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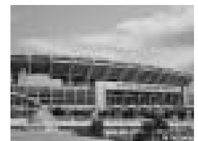
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Perspective

The Government Turns on Goldman Sachs

Goldman Sachs took a beating during the spring. The SEC and a Senate committee were investigating whether it behaved improperly when it participated in a bet against the shaky mortgages fueling the housing boom and allegely failed to disclose this to buyers of its "synthetic collateralized debt obligations."

The allegation of wrongdoing is an empirical question, of course, but a few things occurred to me as the case was unfolding:

Financial firms have been roundly criticized for their "herd mentality"—that is, their incentive to run headlong into too-risky mortgage-backed instruments because everyone else was doing it. No firm wanted to be on the sidelines having to explain to its clients why everyone was making tons of money but them. Yet here Goldman went against the herd, and was coming under fire precisely for that reason. By betting against the sustainability of the boom (if that's what it did) on the basis of hedge-fund trader John Paulson's analysis, it injected needed information about the housing bubble into the market. More information is always better than less, and no social good would come from restrictions on activities that produce information that goes against the trend, such as short selling and trading credit default swaps. Whether fraud was in the picture, I can't say (it seems doubtful), but I am confident that Goldman's hedge strategy—and its delight over making money when mortgage-backed securities started losing value—would have drawn criticism in any event. It's a no-win situation.

Second, the absolute worst place to get to the bottom of things is in Congress. Every member of the committee had an overriding incentive to engage in demagoguery, information be damned. Goldman Sachs is not exactly a positive household name, so which congressman could have resisted the temptation to denounce the company in public? It's an easy target with no downside risk.

If there is evidence of criminal activity, there are appropriate agencies for such investigations. Better

yet, if the "victims" of Goldman Sachs really believe they are victims, let them sue. This is not to say that criminal-justice agencies are above demagoguery—politically ambitious U.S. attorneys are notorious for it—but at least we should be spared the spectacle of self-righteous congressmen pontificating on matters for which the Congress itself is heavily responsible: the housing boom and encouragement of dubious mortgages. We already suffer the obscenity of Sen. Chris Dodd and Rep. Barney Frank rewriting the financial rules to prevent, so they say, a repeat of the debacle that they themselves did so much to bring about. *These* people are the systemic risk.

Finally, we must not lose sight of the fact that whatever Goldman did, it was in the context of a corporate State, a banking cartel, and loose fiat money, in which Big Finance exercises extra-market power derived from the rules written by Congress and the regulatory agencies. That's the derivative to worry about.

These are hardly free-market enterprises. It is no coincidence that current and former Goldman principals have their fingerprints all over the government's bailout response to the meltdown and that the firm was a major beneficiary. In an actual free market—without inflationary fiat money, implicit guarantees behind underwriters of dubious mortgages, and regulatory protection against open competition—a financial debacle such as we've seen is unlikely to have occurred. Even so, that doesn't mean that everything that went on was a crime.

⋆ ⋆ ⋆

Greece, one of many overextended welfare states, is facing the kind of fiscal crisis that some people fear is in America's future. Steven Horwitz thinks we'd better pay attention.

Congress keeps trying to create a national ID, despite repeated rejections. Now the politicians are trying to smuggle it in via immigration. Becky Akers won't let them past Customs.

Doctors say they want government out of medicine, but do they mean it? Theodore Levy analyzes the economics and decides they really don't.

Energy is on everyone's mind, and everyone has a plan. As Robert Bradley, Jr., shows, the best plan is no plan at all.

"Profit" remains a dirty word, but maybe if people understood how pervasive it is in human action, they'd think differently. Richard Fulmer explains.

When government grows, it doesn't only shrink freedom. It also sets in motion a moral atrophy. James Dorn revisits this issue.

President Obama wants more people to go to college. George Leef says too many go already.

A nighttime satellite photo of the border between North and South Korea couldn't be more revealing. T. Norman Van Cott explains the economics behind the stark contrast.

Here's what our columnists have whipped up: Lawrence Reed visits Walmart. Thomas Szasz identifies the essence of psychiatry. Robert Higgs digs into the government's debt. John Stossel shows how politicians ruin cities. Charles Baird sees respect for unions sinking ever deeper. And Jeb Bleckley and Joshua Hall, reading the claim that higher taxes are benign, rebut, "It Just Ain't So!"

Books on medical costs, pirates, public-employee unions, and thrift come under our reviewers' microscopes.

—*Sheldon Richman*

Good Economists, Bad Economists, and Walmart

BY LAWRENCE W. REED

Good economists are seldom popular with the political class. This is not unique to democratic systems; dictators like good economists even less.

Why?

As a rule, politics doesn't educate. It obfuscates, pontificates, and prevaricates. It often seeks to advance the interests of the few at the expense of the many. It is a playground for the shortsighted and the demagogic. Economics, on the other hand, tells us a great deal about how material life can be improved through the operation of entrepreneurship and markets. It informs us that there are laws beyond those that legislatures pass, and consequences for ignoring them.

The good economist takes the discussion of economic matters to the lofty level it deserves. While others spout clever sound bites, unsubstantiated charges, and snake-oil remedies, the good economist raises his hand and calmly declares, "Wait a minute! Let's look at the facts. Let's separate the wheat (truth, logic, and evidence) from the chaff (nonsense, false assumptions, and panaceas)."

Many people assume that bigness in business automatically implies a woeful trail of victims.

Last summer at the FreedomFest conference in Las Vegas I witnessed a remarkable debate on the question, "Wal-mart: Good or Bad for America?" The debaters were Al Norman, described as the "guru of the anti-Wal-Mart movement," and Richard Vedder, Ohio University economist and coauthor with Wendell Cox of the 2007 book, *The Wal-Mart Revolution: How Big Box Stores Benefit Consumers, Workers, and the Economy*. The clash between Norman and Vedder couldn't have typified better the difference between good and bad economics. Norman is no economist, but he'd be a bad one if he were. His arguments against Walmart were just as specious and superficial as those of *New York Times* columnist and Nobel laureate Paul Krugman, who *does* have the audacity to call himself an economist.

Krugman on numerous occasions has poured his vitriol on the retail giant, whom he charges with waging a "war on wages." His diatribes were often cited a couple of years ago when the anti-Walmart drumbeat reached a fever pitch in Washington and in political campaigns around the country.

Big Box of Polarization

The Norman/Krugman critique of Walmart is little more than an anti-capitalist rant against a company that pays no more than it has to in order to attract the workers it needs and sells its wares at prices others sometimes find it difficult to compete with. Not surprisingly, demagogic politicians have used their arguments in a populist crusade for government to "do something" about Walmart.

