THE FREEMAN
IDEAS ON LIBERTY
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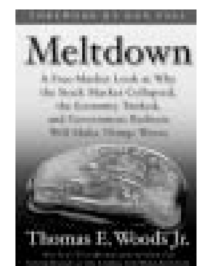

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President Lawrence W. Reed
Editor Sheldon Richman
Managing Editor Michael Nolan
Book Review Editor George C. Leef

Columnists
Charles Baird David R. Henderson
Donald J. Boudreaux Robert Higgs
Stephen Davies John Stossel
Burton W. Folsom, Jr. Thomas Szasz
Walter E. Williams

Contributing Editors
Peter J. Boettke Dwight R. Lee
James Bovard Wendy McElroy
Thomas J. DiLorenzo Tibor Machan
Joseph S. Fulda Andrew P. Morriss
Bettina Bien Greaves James L. Payne
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Perspective

Are We Really All Healthcare Collectivists Now?

"We have to do something about health care."

The scariest word in that sentence is not *something*. It's *we*.

The first-person plural form is not merely a convenience, as in "We're in for a cold winter." It indicates that decisions about "the healthcare system" should be made collectively, with one decision binding everyone.

That's collectivism.

So why is virtually everyone a collectivist when it comes to health care? I do not exaggerate. Every prominent participant in the current debate over how to "reform" the medical industry approaches the issue in collectivist terms. They have differences at the margin—tax increases versus tax credits, a government-run "public option" versus subsidized nonprofit cooperatives—but there is no disagreement that "we" must have *a* policy.

But why must *we* do anything about health care? Why can't *you* do what you want, *I* do what I want, and *he* and *she* do what they want? Isn't that what's supposed to happen in a *free* society? Reformers would say that costs are rising too much and some people can't afford insurance. But that is no answer. It tells us only that possibly ameliorable conditions exist, not that collectivism is a good approach.

When we see problems in other important markets, most of us don't expect televised presidential town-hall meetings, congressional committees, and omnibus legislation to give us the answer. We individually adjust our behavior in the marketplace and anticipate that entrepreneurs will cater to us. Solutions, with inevitable tradeoffs, are micro, marginal, and tailored to individual needs, not macro, holistic, and procrustean. Out of this arises an orderly marketplace—without a conscious overall plan. No one has found a better way to make masses of people better off.

Why is health care different? Must *we* collectively reinvent the industry? The social knowledge problem

that F. A. Hayek spelled out should make us wary of any collective response.

The reformers' stock answer is that this is something only *we*, acting through the "democratic process," can handle. That's an assertion. Where's the proof? What if earlier collectivist decisions gave us rising medical and insurance costs?

In fact they did. Nearly every aspect of medicine and health insurance that the politicians say needs fixing is the result of "our"—that is, politicians'—previous attempts to fix something. Much of the escalation of prices comes from consumer demand freed from normal cost constraints thanks to third-party payers: government-privileged insurance companies, Medicare, and Medicaid. While that intervention boosts demand by eliminating cost consciousness, others constrict supply: occupational licensing, insurance mandates and barriers to entry, patents on drugs and devices, FDA regulations, certificate-of-need requirements, and more.

So let's hear no more about what *we*—collectively and coercively—must do about health care. If government would get out of the way, *we*—individually and cooperatively—will figure out what to do. Collectivism and government planning trample freedom and foster social stupidity. Individualism and free markets respect each person's dignity and liberty while getting the most out of the "wisdom of crowds" in the marketplace.

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Why did it take a major recession to get politicians thinking about fixing the roads and bridges? Because there is glory in starting big flashy projects, but none in maintaining them. Jim Powell documents this truth.

The debate raging over the legitimacy of intellectual property rights is about more than rock bands trying to stop kids from swapping MP3 files over the Internet. It's about whether people are free to use their human capital to compete with entrenched dinosaur corporations looking to the State for protection. Kevin Carson assesses what's at stake.

In the future, when government retrenches and the market is finally free, people will obtain their medical care differently from how they do now. Ross Levatter speculates on how things might look.

Political leaders are always haranguing us to volunteer in our communities. So why do they make it so darn difficult? James Payne describes the mess that awaits would-be volunteers.

In every era do-gooders condemn the consumer-credit trap and propose ways to shield supposed victims from predatory lenders. It's happening again now with credit cards. Todd Zywicki summarizes the history of consumer credit in America and the harm done by protecting people from themselves.

Curaçao was once a popular offshore financial center. Now it's not. Andrew Morriss explains the lessons to be learned from its rise and fall.

Here's what our columnists have brewed up this month: Lawrence Reed commemorates Poland's break from the Soviet bloc. Donald Boudreaux contemplates working for a state-run university. Thomas Szasz recounts the psychiatric attempt to deny General Edwin Walker a criminal trial. Stephen Davies shows that true heroes are not politicians and generals. John Stossel finds healthcare reformers arrogant. David Henderson defines privilege. And Peter Lewin, contemplating the argument that free-market advocates should welcome financial regulation, protests, "It Just Ain't So!"

Books undergoing dissection deal with slave emancipation, the current financial turmoil, the essays of a great economist, and media freedom.

—*Sheldon Richman*
srichman@fee.org

A Tribute to the Polish People

BY LAWRENCE W. REED

The cause of liberty saw memorable highs and unconscionable lows in 1989. Surely that year will be best remembered as the year Soviet hegemony over central Europe disintegrated, paving the way for the dissolution of the Soviet Union itself in 1991. Free people everywhere should toast the brave people of one nation in particular—Poland—for the pivotal role they played in those momentous events.

Twenty years ago this fall, just days after the Berlin Wall had come crashing down, I visited with friends in Warsaw and Krakow to celebrate. The Velvet Revolution was underway in neighboring Czechoslovakia. Hungary had opened its doors to the West a few weeks before. Romania's megalomaniac, Nicolai Ceausescu, would be gone by Christmas. But Poland had led the way.

It was on June 4, 1989, as Chinese government tanks crushed a mass uprising in Tiananmen Square, that Poland electrified the world by holding the first free elections in communist Europe. Anticommunist (and in many cases, also *antisocialist*) activists stunned even fellow Poles by their showing. They won 99 of 100 seats in the Senate and every single one of the 161 seats in the lower house of Parliament that the regime allowed to be contested. These results assured that the momentum for liberty across the Soviet empire would mushroom until it toppled dictators and parties from East Berlin to Ulan Bator.

On June 4, 1989, as Chinese government tanks crushed a mass uprising in Tiananmen Square, Poland electrified the world by holding the first free elections in communist Europe.

Poland's communist leader Gen. Wojciech Jaruzelski had struck an agreement with Lech Walesa's banned Solidarity organization early in the year to legalize suppressed political groups and schedule elections for June 4. He had little choice. Poland, he declared, had become "ungovernable." I knew exactly what he meant because I had witnessed it myself in November 1986 while living for ten days with underground elements of both Solidarity and a youth group called Freedom and Peace.

The Torchbearers

The history of Poland from the imposition of martial law and the crushing of Solidarity in December 1981 to the glorious elections of 1989 is not the saga of a pessimistic, defeatist, or compliant people. Rather, it is a remarkable testament to the human will to be free. While the constellation of strong leaders in Britain, the United States, and the Vatican (Thatcher, Reagan, and John Paul II) helped the process of communist disintegration immensely, those very same leaders rightfully and repeatedly credited the defiant spirit of the Poles. "The people of Poland," declared Reagan, "are giving us an imperishable example of courage and devotion to the values of freedom in the face of relentless opposition . . . . The torch of liberty is hot. It warms those who hold it high. It burns those who try to extinguish it."

One of the intellectual giants of Polish liberty, Leszek Kolakowski, died this past July at the age of 81. Kolakowski labeled Marxism "the greatest fantasy of our century" and regarded totalitarian brutality as the inevitable outcome of the concentration of power. He told the *New York Times* in 2004, "This ideology was supposed to mold the thinking of people, but at a certain moment it became so weak and

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

so ridiculous that nobody believed in it, neither the ruled nor the rulers."

I learned during my 1986 visit that five years after the regime's harsh crackdown, Poles were dodging and weaving around the Jaruzelski regime in ways that almost defied imagination. Shortages of basic foodstuffs, double-digit inflation, and a powerful secret police did not deter them from creating thriving black markets and flourishing private institutions, from radio to theaters to publishing houses and schools. Solidarity's Wiktor Kulerski had sketched the outlines of Polish resistance a few years before when he wrote, "This movement should create a situation in which authorities will control empty stores, but not the market; the employment of workers, but not their livelihood; the official media, but not the circulation of information; printing plants, but not the publishing movement; the mail and telephones, but not communications; and the school system, but not education."

Thirty-eight million Poles were thumbing their noses at the State. They knew from painful experience that, as dissident Stefan Kisielewski put it (and was arrested and beaten for saying), "Socialism is stupidism." They had had enough of it.

> Thirty-eight million Poles were thumbing their noses at the State. They had had enough of it.

Lloyd's of Warsaw

At a dinner party hosted secretly for me by several underground printers in Krakow, I was dazzled by the scope of what my hosts called "independent publishing ventures." They had translated and printed "subversive" works by Alexander Solzhenitsyn, George Orwell, and even Murray Rothbard and Ayn Rand.

"Where do you get the paper to print all this stuff?" I inquired. A young Pole named Pawel answered, "We get it from two places: We smuggle it in from the West and we steal it from communists." Pawel explained that workers in government printing houses who were sympathetic to the resistance often spirited paper to the underground. When the coast was really clear, they even printed the illegal stuff on the government's own printing presses. When the government mounted a campaign to confiscate the cars of their distributors, the underground printers formed their own insurance company (they called it "Lloyd's of Warsaw") to cover the costs of the confiscation of their cars, paper, and materials.

I asked those printers who entertained me that evening how I could help. It turned out that they had a specific request already planned for me. If I could raise $5,000 and channel it to their émigré allies in Paris, they would eventually get the money and be able to translate into Polish and print several thousand copies of Milton and Rose Friedman's classic *Free To Choose*. Among my most prized possessions is a copy of that book, inscribed by activist Wojciech Modelski with these words: "Thank you, Larry! Without your help it was not be [sic] possible to publish this book."

My favorite story from that visit, though, involves a very brave couple, Zbigniew and Sofia Romaszewski. They had only lately been released from prison for running an underground radio station. "How did you know when you were broadcasting if people were listening?" I asked. Sofia answered, "We could only broadcast eight to ten minutes at a time before going to another place to stay ahead of the police. One night we asked people to blink their lights if they believed in freedom for Poland. We then went to the window and for hours, all of Warsaw was blinking."

Zbigniew Romaszewski won election to the Polish parliament in those June 1989 elections, and he serves in its Senate today. Jan Rokita, a leader of Freedom and Peace and my chief escort until I was arrested, strip-searched and deported, was elected to the lower House in 1989 and served there until retiring in 2007. Among the liberty-loving organizations in Poland today is the Polish-American Foundation for Economic Research and Education (www.pafere.org), which regularly reprints articles from this magazine.

To all those millions of Polish freedom-fighters who ushered communism into the dustbin of history twenty years ago, *thank you* for your courage, your perseverance, your vision, and your example. FEE

Free-Marketeers Should Welcome Regulation? It Just Ain't So!

BY PETER LEWIN

In a *Wall Street Journal* op-ed, Paul Singer, chairman of the Manhattan Institute, suggests that "there is an urgent need for a new global regulatory initiative" to address the causes of the worldwide financial collapse and that even those who appreciate the qualities of free markets should welcome the new and different regulations he proposes (April 3). Singer's good intentions notwithstanding, his position is based on two crucial mistakes. One concerns the fundamental causes of the crash. The other concerns the nature of regulation of any kind.

Singer proposes "three fundamental tests" for the new "regulatory infrastructure": 1) assess and measure risks accurately, including the compounded risks of herding; 2) impose significant margin requirements on all exposures; and 3) bring all investors and traders—regardless of whether the risk holder is a hedge fund, bank, private equity fund, individual, or government agency—under the regulatory umbrella.

Calls for new regulations misunderstand both the causes of the crash and the nature of regulation.

These are not trivial or piecemeal steps. The last especially implies a substantial expansion of government reach into *all* parts of the investment environment. That alone would give free marketeers extreme pause, especially since Singer wants "a global mandate."

Perhaps his boldest assertion, however, is that "The private sector, not the public sector, is where the biggest mistakes were made."

By saying this Singer joins the chorus that attributes the financial collapse to the "excesses" of the free market—to the lack of regulation that characterized the pre-crash environment. The Orwellian nature of this position is a source of painful—though not unpredictable—frustration for those who understand that the true cause of our current problems is, and continues to be, massive government regulation that prevented markets from working and pushed resources into investments that could not be sustained. Those who understand this also understand that if government is the problem, it cannot be the solution.

The crash of 2008 will be hotly debated for a long time to come, and the precise nature of its causes will be the subject of much historical research. Matters now somewhat obscure will emerge with greater clarity as time goes by. We do know enough right now, however, to identify with great certainty three fundamental causative factors: easy money, "innovations" in mortgage lending, and misleading credit rating. Disagreement about the precise role of easy money probably will continue. (It is not easy to know if the crash would have occurred had the Fed not been so accommodating.) But there is a compelling case about the other two.

First, what does "innovative" mortgage lending mean? According to Professor Stan Liebowitz's in-depth examination of the mortgage industry, "[I]n an attempt to increase home ownership, particularly by minorities and the less affluent, virtually every branch of government undertook an attack on underwriting standards starting in the early 1990s" ("Anatomy of a

Peter Lewin (plewin@utdallas.edu) is Clinical Professor of Finance and Managerial Economics at the University of Texas at Dallas School of Management.

Train Wreck: Causes of the Mortgage Meltdown," www.tinyurl.com/3m4bzv).

The huge consumer leverage in residential real estate that ensued was in fact the brainchild of those persistent and self-righteous legislators (chief among them Barney Frank), aided and abetted by progressive journalists and academics. Their much-touted agenda to increase homeownership in America, particularly among minority low-income earners, succeeded spectacularly. And it is precisely these new homeowners who have featured most prominently in the meltdown that home foreclosures triggered. These legislators and their cheering section in the press and academia have a lot to answer for in having precipitated a world financial crisis. Would that they were at least aware of their culpability.

Gold (Plated) Standards

In the meantime, of course, the run-up in housing prices attracted investors from other parts of the financial sector and encouraged experimentation with new types of financial instruments and insurance based on these high-performing mortgage assets. Absent the systematic and massive intentional degrading of mortgage-lending standards, it is hard to see how this could have occurred. Still, it is clear that the three existing credit-rating agencies systematically misread and underestimated the riskiness of these assets and misled the entire market in the process. Notably, all three agencies (Moody's, Standard and Poor's, and Fitch) earn their incomes from the companies whose assets they rate. They all made substantial profits from rating mortgage-backed securities. There are no independent agencies because those three are "government approved" to rate assets in which government-created financial institutions can invest. These agencies were in effect protected from competition and subject to serious conflicts of interest. The positive glow generated by their consistently high ratings, fueled in part by implicit government guarantees, obscured the darker warning signs emanating from less prominent sources.

Regulators are fallible human beings whose knowledge of the present and ability to predict the future are seriously limited.

Against this backdrop Singer's reasoning is difficult to understand. On what basis can he possibly claim that the biggest mistakes were made by the private sector? What mistake could be bigger than the willful encouragement—even mandating—of irresponsible lending by private-sector institutions that otherwise would have continued to adhere to their time-tested standards for assessing the reliability of mortgage borrowers? In the absence of this legislative abuse, the margin requirements for which Singer calls would not be necessary because the underlying assets would be more reliably valued. And surely, in the absence of government protection, independent rating competitors would have had a much better chance of bringing some sanity to bear on the market.

The Nature of Regulation

Singer seems to misunderstand the nature of regulation itself. He calls for regulators (with the aid of the private institutions in the pay of the regulators!) to "accurately assess" risks, including the risks of herding (psychological contagion that causes markets to tank), and to use this assessment as the basis for new and enlightened regulations. We might as well pray for the Messiah to come next Thursday.

