite for any kind of ordered society and is thus always commanded by the impartial spectator, benevolence, which goes beyond justice, is only called for contingently. As Otteson puts it, "Smith argued that the impartial spectator approves of an ascending degree of benevolence towards others in direct relation to our knowledge of and familiarity with them." According to this "familiarity principle," behavior consistent with the letter of the law that would be quite proper in dealing with strangers would be scandalous if applied to family and friends.

Since we conduct most of our economic transactions with strangers or near-strangers, the premises set forth in *The Theory of Moral Sentiments* lead directly to the conclusion that self-interest properly trumps benevolence in the economic realm depicted in *The Wealth of Nations*. Thus the two books, rather than contradicting each other, share a common core. Otteson's original contribution is to have identified that core and how Smith saw it playing out in the moral realm.

In making this contribution, he displays virtuoso scholarship. Otteson assiduously examines the points of view of others who have studied this issue without ever letting the reader lose sight of his own argument. Moreover, for nearly every question this thought-provoking work raised in the mind of this reader, the author provided a satisfying answer within a couple of pages. To top it off, Otteson spells out what makes his inquiry more than a mere exploration of arcane issues—namely, that it gives us compelling "reasons to spread human freedom as widely as possible."

Not only will Smith scholars find much food for thought in these pages, but the newcomer to the works of Adam Smith will not leave the table intellectually undernourished. The author lets his arguments build systematically, almost in the manner of a programmed text, and provides recaps of his main points that leave no room for confusion. If Professor Otteson teaches the way he writes, his students at the University of Alabama are getting more than their money's worth.

One big question this work does not fully answer is how reliable Smith's impartial spectator is at yielding an ethic consistent with liberty. In an age where most people have been brainwashed into believing the opportunity to feed at the government trough is a God-given right, it is doubtful that everyman's impartial spectator would today recoil from participation in the plunder disguised by a veneer of legality, as so many would have 150 years ago. So while Otteson has solved one interesting problem, an even more important one awaits a solution. ☐

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The Great Tax Wars: Lincoln to Wilson—The Fierce Battles over Money and Power that Transformed the Nation

by Steven R. Weisman

Simon & Schuster • 2002 • 419 pages • $27.00

Reviewed by Burton W. Folsom, Jr.

The Great Tax Wars describes the 60-year battle (from Presidents Lincoln to Wilson) that led to the permanent federal income tax. As important as the income tax is to explaining the rise of big government in the twentieth century, we have regrettably few books on why and how the income tax came into existence. Weisman's book, therefore, is welcome even though the author's analysis is often unsatisfying.

On the positive side, his account is informative and he sprinkles his narrative with interesting biographical sketches of key figures in the tax debate. If you're interested in the historical battle over the constitutionality and desirability of the federal income tax, Weisman's book covers it well. On the negative side, though, he is blinded by statist presuppositions on the role of government and never seriously questions the conventional liberal/progressive view of American history.

At least he announces his biases at the beginning. "The income tax is . . . a kind of leveler," Weisman writes. "[I]t softened the edges of the distribution of wealth in the interest of justice and fairness—and among progressives, in the interest of maintaining a certain level of social stability." The income tax, in Weisman's view, is "desperately needed to underscore the idea of social justice in the distribution of rewards and sacrifice in our society." With this framework, Weisman depicts those who favored an income tax, especially a progressive tax, as heroic and courageous; their opponents are labeled "ultraconservative" defenders of entrenched, selfish, and wealthy interests. It evidently never occurs to him that lusting after the income of individuals in order to lavish it on politically driven programs might be the quintessence of greed.

Weisman's narrow view of tax history leads to three problems. The first is imprecise definitions. He talks constantly of the need for a "fair" income tax that targets those with the ability to pay. But as an advocate of a progressive tax, he never can say with any precision what a "fair" top rate would be—7 percent (the 1913 rate), 77 percent (the 1918 rate), or 100 percent (President Roosevelt's advocated rate in 1942 on all income over $25,000).

Weisman's second problem is that he is so anxious to show a need for an income tax after the Civil War that he misses the dangers to liberty that existed when the tax was in place during the war. Weisman expresses no alarm that George Boutwell, the first commissioner of the IRS, concealed revenue, thus creating a shortfall that undermined President Grant's case that the income tax was no longer needed. The power to tax, as the Supreme Court insisted long before the income tax, is the power to destroy: It was only another step to Franklin Roosevelt and his use of the IRS to investigate political opponents such as Huey Long and William Randolph Hearst. The dark side of the tax bureaucracy had manifested itself long before the Sixteenth Amendment was enacted, but Weisman turns a blind eye to it.