Perhaps it was inevitable that the one company virtually all of us have patronized would become a political football. Any firm that makes its way to the top spot on the Fortune 500 list, as Walmart did for the first time in 2002, is bound to attract attention and polarize people, getting praise and admiration from some and envy and hostility from others. More than a few people have come to assume that bigness in business automatically implies a woeful trail of victims; some of those folks then make a nice career out of convincing the victims to accept their help. All too often emotion drives the debate at least as much as information does.

As an occasional patron of big-box retail stores like Walmart, I could never quite relate to many of the routine attacks on them. On each visit I park in an ample

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parking lot. I'm greeted by employees who smile, say hello, ask to help if I seem to need assistance, and thank me as I walk out the door. If I'm unhappy with price or service (I can't remember the last time I was), I know I can get a quick refund and shop elsewhere. My search costs as a consumer are usually lowered by buying there, and it seems my wallet benefits as well—no doubt because competition makes big-box retailers pass on their natural economies of scale in the form of lower prices.

The sheer volume of Walmart's trade alone suggests that far more people vote for Walmart with their dollars than for president or Congress. I could choose to work for Walmart myself but I don't; if I did accept an offer to work for the company, I could quit at the drop of a hat if I felt exploited.

Even as an economist, I still learned much that I didn't know from a 2007 book by Michael J. Hicks, *The Local Economic Impact of Wal-Mart*. I authored the book's foreword, from which I've drawn heavily for this column. Hicks shows that Walmart's influence on labor markets is surely less than most would expect, in part because it employs less than 1 percent of the U.S. workforce. The company receives comparatively little in the way of subsidies in spite of the misguided generosity of state and local governments that try to pick winners and losers in the marketplace.

The average person lives longer than most companies do. Size is hardly a guarantee of permanence.

The anti-Walmart campaigns of today are eerily reminiscent of the Luddite crusades against chain stores seven decades ago—proof of the old adage that the more things change, the more they remain the same. The 1975 law against resale-price-maintenance agreements probably gave a huge, unintended boost to big-box retailers at the same time it hurt smaller, more traditional stores. And it's quite likely that other big-box retailers have more to fear from an efficient, aggressively competitive Walmart than do locally owned mom-and-pop shops.

But as Hicks himself explains, economics is less about a particular firm than it is about the markets in which it operates and the market forces that both propel and discipline the behavior of all firms.

Good economists know all this. Bad ones advise politicians to save us from a company millions of Americans endorse every day with their hard-earned dollars.

Corporations: Dropping Like Flies

Corporate mortality in free (or relatively free) markets is markedly high. The average person lives longer than most companies do. Competition, after all, is a dynamic, ongoing, leapfrog process whereby today's leader can become tomorrow's follower, or even disappear altogether. Size is hardly a guarantee of permanence. Indeed, the vast majority of the firms on the Fortune 500 list 40 years ago are no longer with us. It should be sobering to even Walmart's most severe critics that not even their behemoth nemesis can safely behave as though markets don't matter.

So while the Normans and the Krugmans and their political friends deliver their jeremiads, the rest of us happily choose to buy—or choose not to buy—from the object of their wrath. If justice prevails, Walmart's fate will hinge on keeping its workers and customers happy, not its critics.

Nothing clarifies and informs quite like facts—backed up with solid evidence, emotion-free analysis, and sound, logical reasoning. That's why bad economists are generally more popular in government than good ones. FEE

Higher Income Taxes Are Benign? It Just Ain't So!

JEB BLECKLEY AND JOSHUA HALL

In a recent issue of the online magazine *Slate*, former New York Governor Eliot Spitzer attempts to debunk the alleged myth that higher taxes reduce growth (www.tinyurl.com/y4trlve). Spitzer opens with the undeniable truth that the "American debate over taxes is ferocious and highly partisan." If only he had continued to state the obvious, we would not feel compelled to write this response.

Spitzer, however, does not stop there. He begins by longing for a simpler time, a time before people took notice of obscenely high levels of taxation. After all, Spitzer reminds the reader, it was the great Franklin Delano Roosevelt who argued in 1942 that in a time of "grave national danger" no American ought to have an after-tax income in excess of $25,000 (about $325,000 in today's dollars). "Can you conceive of a modern president suggesting that no American should earn more than $323,000 after taxes?" he wistfully notes.

Taxes and Growth

Sadly, Spitzer's defense of high marginal tax rates did not end with normative statements in favor of higher taxes on the wealthy. After a brief and surprisingly lucid explanation of how correlation is not causation, he states, "[I]t's obvious that there is no correlation between higher marginal tax rates and slowing economic activity. During the period 1951-63, when marginal rates were at their peak—91 percent or 92 percent—the American economy boomed, growing at an average annual rate of 3.71 percent. The fact that the marginal rates were what would today be viewed as essentially confiscatory did not cause economic cataclysm—just the opposite."

Then he adds, "And during the past seven years, during which we reduced the top marginal rate to 35 percent, average growth was a more meager 1.71 percent."

We could, of course, play the same game by choosing different starting and ending points (say, the late 1940s or 1990s). However, we prefer to stick to a discussion of the peer-reviewed academic literature, as Spitzer promises to do when he cites a *Yale Law Review* article while defending his claim that "more sophisticated efforts" to find a relationship between marginal tax rates and economic growth have produced "murky" results. According to Spitzer, this review of the literature in the *Yale Law Review* "concludes that there is scant, if any, legitimate academic support for the proposition that moderate, as opposed to dramatic, increases in marginal tax rates have any impact on the willingness of the wealthy to participate in the economy."

> Marginal taxes are the ones that matter for behavior.

Setting aside the question of what "moderate" increases in marginal tax rates are, it needs to be pointed out that this article is not a review of the literature at all but a book review! It is hard to fathom that a book review—even a review of a book on how the wealthy respond to changes in taxes—can overturn the

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basic economic conclusion that higher income tax rates inhibit growth.

Marginal taxes are the ones that matter for behavior because, as the Austrian economist Carl Menger first pointed out his 1871 book, *Principles of Economics*, individuals behave according to their subjective valuation of the marginal benefits and costs of an action. Higher income tax rates therefore reduce the marginal utility of working—since after-tax income goes down—and will usually reduce the number of hours worked or the amount of income realized. This is because if you are getting less reward you will be less willing to suffer the least pleasant parts of your job, giving an incentive to cut back on your hours or some similar action.

Plenty of Evidence

Thus it is no surprise that if you were to look at the *economics* literature you would see plenty of research showing that higher marginal income tax rates reduce growth. In a 2006 issue of *Tax Notes*, for example, Harvard economist Martin Feldstein estimates that a 1 percent increase in marginal income tax rates would cause taxable income to fall by $6.6 billion. When combined with the decline in payroll tax revenues, Feldstein estimates that every additional dollar of revenue raised costs taxpayers $1.76 when all the costs of raising the revenue are included. As we are unaware of any government projects or programs that yield more than $1.76 in output for every $1 spent, we feel it is pretty safe to say that higher marginal tax rates will lower growth.