Regulators are fallible human beings whose knowledge of the present and ability to predict the future—including the future consequences of their actions—are seriously limited. The future is and will always be unpredictable. One might wonder whence even dedicated public servants are to come up with such "accurate assessments" when such assessments depend on events beyond their ability to foresee. Why should they do better than the market in this respect? After all, it is not even their own money they are regulating.

Successful regulation is rare. Market successes, on the other hand, are abundant. Bubbles may be unavoidable, but in the absence of clumsy government pushing and shoving, they are likely to be small, short-lived, and confined in scope. The housing monster-balloon is a creature of the most egregious regulation. How can we expect more regulation to be the solution? FEE

Why the Government Fails to Maintain Anything

BY JIM POWELL

As the mad scramble to pass President Obama's stimulus bill reminded us, politicians love to start new government programs. They gain things they can brag about during their reelection campaigns. But there's little to be gained by maintaining programs somebody else started. No surprise, then, that in budget battles, maintenance tends to be under-funded.

Moreover, as power is centralized, those further down the chain of command, who are nominally responsible for maintaining government assets, have less and less authority to do so. Since nobody really owns government assets, nobody has a personal stake in protecting their value. Consider a few cases.

There is no political incentive to maintain New Orleans's levees, even after Katrina.
commons.wikimedia.org

Why Can't Government Maintain New Orleans's Levees?

The nearly half-million people of New Orleans wanted to live in their big bowl below sea level, and they entrusted politicians with the job of maintaining more than 125 miles of levees. These large walls, typically made of earth and/or stone, surrounded the city to keep out water from the Mississippi River (to the south and southeast of the city), Lake Borgne (to the east), Lake Pontchartrain (to the north), and various canals. Since water continuously leaked into the city, there were floodwalls, about 200 floodgates, plus pumps and drainage canals for additional protection.

Then Hurricane Katrina hit. It crossed Florida on Thursday, August 25, 2005, as a Category 1 (weakest category) hurricane, then gathered strength as it reached the warm waters of the Gulf of Mexico. Wind velocities accelerated, and by Sunday, August 28, Katrina was a Category 5. It weakened somewhat to a Category 4 when it made landfall east of New Orleans the next day, with winds of up to 145 miles per hour. We all know what happened next.

But why did it happen? There seemed to be problems almost everywhere in New Orleans's levee system. Dr. Peter Nicholson, associate professor of civil and environmental engineering at the University of Hawaii, headed a study of the levee failures on behalf of the American Society of Civil Engineers. He reported, "We found literally dozens of breaches throughout the many miles of levee system. A number of different failure mechanisms were observed." Ivor van Heerden, deputy director of Louisiana State University's Hurricane Center, criticized the design and suggested that inadequate construction could also be an issue. Forensic teams that studied these levees generally agreed with the assessment.

Jim Powell (powellj@optonline.net), a senior fellow at the Cato Institute, is the author of FDR's Folly, Wilson's War, Bully Boy, Greatest Emancipations, The Triumph of Liberty, *and other books.*

Who was responsible for the failure of the levees?

They needed maintenance because everything needs maintenance and because each year the city was sinking about an inch deeper into the Mississippi River mud. Although New Orleans politicians' most important job was public safety and the levees obviously affected public safety, politicians seemed to believe doing maintenance work—which would probably go unseen—wouldn't serve their personal interests (especially getting reelected).

The state had established the New Orleans District Levee Board in 1890 to be responsible for maintaining the levees around the city. But the board members, a majority of whom are appointed by Louisiana's governor, pursued their interests by expanding their power, gaining jurisdiction to develop properties around the levees. Board members spent time on such matters as licensing a casino, leasing space to a karate club, and operating an airport and marinas. The Senate Homeland and Governmental Affairs Committee reported, "A review of the levee-district board minutes of recent years revealed that the board and its various committees spent more time discussing its business operations than it did the flood-control system it was responsible for operating and maintaining."

James P. Huey, who had been on the board for 13 years and served as its president for nine years, blamed the state legislature. He claimed that the board had to generate money from those time-consuming extraneous businesses because the state legislature had cut the board's revenue in half. So even though members of the board knew that a levee in New Orleans East was three feet below its design height—which would affect its ability to withstand a storm surge and therefore jeopardized the people in the city—they didn't get it fixed because they were squabbling about who would pay for it. The Army Corps of Engineers refused. The board wrote letters to their members of Congress asking Washington for money, but they were busy with other things. And the Flood Control Act, which Congress passed in 1965, sent a clear signal that the federal government would bail out people who wanted to live in flood-prone areas like New Orleans.

The U.S. Army Corps of Engineers handled design and construction of the levees, as it handled flood-control projects throughout the United States. But its budget consisted almost entirely of "earmarks," assuring that appropriations would be spread around congressional districts. That gave incumbents something to brag about during their election campaigns. The problem was that spending a lot more money on New Orleans flood protection wasn't the top priority for the state's politicians. J. Bennett Johnston Jr., for example, when he was a Louisiana senator, secured appropriations for four new dams on the Red River between Mississippi and Shreveport, costing $2 billion.

Bottom line: Nobody in the city, state, or federal governments wanted responsibility for maintaining the levees.

Why Can't Government Maintain Public Housing?

Because poor people tend to live in poor housing, many people thought it would be a good idea for government to build housing. This started during the New Deal and accelerated after World War II as the federal government subsidized municipalities. Public hous-

ing projects were given names—like Cochran Gardens, Maplewood Court, Henry Horner Homes, and Rockwell Gardens—that suggested they might be charming.

A guiding principle of the time was that housing projects should be massive. In part this reflected the influence of the Swiss-born architect Charles-Édouard Jeanneret-Gris—later known as Le Corbusier—who urged during the 1920s that people be concentrated in big buildings consisting of cell-block apartments. The buildings were set pieces, surrounded by empty parks and separated from their neighborhoods. Bigness became a kind of architectural cult, embraced by Soviet mass murderer Joseph Stalin and others during the mid-twentieth century. Like so many Soviet buildings, U.S. housing projects tended to be big and ugly.

> A guiding principle of the time was that housing projects should be massive. Bigness became a kind of architectural cult, embraced by Soviet mass murderer Joseph Stalin and others during the mid-twentieth century.

Consider the experience of the Chicago Housing Authority, the third-largest public-housing bureaucracy in the United States. It built a four-mile stretch of housing projects. Just one of them, the Robert Taylor Homes, included a couple dozen 16-story buildings containing 4,400 units altogether. It was reportedly the world's largest housing project.

These monstrosities quickly deteriorated. "The buildings in its enormous family developments are literally crumbling," reported housing analyst Susan J. Popkin in 2000. "They are relatively old; most construction occurred during the 1950s and early 1960s. The original materials were cheap and have not held up well over time. Further, the buildings are poorly designed, with exterior hallways and elevators that have proven extremely difficult to maintain." The government couldn't begin to take care of this development. Popkin went on, giving a litany of problems familiar to many residents of "the projects" across the country:

> Because the hallways of the high-rises are covered with metal grates, the buildings look like prisons. Many apartments (and some entire buildings) are boarded up because their major systems—plumbing, heating, electrical—have failed. The grounds and hallways are often filled with refuse and reek of human waste. The buildings are infested with vermin, including rats, mice, roaches, and even feral cats. Lights in interior hallways, elevators, and stairwells are vandalized regularly, leaving these areas dark twenty-four hours a day. The buildings' exteriors, halls, and stairwells are often covered with graffiti or, in the better-maintained developments, the evidence of the janitors' attempts to paint over the mess.
>
> Without constant vigilance it is nearly impossible to keep the units clean. In addition to the dirt that blows in from outdoors, it is not uncommon to see apartment walls literally crawling with roaches. Most apartments also have serious maintenance problems, owing to years of neglect and failed structural systems. For example, in some units, it is impossible to turn off the hot water in the bathrooms, so the walls now have severe moisture damage.

Despite spending millions of dollars on law enforcement in the housing projects, neither the federal government nor the city have been able to maintain public safety. Maintenance people were afraid to enter the housing projects, which contributed to their deterioration.

During the 1980s real estate developer Vincent Lane became chairman of the Chicago Housing Authority and ordered police to "sweep" through public housing projects, ejecting people who weren't legitimate residents. But the American Civil Liberties Union challenged these sweeps, and evidently they were discontinued. Moreover, they were expensive—about $175,000 per building—and Lane became embroiled in conflict-of-interest scandals involving security service contracts. The Chicago Housing Authority had trouble securing enough funding for its operations, and by the 1990s it had ceased making major repairs.

The next short step was to demolish the disastrous housing projects. The last tower came down in 2007. The city of Chicago began building townhouses, some of which were sold to middle-income private buyers, while others were reserved for former tenants in the projects. Applicants were screened in an effort to avoid drug users or those with criminal records. But construction is likely to proceed slowly and accommodate a fraction of the people who had lived in the projects.

Perhaps the most notorious of all housing projects was Pruitt-Igoe in St. Louis, designed by Minoru Yamasaki, winner of a number of architectural awards and praise in *Architectural Forum*. Pruitt-Igoe included 33 11-story buildings on 57 acres in DeSoto-Carr, a poor section of the city. There were 2,870 apartments.

The project was finished in 1956. "Only a few years later," reported Alexander von Hoffman of Harvard's Joint Center for Housing Studies, "disrepair, vandalism, and crime plagued Pruitt-Igoe. The project's recreational galleries and skip-stop elevators, once heralded as architectural innovations, had become nuisances and danger zones. Large numbers of vacancies indicated that even poor people preferred to live anywhere but Pruitt-Igoe. The St. Louis Housing Authority spent $5 million trying to fix the problems but failed." In 1972, three of the 16-year-old Pruitt-Igoe buildings were demolished. The following year, the U.S. Department of Housing and Urban Development agreed Pruitt-Igoe was hopeless, and the rest of it came down.

Similar public housing projects across the country were just as wretched. Joseph Petrone, a former maintenance supervisor with the Philadelphia Housing Authority, recalled: "I'd go to work at Schuylkill Falls [a PHA project] with a .38-caliber revolver in my belt and a big stick in my hand. The stick was for the German shepherds people kept tied to their doorknobs. The halls were covered with trash because the dogs would tear up the trash bags. We'd find bodies in the elevator shafts; the kids would play there, get stuck, and fall or get crushed." The government was incapable of maintaining anything it built.

Why Can't Government Maintain National Parks?

More than a century ago, "Progressives" promoted the idea that only government could be trusted

The much-heralded Pruitt-Igoe housing project lasted less than twenty years.
U.S. Department of Housing and Urban Development

Nice to look at, not politically useful to maintain.
www.nps.gov

Since the federal government "owns" the national parks, their funding depends on Washington politics. The prevailing policy has been that most revenue generated in the parks goes to Washington. As a consequence, the parks have had to lobby politicians for appropriations. But over the years the biggest increases in federal spending have involved wars and social programs. The National Park Service has had a hard time competing for funds with the likes of Social Security, Medicare, and Medicaid. It's a small pig at the trough. There has been a big backlog of deferred National Park Service maintenance jobs that lacked funding. Roads are sometimes hazardous because of potholes. Visitor facilities are falling apart. Historic structures are in jeopardy. Sewage systems have broken, causing pollution.

to take care of natural wonders like Yellowstone and the Grand Canyon. Things have worked out rather differently. Apparently when politicians began considering the idea of national parks, nobody thought much about maintenance. For example, Congress was assured Yellowstone wouldn't cost Washington anything once the initial roads and buildings were constructed. In 1916 Stephen Mather, who managed the national parks, reported, "The revenues of several parks might be sufficient to cover the costs of their administration and protection and Congress should only be requested to appropriate funds for their improvement."

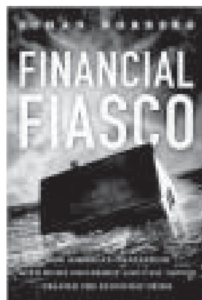
Over the years, presidents have bragged about how much they added to the National Park Service. Now it includes some 6,000 historic structures, 8,500 monuments, 2,000 bridges and tunnels, 4,300 employee housing units, and 27,000 campground sites, as well as docks, parking areas, and other assets. But it wasn't until 2002 that the National Park Service began to assess their condition.

Why Should Government Start Something It Can't Maintain?

Government cannot be counted on to maintain anything well because there's no political glory in maintenance. Those who sign major laws, who launch new government programs, and who cut the ribbons for new government buildings can brag about their exploits during reelection campaigns. But politicians don't seem to gain any credit with voters when they maintain programs that somebody else started. In many cases, like adding more cement to New Orleans levees, maintenance work is invisible.

Since taxpayer money is wasted when it's spent on projects that subsequently suffer from inadequate maintenance, and often much harm is done, government should be limited to projects it might be able to maintain. If this means government ends up doing little, so be it. FEE

The World's Best Books on Liberty



Financial Fiasco

In six concise chapters, Johan Norberg's *Financial Fiasco* tells the complex story of the crisis, showing how monetary policy, housing policy, and financial innovations combined to create financial catastrophe. The final two chapters describe the government's mismanagement of the crisis and how we are now dangerously repeating many of the very same mistakes that caused it. An understanding of the roots of the financial crisis is crucial for every American who has felt its effects—and would like to prevent the same disaster from happening again.*Financial Fiasco* provides that understanding, with great insight, clarity, and wit.

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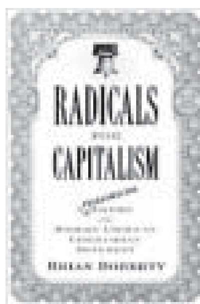

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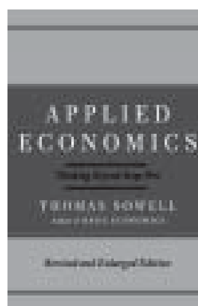

Applied Economics

This revised edition of Thomas Sowell's *Applied Economics* is about fifty percent larger than the first edition. It now includes a chapter on the economics of immigration and new sections of other chapters on such topics as the "creative" financing of home-buying that led to the current "subprime" mortgage crisis, the economics of organ transplants, and the political and economic incentives that lead to money earmarked for highways being diverted to mass transit and to a general neglect of infrastructure. On these and other topics, its examples are drawn from around the world. Much material in the first edition has been updated and supplemented. The edition of *Applied Economics* retains the easy readability of the first edition, even for people with no prior knowledge of economics. Hardback, 336p., list price $35.00. **Our price $15.00.**

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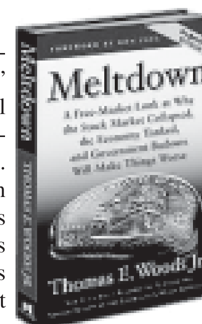

The media tells us that "deregulation" and "unfettered free markets" have wrecked our economy and will continue to make things worse without a heavy dose of federal regulation. But the real blame lies elsewhere. In *Meltdown*, bestselling author Thomas E. Woods Jr. unearths the real causes behind the collapse of housing values and the stock market—and it turns out the culprits reside more in Washington than on Wall Street.

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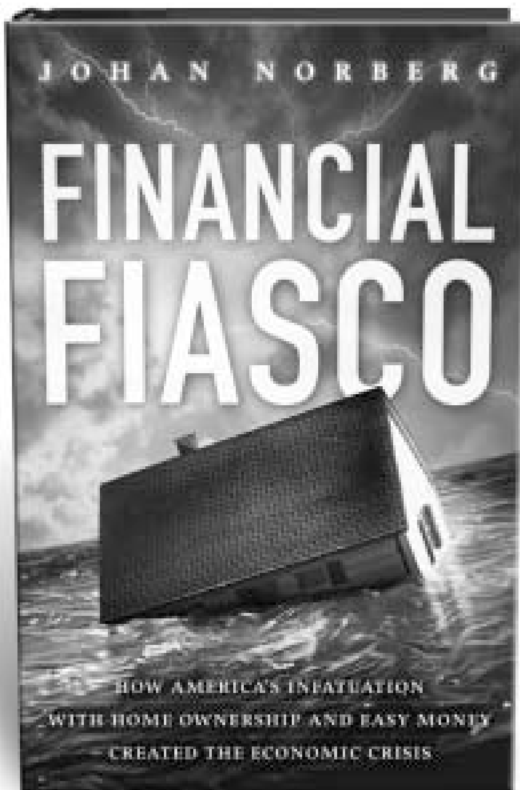

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Eugene Stephenson Thorpe (1913–2001) was born in Elroy, Wisconsin, and graduated from Cornell University with a degree in civil engineering. An early critic of FDR and the changes his policies made in the fabric of American life, Mr. Thorpe’s core beliefs included hard work, free trade, small government, and self-reliance. He was a longtime supporter of the Foundation for Economic Education and a devoted reader of ***The Freeman***. His children have fittingly established the Eugene S. Thorpe Award as a tribute to his life and ideas.