The third problem with the book is that Weisman never views taxation as dynamic—that is, lower tax rates can yield larger revenues. He stops his story at 1920, when the top rate was over 70 percent. What that misses is the Mellon tax cuts, which during the 1920s slashed all rates by about two-thirds and resulted in sharply increased revenue from the income tax—entrepreneurs, under the lower rates, were encouraged to invent products, from radios to air conditioners.

Finally, Weisman, who is a journalist with the *New York Times,* makes a variety of historical errors. The top tax rate after the revenue act of 1932 was 63 percent, not 55 percent; the top rate after Roosevelt's tax bill of 1935 was jacked up to 79 percent, not 75 percent. Also, Albert Fall was U.S. Senator from New Mexico, not Nebraska, as Weisman insists.

The Great Tax Wars has some useful information on the history of a neglected subject, but readers must separate its history from its statist philosophizing. A recent and better book on the subject is W. Elliot Brownlee's *Federal Taxation in America.* □

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Pieces of Eight

by Edwin Vieira, Jr.

Sheridan Books • 2002 • 1,666 pages (two vols.) • $49.95

Reviewed by George C. Leef

Take out your wallet and examine the rectangular pieces of greenish paper in it. You'll probably first think "money," then "dollars." Looking closely, you see the words "Federal Reserve Note" and "legal tender." You have perfect confidence that you can exchange the pieces of paper for valuable goods and services. Whether those paper bills have any constitutional validity certainly does not cross your mind. The government prints the stuff, so it must be legit, right?

If, however, you have read Edwin Vieira's monumental work on our monetary system, you would look quite differently on the money in your wallet. With remarkable breadth and depth of scholarship, lawyer and constitutional expert Vieira has given us a treatise on, as the subtitle of this two-volume work says, "The monetary powers and disabilities of the United States Constitution." First published in 1983, this is a second, expanded edition, beautifully printed and bound. The author has woven together constitutional provisions, statutes, court decisions, and his own sharp legal analysis into an encyclopedic work on our monetary system that should be the starting point for anyone with an interest in the chasm between the system we now have and that which the Constitution ordained.

What is the Constitution's definition of a "dollar?" For Vieira, that is the essential first question. The answer, under Article I, Section 9, Clause 1, is that it is a coin containing 371.25 grains of fine silver. How odd that seems. But that was the weight of the most widely circulated coin in the colonies and early United States. The coin was the Spanish milled dollar, commonly known as a "Piece of Eight"—hence the title of the work. Vieira writes that silver coins of 371.25 grains are the lawful foundation of our monetary system, "not any gold coin or base-metallic coin, let alone any paper currency, be it the first legal-tender United States notes (the "Greenbacks"), the later National Bank Notes, or today's Federal Reserve Notes. And, the Constitution never having been amended in this particular since 1788, that meaning remains legally controlling today."

Or at least it should be. What Vieira subsequently shows is that the Constitution's monetary strictures (like its strictures in so many other areas) have been evaded and destroyed by politicians and that the Supreme Court has chosen to turn a blind eye to the monetary shenanigans of Congress. The surprising conclusion of *Pieces of Eight* is that there is *no legal authority* for our present system of irredeemable fiat currency. Vieira maintains that "To introduce the FRN (federal reserve note) as a new paper currency in 1913, the government had to tie it by a right of redemption to the circulating money of that day, gold coin. And then, to transmogrify the FRN into a currency fit for limitless inflation, the government had to cut that tie to gold (and silver as well). . . . If the FRNs were not 'dollars' when they explicitly promised to pay in gold, they did not magically become 'dollars' when they stopped promising to pay in anything at all, and statutorily can be redeemed in nothing better than base-metallic coin."

Inflation. There's the key. The Constitution gave the United States a monetary system under which money could be coined by the government, but not created out of thin air. Once they had been freed from the Constitution's restraints, politicians were able to spend money without the unpopular need to levy taxes. Furthermore, absent the monetary mismanagement of our central bank—the Federal Reserve—our economy would have been spared the boom-and-bust cycles that we have endured at its clumsy hands. In the court of history, those who planned and acquiesced in the destruction of the Constitution's monetary framework have much to answer for.