These results hold at the state level as well. University of Colorado at Boulder economists Barry Poulson and Jules Gordon Caplan looked at state marginal income tax rates and economic growth from 1963 to 2004 in a 2008 article in the *Cato Journal*. They found clear evidence that "higher marginal tax rates had a negative impact on economic growth in the states." The same has been found across major developed countries, as a 2002 article in the *European Journal of Political Economy* pointed out.

Maximizing growth is not the same thing as maximizing well-being. Even if people work more to pay higher tax bills, keeping growth up, that doesn't mean they are better off.

Growth and Well-Being

As you can see, had Spitzer delved a little deeper into the academic economics literature, he would have found ample evidence in favor of the conclusion that marginal tax rates affect economic behavior, including economic growth. Even if the empirical evidence showed otherwise, of course, this would not have made the case for higher marginal tax rates. Maximizing growth is not the same thing as maximizing well-being. Even if growth does not fall in response to higher marginal income tax rates because people work more to pay the higher tax bill, that doesn't mean they are better off. Clearly they would prefer a world where they had more after-tax income and the liberty to spend it as they wanted. Whether the criterion is economics or liberty, however, the answer is the same: Higher marginal tax rates are a bad idea. FEE

Greece: The Canary in the U.S. Coal Mine?

BY STEVEN HORWITZ

With everything that was going on in the U.S. economy this past winter, the beginnings of the crisis facing the Greek economy were certainly easy to miss. As that crisis has now come to full flower, American observers overlook it at their peril: Greece's problems, and those of other European countries, might well represent a possible future for the U.S. economy if we cannot get our fiscal house in order.

Like a canary in a coal mine, the crisis in Greece should serve as a warning that polluting the fiscal air with large budget deficits, a growing public sector, and high debt-to-GDP ratios is a sure way to kill an economy. A serious examination of the situation in Greece should lead other Western countries to think carefully about the paths they are on. Continuing growth in government expenditures means continued deficits, which means growing debt—which means temptation to inflate and the possibility of default.

The cycle of deficits and debt leads down a dead-end road. Once a nation starts on that road, it must make a conscious decision to turn around or it will find itself with the same sorts of problems that plague Greece.

Understanding the crisis that faces Greece, and could face the United States, requires a short detour into the world of fiscal policy. In their path-breaking book, *Democracy in Deficit*, Richard Wagner and Nobel laureate James Buchanan offer one of the clearest examinations of the nature of the bind we find ourselves in. They argue that for most of the history of the West, governments treated their budgets much like a household would treat its budget: Expenses should be paid out of current income, with two exceptions. First, large expenditures on capital items with long lives could be financed with debt. Second, in times of crisis, especially war, debt was an acceptable way to pay. But, they note, the expectation was that any such debt incurred would be paid off with surpluses during the life of the capital item or after the war. Temporary deficits were acceptable, but permanent ones were not.

Permanent debt was problematic because its costs were borne by future generations. This reduced future

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economic growth while unjustly taxing not only those "without representation" but also those who had not even been born yet!

The rise of Keynesian economics changed all of this by offering a theory of government and the economy that drove a stake through the heart of the old implicit fiscal constitution. Keynesian economics removed the long-observed constraints on deficit spending by arguing that governments should use the budget to steer the economy: running deficits during recessions to stimulate macroeconomic aggregates and surpluses during good times to prevent the economy from getting out of hand.

Politicians were thrilled with this change, since increasing spending without raising taxes is a sure-fire way to get votes. Because most government spending concentrates benefits on a few identifiable groups but spreads the future costs of borrowing thinly across many people, it is easy to get votes for spending. Perennial deficits resulted because politicians had no incentive to do what Keynesian blackboard models advised: run surpluses in good times. Budget surpluses are generally vote losers for politicians. Buchanan and Wagner demonstrate that once the old restraints were broken, a cycle of spending, deficits, and debt was sure to follow.

Because most government spending concentrates benefits on a few identifiable groups, it is easy to get votes for spending.

To finance that rising debt governments must be able to sell bonds. As long as bond markets have confidence that governments will be able to pay back the debt, the bonds will be sold. And because most governments are considered politically stable, government bonds usually have no risk attached to them and thus provide safe, if low, returns.

If bond buyers hesitate, however, governments face one of two scenarios: They will have to sell their bonds at a lower price, which implies higher future interest payments, or they will use their central banks to create money to buy up their own bonds, which is likely to be inflationary. Rising debt is also self-perpetuating since continued deficits mean more interest payments, which increase future expenditures and contribute to future deficits.

Herculean Profligacy

Against this background, Greece found itself in trouble early this year. After the country moved to the euro in 2001 it had better access to investment markets; politicians naturally reacted by dramatically increasing government spending. Government accounts for approximately 40 percent of Greek GDP, and government workers there have some of the most lavish benefits in Europe, including the possibility of retirement at age 50 or earlier. That large State sector explains Greece's low ranking (81st) on the Index of Economic Freedom. Not surprisingly, it has a high degree of economic and political corruption, as well as rampant tax evasion. By 2009 the budget deficit was 12.7 percent of GDP and the debt was 113 percent of GDP. The government tried to cover up the extent of its debt by fudging its numbers, which helped precipitate the crisis.

The most obvious sign of Greece's problems was the rise in the interest rate on its ten-year bonds to 7 percent, which is high for government bonds. (By contrast, the yield on U.S. ten-year bonds averaged 3.5-4 percent for the first three months of 2010.) Those high rates reflected a loss of confidence in Greece's ability to pay its debts. The problem, of course, is that those high rates exacerbate the self-perpetuating nature of deficits by requiring larger interest payments in the future, leading to greater deficits.

Since Greece, as a euro country, has no central bank of its own to buy up its bonds, and foreign investors (who own 80 percent of the debt) found the lending too risky, concerns about default rose substantially, prompting calls for emergency bailout loans from healthier European Union countries such as Germany.

The Greek government proposed a variety of measures to try to cut expenditures, including raising the retirement age, overhauling the tax system, and reducing government-employee pay and benefits. Government workers and other union members, predictably, reacted with protests and threatened social unrest if the austerity measures took effect.

This is the trap that Buchanan and Wagner identified. By concentrating benefits on the few, government spending creates beneficiaries who would sustain concentrated losses when spending was cut—giving them every reason to resist the cuts. So Greece finds itself in a bind: To reduce its debt and the possibility of default it must cut spending, which is enormously unpopular among influential constituencies. The near trillion-dollar bailout engineered in May only enables Greece and other beneficiaries to delay the difficult decisions they will eventually have to make.