Visit www.fee.org for full contest rules.

Looking in the Mirror

BY DONALD J. BOUDREAUX

Quite frequently, I hear, "How do you justify working at a state university *and* holding libertarian views? That's hypocritical!"

The question is not as easy to answer as I would like—a fact that makes the accusation understandable (but, I hope, in the final analysis untrue).

My employer, George Mason University, is indeed a government-created and -owned outfit. And I indeed spend most of my time decrying government interference in people's lives as well as decrying the taxation necessary to fund that interference.

How *do* I justify myself?

The easy answer is that our world isn't ideal. In a less-than-ideal world, navigating reality requires compromises. After all, would you have me also not drive? Roads and highways are almost all government-owned and -operated.

Given that it is nearly impossible to live as part of society without consuming some government-supplied goods and services—and without helping to pay for those things (which is to say, without helping to encourage the state provision of those things)—each libertarian must make compromises with this reality. Each libertarian must do his or her level best to decide where acceptable compromises with the State begin and where they end.

Each libertarian must do his or her level best to decide where acceptable compromises with the State begin and where they end.

Because so many universities are state-owned and -operated, and because almost all but a tiny handful of the "private" universities receive vast sums of government largess, working for a state university is, for me, an acceptable compromise. This compromise is even more acceptable when I reflect on the fact that the department of economics at George Mason University is by far the best department for the kind of economics I admire and I strive to do. I can best contribute to the scholarly endeavor and to the great cause of human freedom by serving on the GMU faculty of economics.

The above isn't a *bad* argument. I believe it. But I confess that it's not fully satisfying. Do I believe that argument only because by believing it I'm able to rationalize my employment at GMU?

Government-Issue Moral Dilemma

I *think* that the answer to the last question is no, but I'm really not sure.

Principles, after all, are ideals to uphold even when—indeed, especially when—doing so is personally costly or difficult. For me to resign my position at GMU Econ would be difficult (because I put great store in being part of a faculty that so deeply understands markets and values freedom). So perhaps I'm not as principled as I fancy myself to be.

On the other hand, resigning from GMU would not be costly to me in a monetary sense. A few private universities have offered me jobs with salaries higher than what I earn at GMU. My reason for rejecting each of those offers is that I feel a deep commitment to GMU Econ and the iconoclastic and pro-market role it plays in the economics profession as well as in public discourse. So by remaining at GMU despite more lucrative offers at private schools, do I demonstrate my commitment to the ideal of sound economic teaching and research? Do I demonstrate my commitment to the brand of liberalism

Donald Boudreaux (dboudrea@gmu.edu) is a professor of economics at George Mason University, a former FEE president, and the author of Globalization.

that is so prominently featured and furthered at GMU Econ? Or do I demonstrate hypocrisy by continuing in the employ of the state?

These questions aren't rhetorical. I myself cannot answer them with any great confidence. I'm pretty sure that, were I to resign from GMU (which is the largest university in Virginia), fewer young people would be exposed to my teaching and my writing. Given that my comparative advantage (such as it is) lies in introducing students to the economic way of thinking, would I harm the cause that I so profoundly believe in by resigning from GMU? Or would I further that cause by demonstrating my commitment to the principle of separation of school and State?

And does it matter that I have my 12-year-old son in private school? My wife and I pay the substantial tuition each year not so much because the government schools in Fairfax County are lousy (they're not), but because of our principled objection to government schooling.

Blurring the Line

The larger lesson is that the State does more than act to protect us from violence—so much more, in fact, that it blurs the distinction between itself and society. I have no doubt that, were the government completely out of education, excellent private schools would flourish at all levels, from pre-K through post-doc. And I have no doubt that the quality of education would be greatly improved.

> The State does more than act to protect us from violence—so much more, in fact, that it blurs the distinction between itself and society.

But the State *is* involved, and heavily. This involvement makes it artificially difficult for private schools to thrive. So should educators and researchers who oppose such involvement as a matter of principle content themselves to teach only at the very small number of schools that get no government funds? And should those libertarian educators and researchers who can find no employment at such schools find some other occupation, even if it's likely that they can contribute more to the cause of freedom by teaching and researching than by abandoning that career?

I wish that I had unambiguous answers to these questions, but I don't.

No Easy Answers

Another consideration turns on the distinction between choosing rules and choosing how to act within a given set of rules. It would be a clearer case of unethical behavior on my part if I voted for further government involvement in higher education than if I simply accepted the reality of that involvement—a reality unlikely to be changed any time soon. I can legitimately say, "I would arrange education differently, but because that power is not mine, it's okay for me to work for a government school even though I would prefer that such things not exist. I don't make the rules."

This argument, too, has some merit. But it also has a weakness: Society's rules often are changed by persons who refuse on principle to accept what seems inevitable. "Playing by the rules" is not a free ticket to violate your ethical norms.

The bottom line is that I don't believe that I violate my libertarian principles by working for GMU Econ, which happens to be a state institution (although one that also receives a good deal of private support). But I don't think it's unreasonable for anyone to question me strongly and skeptically on this matter. FEE

How “Intellectual Property” Impedes Competition

BY KEVIN CARSON

Any consideration of “intellectual property rights” must start from the understanding that such “rights” undermine genuine property rights and hence are illegitimate in terms of libertarian principle. Real, tangible property rights result from natural scarcity and follow as a matter of course from the attempt to maintain occupancy of physical property that cannot be possessed by more than one person at a time.

“Intellectual property,” on the other hand, *creates* artificial scarcity where it does not naturally exist and can only be enforced by invading real, tangible property and preventing the owner from using it in ways that violate the supposed intellectual property rights of others. As Stephan Kinsella points out, had a particularly gifted Cro-Magnon man been able to patent the building of log cabins, his heirs today would be entitled to prevent us from building cabins on our own land, with our own logs, until we paid whatever tribute they demanded.

> “Intellectual property” creates artificial scarcity where it does not naturally exist and can only be enforced by invading real, tangible property.

The business model required by proprietary digital information is even more invasive of genuine property rights than traditional copyright law. The digital copyright regime in force under the terms of the Digital Millennium Copyright Act (DMCA), the WIPO Copyright Treaty, and the TRIPS provisions of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), focuses entirely on preventing one from using his own hard drive and other property as he sees fit. It is actually illegal, thanks to such legislation, to sell hardware capable of circumventing DRM (digital rights management) or to publicize the codes enabling someone to circumvent it. As Cory Doctorow points out, “It’s funny that in the name of protecting ‘intellectual property,’ big media companies are willing to do such violence to the idea of real property—arguing that since everything we own, from our t-shirts to our cars to our e-books, embody someone’s copyright, patent and trademark, that we’re basically just tenant farmers, living on the land of our gracious masters who’ve seen fit to give us a lease on our homes.”

All-pervasive DRM prevents the easy transfer of content between platforms, even when a CD or DVD buyer simply wants to play the content somewhere more convenient. And the DMCA legally prohibits circumventing such DRM, even when—again—the purchaser simply wants to facilitate his own use on a wider and more convenient variety of platforms.

The levels of invasiveness required by “intellectual property” in the digital age cannot be exaggerated. The intrusive and inconvenient DRM embedded in proprietary media, and the draconian legislation criminalizing technical means of circumvention, should make that clear. The logical tendency of the digital copyright regime was portrayed quite convincingly by Richard Stallman in a dystopian

Kevin Carson (free.market.anticapitalist@gmail.com) is the author of Organization Theory: A Libertarian Perspective *and a research associate at the Center for a Stateless Society. He blogs at Mutualist Blog: Free Market Anti-Capitalism (www.mutualist.blogspot.com).*

short story, "The Right to Read" (just Google it—it's well worth your time).

Corporations rely on increasingly authoritarian legislation to capture value from proprietary information. Johann Soderberg compares the way photocopiers were monitored in the old USSR, to protect the power of elites in that country, to the way the means of digital reproduction are monitored in this country to protect corporate power. Privileged state-connected economic interests are becoming increasingly dependent on such controls. Unfortunately for them, such controls are becoming increasingly unenforceable thanks to BitTorrent, strong encryption, and proxy servers. Case in point: the "DeCSS uprising," in which court injunctions against a code to hack DVD encryption met with the defiant publicizing of the code on blogs, mirror sites, and even T-shirts. The unenforceability of intellectual property rights undermines the business model prevalent among a major share of privileged state-connected firms.

Unenforceable: When a judge tried to block DeCSS, a DVD-cracking program, people printed the code on t-shirts.
Photo by Casey Bisson.

Obsolete Business Model

In the old days, the immense value of physical assets was the primary structural support for corporate boundaries and in particular for the control of corporate hierarchies over human capital and other intangible assets. This has changed as physical assets have become less important than human capital. As human capital becomes the primary source of corporate equity, the old rationale for corporate institutional control is evaporating.

In the information and entertainment industries, before the digital and Internet revolutions, the initial outlay for entering the market was in the hundreds of thousands of dollars or more. The old electronic mass media, as Yochai Benkler put it, were "typified by high-cost hubs and cheap, ubiquitous, reception-only systems at the end. This led to a limited range of organizational models for production: those that could collect sufficient funds to set up a hub." The same was true of print periodicals: Between 1835 and 1850, the typical startup cost of a newspaper increased from $500 to $100,000—or from roughly $10,000 to $2.38 million in 2005 dollars.

The networked economy, in contrast, is distinguished by "network architecture and the [low] cost of becoming a speaker." The central change that makes this possible is that "the basic physical capital necessary to express and communicate human meaning is the connected personal computer." The desktop revolution and the Internet mean that the minimum capital outlay for entering most of the entertainment and information industry has fallen to a few thousand dollars at most, and the marginal cost of reproduction is zero. The networked environment, combined with endless varieties of cheap software for creating and editing content, makes it possible for the amateur to produce output of a quality once associated with giant publishing houses and recording companies. That is true of the software industry, the music industry (thanks to cheap equipment and software for high-quality recording and sound editing), desktop publishing, and to a certain extent even film (as witnessed by affordable editing technology and the success of *Sky Captain*). Podcasting technology makes it possible to distribute "radio" and "television" programming, at virtually no cost, to anyone with a broadband connection. A network of amateur contributors have peer-produced an encyclopedia, Wikipedia, which Britannica sees as a rival. As Tom Coates put it, "[T]he gap between what can be accomplished at home and what can be accomplished in a work environment has narrowed dramatically over the last ten to fifteen years."

It's also true of news, with ever-expanding networks of amateurs in venues like Indymedia, alternative news

operations like Robert Parry's and Greg Palast's, and Iraqis and American troops blogging news firsthand from Iraq, at the very same time that the traditional broadcasting networks are shutting down.

Agency Problems, Breakaway Firms

This has profoundly weakened corporate hierarchies in the information and entertainment industries, while creating enormous agency problems. As human capital eclipses physical capital as the main source of corporate equity, it becomes increasingly feasible for the human capital assets to vote with their feet. People can take their skills elsewhere, form "breakaway firms," and leave their former employers as hollowed-out shells owning little more than the company name. This has happened in a few high-profile cases, such as Maurice Saatchi's walkout from the Saatchi and Saatchi advertising agency, and Salomon Brothers' loss of a group of traders responsible for 87 percent of the bond-trading firm's profits. As organization theory writer Luigi Zingales put it, "[I]f we take the standpoint that the boundary of the firm is the point up to which top management has the ability to exercise power . . . , the group was not an integral part of Salomon. It merely rented space, Salomon's name, and capital, and turned over some share of its profits as rent."

Economist David Prychitko remarked on breakaway firms in the tech industry back in the 1990s when it was barely underway:

> Old firms act as embryos for new firms. If a worker or group of workers is not satisfied with the existing firm, each has a skill which he or she controls, and can leave the firm with those skills and establish a new one. In the information age it is becoming more evident that a boss cannot control the workers as one did in the days when the assembly line was dominant. People cannot be treated as workhorses any longer, for the value of the production process is becoming increasingly embodied in the intellectual skills of the worker. This poses a new threat to the traditional firm if it denies participatory organization.

The appearance of break-away computer firms leads one to question the extent to which our existing system of property rights in ideas and information actually protects bosses in other industries against the countervailing power of workers. Perhaps our current system of patents, copyrights, and other intellectual property rights not only impedes competition and fosters monopoly, as some Austrians argue. Intellectual property rights may also reduce the likelihood of break-away firms in general, and discourage the shift to more participatory, cooperative formats.

In this environment the only thing standing between the old information and media dinosaurs and their total collapse is their so-called intellectual property rights—at least to the extent they're still enforceable.

In this environment the only thing standing between the old information and media dinosaurs and their total collapse is their so-called intellectual property rights—at least to the extent they're still enforceable. Ownership of intellectual property becomes the new basis for the power of institutional hierarchies and the primary buttress for corporate boundaries.

The increasing prevalence and imploding cost of small-scale distributed production machinery, along with the rise of "crowdsourced," distributed means of aggregating capital from small donors, mean that physical production is governed by the same phenomenon to a considerable extent.

Without intellectual property, in any industry where the basic production equipment is widely affordable, and bottom-up networking renders management obsolete, it is likely that self-managed, cooperative production will replace the old managerial hierarchies. The network revolution, if its full potential is realized (as James Bennett put it in the appropriately titled article "The End of Capitalism and the Triumph of the Market Economy"),

will lead to substantial redistribution of power and money from the twentieth-century industrial producers of information, culture, and communications—like Hollywood, the recording industry, and perhaps the broadcasters and some of the telecommunications giants—to a combination of widely diffuse populations around the globe and the market actors that will build the tools that make this population better able to produce its own information environment rather than buying it ready-made.

Paying for the Name

Another effect of the shift in importance from tangible to intangible assets is that a growing portion of product prices consists of embedded rents on intellectual property and other artificial property rights, rather than the material costs of production. Tom Peters, in *The Tom Peters Seminar*, was fond of gushing about the increasing portion of product "value" made up of "ephemera" and "intellect" (that is, the amount of final price consisting of tribute to the owners of intellectual property) rather than labor and material costs. To quote Michael Perelman, "[T]he so-called weightless economy has more to do with the legislated powers of intellectual property that the government granted to powerful corporations. For example, companies such as Nike, Microsoft, and Pfizer sell stuff that has high value relative to its weight only because their intellectual property rights insulate them from competition."

Unnecessary: Radiohead let people choose how much to pay (if anything) to download this DRM-free album.
Anthony Sigalas designed his own cover for the downloaded album.

But intellectual property, as we have already seen, is becoming increasingly unenforceable. As a result, the ownership of proprietary content is becoming increasingly untenable as a basis for corporate institutional power. And we can expect the portion of commodity prices resulting from embedded rents on artificial property rights to implode.

A major component of the business model that prevails under existing corporate capitalism is the offer of below-cost platforms coupled with the sale of patented or copyrighted spare parts, accessories, and so on at an enormous markup. So one buys a cell phone for little or nothing, with the contractual obligation to use only a specified service package for so many years; one buys a fairly cheap printer, which uses enormously expensive ink cartridges; one buys a cheap glucometer, with glucose testing strips that cost $100 a box. Hacking one's phone to use a different service plan, or manufacturing generic ink cartridges or glucose testing strips in competition with the proprietary version, is illegal. The same goes for manufacturing generic replacement parts for a car or appliance, in competition with the corporate dealership.

"Intellectual property" also serves as a bulwark to planned obsolescence and high-overhead production. As it is now, appliances are generally designed to thwart repair. When the repairman tells you it would cost more than it's worth to repair your washing machine, he's telling the truth. But he fails to add that this state of affairs reflects a deliberate design: The machine *could* have been designed on a modular basis, so that the defective part might have been cheaply and easily replaced. And if the manufacturer were subject to unfettered competition, the normal market incentive would be to do so.