There is no part of this fascinating story that Vieira doesn't cover in penetrating detail. The precise meaning of the relevant constitutional provisions, the several Coinage Acts of the early 1800s, the First and Second Banks of the United States, the Supreme Court's blunder in sustaining the constitutionality of legal tender U.S. notes, the institution of the Federal Reserve, Franklin Roosevelt's gold seizure, the severing of the final ties to redeemability in gold and silver—all that and far more is covered in these volumes.

People who fancy themselves as "realists" might snicker and say, "So what? We can't go back to an antique system with people carrying around silver dollars to make their purchases." Vieira's task here is not to set forth the ways in which our monetary system could have evolved to suit modern commercial needs without destroying the constitutional base, but other scholars have done so. The problem is not that a modern economy is impossible without government monetary control, but that the politicians will fight like mad to keep the power they have taken illegitimately.

Pieces of Eight is an indispensable work for anyone who believes in upholding the Constitution. ☐

George Leef is book review editor of Ideas on Liberty.

Terrorism and Tyranny: Trampling Freedom, Justice, and Peace to Rid the World of Evil

by James Bovard

Palgrave Macmillan • 2003 • 440 pages • $26.95

Reviewed by Richard M. Ebeling

Wars have always seen a growth in state power. Under the appeal of "national security" and "wartime emergency," individual liberties have been abridged or abolished, property rights have been weakened or abrogated, accumulated wealth has been heavily taxed or confiscated, and freedom of enterprise and trade have been severely constrained or completely placed under government control and planning.

Most tragically, the young men of society have been sent into battle, often under illusions of national glory and a false sense of patriotism. Many of these young men do not return home; others return with wounds that leave them and their families ruined and scarred for life.

Court historians soon fill the pages of their books with versions of the war that present the political leaders of their country as Olympian-like gods, selfless beings who only thought and acted for "the good of the nation." Every loss of personal freedom, every abridgment of economic liberty, and every expansion of government power is rationalized away as having been necessary and indeed essential for the national interest during that time of crisis.

And when many of these freedoms are not fully restored when the wartime emergency ends, those same apologists for political power then babble on about "new times" and "changing circumstances" and a "less simple world" that cannot afford the "luxury" of human liberty to the same extent it existed in "days gone by." In the meantime, freedom has been lost and government has grown in power and control.

Before these court historians and apologists for state power can completely dominate the shelves in the bookstores, James Bovard has waded in to challenge the rationales for the most recent losses of freedom and to show the consequences. His new book, *Terrorism and Tyranny*, is like his many other exposés of government power and corruption: clear, dispassionate, factual, and heavily documented. He is the Joe Friday of political analysis: Just the facts, ma'am. And the facts will make your blood boil.

Bovard begins by summarizing the extent to which the government's own foreign-policy and security incompetence set the stage for the tragic events of September 11, 2001. To cover up their own failures and create an image of "doing something," government investigative agencies, even before the dust had cleared where the Trade Towers once stood, undertook dragnets through Arab-American communities. Hundreds of people were rounded up and held for months without charges and without access to lawyers or family members; some were physically abused. Virtually all were found to have had no contacts or connections with suspected terrorists.

The USA Patriot Act, Bovard explains, was rushed through Congress with little critical thought about the extent to which it dangerously added to government's intrusive powers. The result of this and related legislation: greater wiretapping discretion, increased asset-forfeiture authority, expanded privacy and property invasions, and reduced citizen recourse to fight these violations of freedom. And as always, Bovard makes these abstractions come alive with numerous examples of how many ordinary, innocent people have been victimized in the spider's web of these new controls.

He also offers an insightful and valuable analysis of the U. S. government's conception of "terrorism." In essence, it amounts to any attempt, by any group, for any reason, to take up arms against the existing government in any country in the world. But the problem is that in many parts of our world, governments are not democratic and are often in the hands of corrupt tyrants and violators of personal and economic liberty. Thus by the Bush Administration's definition of terrorism, all the American Founding Fathers should be considered "terrorists" since they took up arms against the "legitimate" British government.

Bovard also effectively discusses what he calls the "bastardizing of freedom." In the wake of 9/11, the U.S. government wrapped everything it did in an a version of George Orwell's "newspeak." Political control became personal freedom; government intrusiveness became security in one's person and property; violations of the writ of habeas corpus became protection of civil liberty; and trampling on constitutional restraints became preserving the American way of life.