If we look at some comparable numbers in the United States today, we can see how far the Bush and Obama administrations have taken us down Greece's path. The most recent data from the Congressional Budget Office (CBO) are sobering. If the Obama administration's proposed budgets pass, the deficit would be $1.5 trillion this year and $1.3 trillion in 2011, representing 10.3 percent and 8.9 percent of projected GDP, respectively. That is not far from the 12.7 percent Greece faced in 2009. The CBO estimates the deficit will fall as a percentage of GDP toward the middle of the coming decade, but that rests on the heroic assumptions that new reasons for major welfare-state, corporate-bailout, and military spending will not be found and that spending on the health insurance revamp does not grow in the exponential ways we have seen with other social programs.

Politicians rarely get punished for inflation as they do for cutting expenditures.

At the end of 2009 the cumulative debt of the U.S. government was about $12 trillion, with $7.5 trillion—53 percent of GDP—held by the public. The CBO estimates that at the end of 2020 publicly held debt will be a staggering $20.3 trillion—90 percent of GDP—with total debt being notably higher than that. By 2020, therefore, we will not be far behind where Greece is now. Looked at differently, in 2020 the value created by the U.S. economy for the year would be just enough to pay off our total public holdings of debt, but barely. The CBO also provides some evidence for the self-perpetuation process: Between 2010 and 2020 net interest payments are projected to more than quadruple in nominal dollars, and as a share of GDP they will rise from 1.4 percent to 4.1 percent of GDP.

New Money for the New World

The United States, however, has one piece of the puzzle that Greece lacks, which could change the way this process unfolds. As noted, Greece is on the euro, so it lacks a domestic central bank with which to monetize its debt. The United States has the Federal Reserve, so one outlet the federal government has, if skeptical bond markets demand higher yields, is the Fed's purchase of bonds with newly created money.

Buying bonds in the open market is how the Fed normally increases the money supply, so this is not a new process. When the Fed does this, it returns the yield to the Treasury, thereby giving the government an interest-free loan. Each time the Fed buys a government bond from the public, it enables the government to run additional debt—float more bonds—without a net increase in interest payments.

The Fed could also buy bonds directly from the Treasury and instantaneously extend an interest-free loan through the creation of new money. Historically, it has not done this, but since the current recession and financial crisis began in 2008, it has dipped its toe into those waters. Doing so will become increasingly tempting for the Fed if the rising level of U.S. debt begins to scare off bond buyers.

Of course the danger of doing this too much is inflation. The Greek economy has a very low rate of inflation at the moment, thanks to the relative stability of the euro. However, many other countries faced with similar fiscal situations have resorted to the printing press, generating high levels of inflation that did major damage to their economies.

The U.S. government will be tempted to monetize the debt. If China's demand for U.S. bonds weakens, driving up yields, the alternative to reducing deficits and paying off debt, or getting a bailout, will be monetization and debasement of the dollar. It will be tempting because the costs of inflation are disguised, dispersed, and stretched over the long run. Politicians rarely get punished for it as they get punished for cutting expenditures. FEE

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Yet Again with the National ID

BY BECKY AKERS

Fresh from their defeat in forcing national identity papers on us with REAL ID, the feds are trying once more. Their plea this time isn't terrorism but immigration—though they're pretty much the same, according to the State.

Introduced in 2005 to combat the waves of terrorists thronging our shores, REAL ID was supposed to thwart the bad guys by transforming our drivers' licenses into a national ID card. We'd have submitted this card on demand to government's agents—as do the victims in totalitarian regimes. Never mind that "almost no empirical research has been undertaken to clearly establish how identity tokens can be used as a means of preventing terrorism," according to Privacy International, or that "terrorists have traditionally moved across borders using tourist visas," unless they "are equipped with legitimate identification cards." The 9/11 hijackers and the Madrid bombers, respectively, provide two recent examples.

Governments itch to tag their subjects like so many cattle, on any pretext whatsoever.

Any Pretext Whatsoever

Governments itch to tag their subjects like so many cattle, on any pretext whatsoever. Ours thought it had a dandy excuse in the attacks of 9/11, and who can blame it? Many Americans would eagerly sell their few remaining liberties so long as a politician assured them that said sale secured the homeland. Ergo, the feds invented a bogus link between terrorism and America's freedom from a national ID. They swore they'd prevent another 9/11 so long as we followed orders to carry "enhanced" drivers' licenses.

Surprisingly, rebellion bloomed—and this among states that have supinely obeyed any number of anti-constitutional decrees since 1865. Fifteen passed legislation prohibiting their DMVs from turning licenses into a de facto national ID; another ten officially denounced REAL ID.

No matter: The feds slapped an alias on their failed legislation—PASS ID—and reintroduced it. But in case such cosmetics can't con us, a couple of senators are aiming at the same goal via another American bugaboo: immigration.

Increased Workplace Patrols

Sen. Lindsay Graham (R-SC) and Sen. Charles Schumer (D-NY) propose to "reform" yet again the feds' cruel and unconstitutional policies on immigration. Their national ID card piggybacks on Social Security cards rather than drivers' licenses.

"The plan calls for a big increase in immigration agents patrolling workplaces," the *New York Times* reported. The Bush administration already tried such raids; their inhumanity devastated whole towns, not just immigrants, and Obama's government supposedly discontinued them. But senators seldom boast an enviable learning curve. Graham and Schumer would also "require all workers, including legal immigrants and American citizens, to present a tamper-proof"—that is, biometric—"Social Security card when they apply for jobs."

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In propaganda the *Washington Post* obligingly published, the senators wrote, "A tamper-proof ID system would dramatically decrease illegal immigration, experts have said, and would reduce the government revenue lost when employers and workers here illegally fail to pay taxes." But, "there's no such thing as a foolproof ID system," as experts have also said. And "reducing lost government revenue" as a reason for national ID adds insult to injury. We should pack papers so the government can keep more of what it loots from us?

The senators also promise that though "we would require all U.S. citizens and legal immigrants who want jobs to obtain a high-tech, fraud-proof Social Security card," we're safe from bureaucratic prying because "no government database would house everyone's information." If you believe that, you no doubt believe as well that these politicians have only our best interests at heart, have studied rather than exploited this topic, and are competent to decide for us who our future neighbors, friends, and relatives will be.

> "Reducing lost government revenue" as a reason for national ID adds insult to injury. We should pack papers so the government can keep more of what it loots from us?

Certainly, Graham and Schumer don't have immigrants' best interests at heart. Indeed, whether immigrants can live here is determined solely by whether we can use them to "ensur[e] America's future economic prosperity." Ergo, the senators' "legislation would award green cards to immigrants who receive a Ph.D. or master's degree in science, technology, engineering or math from a U.S. university. It makes no sense to educate the world's future inventors and entrepreneurs and then force them to leave when they are able to contribute to our economy."

Nationalist Agenda

Forget about those hungry, tired, and poor yearning to breathe free; the persecuted; and the tortured. If you can't advance politicians' nationalistic agendas, you won't find a toe-hold here.