Absent legal constraints, it would be profitable to offer competing generic replacements and accessories for other firms' platforms. And in the face of such competition, there would be strong pressure toward modular product designs that were amenable to repair and interoperable with the modular components and accessories of other companies' platforms. Absent the legal constraints of patents, an appliance designed to thwart ease of repair through incompatibility with other companies' platforms would suffer a competitive disadvantage.

At the global level, intellectual property plays the same protectionist role for transnational corporations that tariffs performed in the old national economies. It's hardly coincidental that the dominant industrial sectors in the global corporate economy—software, entertainment, biotech, pharmaceuticals, and electronics—all depend heavily on intellectual property. And the central focus of the neoliberal regime, which has been falsely identified with "free trade" and "free markets," is on

strengthening the legal intellectual property regime as the primary source of profits.

On a global scale, patents lock transnational manufacturing corporations into a permanent monopoly on productive technology. The central motivation in the GATT intellectual property regime is to secure the transnational corporations' (TNCs) collective monopoly of advanced technology and prevent independent competition from ever arising in the Third World. It would, as the Third World Network's Martin Khor Kok Peng writes, "effectively prevent the diffusion of technology to the Third World, and would tremendously increase monopoly royalties of the TNCs whilst curbing the potential development of Third World technology."

Drawing to a Close

But to repeat, the good news is that, in both the domestic and global economies, this business model is doomed. The shift from physical to human capital as the primary source of productive capacity in so many industries, along with the imploding price and widespread dispersion of ownership of capital equipment, means that corporate employers are increasingly hollowed out and only maintain control over the physical production process through legal fictions. When so much of actual physical production is outsourced to the independent small shop (be it a Chinese sweatshop or a GM supplier) the corporation becomes a redundant "node" that can be bypassed. As blogger David Pollard described it, from the perspective of a future historian in 2015:

> The expensive outsourcers quickly found themselves unnecessary middlemen. . . . The large corporations, having shed everything they thought was non 'core competency', learned to their chagrin that in the connected, information economy, the value of their core competency was much less than the inflated value of their stock, and they have lost much of their market share to new federations of small entrepreneurial businesses.

Whether or not intellectual property is necessary to profit from certain forms of economic activity is beside the point.

For all the harm it does, intellectual property is not really even necessary as an incentive for innovation. Industrial analyst F. M. Scherer argued in the 1990s, based on a survey of 91 companies, that some 86 percent of all process and product innovations would have been developed from "the necessity of remaining competitive, the desire for efficient production, and the desire to expand and diversify their sales."

And copyright is no more necessary for artistic creation than patents are necessary for invention. In the open-source world there are many businesses that manage to make money from auxiliary services even though their content itself is not proprietary. For example, Red Hat makes money off the open-source Linux operating system by customizing the software and offering specialized customer support. Phish has actively encouraged fans to share its music free of charge, while making money off of live performances and concessions. Radiohead offered a recent album for free download, collecting only voluntary contributions via what amounted to a glorified PayPal tip jar.

Since intellectual property is not necessary to encourage innovation, this means that its main practical effect is to cause economic inefficiency by levying a monopoly charge on the use of existing technology.

In any case, for those whose libertarianism follows from the principles of self-ownership and nonaggression, whether or not intellectual property is necessary to profit from certain forms of economic activity is beside the point. That's the same argument used by protectionists: Certain businesses would be unprofitable if they weren't protected by tariffs. But no one has a *right* to profit at someone else's expense, through the use of force. In particular, no one has the right to make a profit by using the State to prevent others from doing as they please with *their own* pens and paper, hard drives, or CDs. A business model that isn't profitable without government intervention *should* fail. FEE

If You Really Love Volunteers, Mr. Obama . . .

BY JAMES L. PAYNE

Barack Obama gave volunteerism a big boost early this year, visiting service centers on Martin Luther King Day, greeting volunteers, and working alongside them. "Everybody's got to be involved," he said. "If we're waiting for somebody else to do something, it never gets done. We're going to have to take responsibility, all of us."

These are wonderful sentiments, of course. Everyone agrees that a healthy America needs citizens who play a direct role in helping in their communities. However, when we look closely at what it takes to promote citizen involvement, we discover that politicians are straddling a divide. With one hand they wave volunteers on, urging them off their couches, out of their homes, and into community self-help projects. Yet with the other, with the lawmaking hand, they make the prospects for volunteering ever more difficult and daunting.

I was reminded of this paradox the other morning when a shocking e-mail message popped up on my screen. It was from Teresa, the president of a volunteer group we had just started to provide after-school activities for teenagers.

The subject line was, "Liability Issues and Board Function," her way of alluding to the many legal threats and challenges that loomed over our small-town charity. Teresa wrote that she was resigning, effective immediately.

The message was shocking because Teresa was the heart and soul of the teen center. She had felt drawn to these youngsters with their stringy hair and too-long jeans, seeing them at loose ends after school, so ready to drift into drugs, alcohol abuse, and crime, and felt impelled to do something. Her tireless recruiting brought in board members and other volunteers, and her eager telephoning brought us our first donations. Since the center opened last month, she has worked there almost every day, greeting the youngsters, playing ping-pong with them, and leading the prayer at snack time.

Though Teresa's message was shocking, it was not surprising. A volunteer who tries to set up a human-services organization in this country quickly discovers she is entering a jungle of government regulation. This jungle is expensive to negotiate, requiring the assistance of lawyers, tax accountants, insurance agents, and risk assessors, and requires vast amounts of paperwork. Large non-profits have bureaucracies to stay on top of, and defend against, the demands of government officials, but idealistic newcomers have no such protection. They stand alone and unprotected in this jungle, fearful that a legal misstep could, in an extreme case, deprive them of their property or land them in jail. This was how Teresa saw it in explaining her decision to resign. "I can't jeopardize our home," she told me.

> A volunteer quickly discovers she is entering a jungle of government regulation.

We got our first taste of regulation when we tried to open a bank account. Because of new regulations from

Contributing Editor James Payne (jimpayne@nctv.com) has taught political science at Yale, Wesleyan, Johns Hopkins, and Texas A&M. His latest book is A History of Force: Exploring the Worldwide Movement against Habits of Coercion, Bloodshed, and Mayhem.

Homeland Security, we were required to get an EIN (employer identification number) first. Who was going to sign the application for the EIN and offer himself as a hostage to the IRS? I finally agreed to be the guinea pig. As it turned out, the IRS added insult to injury: Just getting the number cost me $88.

Board members started asking if we had a 501(c)(3). This expensive and burdensome paperwork, which began as an IRS device to regulate the charitable tax deduction, has taken on a life of its own in the voluntary sector. Many volunteers assume you aren't a legal voluntary group unless you have it. Others believe it is illegal to raise funds without it, an impression reinforced by donors who keep asking if the group has 501(c)(3) status.

We worried about lawsuits. Parents might sue us if a kid crushed his finger playing air hockey, or if he fell off his bike after he left the center, or if we authorized emergency medical treatment without formal permission. Someone who disagreed with a decision might sue individual board members. Obviously, we needed costly liability insurance, but how many different kinds of insurance did we need? Once, a volunteer suggested taking some teens down the street to rake leaves for a shut-in grandmother. Someone else said she didn't think we had liability insurance for off-premises activities.

We became aware of threats from state and federal agencies. They might prosecute us for failing to adhere to requirements on nondiscrimination, or child-abuse reporting, or the Americans with Disabilities Act. We noticed that under the new Sarbanes-Oxley Act board members can face criminal prosecution for alleged lapses in financial management and disclosure.

The anxiety came to a head at our recent board meeting. Participants reviewed the above-mentioned challenges and brought to light some new ones. One woman feared we were subject to OSHA regulations and could be fined if our rented space was found in violation. Another thought we needed a state permit for a commercial kitchen, since we prepare nachos for the kids in our little oven. Since we were going to hire one part-time employee, that brought upon us the legal requirements of withholding and depositing payments to the IRS: Would we be able to get them all right? In this connection one board member told a frightening tale. She was a bookkeeper for a firm that went bankrupt, and the IRS came to her for missing taxes. "I had to hire a lawyer to defend myself," she said, "and take out a second mortgage on my house to pay for it. I'm never going to go through that again." It was a very depressing meeting, and I was not surprised that it would lead a board member to resign.

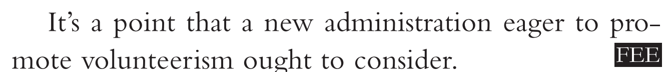
The Unseen Cost of Regulation

In theory government regulation is supposed to prevent bad things from happening. Someone falls on a broken stair, so you set up an agency to punish people with broken steps—or encourage liability lawyers to sue the pants off owners of broken steps. For those who live on the mountaintop of authority, it seems a grand system.

For those of us living in the real world below, government regulation has a nasty side effect: To act against supposed bad apples, you have to burden and intimidate millions of well-intentioned and perfectly innocent people engaged in creative activities. Everyone agrees that in an ideal society, friends should get together to help neighbors in their community, with tutoring, counseling, child care, teen activities, senior care, and so on. Yet this ideal is every day undermined by the tide of government regulation that threatens the liberty and property of local reformers. If we continue down this path, the only safe place for a Good Samaritan will be on the couch watching TV, and the job of helping neighbors will be done—to the extent that it is done at all—by impersonal bureaucracies.

Lawmakers need a broader understanding of regulation. Today, they focus on a supposed problem, like broken steps or misleading bookkeeping, and devise ever more ferocious penalties to punish those thought responsible. With their gaze fixed on malefactors, they overlook the impact of these penalties on the world's benefactors. In the grip of this narrow perspective, lawmakers and liability lawyers are unintentionally creating a social monster, a system of controls and penalties that threatens an idealistic community volunteer with the loss of her home.

It's a point that a new administration eager to promote volunteerism ought to consider.



Health Care: A Future Free-Market Alternative

BY ROSS LEVATTER

I visit a new doctor because of complaints I've been having. The primary-care doctor begins his first visit with me by explaining his payment system. I need to put down a retainer based on his assessment of the time it will take him to deal with my problem, which he'll inform me of at the end of this, his first, evaluation, for which I'll be charged a flat fee. If I find this acceptable, I sign a form stating my understanding.

The doctor indicates that labs, imaging studies, and other services will be paid by me and I can go anywhere I choose. However, he has made arrangements for reasonable fees with quality providers he can recommend if I wish.

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The doctor then takes a history and physical, spending about 30 minutes with me, for which the flat fee is $50. He explains his hourly billing is $100—much less than a typical lawyer charges, I'm happy to note. He tells me at the end of the evaluation that my problem can likely be evaluated in under five hours of his time, and that the retainer will be $500. I will be billed monthly and asked to replenish the retainer if it drops below $150. I can pay cash, write a check, or use a credit card, but I have money saved in a health savings account (HSA), so I just pay using my HSA debit card.

I do not have to wait to see my physician. He makes himself or his physician assistant (PA, who bills at only $50 an hour) readily available to me. He phones and e-mails to answer any questions I have or to convey health information to me in a timely fashion.

The doctor successfully manages my health problem in only three hours over the course of two months and four visits (not all of this is face time, of course; he bills me for his research time, time to consult with other physicians, time to review my test results, time talking with me over the phone or e-mailing me, and so on), and with the final month's bill comes a check for $150, retainer minus charges.

Since I'm generally healthy, I find my costs each year are under $1,000. I recognize that at some point I'll likely have a significant illness, so I have an insurance policy that pays for all charges over $10,000. It's a very inexpensive policy that, like my fire insurance, I've never had to make claims on.

My mother, who has a chronic problem, diabetes, tells me she has a specialist who offers a flat fee per year to his patients. It's more expensive than what I pay, of course, but she uses the service much more than I use mine. Fortunately, she bought insurance coverage years ago, before the diabetes developed, and paid a little extra for guaranteed renewability at a stable price (inflation charges only). She tells me her specialist places his patients in one of three tiers, with graduated prices, based on the severity of their

Ross Levatter (rlevatter@me.com) is a physician in Arizona.

problem and associated complications. In an effort to minimize her charges, she works diligently to keep her blood sugar in the appropriate range and has consequently had few complications so far.

Sadly, some people develop chronic diseases without having obtained insurance. Many of them, who can afford it, simply accept that they will pay more for their health care, just as very litigious people pay more for their legal care. Some can't afford it on their own, and family or church is often there to support them, as was the case before third-party payers took over that role. In addition, such people often receive pro bono care from a wide variety of physicians who feel offering such free care for a percentage of their practice is both good business and the professional thing to do. It's also true that once you have a working relationship with a doctor, he can't just drop you because you're falling behind in payments (which is why doctors demand retainers in the first place).

Many healthcare items—from CTs to cholecystectomies—are clearly priced, and people compare prices and shop for quality as well. You can look up surgeons and radiologists on the Internet, for example, and see what prior customers thought of the quality of their services. Other people choose to use a qualified middleman to recommend a local physician of high quality and reasonable price. Such middlemen advertise their services and list many reasons to use them, including the opportunity to take advantage of volume discounts and to have someone knowledgeable to guide you through the various medical options. Yet others make their own decisions, using the Internet and new software programs, just as they use software to help them make the right taxpaying decisions.

Mayo and Kaiser, among others, take strong advantage of their brand name, which signifies quality, but the competition from many other physicians makes it difficult for them to charge too much additional for "value-added."

Of course, I am not forced to see a licensed physician. If I am willing to assume the risk (usually associated with a lower price) of seeing an unlicensed physician, it is my own choice. The law says only that those offering the services of a physician must truthfully and prominently display whatever certificates they have. Often there is little actual risk: It turns out that many "unlicensed" physicians are simply physicians who are properly licensed elsewhere (another state, another country) but who didn't want to jump through all the regulatory hoops to get one more license. Given that this is allowed, the cost and hassle of additional licenses is, I hear, coming down. (Before these licensing regulations were changed—back in the 1990s, for example—you had bizarre situations where top-flight general surgeons from Britain or Canada became anesthesiologists or even PAs here, because those licenses could be obtained more quickly than that of a general surgeon. What an economically inefficient use of scarce resources, economists pointed out.)

Many healthcare items are clearly priced, and people compare prices and shop for quality as well.

I need not even see a doctor for all my medical complaints. For example, nurse practitioners and PAs both offer deep discounts on monospot swabbing and rapid strep test if I have a sore throat. And pharmacists are happy to make recommendations for medications, which no longer require a physician's prescription. Granted, many people are not comfortable taking what had been prescription meds without some input by a physician and are willing to pay extra for that privilege, but in some instances and with some people, the pharmacist seems sufficient. (Most pharmacists feel comfortable not getting the advice of a physician as to what drugs are best for their diagnosis.) Some upper-scale pharmacies require you to compensate the pharmacists for their time and advice, as you do other professionals, though some large-scale businesses like Walgreens and Walmart offer the pharmacist consultation as part of the price package.

People make mistakes, of course, as with any institution involving human beings, though the mistakes associated with overly burdensome regulation are no longer a problem. When they do make mistakes, they can be sued, as before. But the introduction of a "loser pays"

principle in malpractice suits has reduced spurious lawsuits. Some physicians offer discount fees to those who agree to waive their right to sue, and courts have recently modified past precedent to allow people this option. (Reputation is sufficient to prevent abuse.)

Hospitals are run competitively. Some are small boutique hospitals, catering to those with specific problems—cardiac, musculoskeletal, and others. Others are megaplexes that offer a total package with every imaginable specialist coordinating all aspects of your care. For many problems there are clear prices that cover all aspects (labs, imaging, post-op care), and long-term payment plans are commonplace. Many hospitals have a sliding scale for the less fortunate, but the idea of offering "free care" is considered laughable, since most recognize that people overutilize scarce resources that are underpriced. Some have a local reputation, while others are branches of well-respected national chains. Mayo hospitals are often located near major highways and can be recognized from afar by their bright yellow arches. The price of a major operation is typically more than an inexpensive car, less than an inexpensive house (though transparent pricing and market competition lower these prices each year), and is financed as people finance cars and houses: long-term. Hospital companies, like car companies, have associated financing wings (such as "MAYOAC") that offer long-term financing options.