Bovard does not deny the need for government to protect us from violent invaders, and he strongly believes that those responsible for the events of 9/11 should be brought to justice. But he is deeply concerned that in the name of securing life, liberty, and property, that same government is destroying the freedoms it is supposed to protect. What will we have gained if the "war on terrorism" costs us what made America great? □

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IDEAS ON LIBERTY
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People Before Profits

Whether it's Nation of Islam Minister Louis Farrakhan leading the Million-Man March, anti-WTO (World Trade Organization) protesters, or AIDS activists, we're frequently treated to the chant demanding "People Before Profits." Since profit demagoguery is a deceptively appealing tool used by scoundrels everywhere, let's demystify the concept of profits.

Let's first get its definition out of the way. Profits represent the residual claim earned by entrepreneurs. It's what's left after all other costs—wages, rent, interest—have been paid. The entrepreneur is generally seen as the person who takes risks, innovates, and makes decisions. It's important to recognize that profits are a cost of business just as are payments to labor, land, and capital. If wages, rent, and interest are not paid, labor, land, and capital will not be offered; similarly, if profit is not paid, entrepreneurs won't be seen either.

Roughly six cents of each dollar companies take in represent after-tax profits. By far, wages are the largest part of that dollar, representing about 60 cents. As percentages of 2002 national income, after-tax profits represented about 5 percent and wages about 71 percent. Far more important than simple statistics about the magnitude of profits is the role played by profits, namely, that of guiding resources to their highest-valued uses, determined not by some tyrant but by ordinary people's wants and desires. Let's discuss just a few examples.

Remember when Coca-Cola introduced the "new" Coke? Pepsi president Roger Enrico called it "the Edsel of the 80s," representing one of the greatest marketing debacles of the decade. Who made the Coca-Cola Company bring back the old Coke? Was it Congress, the courts, the President, or other government officials who claim to have our interests at heart? No way. It was the specter of negative profits (losses) that convinced Coca-Cola to bring back the old Coke. Thus one role of profits is to discover what consumers want. If producers make mistakes, profits work to correct them.

After the 1992 massive destruction caused by Hurricane Andrew, South Florida stores sold sheets of plywood for twice the price it had sold for prior to the storm. Escalating plywood prices brought charges of price-gouging and prosecutory threats. But look what higher prices and the potential for windfall profits did. Plywood destined to be shipped to the Midwest, West, and Northeast suddenly was rerouted to South Florida. Lumber mills increased production. Truckers and other workers worked overtime so as to increase the availability of plywood and other construction materials to Floridians. Rising plywood prices meant something else. All that plywood heading south meant plywood prices rose in other locations, thus discouraging "less valued" uses of plywood, such as home-improvement projects. After all, rebuilding and repairing destroyed

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homes is a "higher valued" use of plywood.

What caused these market participants to do what was in the social interest, namely, sacrifice or postpone alternative uses for plywood? The answer reveals perhaps the most wonderful feature of this process: rising prices and opportunities for higher profits encouraged people to do voluntarily what was in the social interest: help their fellow man recover from a disaster.

Profits also force producers to behave themselves. If producers waste inputs, their production costs will be higher. To cover their cost, they'll charge prices higher than what consumers are willing to pay. After a while the company will make unsustainable losses (negative profits) and go out of business. As a result, the company's resources will become available to someone else who'll put them to wiser use. This process is short-circuited if government offers bailouts in the forms of guaranteed loans, subsidies, or restrictions on competitive products from abroad, such as tariffs and import quotas. Government "help" enables failing companies to continue squandering resources.

If we care about people's wants, rather than beating up on profit-making organizations we should pay more attention to government-owned nonprofit organizations. Government schools are a good example. Many squander resources and produce a shoddy product, while administrators, teachers, and staff earn higher pay and perks, and customers (taxpayers) are increasingly burdened. Unlike other producers, educationists don't face the rigors of the profit discipline and hence they're not as accountable.

How about the U.S. Postal Service? They also provide shoddy and surly services, but the management and workers receive increasingly higher wages, while customers pay higher and higher prices. Again, wishes of customers can be safely ignored because there's no bottom-line discipline of profits.

Here's Williams's law: whenever the profit incentive is missing, the probability that people's wants can be safely ignored is the greatest. It's not just the post office and schools, but delivery of police services and garbage collection as well. If a poll were taken asking people what services they are most satisfied with and those they are most dissatisfied with, for-profit organizations (supermarkets, computer companies, and video stores) would dominate the first list while nonprofit organizations (schools, post office, and offices of motor-vehicle registration) would dominate the latter list. In a free economy, the pursuit of profits and serving people are one and the same. □

We have enclosed an important reader survey with this issue. Please complete the questionnaire and return it in the accompanying postpaid envelope. We are eager to hear from you!