The senators aren't content to menace only immigrants; they also threaten and penalize Americans who, unlike themselves, are productive: "Prospective employers would be responsible for swiping the [national ID] cards through a machine"—and who pays for the gizmo?—"to confirm a person's identity and immigration status. Employers who refused to swipe the card or who otherwise knowingly hired unauthorized workers would face stiff fines and, for repeat offenses, prison sentences."

Our rulers have spent the last 150 years ginning up fear of immigrants, pitting established Americans against newcomers, contriving a hobgoblin from which they squawk about rescuing us. They've succeeded so well that modern Americans happily don chains so long as it means immigrants wear them, too. National ID, raids on offices and factories, a wall on our southern border: Nothing is too dictatorial when it comes to controlling migration.

Schumer and Graham are betting Americans' fear of immigrants outweighs their love of liberty. Tragically, that looks like a winning wager. FEE

The Art and Science of Pseudology

BY THOMAS SZASZ

The common belief that the scientist's job is to reveal the secrets of nature is erroneous. Nature has no secrets; only persons do. Secrecy implies agency, which is absent in nature. This is the main reason the so-called "behavioral sciences" are not merely unlike the physical sciences but are in many ways their opposites.

"Nature," observed Thomas Carlyle (1795-1881), "admits no lie." While nature neither lies nor tells the truth, persons habitually do both. As the famous French mathematician and philosopher Antoine Augustin Cournot (1801-1877) observed, "It is inconceivable that [in the science of politics] telling the truth can ever become more profitable than telling lies." Indeed, deception and prevarication are indispensable tools for the politician and the psychiatrist—experts expected to explain, predict, and prevent unwanted human behaviors.

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The integrity of the natural scientific enterprise depends on truth-seeking and truth-speaking by individuals engaged in activities we call "scientific," and on the scientific community's commitment to expose and reject erroneous explanations and false "facts." In contrast, the stability of political organizations and of the ersatz religions we call "behavioral sciences" depends on the loyalty of its practitioners to established doctrines and institutions and the rejection of truth-telling as injurious to the welfare of the group that rests on its commitment to fundamental falsehoods. Not by accident, we call revelations of the "secrets" of nature "discoveries," and revelations of the secrets of powerful individuals and institutions "exposés."

Because nature is not an agent, many of its workings can be understood by observation, reasoning, experiment, measurement, and calculation. Deception and divination are powerless to advance our understanding of how the world works; indeed, they preempt, prevent, and substitute for such understanding.

Psychiatry is one of the most important institutions of modern American society. Understanding modern psychiatry—the historical forces and the complex economic, legal, political, and social principles and practices that support it—requires understanding the epistemology of imitation and the sociology of distinguishing "originals" from "counterfeits." With respect to disease, the process consists of two parts: One part is separating persons who suffer from demonstrable bodily diseases from those who do not, but pretend or claim to; another part is separating physicians who believe it is desirable to distinguish between illness and health, sick persons and healthy, from physicians who reject this desideratum and insist that everyone who acts or claims to be sick has an illness and deserves to be treated. In an effort to clarify the difference between medicine and psychiatry—between real medicine and fake medicine—I proposed a satirical definition of psychiatry, slightly revised as follows:

The subject matter of psychiatry is neither minds nor mental diseases, but lies, beginning with the names of the participants in the transaction—the designation of one party as "patient," even though he is not ill, and the other party as "therapist" even though he is not treating any illness. The lies continue with the decep-

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tions that comprise the subject matter proper of the discipline—the psychiatric "diagnoses," "prognoses," and "treatments"—and end with the lies that, like shadows, follow ex-mental patients through the rest of their lives—the records of denigrations called "depression," "schizophrenia," or whatnot, and of imprisonments called "hospitalization." If we wished to give psychiatry an honest name, we ought to call it "pseudology," or the art and science of lies and lying.

The imitation of illness is memorably portrayed by Molière (1622–1673) in his famous comedy, *The Imaginary Invalid* (*Le malade imaginaire*). The main character is a healthy individual who wants to be treated as if he were sick by others, especially doctors. Since those days, we in the West have undergone an astonishing cultural-perceptual transformation of which we seem largely, perhaps wholly, unaware. Today medical healing is regarded as a form of applied science. At the same time, the medical profession defines imaginary illnesses as real illnesses, in effect abolishing the notion of pretended illness: Officially, malingering is now a disease "just as real" as melanoma.

The view that pretending to be mentally ill is itself a form of mental illness became psychiatric dogma during World War II. Kurt R. Eissler (1908-1999), then the quasi-official pope of the Freudian faith in America, declared: "It can be rightly claimed that malingering is always the sign of a disease often more severe than a neurotic disorder. . . . The diagnosis should never be made but by the psychiatrist." Now, more than 50 years later, this medicalized concept of malingering is an integral part of the mindset of every well-trained, right-thinking Western psychiatrist. For example, Phillip J. Resnick, a leading American forensic psychiatrist, declares: "Detecting malingered mental illness is considered an advanced psychiatric skill, partly because you must understand thoroughly how genuine psychotic symptoms manifest."

In World War I soldiers afraid of being killed in battle malingered; psychiatrists who wanted to protect them from being returned to the trenches diagnosed them as having a mental illness, then called "hysteria." Today, almost a hundred years later, soldiers returning home and afraid of being without "health care coverage" diagnose themselves as having a mental illness, called "post-traumatic stress disorder (PTSD)": Almost 50 percent of the troops returning from Iraq suffer from post-traumatic stress disorder (PTSD) and depression "because they want to make sure that they continue to get health care coverage once their deployments have ended." (*Syracuse Post-Standard*, Nov. 25, 2007, E1).

Psychiatrists and the science writers they deceive—and who eagerly deceive themselves—love to dwell on how far psychiatrists have "progressed" from their past practices. They have indeed, if we consider creating ever more mental illnesses/psychiatric diagnoses "progress." Today psychiatrists assert that the person who regards himself as a mental patient suffers from a bona fide illness and laud him for his insight into his "having a disease" and "need for treatment." At the same time, they lament the person who "denies" his mental illness, his "lack of insight" into being ill, and his "negative attitudes toward treatment seeking." For example, from the *International Journal of Eating Disorders* we learn: "Considering that males have negative attitudes toward treatment-seeking and are less likely than females to seek treatment, efforts should be made to increase awareness of eating disorder symptomatology in male adolescents."

Counterfeit art is forgery. Counterfeit testimony is perjury. But counterfeit illness is still illness—mental illness.