Some people choose to go without insurance, as is their right. For young, healthy people it is often a reasonable risk to take. When people without insurance have an acute medical problem or trauma requiring immediate care, they are usually treated in a basic fashion and compensation is handled at a later, more appropriate time. Hospitals often try to attract physicians to help with things like trauma by offering to compensate them immediately and up front, adding these costs onto the bill to be financed.

Most people, though, have health insurance. Because there are no state or federal mandates, health insurance is inexpensive, especially for high-deductible packages. You only insure against those things you want to insure against. Cancer and diabetes: yes. In vitro fertilization and hair transplant (to name two of several hundred mandates previously required in one or more of the 50 states): no.

> Most people have health insurance, which is inexpensive. You only insure against those things you want to insure against.

Even a majority of the poor can afford health care now, just as they can, according to government studies, afford flat-screen TVs, air conditioning, computers, cell phones, two cars per family, and many other goods and services not available to the rich of 50 years ago. There is a society-wide discussion about how to help the poorest of the poor—some urge reliance on family, charity, and the resurgent friendly societies; others seek some form of government involvement—but all agree that concern for the poor in no way justifies government take over of nearly 17 percent of the national economy.

Health care is not perfect. But we have saved a lot of money by no longer pretending it could be made perfect if we handed it over to the political class. If only we could as easily solve the continuing problem of first-class mail delivery. FEE

The Shame of Medicine: The Case of General Edwin Walker

BY THOMAS SZASZ

In 1962 James Meredith, an African-American student, tried to enroll at the University of Mississippi. His admission was opposed by Ross Barnett, the Democratic governor of the state, former Major General Edwin A. Walker (1909–1993), a decorated hero of World War II and prominent "right-winger," and a group of segregationist white students. To ensure Meredith's enrollment and maintain order, President John F. Kennedy sent 400 federal marshals and 3,000 troops to Oxford, Mississippi.

On September 29, 1962, Walker issued a public statement: "This is Edwin A. Walker. I am in Mississippi beside Governor Ross Barnett. I call for a national protest against the conspiracy from within. Rally to the cause of freedom in righteous indignation, violent vocal protest, and bitter silence under the flag of Mississippi at the use of Federal troops. . . ."

Gen. Edwin Walker.
Photo courtesy of U.S. Army

The campus demonstration led to a riot in which two people were killed and six federal marshals were injured. Importantly, according to a United Press report, "During a lull in the rioting, General Walker mounted a Confederate statue on the campus and begged the students to cease their violence. . . . His plea was greeted with one massive jeer."

Unnoticed at the time and forgotten today is the fact that while the federal government used the military to guarantee Meredith's constitutional right to equal protection of the laws, it used psychiatry to deprive Walker of his constitutional right to trial. This was another example of my long-held view that we are replacing social controls justified by race with social controls justified by psychiatric diagnosis.

Guilt by Diagnosis

Arrested on four federal charges, including "inciting, assisting, and engaging in an insurrection against the authority of the United States," Walker was taken before a U.S. commissioner and held pending the posting of $100,000 bond. While he was making arrangements to post bail, Attorney General Robert Kennedy ordered Walker flown, on a government aircraft, to Springfield, Missouri, to be incarcerated in the U.S. Medical Center for Prisoners for "psychiatric observation" on suspicion that he was mentally unfit to stand trial.

Walker's entry in Wikipedia mentions neither this nor the ensuing confrontation between Walker's legal team and the government's psychiatric team. The reader is told only that Walker "posted bond and returned home to Dallas, where he was greeted by a crowd of 200 supporters. After a federal grand jury adjourned in January 1963 without indicting him, the charges were dropped."

How could this happen? Was it legal? It was legal, and in *Psychiatric Justice* (1965) I presented a detailed, documented account of how it happened. Here I wish to add a few personal details not previously reported.

News of Walker's psychiatric incarceration had barely hit the newspapers when I received a telephone call from Robert Morris, then president of the University of Dallas, formerly chief counsel to the Senate Judiciary Subcommittee on Internal Security. He identified himself as one of Walker's attorneys, explained he had been given

Thomas Szasz (tszasz@aol.com) is professor of psychiatry emeritus at SUNY Upstate Medical University in Syracuse. His latest book is Antipsychiatry: Quackery Squared.

my name by William F. Buckley, Jr., and asked me to help his team to free Walker from psychiatric imprisonment.

I flew to Dallas and spent a long afternoon and evening with Morris and his team of lawyers. They believed it was obvious that Walker was sane. They wanted me to examine him and say so in court. It was not easy to disabuse them of their conventional beliefs about mental illness as a medical disease and psychiatry as a medical specialty. I summarized the evidence for my view that psychiatry is a threat to civil liberties, especially to the liberties of individuals stigmatized as "right-wingers," illustrated by the famous case of Ezra Pound, who was locked up for 13 years while the government ostensibly waited for his "doctors" to restore his competence to stand trial. Now the Kennedys and their psychiatrists were in the process of doing the same thing to Walker.

I reminded the attorneys that a courtroom confrontation concerning his "sanity" would not be a search for truth or justice (which they well understood), and noted that they were on the losing side of the civil rights battle (which they well knew). I urged them to avoid unnecessary dramatics and focus on freeing Walker from psychiatric detention as their sole goal. Finally, I persuaded them that in a Mississippi courtroom, I—with a foreign name and a foreign accent—would not be the best possible expert for Walker and talked them out of their plan to have me examine him and engage in a contest of "expert opinions" about the predictably dire diagnoses of the government's psychiatric experts. Instead, I proposed that they "nominate" a prominent Dallas university psychiatrist as their defense expert—that is, a local, publicly employed physician who could ill afford to declare Walker insane on the basis of his "racist" views. (Before the Civil War, proslavery physicians in the South diagnosed black slaves who tried to escape to the North as mentally ill, "suffering from drapetomania." In the Walker case, pro-integration psychiatrists in the North diagnosed white segregationists as mentally ill, "suffering from racism.") Next morning I flew back to Syracuse.

Psychiatry is despotism in the service of the Therapeutic State, rationalized as "progressive" science.

For Whose Own Good?

A competency hearing was scheduled. Dr. Robert L. Stubblefield, chief psychiatrist at the Southwest Medical Center in Dallas, was to examine Walker and testify in his defense. The prosecution's expert was Dr. Manfred Guttmacher, long-time chief medical officer at Baltimore City's Supreme Court. Walker's attorneys had no trouble exposing Guttmacher for the evil quack he was. Guttmacher kept referring to Walker as if Walker were his patient and supported the prosecution's request that Walker be incarcerated ("hospitalized") for up to three months, testifying under oath that doing so would be "for Mr. Walker's own good from a medical point of view."

In the end, the government's psychiatric plot failed. Walker was declared mentally fit to stand trial, a federal grand jury refused to indict him, and the charges against him were dropped.

Less than two years later, my view that organized American psychiatry was becoming overtly political, seeking the existential invalidation and psychiatric destruction of individuals who do not share the psychiatric establishment's left-liberal "progressive" views, received further dramatic support. In 1964, when Senator Barry Goldwater was the Republican candidate for president, 1,189 psychiatrists publicly declared—without benefit of examination—that Goldwater was "psychologically unfit to be President of the United States." Many offered a diagnosis of "paranoid schizophrenia" as the basis for their judgment.

Psychiatry is despotism in the service of the Therapeutic State, rationalized as "progressive" science and "compassionate" medical care. In the past, racial stigmatization and segregation were indispensable for the political class and the State. Today, psychiatric stigmatization and segregation are indispensable for the political class and the State. This is why no exposure of brutal psychiatric injustices makes a dent in the mental health system's lofty social status as a benevolent, ethical, scientific medical discipline. FEE

America's Debt Paranoia

BY TODD J. ZYWICKI

The headlines are alarming. The *New York Times* panicked that Americans are "Running in Debt" and just a few years later warned that Americans were "Borrowing Trouble." *Business Week* asked, "Is the Country Swamped with Debt?" and *U.S. News and World Report* worried that "Never Have So Many Owed So Much." *Harper's* even expressed fear that "Debt Threatens Democracy."

A labor leader bemoaned the improvidence of America's consumers: "Has not the middle class its poverty? Very few among them are saving money. Many of them are in debt; and all they can earn for years, is, in many cases, mortgaged to pay such debt."

An academic report concluded that consumers' promiscuous borrowing has "'lured thousands to ruin' encouraging people to buy what they could not pay for and making debt 'the curse of countless families.'" And not merely the poor and improvident were lured into ruin, but upstanding middle-class families as well, as they engaged in a heated rivalry of conspicuous consumption with their neighbors.

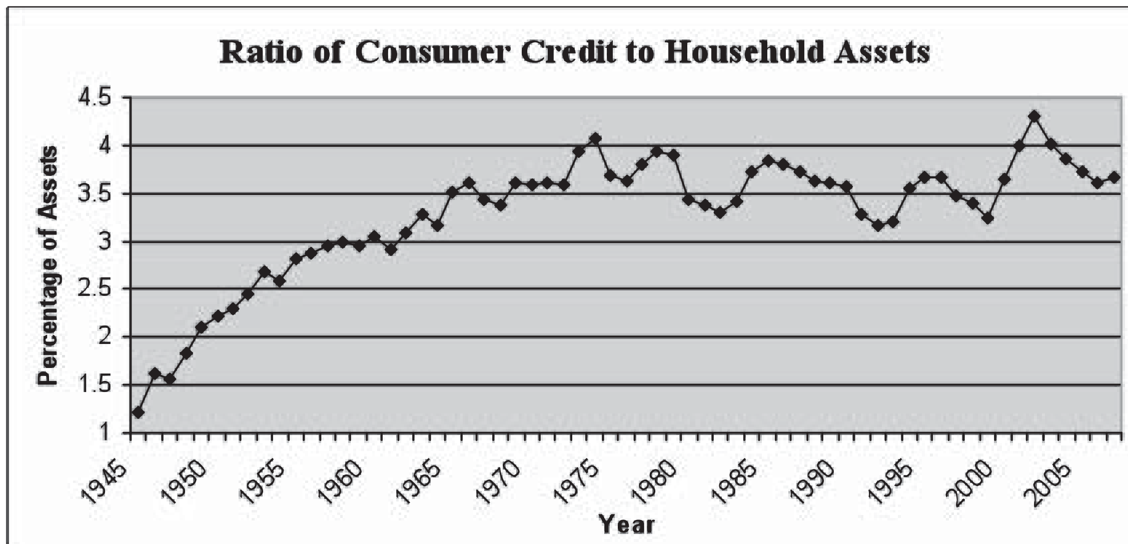
An indictment of our times? Not exactly. The first headline from the *New York Times*, as well as the labor leader's concerns, were both from 1873, and the latter *Times* headline from 1877. The academic report appeared in 1899 and criticized the availability of installment credit, or the practice of buying consumer goods "on time." Thorstein Veblen voiced his concerns about "conspicuous consumption" and Americans' willingness to go into hock to fund it in 1899. The *Business Week* and *U.S. News and World Report* headlines ran in 1959. And *Harper's* fretted that "Debt Threatens Democracy" in 1940.

As these evergreen headlines suggest, three facts of American life appear constant: First, consumer credit is ubiquitous in America; second, at least some Americans have always gotten in over their heads with credit; and third, an omnipresent chorus wails that *other* people are using consumer credit excessively to buy things that they shouldn't want or can't afford. Finally, every era has complained that everybody was thriftier in "the old days," a mindset that author Lendol Calder has referred to as the "myth of lost financial virtue." The massive credit-induced bubble in the real estate market over the past decade and the subsequent crash have led to a reprise of these time-tested themes—and a predictable move toward more government regulation.

> Every era has complained that everybody was thriftier in "the old days."

And, indeed, there was undoubtedly a credit-driven bubble in home prices that has popped with catastrophic effect. But exploding home prices and an expansion of risky real estate lending should be distinguished from trends in consumer credit. Even during the bubble years, over 80 percent of home mortgage debt was for home purchase, home improvements, or other residential real estate, with only about 7.7 percent going for the purchase of goods and services, according

Todd Zywicki (tzywick2@gmu.edu) is a professor at George Mason University School of Law and the author of Bankruptcy and Personal Responsibility: Bankruptcy Law and Policy in the Twenty-First Century.



to a 2009 report in the Federal Reserve Bulletin. Conventional wisdom holds that this growth in mortgage lending was just part of a larger growth in promiscuous consumer borrowing in recent years. But the reality is more complex and interesting. In fact, nonmortgage consumer lending illustrates an evolutionary trend that reaches back decades, rather than a revolutionary change in recent years.

The story of consumer credit in America is one of relentless competition and innovation as the forces of creative destruction have swept away older forms of consumer credit and replaced them with newer types. Central to this story in the second half of the twentieth century is the rise of credit cards. Many commentators see credit cards as uniquely pernicious innovations that have led to disastrously high levels of consumer indebtedness. To understand why this is not the case, it is essential to look back at the use of consumer credit in America.

Consumer Credit in Early America

In pre-Civil War America most Americans were farmers living outside major population centers. Gold and silver coins were scarce. Personal credit, however, was not, and farmers relied on credit to smooth investment and consumption across the crop-harvesting season. Credit, as much as the Conestoga Wagon, conquered the West.

After the war, a tide of immigrants swept into America and built the great cities. Largely unskilled blue-collar workers with unpredictable employment and income, they relied on the consumer credit industry to cope with those uncertainties. In time the emerging American middle class became homeowners and home furnishers through mortgages and consumer installment credit. Overall, late-nineteenth-century households sought financial assistance from five major credit sources: pawnbrokers, illegal small-loan lenders, retailers, friends and family, and mortgage lenders. In post-Civil War New York City, for instance, two-thirds of the city's total consumer lending came from small-loan agencies, including loan sharks and "wage assignment" lenders, forerunners to today's payday lenders. Pawn shops proliferated—in some neighborhoods virtually the entire population had a pawn ticket at all times, and as many as 12 in the winter when factories typically closed down, Calder writes. These various lenders charged interest rates approaching 300 percent annually and resorted to embarrassing and aggressive collection practices to enforce repayment of these illegal debts. (Interest rates on these loans were comparable to modern payday lenders.) Counterproductive usury regulations made operations unprofitable for legitimate lenders, former Federal Reserve Chairman Alan Greenspan has pointed out, driving many urban consumers into the hands of illegal lenders. In 1911 an esti-

mated 35 percent of New York City's employees owed money to illegal loan sharks, a situation Greenspan described as "virtual serfdom."

The most important source of short-term credit for lower-income Americans, however, has been friends and family. Even today, a recent survey of households in low- and moderate-income areas of Los Angeles, Chicago, and Washington found that 53 percent of respondents said they would rely on friends or family to borrow $500 for three months. A recent survey of low-income women in Boston found that 93 percent had actually borrowed money from friends and family in the past and many had lent money to friends and family as well. Ten percent of those surveyed have borrowed *only* from friends and family. But friends and family obviously are not a reliable source of credit.

Consumer credit expanded following World War I. Credit unions, small local savings banks, and a national network of licensed consumer finance companies, such as the Beneficial Industrial Loan Corporation and the Household Finance Corporation, provided consumer loans. These installment loans obliged the consumer to repay a fixed sum plus interest over a fixed period in equal installments.

The typical credit card user carries no balance, and most of those who do carry only a modest balance.

Beginning with Singer sewing machines, installment credit soon spread to furniture, pianos, household appliances, and finally to automobiles. By the 1930s most sales of household furniture, appliances, radios, cameras, and jewelry were credit sales, as were a substantial percentage of rugs, hardware, sporting goods, and books (such as encyclopedia and other book sets). Financing these purchases through credit made it possible to acquire and use the goods immediately, rather than having to save for long periods of time to afford them. Between 1900 and 1939 total consumer non-mortgage installment debt quadrupled in real dollars, increasing 2½ times during the 1920s alone.

Consumer debt exploded in the 1940s and 1950s during the postwar migration to the suburbs as consumers used credit to buy new cars and to fill their new homes with new furniture and appliances. The ratio of consumer credit to household assets rose from about 1 percent to over 3 percent from 1945 to 1960, where it has hovered ever since.

Today's concerns about credit cards echo similar paternalistic comments about the spread of installment credit. Installment selling allegedly induced overconsumption by American shoppers, Calder notes, especially by supposedly vulnerable groups such as "the poor, the immigrant, and the allegedly math-impaired female." By the same token, rapacious installment sellers supposedly led unworthy borrowers to purchase unnecessary products, generating overwhelming debts, by extending credit. Department stores were criticized for "actively goad[ing] people into contracting more debt." Critics called installment selling a "menace" that trapped Americans in "a morass of debt" and the "first step toward national bankruptcy."

Moreover, although most Americans believed that installment selling was a "good idea" in general and were confident in their own ability to use it responsibly, three out of four also thought that their neighbors used installment credit excessively—a judgment mirrored in modern surveys of consumers about credit card use.

Overall, most Americans use credit cards responsibly. Less than half of credit card owners carry a balance, and the median value of revolved balances is about $3,000, with a mean of $7,300. Thus, the typical credit card user carries no balance, and most of those who do carry only a modest balance, especially compared to their mortgages, auto loans, or student loans. The fact that some people misuse credit cards—just as they misused installment credit in the past—does not justify reducing access and raising costs to millions of those who use their cards responsibly.

Early Credit Cards

The dawn of the age of credit cards was just an evolution of this trend. Although department stores, gas companies, and hotels began using crude versions of credit cards even before World War I, the modern age of credit cards began with the introduction of Diner's

Club in 1949. Diner's Club, unlike its predecessors, was a third-party card honored by many merchants. Diner's Club bore the risk of nonpayment, not the merchant. In return for this assured payment and convenience, participating merchants paid a 7 percent fee for each use.

But universal third-party cards took off slowly. Retail store credit cards dominated the consumer credit market through the 1970s, primarily because usury laws restricted certain types of consumer lending. Usury regulations generally produce three types of unintended consequences. First, they encourage lenders to "re-price" other terms of their credit contracts to try to offset the inability to charge market rates of interest, such as requiring larger down payments, higher upfront fixed fees or annual fees, shorter grace periods, or myriad other terms. Second, usury regulations lead to product substitution, such as switching to less-preferred types of credit like pawn shops or payday lenders. Third, to the extent re-pricing and switching are not fully possible, some borrowers may be unable to get any legal credit on any terms. All three phenomena appear to have resulted from the usury regulations imposed in the 1970s.

A rapid rise in underlying interest rates in the 1970s combined with usury caps made credit card operations for banks unprofitable. Thus bank-type credit card operations remained modest. Banks avoided some of the restrictions by altering other terms of the cardholder agreement or bundling lending with other services. Banks in states with strict usury regulations restricted their hours of operation, reduced customer service, tied their lending operations to other products and services not restricted in price (such as requiring checking or savings accounts), or imposed higher service charges on demand deposit accounts or checking account overdrafts. Most important, to evade usury regulations credit card issuers imposed annual fees, usually ranging from $30 to $50. (Because this fee was assessed on revolvers and transactors alike, it effectively resulted in transactors subsidizing lower interest rates for revolvers.)

In 1978 the Supreme Court effectively deregulated interest rates on credit cards. The results have been dramatic.

Issuers adjusted other terms of the credit contract to compensate for the inability to charge a market rate of interest, including adjusting grace periods and using alternate methods for calculating interest charges. Credit card issuers also rationed credit card privileges to only the most creditworthy consumers, forcing others to turn to less-attractive types of credit.

Credit-issuing department stores had an even more effective way of evading usury restrictions: They could simply bury the credit losses in the price of the goods they offered and sell the bundled product. For instance, prices on major appliances, typically sold on credit, were significantly higher in states with the strictest usury caps. Retailers in these states also reduced their services to consumers. Usury laws also provided large retailers with a substantial comparative advantage over smaller competitors who could not afford to establish and maintain their own credit operations.

Credit Cards Today

In 1978 the Supreme Court effectively deregulated interest rates on credit cards by holding that the applicable rates for nationally chartered banks would be those of the issuing bank's home state, rather than of the consumer (*Marquette National Bank v. First of Omaha Corp.*). The results have been dramatic. In 1970 only 16 percent of American households had a general-purpose bank-type card; today 71 percent do.

By effectively eliminating usury regulations, *Marquette* eliminated the incentives to engage in term re-pricing. Beginning in the early 1990s credit cards eliminated annual fees on standard cards, making pricing more efficient and more consumer-friendly, and enabling consumers to hold multiple cards simultaneously. This spurred heated competition that has led to lower interest rates, the general elimination of annual fees, and a proliferation of card benefits.

Credit cards have grown at the expense of layaway and installment-purchase plans important to the sales volume at many retail stores in earlier decades. The same applies to all unsecured credit products.

While pawn shops, layaway plans, payday lenders, check cashers, personal finance companies, retail store credit, rent-to-own, loan sharks, and friends and family have all served as important sources of consumer credit in American history, those who use these high-priced and inconvenient lending products today do so because they are unable to get credit cards at all or have reached their credit limits.

Beware Well-Intentioned Regulations

As this brief history suggests, falling prices and growing consumer choice over time have defined the dynamic of consumer credit. Consumers today are no longer captives of local banks or pawnbrokers. Instead, they can choose from over 6,000 issuers of credit cards operating in a national market. Instead of being forced to buy their new stereo or television from the local department store just because that is the place that happens also to offer credit, consumers can buy appliances at small boutiques, through a catalogue, or online, and use their general bank card to pay for them.

> Historically the greatest threat to modernization of consumer credit has been the heavy hand of government regulation.

As a consequence of the general tightening of credit markets over the past year, however, consumers and small businesses have lost some access to the lower costs and more flexible terms of credit cards. According to news reports, the response has been a migration toward greater use of alternative types of credit—like pawnshops, layaway plans, and payday lenders—by middle-class borrowers and small businesses. Drying up access to credit card credit will roll back the clock to these old forms of credit that had been thought long abandoned.

Historically, though, the greatest threat to modernization of consumer credit has been the heavy hand of government regulation. Like usury laws, the so-called Credit Cardholders' Bill of Rights, passed earlier this year, can be expected to have many unintended consequences, too. For example, it prohibits issuers from raising rates "retroactively" on outstanding credit card balances. This proposal, however, ignores that fact that unlike traditional installment credit, a credit card loan amounts to a new loan every month—hence the name "revolving." Similarly, consumers can pay off balances with no prepayment penalty by switching to a new, lower-interest card. Under the new regulation consumers can always reduce their interest rate by switching cards, but the credit card issuers are prohibited from raising rates when economic conditions change. As a result issuers will be reluctant to offer lower rates on the front end. This will mean less flexibility and higher rates for all consumers.

Once again we'll see that the Law of Unintended Consequences can't be repealed. FEE

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A Family of Heroes

BY STEPHEN DAVIES

In any major city, particularly a capital, the great majority of statues and memorials pay tribute to monarchs and presidents, priests, generals, and statesmen. This reflects the way history is commonly understood and taught: as the story of the achievements of those associated with political power, government, and war. Memorials to the historical figures associated with trade, science, and industry are much less common, although such people have played at least as significant a part in human history.

In a large park in the heart of the Indian city of Jamshedpur, however, stands an exception to this story: a statue of and public memorial to Jamsetji Tata. Jamsetji Tata was truly a hero and indeed the founder of what we may call a dynasty of heroic figures who have played a major part in the history of modern India and, increasingly, the world. Born into a Parsee family in 1839—when Britain still ruled India—young Tata came to live in Bombay (now Mumbai) when his family moved there and set up in the cotton trade. He worked in the firm and established trading links to Hong Kong and east Asia. In the 1860s the firm went bankrupt due to the disruption caused by the American Civil War. However, he refounded the company and went into manufacturing, setting up a large cotton mill at Nagpur.

The Tata family.
From the Collection of the Tata Central Archives

Early Liberal and Visionary

As a successful businessman by the end of the 1870s, he became involved in public life in India and was associated with the early classical liberal elements of Indian nationalism as represented by people such as Dadabhai Naoroji and Pherozshah Mehta. He also came to have four great goals or visions. These were to build a truly world-class hotel in Bombay, to create a top educational institution, to set up hydroelectric power in India, and to create a profitable domestic steel industry. He devoted the rest of his life to realizing these, with the help of his cousin Ratanji Tata and his sons—particularly the elder, Dorabji.

In 1903 he opened the Taj Mahal hotel in Bombay, built at a cost of $250,000. In 1901 he and Dorabji hired American technical experts to search for sources of iron ore and coking coal in a suitable location for building a steelworks. The search began seriously in 1904 but Jamsetji died while visiting Germany that May. Dorabji carried on the search and in 1907 discovered an ideal site and a virtual hill of iron ore at the village of Sakchi, about 150 miles west of Calcutta. The Tata Iron and Steel Company was incorporated that year. Unable to raise capital on the London market but undaunted, Dorabji and Ratanji returned to India and raised what was needed by subscription from more than 8,000 domestic investors. The first steel ingots rolled out of the new plant in 1912. Meanwhile another of Jamsetji's goals had been realized with the formation of the Tata Power Company in 1911 to provide the required power. The firm also had to construct its own railroad, locomotive, and railroad-engineering works.

Following this the Tata firms continued to grow and develop, although they only survived the 1930s economic slump because Dorabji and other family members pledged their entire wealth as security. Dorabji

Stephen Davies (steve365@btinternet.com) is a program officer with the Institute for Humane Studies.

died in 1932. In 1938 Ratanji's son J. R. D. Tata stepped in to run the firm. He would remain chairman until 1991. He was the first qualified Indian pilot and a pioneer of aviation. He founded India's first airline in 1932. It became Air India in 1946 before being nationalized by the Nehru government in 1953. When J. R. D. took over, the Tata group contained 14 companies. It had grown to 95 by the time he retired, with expansion into areas such as chemicals, automobiles, and tea. In 1945 he realized the last of Jamsetji's goals by creating the Tata Institute of Fundamental Research, now one of India's leading universities. Unlike many of his contemporaries, who became hugely wealthy by exploiting the so-called "permit-raj"—the nightmare of regulations and permits created by the Nehru administration—J. R. D. refused to give bribes to politicians or use the black market. He insisted instead on high ethical standards, first-class performance and customer service, and concern for the welfare of employees.

The Tata family had a vision that they pursued and realized in the face of seemingly insuperable difficulties, obstacles, and setbacks.

Real Heroes of Indian Independence

The Tata group, now headed by J. R. D. Tata's son Ratan Tata, is of course still very much with us. Tata Steel is now the world's sixth largest steel company, while Tata Power is the largest private electric power producer in India. In fiscal year 2009 the group grossed $72.5 billion and it continues to expand and innovate. Thus in 1998 it launched Westside, a major retail chain, and in the same year launched the Nano, a car priced at just $2,200. The village of Sakchi, which became the site of the original steelworks, is now a small part of the city of Jamshedpur, which has a population of over one million. The company built the entire city from scratch and still runs it. Unlike other major Indian cities, it has reliable supplies of electricity and potable water. Politicians have moved to set up a municipality but have met resistance from the local population, which values the honesty and efficiency of the current administration. Jamshedpur is perhaps one of the largest examples in the world of the provision of a huge range of "public goods" by a private entity. Among other things, it is a model for environmental protection, despite still being the home to a huge steelworks and many other massive manufacturing plants.

In a sane world this family would receive the kind of kudos that scholars give to politicians and soldiers. The objection of course is that these are mere businessmen (and businesswomen—Simone Tata is the head of Westside, for example). In fact the stories of Jamsetji, Dorabji, and J. R. D. Tata show the qualities of classical virtue, which we traditionally associate with heroism. They had a vision that they pursued and realized in the face of seemingly insuperable difficulties, obstacles, and setbacks. They achieved their vision not through the use of force or fraud or by compelling people by threats, but by open, free exchange and agreement. It was done and continues to be done by providing products and services of high quality that people buy voluntarily. Throughout, there has been an emphasis on honesty and high standards.

Jonathan Swift famously observed that the man who made two blades of wheat grow where but one grew before did more for humanity than the entire tribe of philosophers and politicians. Who has done more for India over the last hundred years? The Tata family shows that we should never forget that commerce and business at their best are virtuous activities more worthy of respect than many kinds of activity that get far more attention. FEE

The Rise and Fall of Curaçao's Offshore Financial Sector

BY ANDREW P. MORRISS

In the late 1970s virtually every major U.S. corporation had a subsidiary in the Dutch Caribbean island of Curaçao, which was used to obtain cheap capital from the vast Eurodollar bond market. By 1982 the Eurobond market reached $48.9 billion, compared to the U.S. corporate bond market's $33.5 billion, and more than half was likely issued through Curaçao-based subsidiaries of U.S. firms. Many early hedge funds (including George Soros's) were also domiciled there.

A few years later Curaçao's offshore finance business collapsed almost overnight. How did an obscure Dutch possession in the Caribbean come to be so important to the U.S. economy and why did its finance business collapse so quickly? As the United States and European Union ramp up their war on offshore finance, a look back at the history of Curaçao provides a cautionary tale about the conflict between onshore tax authorities and offshore financial centers (OFCs).

> A look back at the history of Curaçao provides a cautionary tale about the conflict between onshore tax authorities and offshore financial centers.

The discovery of oil in Venezuela launched an economic boom in Curaçao beginning at the start of the 1920s. Venezuelan political instability made the Anglo-Dutch oil company Royal Dutch Shell unwilling to refine oil there, and so the company built a major refinery in Curaçao. Along with prosperity, the refinery brought accountants, lawyers, and other professionals to the Dutch islands, a crucial ingredient for the development of the OFC. Even more came after Nazi Germany invaded the Netherlands and Dutch multinationals shifted their legal domiciles there. An entrepreneur, Anton Smeets, created the Curaçao International Trust Company (CITCO) to manage overseas Dutch firms for their owners.

While most of the multinationals returned to the Netherlands after the war, the companies had learned how to operate in Curaçao, and Smeets seized the opportunity to persuade them to locate subsidiaries there by convincing the Antillean government to create a special low-tax regime with rates of 2.4–3.0 percent for foreign companies legally resident in Curaçao but not physically doing business there. Curaçao's OFC was born.

The Dutch islands were able to seize the opportunity Smeets provided because the restructuring of the Kingdom of the Netherlands after the war left them considerable autonomy over their domestic affairs. In an unsuccessful attempt to persuade Indonesia to remain part of the kingdom, the Dutch offered their non-European possessions equal status within a federal structure. Indonesia left anyway, but the remaining territories saw considerable advantages to remaining. However, the five smaller Dutch islands (Aruba, Bonaire, Saba, Sint Eustatius, and

Andrew Morriss (morriss@law.uiuc.edu) is H. Ross and Helen Workman Professor of Law and Professor of Business at the University of Illinois, Urbana-Champaign. A longer examination, with footnotes, of Curaçao's rise and fall, "Change, Dependency, and Regime Plasticity in Offshore Financial Intermediation: The Saga of the Netherlands Antilles," by Craig M. Boise and Andrew P. Morriss, is forthcoming in the Texas International Law Journal *and is available on SSRN (www.tinyurl.com/n8tlkx).*

Sint Maarten) resisted being lumped together with Curaçao in a single entity, fearing the larger island would dominate the shared government and grab most of the development assistance expected from the Dutch. A compromise brought the six together into a federal unit (the Netherlands Antilles) within the larger kingdom and solved that problem, but left the islands without enough politicians to effectively run three levels of government. To solve the staffing problem, kingdom institutions were scaled back, with the Dutch Parliament and cabinet serving as the Kingdom Parliament and cabinet when augmented by overseas members.

The refinery-driven economy slowed after the war as automation began to reduce labor needs and Venezuelan demands for a share of the refining business prompted Royal Dutch Shell to shift capacity to the mainland. This provided Smeets with a ready audience for his proposals for economic development through financial services. The island's relationship with the Dutch gave it the remaining two things it needed to attract international businesses. First, since they could appeal to the highly regarded Dutch courts in The Hague, investors did not need to fear that local prejudice would influence cases. Second, the Netherlands' postwar tax treaty with the United States allowed for a routine extension to Dutch overseas territories, making the Antilles attractive for U.S. firms. With these elements in place, Curaçao began to attract offshore business despite the twin handicaps of an unfamiliar (to Americans) civil law legal system and the requirement of Dutch-language legal documents.