Counterfeit art is forgery. Counterfeit testimony is perjury. But counterfeit illness is still illness—mental illness, officially decreed "an illness like any other." The consequences of this policy—economic, legal, medical, moral, personal, philosophical, political, and social—are momentous: counterfeit disability, counterfeit disease, counterfeit doctoring, counterfeit rehabilitation, and the bureaucracies, courts, industries, and professions studying, teaching, practicing, administering, adjudicating, and managing them make up a substantial part of the national economies of modern Western societies and of the professional lives of the individuals in them. FEE

Why Doctors Don't Want Free-Market Medicine

BY THEODORE LEVY

You may have heard that the AMA and "America's physicians" favor universal health care. That's true of the AMA, but that organization represents fewer than 20 percent of the nation's doctors. And it's true of many academic university physicians, but anecdotally it is obviously untrue of most doctors in private practice. Many of those docs desire to "get government out of medicine."

But those physicians have a problem, of a sort that "getting government out of medicine" doesn't solve. I'll describe the problem in a moment; but first, an economic interlude:

Noel Hidalgo [flickr]

When special interests get special grants of power from government, they benefit, of course. But the benefits—what economists call rents—are not static. Over time they tend to dissipate, because the prices of the factors of production required to obtain them are bid up. A new market equilibrium is formed. Some examples:

• The chattel-slave system present during the first century of this country's existence gave the lie to the noble words of the Declaration of Independence that all men are created equal. I have much sympathy for abolitionist William Lloyd Garrison's famous epithet that, because it sanctioned slavery, the Constitution was a "covenant with death and an agreement with hell." But slavery persisted. Economic historians have asked why. Nobel laureate economist Stanley Engerman, in his work *Time on the Cross*, coauthored with Robert Fogel, investigated the tricky economics of slavery. Do slaves financially benefit the slave owner? One would think they must, and at first that had to be true. But one had to purchase slaves. What is the "market price" of a slave? In theory it would be the same as with any other long-term capital good: the discounted marginal value of the revenue stream the slave could generate over his lifetime of work. People who bought slaves before markets were well established may have benefitted, but over time the economic benefits of slavery were transmitted down the structure of production. So the slave owner ended up paying, on average, the discounted value of what the slave would end up producing. This is not to say that slave-owners therefore had no interest in maintaining the slave system. While not making large profits in holding slaves, they were at risk of incurring large capital losses if slavery ended.

• Few people think today that Social Security is a good deal. Young people doubt it will be around when they retire. Middle-aged people and those recently on Social Security know they could have done better had they been allowed to invest the money themselves in a diversified low-risk portfolio. Granted, those who turned 65 in the early years after FDR began the program benefitted, as they

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received benefits without incurring costs. But those days are long gone. Now people on Social Security may only break even, and surely in the future they will suffer a financial loss. Nonetheless, current recipients don't want the system to end, because they'd lose even the little money they're counting on.

• In New York City and other large metropolitan areas, before you can legally drive a taxi, you have to purchase a medallion (license) from the government. The nominal price of a medallion is not high, but to restrict the supply of cabs the municipality sharply limits the number sold. So (as with ticket scalping) in the resale market the price is much higher than the face value, sometimes several hundred thousand dollars or more. The system benefitted the taxi companies operating at the time licensing was enacted—unsurprisingly, these were the very companies that lobbied for them—because restricting medallions restricted taxi supply and increased the amount the companies could charge their customers. But it didn't help make a larger profit for the taxi owners who came along later, because the larger fees they were able to earn from a lower supply of cabs were offset by the exorbitant cost of the now-expensive medallions. And yet, although making only market incomes, the current taxi owners have every incentive to maintain the medallion system because eliminating it now would cause them an even greater loss when the market price of medallions fell to zero.

What does any of this have to do with medical care? Medical licenses are like taxi medallions. The AMA assiduously sought the licensing of medical professionals from its very beginning in 1847. At that time, ironically, schooled physicians had little more to offer patients than charlatans did and often caused more harm than good through what was known as "heroic therapy," treatments like leeching and the use of arsenical purgatives. Finally, about a hundred years ago, medical services were cartelized. After the release of the Flexner Report (1910), the number of medical graduates declined by approximately half over the next decade, a decrease falling disproportionately on minority and female physicians.

How Much Training?

The question is not whether it's a good thing to have better-trained doctors; the question is whether overtraining is possible, and how to know without market competition whether we've reached that point. A recent physician survey asked if doctors thought every M.D. needed all the training he received to be able to provide high-quality care. Many respondents answered no.

> The question is not whether it's a good thing to have better-trained doctors; the question is whether overtraining is possible, and how to know without market competition whether we've reached that point.

Perhaps doctors as good as those currently practicing could be trained in six or seven years—rather than the 12 or more today. Perhaps a combination of less human training but better computer diagnostics would be of value. Perhaps an apprenticeship model would work better than the current didactic educational model. Without a competitive market, there's no way to tell.

No doubt most physicians are sincere when they say they can't imagine a system with less training that would protect the patient from charlatans. But it's also true most citizens under Soviet rule couldn't imagine how shoes would reach market without central command, and no doubt at least some plantation owners were sincere in their concern that if slavery ended, the slaves would not know what to do or where to go.

Most everyone has met a bad doctor. And yet he, too, spent four years in medical school and passed the boards as presently constituted. If quality were the only consideration, isn't that evidence that four years plus residency is not enough? Should medical school be eight years long? The point, of course, is that extra training before practice has a cost as well as a benefit.

Just as the economic rent (the excess earnings over the amount necessary to keep the factor of production in its current use) from taxi medallions was dissipated over time as the cost of obtaining the medallions increased, so too the economic rent of a medical license over time does not go to doctors but rather to those who can charge doctors more to meet the license and practice requirements. In the decades after Medicare spending increased the income of physicians, the price of medical school skyrocketed. So while licensed doctors made more money, becoming a doctor with a license cost more money. Doctors all complain about the high cost of malpractice insurance, but few realize that one reason such insurance commands a high price is that doctors can pay it.

Like most other licensed professionals, doctors complain only about the regulations that harm them to the benefit of others, not those that benefit them at the expense of others.

Trouble Breaking Even

Current doctors have all paid huge costs to be where they are today. Yet many of them describe trouble breaking even financially, even though the average doctor makes a great income compared to the average American. Like those currently collecting Social Security, they would be hurt by a change in the system that lowered their incomes.

So most doctors do not really want "less government" in health care. They want the type of government control and regulation that restricts supply and limits innovation to that which directly benefits the medical cartel. They don't want nurses doing things—even simple things—without physician supervision for the same reason dentists don't want dental hygienists to do even simple basic cleanings without dental supervision. They prefer to view ancillary personnel as subordinates rather than competitors. Like most other licensed professionals, they complain only about the regulations that harm them to the benefit of others, not those that benefit them at the expense of others.

Society was better off ending slavery and would be better off ending the Ponzi scheme of Social Security and the legal cap on taxi medallions. But there are always special interests who will be hurt by socially beneficial reforms. No one likes to see himself as a special interest. But physicians as a group would likely be financially harmed by a true free market in health care, one that ended not only the burdensome regulation doctors all complain about but also the restrictions placed on who is legally allowed to offer services labeled as "health care," restrictions that redound to physicians' benefit.

Fortunately for the physicians, almost no one is calling for a free market in health care. Doctors want regulations that free them to practice as they wish, while still having the government assure that everyone can get health insurance and thus pay doctors for practicing as they wish. Patients want as much care as they need and desire, paid for by others. Insurance companies want to maintain their cozy relationships with state regulators, built up over years, and not have to compete nationally, and are therefore opposed to calls to end the prohibition of interstate sales of health insurance. Everyone calls for help from the State, which, as Bastiat pointed out, is the fiction by which everyone tries to live at the expense of everyone else. FEE

A Free-Market Energy Vision

BY ROBERT L. BRADLEY, JR.

Energy is the master resource. Without it other resources could not be produced or consumed. Even energy requires energy: There would not be usable oil, gas, or coal without the energy to manufacture and power the requisite tools and machinery. Nor would there be wind turbines or solar panels, which are monuments to embedded fossil-fuel energy.

And just how important are fossil fuels relative to so-called renewable energies? Oil, gas, or coal generates the electricity needed to fill in for intermittent wind and solar power and ensure moment-to-moment reliability. So renewable energy, ironically, is codependent on nonrenewable energy short of (currently) prohibitively expensive battery technology firming the flow of electricity.

As a component of all products and services, energy needs to be affordable, convenient, and reliable. To this end, public policy should respect consumer preference and allow energy producers to meet the demands of the marketplace. This requires a respect for private property rights and voluntary exchange to facilitate the global exchange of energy and its innumerable subcomponents.

As a component of all products and services, energy needs to be affordable, convenient, and reliable. Public policy should allow energy producers to meet the demands of the marketplace.

Global energy supplies are primarily the product of government, unfortunately, not the free market. In state-run economies political elites make the decisions that otherwise would be made by the multitude. Win-win exchanges are supplanted by government-dictated *win-lose* transactions. Wealth is redistributed. Pure waste results from the intervention of (political) third parties into what otherwise would be mutually advantageous self-interested exchange.

For example, electric utilities may be forced to buy wind power, solar power, or another politically correct energy under state law. A mandate is required because a free marketplace would not support such expensive, unreliable—*non*competitive—supply.

Oil and gas producers may be unable to access offshore properties because of government constraint. In such cases, supply is not produced and higher-cost substitutes elsewhere pick up some of the slack. Consumers are left with less supply and higher prices. Economists have a name for this: inefficiency.

Government intervention may also give life to uneconomic projects. Such ventures may include carbon capture and storage, a "smart" electricity grid, or even a nuclear plant that requires a federal loan guarantee. Resources that go to these projects do not go to other, more economical projects (which may or may not be in the energy sector) as judged by the marketplace. Resources are again misallocated.

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Proponents of government intervention cite "market failure" as the reason for regulating or subsidizing energy projects. Negative externalities created by self-interested exchange require the government to modify transactions in ways ranging from a prohibition to a tax, they say.

Nonmarket Failures

But there are two other types of failure that also must be considered before rushing to policy judgment.

One is *analytic failure,* in which the outside evaluator's prescription for intervention (such as a per-barrel "energy security" tax on oil imports or a per-ton "climate change" tax on carbon dioxide emissions) overcorrects or undercorrects for the "real" problem. The error might be purely intellectual—or it might reflect the personal prejudice of the analyst. Fallible self-interest in the marketplace has a counterpart in the ivory tower.

Second, there is *government failure*, whereby even the "correct" analytical blueprint is altered and violated in the political process. Special-interest tinkering adds to or subtracts from the core proposal, and political actors resort to "logrolling," where extraneous issues are added to the legislation just to win votes.

"Market failure" does not automatically require a government correction. Political solutions are likely to be as bad as or worse than the problems.

House passage of a cap-and-trade energy bill last year and health insurance legislation enacted this year are stark evidence of sausage-making in Washington, D.C.—and something scarcely recognizable in "we the people" textbooks.

Thus *"market failure" does not automatically require a government correction*. This suggests a different approach. Knowing that political solutions are likely to be as bad as or worse than the problems, alleged market failures should be scrutinized to see if they are really serious problems. And if so, can the real problems be addressed by novel voluntary approaches and reforms rather than by government dictates?

Intellectual and political debates over energy have revolved around four "sustainability" issues: depletion, pollution, security, and climate change. Whole books address these issues, most from the market-failure viewpoint, concluding that mankind is on a perilous path and government-engineered energy transformation is necessary.

But students of energy history and energy policy must ask: *Has a political makeover of any industry ever worked well for consumers and taxpayers?* Or has it had the opposite effect? Creative destruction—a market makeover from shifting consumer demand—is one thing; having government pick winners with carrots and sticks is quite another.

Free-Market Sustainability

The arguments for allowing free markets, rather than government planning, to address the four sustainability issues can be summarized as follows:

1. Estimated quantities of recoverable oil, gas, and coal have been increasing over time, according to the statistical record. Human ingenuity in market settings has and will continue to overcome nature's limits, leaving in its wake errant forecasts of resource exhaustion. The resource challenge is *political*: restricting access and perverting incentives prevents the *ultimate resource*—human innovation and entrepreneurship—from expanding energy supplies and multiplying energy's productive utilization.

2. Statistics of air and water quality in the United States show dramatic environmental improvement and, in fact, indicate a positive correlation between energy usage and environmental improvement. While improvements have been achieved by politicized, command-and-control environmental regulation, the results could have been achieved at lower cost through market methods.

3. Energy security in the electricity market is assured by abundant domestic coal and the fact that almost all U.S. gas imports come from Canada. Most of the oil needed for transportation comes from

domestic supplies supplemented by imports from a variety of countries led by Canada and Mexico. Oil imports from unstable or unfriendly nations, such as Venezuela and those in the Middle East, can be more effectively addressed by privatizing U.S. oil and gas resources than by government penalties against oil imports that cannot distinguish between "good" and "bad" barrels. Even if the United States were to use the powers of government to pare domestic oil consumption, the resulting drop in world oil prices would encourage non-U.S. demand and subsidize foreign industry. The world oil market will continue to exist and thrive even with reduced U.S. participation, and this will become more true over time.

4. The global warming scare is plagued by open scientific questions, economic tradeoffs, and the reality that carbon-based energy is necessary for economic growth. Carbon rationing (via the Kyoto Protocol) is a failed policy for the developed world and a nonstarter for the developing world. Not only have targeted reductions proved to be elusive, the economic costs of carbon rationing are not unlike those from (postulated) deleterious climate change.