The Growth of the Finance Subsidiaries

In the 1960s the combination of social spending and Vietnam war financing strained U.S. capital markets. The Treasury pressed U.S. multinationals to raise funds outside the United States to finance their foreign operations, encouraging firms to tap into the growing market of dollars deposited in non-U.S. banks. Rising U.S. interest rates in the 1960s led companies to seek Eurobond issues to fund their domestic operations as well. A major obstacle was the 30 percent "withholding tax" the United States imposed on interest payments to foreigners. Since corporate bonds were typically issued on a net basis, a U.S. issuer would have to "gross up" the interest payments to make up for the tax, raising the cost of borrowing and eliminating the advantage of borrowing from the Eurocurrency markets.

The U.S.-Antilles tax treaty exempted interest payments to Antillean entities from this tax. Thus if a U.S. firm established a subsidiary in the Antilles, the subsidiary could sell Eurobonds in the London market and relend the money to its American parent. Interest payments to the subsidiary by the parent would be exempt from the tax under the treaty, and the Antilles imposed no tax on the subsidiary's payments to the third-country bondholder.

> As Americans and foreigners alike became accustomed to the use of Antillean entities, creative entrepreneurs began to find new uses for them.

As Americans and foreigners alike became accustomed to the use of Antillean entities, creative entrepreneurs began to find new uses for them. Moreover, like most civil-law jurisdictions the Antilles permitted the use of anonymous bearer shares, making the ownership of Antillean entities an effective means of concealing the identity of the owner. For foreign investors nervous about domestic reaction to their ownership of U.S. assets, particularly Middle Eastern investors worried about a backlash from the Arab oil embargo in the early 1970s, this provided additional security for foreigners' investments in the United States.

However, as use of Antillean entities grew, so too did opposition within Treasury and law enforcement agencies. Treasury discovered that the tax treaty with the Antilles was becoming what it termed a "treaty with the world," as individuals from countries without tax treaties with the United States created Antillean companies to conduct business here. A newfound concern with "treaty abuse" became a major policy matter at Treasury, although the Antilles insisted that this "abuse" was just a relabeling of long-standing practices consis-

tent with international law. Most important, Treasury found many countries uninterested in negotiating tax treaties with the United States, as their citizens could avoid the 30 percent withholding tax simply by routing their U.S. investments through the Antilles. By undermining Treasury's biggest carrot, the Antilles treaty hampered efforts to persuade countries to sign on to information-sharing agreements with the United States. In addition, Treasury worried that Americans were opting for Antillean vehicles to hold U.S. investments, illegally but undetectably evading U.S. income taxes via the anonymous bearer shares. Law enforcement authorities had similar concerns about money laundering.

By the end of the 1970s the Treasury (which handled U.S. tax treaties) was determined to do something about the Antilles. In 1982, it canceled the tax treaty with the British Virgin Islands; this was intended to send a signal to the world that the United States was serious about closing what it saw as "loopholes" in treaties. This and other measures persuaded the Antilles to open negotiations, and for a time it appeared that a new agreement would be reached. Ultimately this proved impossible, as American demands for information on ownership of Antillean entities and limitation of benefits to entities formed by Antillean residents could not be accommodated without destroying the Antilles' business model and changing fundamental international legal principles about corporate citizenship. Unable to conclude a new treaty, Treasury announced cancellation of the tax treaty in July 1987, effective six months later.

Curaçao's financial sector never recovered from this blow. As a result of the loss of revenue, the Antilles became more dependent on Dutch subsidies, and internal disputes among the six islands led to an ongoing reorganization of their relationship with the Netherlands. Aruba pulled out of the Antilles, but not the kingdom, in the 1980s; Curaçao and Sint Maarten are scheduled to assume similar status in the near future; and the remaining three islands will become overseas municipalities within the Netherlands. The result was the loss of a major funding source, increased emigration to the Netherlands, and greater dependence on Dutch subsidies. Almost half the Antillean population now lives in the Netherlands, including a significant number of young people. In addition, Dutch money has come with strings, and the Netherlands is more involved in Antillean government today than in the past, reducing Antillean sovereignty in practice if not in theory.

Lessons from the Antilles

Curaçao's rise and fall has three lessons for the rest of the world. First, the fragility of even a robust financial services industry is a cautionary tale in an era when government regulators are assuming unprecedented powers over financial institutions. Curaçao lost a thriving financial sector in an instant because of policy changes in the United States. Once gone, it has proven remarkably difficult to get back.

> The Antillean finance industry illustrates how international financial transactions benefit both parties.

Second, the Antillean finance industry illustrates how international financial transactions benefit both parties. The Antilles obtained economic development and government revenue; the United States lowered its firms' cost of borrowing, making them more competitive.

Third, Curaçao lost its leading position because it was not sufficiently flexible to adapt to changed circumstances. The dominant OFCs today—Barbados, Bermuda, the Cayman Islands, the British Channel Islands, Hong Kong, Singapore—have prospered because they have adapted to the changing international climate by inventing new products and services. The creation of captive-insurance laws in Bermuda, Cayman, and Guernsey, for example, brought those jurisdictions considerable business by providing business structures initially unavailable elsewhere. Curaçao had a chance to seize the lead in a number of areas—George Soros located his hedge funds there and a number of others followed—but the island did little to provide specialized services or laws for the nascent funds industry, which is now largely in Cayman.

Curaçao's government was unable to respond to new opportunities as quickly for several reasons. The

government paid less attention to the financial sector than its rivals' governments did, in part because of internal divisions over access to Dutch subsidies. Moreover, the Netherlands is itself a financial center, and the Dutch-controlled kingdom government has been less responsive than the governments of independent jurisdictions (like Barbados) or U.K. overseas territories (like Cayman). As a result, the Netherlands has a more favorable tax arrangement with its fellow EU member Malta than it does with the Antilles. Finally, government business in the Antilles is conducted in Dutch, requiring everything from corporate documents to statutes to be translated. This introduces uncertainty, cost, and delay. This is a significant handicap in an era when some Caribbean OFCs are now allowing the filing of corporate documents in Chinese.

The United States and many European nations are putting new pressures on OFCs through measures like the Stop Tax Haven Abuse Act in the United States and the European Union's Savings Directive. These measures risk harming both sides. Today's OFCs depend on the international financial services industry, but the United States and Europe also benefit from these jurisdictions. For example, a heavy-handed regulatory approach is likely to increase costs for the many U.S. nonprofit hospitals that use the Cayman Islands for their insurance needs, divert investment capital from the United States by making it harder to organize investment funds in tax-neutral jurisdictions, and raise the cost of everything from air travel to televisions by harming the structured finance and shipping registry businesses that enable firms to cut costs. Perhaps the most important lesson for onshore governments has something to do with avoiding cutting off of one's nose to spite one's face. FEE

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Arrogance

BY JOHN STOSSEL

It's crazy for a group of mere mortals to try to design 15 percent of the U.S. economy. It's even crazier to do it in a few months.

Yet that is what some members of Congress presumed to do. They intended, as the *New York Times* put it, "to reinvent the nation's health care system."

Let that sink in. A handful of people who probably never even ran a small business actually think they can reinvent the healthcare system.

Politicians and bureaucrats clearly have no idea how complicated markets are. Every day, people make countless tradeoffs in all areas of life based on subjective value judgments and personal information as they delicately balance their interests, needs, and wants. Who is in a better position than they to tailor those choices to best serve their purposes? Yet the politicians believe they can plan the medical market the way you plan a birthday party.

Leave aside how much power the State would have to exercise over us to run the medical system. Suffice it to say that if government attempts to control our total medical spending, sooner or later, it will have to control *us*.

Also leave aside the inevitable huge cost of any such program. The administration has estimated $1.5 trillion over ten years with no increase in the deficit. But no one should take that seriously. When it comes to projecting future costs, these guys may as well be reading chicken entrails. In 1965, hospitalization coverage under Medicare was projected to cost $9 billion by 1990. The actual price tag was $66 billion.

The sober Congressional Budget Office debunked the reformers' cost projections. Trust us, Obama says. "At the end of the day, we'll have significant cost controls," presidential adviser David Axelrod said. Give me a break.

> How do these arrogant, presumptuous politicians believe they can know enough to plan for the rest of us?

Who Knows Best?

Now focus on the spectacle of that handful of men and women daring to think they can design the medical marketplace. They would empower an even smaller group to determine—for millions of diverse Americans—which medical treatments are worthy and at what price.

How do these arrogant, presumptuous politicians believe they can know enough to plan for the rest of us? Who do they think they are? Under cover of helping uninsured people get medical care, they live out their megalomaniacal social-engineering fantasies—putting our physical and economic health at risk in the process.

Will the American people say "Enough!"?

I fear not, based on the comments on my blog. When I argued that medical insurance makes people indifferent to costs, I got comments like: "I guess the 47 million people who don't have health care should just die, right, John?" "You will always be a shill for corporate America."

Like the politicians, most people are oblivious to F. A. Hayek's insight that the critical information needed to run an economy—or even 15 percent of one—doesn't exist in any one place where it is accessible to central planners. Instead, it is scattered piecemeal

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John Stossel is co-anchor of ABC News' "20/20" and the author of Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong, *now in paperback. His blog, "John Stossel's Take," is at http://blogs.abcnews.com/johnstossel.* *Copyright 2009 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

among millions of people. All those people put together are far wiser and better informed than Congress could ever be. Only markets—private property, free exchange, and the price system—can put this knowledge at the disposal of entrepreneurs and consumers, ensuring the system will serve the people and not just the political class.

To the extent the politicians ignore the benefits of entrepreneurship, they are the enemies of our well-being.

This is no less true for medical care than for food, clothing, and shelter. It is profit-seeking entrepreneurship that gave us birth control pills, robot limbs, Lasik surgery, and so many other good things that make our lives longer and more pain-free.

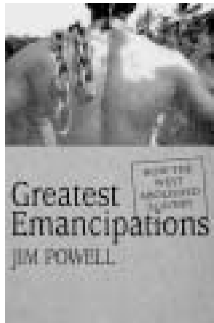
To the extent the politicians ignore this, they are the enemies of our well-being. The belief that they can take care of us is rank superstition.

Who will save us from these despots? What Adam Smith said about the economic planner applies here, too: The politician who tries to design the medical marketplace would "assume an authority which could safely be trusted, not only to no single person, but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it." FEE

Book Reviews

Greatest Emancipations: How the West Abolished Slavery
by Jim Powell
Palgrave Macmillan • 2008 • 288 pages • $26.95

Reviewed by George C. Leef



From time immemorial until the eighteenth century, slavery was an accepted fact of life in most of the world. It was hardly ever questioned, and there were no mass movements calling for its abolition. That finally changed as a result of the success of capitalism. Once people no longer had to labor unceasingly just to satisfy their basic needs, some turned their attention to the suffering of others—prisoners, children in orphanages, animals, and especially slaves. They began criticizing the cruelty of slavery and formed organizations dedicated to ending it.

Historian Jim Powell's latest book deals with the most momentous of all humanitarian movements, the effort to abolish slavery. He gives us a fascinating, detailed investigation of the antislavery campaigns in Britain, the United States, Brazil, Cuba, Haiti, and the Belgian Congo. We meet courageous heroes and unspeakable villains. Powell digs into the arguments, plans, and tactics of pro- and antislavery forces. A focal point of the book is the relative efficacy of nonviolent and violent methods of rooting out slavery. Probably the most controversial aspect of *Greatest Emancipations* will be Powell's conclusion that nonviolence is better.

The first problem that slavery's opponents faced was the absence of a clear reason why people should rise up against it. Slavery was approved by both law and religion. Slaveholders had persuaded many that economic prosperity depended on it, and some of their political allies pushed the idea that it was necessary for national defense. (One of the wonderful contributions of the book is how it illustrates the timelessness of arguments against liberty: Today we often hear similar claims that the economy will deteriorate or the nation's defenses will crumble unless the government continues some authoritarian policy.)

So how could abolitionists get any traction with the deck stacked against them? They advanced the idea of universal human rights. That concept had begun to take hold in seventeenth-century England, and opponents of slavery logically extended it to cover the terrible violation of rights entailed by slavery. Great abolitionists such as Thomas Paine, William Wilberforce, and William Lloyd Garrison won people to their side by arguing that slavery was inconsistent with a coherent theory of individual rights, no matter what the church or the law might say.

Of the six historical cases Powell examines, half involved warfare (the United States, Haiti, and Cuba) and half were mostly peaceful (England, Brazil, and the Congo). What the abolitionists accomplished in the latter instances was to turn public opinion so strongly against slavery that support for it collapsed. Englishmen, Brazilians, and Belgians worked tirelessly and often at great personal risk to tell people the truth about slavery. With gusto, Powell relates the stories of those heroic individuals.

We learn, for instance, about Joaquim Nabuco, a Brazilian who used his magnificent speaking skills to rouse the people against slavery in his country, organizing and speaking at antislavery rallies around the country. When challenged by proslavery advocates who said that ending it would mean economic devastation, he replied, "I fear that the destruction of slavery would affect property as much as I fear that the ending of piracy would destroy commerce."

There are many more stories like this, reminding us that it is possible to stop evil laws and practices if individuals with the right convictions devote themselves to the cause.

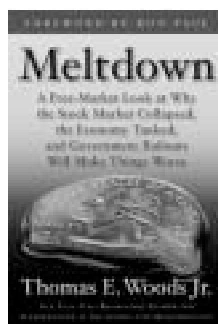
Powell's examination of the abolitionist campaign in the United States and the Civil War will be of utmost interest to readers. He argues that, had peace been maintained, in time slavery would have ended in the southern states without enormous death and destruction, and also without the later recriminations against freed blacks that produced in the postwar era, as another writer puts it, "slavery by another name."

Slavery is based on violence, and Powell argues that it could not persist for long without assistance from government, such as our notorious fugitive slave law. Instead of having the State employ violence to abolish slavery, Powell shows that the vastly better course was for abolitionists to work to get it to stop supporting slavery. FEE

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

Meltdown: A Free-Market Look at Why the Stock Market Collapsed, the Economy Tanked, and Government Bailouts Will Make Things Worse
by Thomas E. Woods, Jr.
Regnery • 2009 • 194 pages • $18.45

Reviewed by Steven Horwitz



Thomas Woods's *Meltdown* is a marvel of writing and publishing. Having arrived on shelves in February, it offers a complete analysis of the causes of the current recession as well as a critical assessment of the mistakes policymakers have already made, and will likely continue to make, in response to the economic decline.

The marvel is the speed with which Woods put together a book of almost 200 pages and Regnery got it on the market. Under the circumstances, one might expect the book to come up short in coverage or depth of analysis, but it doesn't. In fact *Meltdown*, despite a couple of minor flaws, is the best one-stop analysis of the recession available, which makes it *the* book to give anyone who wants to understand how government intervention caused this mess and how Austrian economics can explain those causes and the problems with the proposed cures.

The opening chapter provides an overview of events as well as a taste of the mainstream media analysis of the meltdown. Mostly that consisted in blaming it on "free market," or "unregulated" and/or "laissez-faire" capitalism, with almost no one asking whether such an assessment of blame makes any sense. That chapter also acknowledges the "elephant in the room"—namely, the Federal Reserve System. Woods rightly notes that almost all the commentary on the recession has ignored any substantive discussion of the role that the central bank played in creating the boom that in turn led to the bust.

The broad case for government as the cause of the meltdown is offered in chapter two. Woods names six "culprits." First are Fannie Mae and Freddie Mac, the government-sponsored enterprises that dominate the mortgage market. Largely immune from profit and loss, and able to "make markets" in ways that truly private firms are not, Fannie and Freddie created implicitly government-backed markets for trading mortgages and mortgage-backed securities. This encouraged mortgage originators to keep creating new mortgages, however risky, knowing that Fannie and Freddie could use their special line of credit at the U.S. Treasury to buy those up and resell them on the secondary market. This was hardly a "free market." Rather it was one in which these creatures of government operated without being subject to the market's own normal regulatory processes—namely, profit and loss and risk management.

Minor culprits include the Community Reinvestment Act and other forms of affirmative action in lending, as well as the ways that government policy stimulated speculation. Among the factors Woods mentions here is the role played by the credit ratings agencies, which are themselves a cartel protected by the Securities and Exchange Commission. This is a point that many observers, even free-market ones, have overlooked in their analyses. Woods is to be commended for bringing it in.

But the bulk of his blame lies with the Fed. Woods offers a complete analysis of the Fed's role in the context of an accessible account of the Austrian theory of the business cycle. He clearly explains the interaction of savings, time preferences, and interest rates under stable monetary conditions in order to show what happens when the Fed intervenes with an expansionary monetary policy. Chapter five follows up with a good discussion of the myths of the Great Depression.

The final two chapters are on money and "what now?" The key argument of both is that the Federal Reserve System and the other elements of central

banking are the real source of trouble and that we should reconsider this institution. Woods includes a nice refutation of a number of arguments against gold and other commodity standards. These two chapters are valuable, although I wish Woods had acknowledged that his implicit monetary theory, including his definitions of inflation and deflation, is not the only one in the Austrian tradition. (It relies on a Rothbardian 100-percent-reserve perspective on money and banking.)

Although in a few places Woods comes across as unnecessarily angry, which might turn off readers not predisposed to his message, *Meltdown* is in many ways an extraordinary achievement. He has digested complex theory and a whole range of recent history and presented the single best analysis of the current recession out there. It is a terrific example of using Austrian economics and free-market thinking to analyze the real world—and doing it in a way that is highly accessible to the general reader. FEE

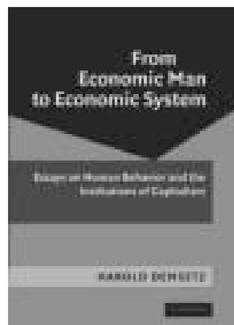
Contributing Editor Steven Horwitz (sghorwitz@stlawu.edu) is Charles A. Dana Professor of Economics at St. Lawrence University.

From Economic Man to Economic System: Essays on Human Behavior and the Institutions of Capitalism

by Harold Demsetz

Cambridge University Press • 2008 • 198 pages • $60.00 hardcover; $48.00 e-book

Reviewed by Gary Galles



Harold Demsetz is among the ten most frequently cited economists in the world. What makes him worth reading is that he has made his mark not through virtuosity with empty formalism but rather by careful reasoning about fundamental questions and evidence. His latest book, *From Economic Man to Economic System*, continues that tradition.

Demsetz considers a wide array of topics, all presented verbally so that the discussion can be followed without any formal economics training. They include fascinating discussions of Richard Dawkins's selfish-gene hypothesis, how capitalism solved the Malthusian population trap, why it took so long for the market order to develop, and why political parties act differently from firms. But his greatest contributions are his defenses of the spontaneous coordination of markets against attacks grounded in logical confusion. Three are of particular note.

Demsetz devotes a chapter to Robert Frank's *Luxury Fever*. Frank argues, following Veblen and Galbraith, that the wealthy seek higher stature by acquiring more luxury goods than their peers, but that the attempt is self-defeating, supposedly justifying progressive consumption taxes to control that wasteful market failure. Demsetz responds, "My objection is to those who believe that we are so locked into serious decision errors that we must be coerced into doing that which we knowingly choose not to do." He reveals holes in Frank's logic, then adds several societal advantages Frank did not consider, including the fact that status-seeking through consumption is far more benign than status-seeking through power over others, which history has shown to be both bloody and massively destructive of liberty. He concludes that "Free choice is much too precious to surrender just because the wealthy buy more expensive goods than some of us think they should. . . . [T]he free society does not entitle [anyone] to coerce them into submission to his idea of what is good for them."

Similarly powerful is Demsetz's discussion of how transaction costs are misunderstood. He refutes the conclusion, tracing it to Ronald Coase, that "positive transaction costs can make the competitive economic system function inefficiently." That idea has spawned almost uncountable assertions of market failure, backed by proposals for "corrective" government coercion. Demsetz shows that courts can make errors in the assignment of rights, but that markets efficiently respond to those errors: "Legal error has caused the problem, not positive transaction cost. There is no inefficiency in the way the market accommodates to the court's mistake."

Perhaps most powerful is Demsetz's analysis of the supposed "separation of ownership and control" in

large corporations, particularly relevant when blaming out-of-control management for everything is in vogue. Demsetz shows that it is not a market failure and that government "fixes" will make matters worse. In a nutshell, the separation-of-ownership-and-control "story" is that large corporations have so many small shareholders that no one monitors management carefully and managers routinely benefit themselves at shareholder expense. Demsetz shows how that story works only by ignoring several market mechanisms that address it. For example, if shareholders know management will mistreat them, they protect themselves by paying less for shares. Takeover possibilities triggered by low share prices also restrict misbehavior. And managers will not ignore how misbehavior will undermine their advancement and future incomes as managers, typically their greatest financial asset.

Demsetz shows that "separation" claims arise from ignoring that one cannot delegate authority without agents (managers) facing different incentives from their principals (stockholders). Principals, however, would not willingly bear such costs except to capture even greater benefits. So where "separation" critics see only deviations from efficiency, Demsetz recognizes that self-interested owners would only choose the corporation form, warts and all, when they expect the gains to exceed the costs, increasing efficiency. Therefore, corporate governance does not demonstrate market failure.

Demsetz further traces these confusions to a mistaken understanding of economists' standard model of competition, which causes many errors in antitrust and regulation. It is actually a model to explain why beneficial spontaneous coordination will emerge in markets, even in the complete absence of central planning. However, its assumption that no individual has power over any choice, useful for understanding decentralized market coordination, makes it an inappropriate standard for judging real-world competitive behavior within or between firms.

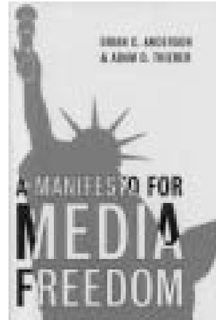
Demsetz's understanding of real individual and institutional behavior and his defense of the market order make *From Economic Man to Economic System* well worth reading for those committed to defending freedom. FEE

Gary Galles (gary.galles@pepperdine.edu) is a professor of economics at Pepperdine University.

A Manifesto for Media Freedom

by Brian C. Anderson and Adam D. Thierer
Encounter Books • 2008 • 180 pages • $21.95

Reviewed by Brian Doherty



Americans are blessed with access to an unprecedented variety of media—not to mention ways in which information can be stored and the points of view and ownership interests represented.

As documented in the brisk book *A Manifesto for Media Freedom,* this cornucopia of media options has led not to celebration of the marvelous diversity that free choices and technology have brought us. Rather, it has prompted forces from both sides of the conventional ideological spectrum to agitate for regulation and restriction of the ownership and delivery of information and entertainment.

The *Manifesto*, by Brian C. Anderson of the Manhattan Institute and Adam D. Thierer of the Progress and Freedom Foundation, is a quick and useful survey of various media regulation realities and proposals, and of cogent explanations of why such regulations range from unnecessary to powerfully damaging to American media users.

The book's greatest virtue is how thoroughly and compactly it delivers the good news about the scope and availability of media. Many antimarket liberals in America are obsessed with fears of too few owners controlling too many different kinds of media outlets, and thus plump to further tighten federal rules about media ownership concentration. (Earlier attempts by the FCC to liberalize those rules were knocked out by a federal appeals court back in 2004, and this year Congress squashed a new attempt by the FCC to loosen them.) Obsession with ownership rules is based on the same misunderstanding that allows for government regulation of broadcast media of a sort that would never be tolerated for other media: that an inherent scarcity requires government to manage distribution and ownership, despite the First Amendment.

As Anderson and Thierer point out, scarcity is far from an issue when it comes to how Americans get

their information and entertainment nowadays. America has nearly 14,000 terrestrial radio stations, twice the number in 1970. (And we now have satellite radio as well.) Cable and satellite TV reach 86 percent of American households. And they are not all controlled by a small cabal of sinister megaconsortiums. As they note, a "2002 FCC survey of ten media markets—from the largest (New York City) to the smallest (Altoona, Pennsylvania)—showed that each had more outlets and owners in 2000 than in 1960."

New means of consuming, storing, and using media are spreading with wildly increasing speed. It took telephones 70 years to go from introduction to 50 percent household saturation; it took Internet access around 15, and MP3 players (which allow portable listening of not only music but all sorts of news and information "podcasts" available for free) even fewer. And the average price for every variety of contemporary electronic media device has fallen anywhere from 17 to 41 percent in the last five years.

All that good news misses the best and most important aspect of our media present and future—the uncountably huge number of websites where everyone everywhere is able to communicate with everyone else. Such a world of free media plenitude doesn't seem to need much in the way of managing.

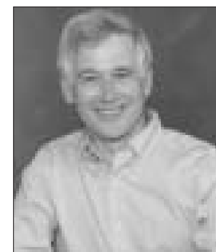
But such wondrous profusion of cultural richness—and no one person is going to value or approve of all of it, but that's exactly the point—means nothing to elites who lament that everyone isn't consuming the media that *they* think people *should* be consuming. This manifests itself in all sorts of regulatory moves, from attempts to censor or hobble innovations such as video games and social-networking sites, to the desire to force us all to pay for "public" broadcasting that can't survive in the marketplace. As Anderson and Thierer note, the political world is rife with people who "won't rest until all of us are watching, reading, and listening to the content that they prefer."

They are savvy in pointing out the most dangerous "media regulation" of all, masquerading as "campaign finance reform," which restricts all except the owners of officially approved media from speaking out freely on candidates and issues within an arbitrary period before an election—and trace the dangerous moves to enforce such tyranny on websites and radio.

The authors are, I think, alarmist in insisting that the Obama administration or the current Democratic Congress will move to reinstate the clearly damaging and unconstitutional Fairness Doctrine (though the Supreme Court unconscionably upheld it the 1969 case *Red Lion v. FCC*). But they are dead on about how it crippled, and would cripple again, lively discussion by enforcing "equal time" on broadcast media in political controversies.

The overall message of this book is optimistic: "The new media abundance will improve democracy, fire creativity, and expand individual and communal knowledge and know-how." But the authors know this will only remain true if citizens make sure those who would regulate away the advantages of free-flowing new media are kept in line. FEE

Brian Doherty (bdoherty@reason.com) is a senior editor at Reason *magazine and author of* Radicals for Capitalism: A Freewheeling History of the Modern American Libertarian Movement *(PublicAffairs) and* Gun Control on Trial *(Cato Institute).*



The Real Meaning of Privilege

BY DAVID R. HENDERSON

"They live in an expensive mansion, fly first-class to foreign countries, and eat at the finest restaurants. They send their kids to private schools. They're so privileged."

How often have you heard some variant of the lines above? I'd bet it's a lot. Yet, typically, the word "privileged" is inaccurate. We certainly all know or know of people who have a great deal of wealth and who spend it the way the people in the quoted lines do. But are these people *privileged*? Not necessarily. They're obviously wealthy, but that's not the same as being privileged. Privilege, instead, has to do with receiving special treatment, typically from government, because of one's special legal status.

Friedrich Hayek points this out in his 1944 book, *The Road to Serfdom*. According to Hayek, the right to own land was at one time reserved for the nobility. That was privilege. But the term, he writes, came to apply to anyone who owned property, even though virtually every adult now has the right to own property. We see something similar today. Rich people are called "privileged" even if they earned their wealth without political pull. Those who are poor, on the other hand, are called "underprivileged," even if their being poor has nothing to do with having less than the average amount of privilege.

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There are many examples of privilege all around us. Think of the student who attends a heavily subsidized state university. The university passes on much of the subsidy by charging a low tuition. Who pays for this subsidy? Taxpayers pay, and these taxpayers include people who will never attend a subsidized state university. The students who do attend are privileged. Why don't many of us think of them as privileged? Because they are not typically wealthy. We have confused wealth and privilege.

Or think of the union member who is paid a wage premium because his powerful union has bargained for high wages. Those high wages discourage employers from hiring as many workers as otherwise. Some of the workers who are priced out of the union jobs work instead in nonunion jobs that pay less. This distinction has become so noticeable in western Europe that economists talk about insiders and outsiders. The insiders are the people working under union protection, many of whom vote for high-wage contracts that cause others not to be hired. Those not hired are outsiders. And why does the union have such power? Because of legal privileges the government gives them. Even in the United States, the government requires that if 50 percent plus one of the nonmanagerial employees at a firm vote for a union, all of that firm's nonmanagerial workers must have the union as their sole bargaining agent. That is privilege.

Another example of a privileged group, an example that came to light recently, is the approximately one million government employees in California who have special license plates that shield them from toll-booth transponders and red-light cameras. California's state government has made it easy for its employees to get such license plates and impossible for other Californians to get them. Moreover, according to www.techdirt.com, when the police stop these state employees for traffic violations and look up their

David Henderson (davidrhenderson1950@gmail.com) is a research fellow with the Hoover Institution and an economics professor at the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, California. He is editor of The Concise Encyclopedia of Economics *(Liberty Fund) and blogs at www.econlib.org.*

records, they find that the drivers are in the "protected" category. Some officers will then decide not to write the ticket. That is privilege.

There are many more such examples. They include hospitals in Illinois, which are protected from competition by a tortuous process that others have to follow to build a new hospital or outpatient medical facility. It was this last regulation, incidentally, that allies of Illinois's notorious ex-governor, Rod Blagojevich, used to shake down Mercy Hospital (www. tinyurl.com/kjggoq).

Regulators' Privilege

Which brings me to one of the most oppressive forms of privilege: government regulation itself. The regulators, simply by virtue of the discretionary power they hold, have privilege. Their privilege is their power to tell the rest of us what to do and to impose sanctions on us if we disobey.

Although wealth and privilege are not the same, it is true that privilege often leads to wealth. Consider the recent census data on U.S. counties with the highest median household incomes. In 2006 five of the top ten (including the top three) were near Washington, D.C.: Fairfax County, Virginia; Loudoun County, Virginia; Howard County, Maryland; Montgomery County, Maryland (eighth); and Arlington County, Virginia (ninth). One reason for this is that working for or lobbying the government attracts highly skilled people who would likely do well elsewhere. But a big reason is that many government employees are in the privileged positions of regulators and granters of privilege.

But this is all just semantics, right? Well, not quite. Once we start using the word "privilege" where what we really mean is "wealth," we start applying this term to those who came by their wealth without special privilege—the Bill Gateses of the world, sure, but also the more-common successful businessmen or professionals who are earning a few million dollars a year down to a few hundred thousand dollars a year and who don't show up on any "richest people" lists. The vast majority of people who get rich in even a semifree economy such as ours do so by producing goods and services that others value. But because the word "privilege" carries a negative connotation, when we call someone "privileged," we are communicating, even if unintentionally, that this person came by his money dishonestly. And if you think that this is not a major issue, consider what President Obama's first budget book, an official U.S. government publication, said about the highest-income people in the United States: "While middle-class families have been playing by the rules, living up to their responsibilities as neighbors and citizens, those at the commanding heights of our economy have not."

There you have it. After decades of using the word "privilege" instead of "wealth," we have the ultimate result: a government that is officially hostile to high-income people.

There you have it. After decades of using the word "privilege" instead of "wealth," we have the ultimate result: a government that is officially hostile to high-income people, whom it accuses, in a completely unsupported claim, of not "playing by the rules."

There's one other major problem with the misuse of the word "privilege." It robs us of the word we need when we really want to oppose privilege. Try objecting to the kinds of privileges I laid out above without using that word. You'll find your justified outrage blunted. In his novel *1984* George Orwell wrote about how the absence of words to express a thought makes the thought harder or impossible to express. The function of the successive editions of the "Newspeak Dictionary" in *1984* was to take away the ability to express certain thoughts. And the oppressors in *1984* who promulgated the famous "Freedom is Slavery" and "War is Peace" slogans did so to confuse people so that they would cease trying to understand. It's time to end that confusion and reclaim a powerful word that has been misused by those who wish to reduce our freedom. FEE