The recent oil spill in the Gulf of Mexico raises an additional sustainability issue: unexpected setbacks that cause massive property damage and even fatalities. Short-run problems, however, can result in longer-term gains so long as the firm faces full liability and pays restitution to the victims. Accountability in private property settings encourages companies to square profits, people, and the environment—and avoid the financial losses that come from performance failure. Currently companies have their liability for damages capped by law at $75 million, though politics could potentially nullify the cap in any given case, as it apparently will in the BP Deepwater Horizon incident.

Rather than expand government, public policy should end preferential subsidies for politically favored energies and privatize such assets as public-land resources and the Strategic Petroleum Reserve. Multi-billion-dollar energy programs at the U.S. Department of Energy should be eliminated. Such policy reform can simultaneously increase energy supply, improve energy security, reduce energy costs, and increase the size of the private sector relative to the public sector.

To Al Gore the "planetary emergency" is five billion to six billion people using oil, gas, or coal for most of their energy needs. But the real energy problem is *that nearly one and a half billion people do not use modern forms of energy*. Rampant statism in place of private property, voluntary exchange, and the rule of law is behind this problem.

> The real energy problem is that 1.4 billion people have no access to clean water, reliable lighting, or other means for comfortable, sanitary living because of statism.

Energy-impoverished people use dried dung and primitive biomass to stay warm and cook their meals, destroying their health and shortening their lives. Without electricity or machines, they do not have clean water, reliable lighting, or other means for comfortable, sanitary living. This here-and-now problem demands energy freedom and an end to debilitating energy statism.

The free-market vision stresses that these impoverished people should not be subject to energy rationing by government. Solar panels and industrial wind turbines can only generate a fraction of the energy produced by diesel generators or a conventional power plant—and are much less reliable. Energy brawn is needed, not inferior but politically correct energies that appeal to energy planners.

Property Rights vs. the Resource Curse

More fundamentally, these victims of statism need private property rights to in-ground minerals and ownership title to energy infrastructure. In this way, they can overcome the so-called *resource curse* whereby siphoned energy wealth underwrites government control and bad economic policy.

Countries worldwide should reject energy planning from a politically endowed elite. Government planners suffer from a "fatal conceit" that their knowledge and goals must override those of the masses. But on-the-spot energy consumers and energy producers, guided by prices and profit/loss, have much more collective wisdom than faceless bureaucrats commanding from on high. Top-down planning misdirects and destroys despite the best efforts of even well-educated, well-meaning bureaucrats.

Freedom—the use of reason and persuasion in place of coercion—is a worthy goal. In the U.S. energy sector, market reliance, though compromised by both pro-business and anti-business government intervention, has produced economic coordination, fostered economic growth, and democratized wealth. Government intervention, on the other hand, such as occurred in the 1970s with U.S. oil and gas price controls, has produced shortages, civil strife, and bureaucratic waste.

Markets are not perfect, inspiring some to devise and champion government intervention. But political solutions must contend with analytic failure, implementation problems, and public-sector (taxpayer) costs. Imperfect markets, in other words, may well be better than "perfect" regulation in the real world. The burden of proof, therefore, should be on government intervention, rather than on voluntary transactions premised on private property and governed by the rule of law. FEE

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Foreign Lenders: Friends Indeed to a U.S. Treasury in Need

BY ROBERT HIGGS

When the U.S. government wishes to spend more money than it receives as tax revenue, it covers the shortfall by borrowing, and foreign lenders have become increasingly important sources of such borrowed funds.

Reliance on foreign lenders is as old as the republic. Indeed, loans from the French and the Dutch proved critical in keeping the American revolutionaries afloat while they broke from the British Empire and established their independence. Later, the huge foreign debt became a major reason for the new national government's assumption of the states' war debts and for the creation of the First Bank of the United States and other measures Alexander Hamilton devised to establish the new government's credit.

> Reliance on foreign lenders is as old as the republic. As a rule, however, the U.S. government had little need to borrow until chronic deficits became a fixture in the twentieth century.

As a rule, however, the U.S. government had little need to borrow. Except during wartime, it more or less balanced its budget, and indeed in many years of the nineteenth and early twentieth centuries, it ran a surplus, which was used to pay down the debt taken on during the preceding war. Only after 1930 did chronic deficits become a fixture of the federal government's financial conduct. Even then, however, foreign lending did not play a large role until the latter part of the twentieth century.

As late as 1970, according to a report issued by the Federal Reserve Bank of New York, foreigners held only about $20 billion, or less than 9 percent, of all privately held U.S. securities outstanding. (A great deal of the total debt is held *within* the government, mainly by the Social Security Trust Fund.) During the following decades, however, foreigners acquired a growing proportion of the debt held outside the government. In the 1970s foreigners purchased $10.5 billion, or about 31 percent of the total sold to the public. In the 1980s, when large government budget deficits pumped up the debt rapidly, foreigners purchased $27.5 billion, or about 18 percent of the total sold to the public.

(Note that all such data are subject to a variety of conceptual and measurement errors. All the figures on foreign holdings of U.S. Treasury debt discussed in this article are admittedly flawed official estimates.)

During the 1990s, as the government first pared its budget deficit after 1992 and then actually ran a small budget surplus during fiscal years 1998 through 2001, the foreign share of U.S. Treasury debt held by the public increased greatly, and by the end of the decade it had reached almost 40 percent of the total, before dipping somewhat during the recession early in the following decade.

After 2002 foreign holdings rose greatly as huge government budget deficits accompanied the Bush administration's guns-and-butter policies, and the foreigners' acquisitions again outpaced those of Americans. By the third quarter of 2009 the foreign share of U.S. debt held by the public stood at nearly 52 percent.

According to data issued by the Treasury and the Federal Reserve Board on March 15, 2010, the largest foreign holders of U.S. Treasury securities in January 2010 were as follows: China (mainland plus Hong Kong), $1,036 billion; Japan, $765 billion; a group of 15

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countries designated "oil exporters," $218 billion; Brazil, $169 billion; a group of four island nations plus Panama, designated "Caribbean banking centers," $144 billion; Russia, $124 billion; and Taiwan, $120 billion. These countries' holdings altogether totaled $2,576 billion, or about 70 percent of the $3,706 billion owned by all foreign holders at that time.

China's Emergence

China's emergence as the leading foreign holder of U.S. Treasury debt has occasioned a great deal of commentary, including many expressions of apprehension. Many writers still view the Chinese as enemies of the United States, notwithstanding the two countries' close financial and trade ties, among other important links. Xenophobes worry that should the Chinese "dump" their holdings of U.S. government debt, they would create financial havoc and jeopardize U.S. national security.

To be sure, Chinese government leaders and other Chinese spokesmen have recently expressed serious concern about the U.S. Treasury's ability to service its rapidly growing debt. They worry that the U.S. government is getting itself into deeper and deeper financial difficulty by running budget deficits well in excess of $1 trillion per year in fiscal years 2009 and 2010 and, according to projections, only slightly smaller deficits for many years to come. The persistent recession that began early in 2008, from which little recovery was evident even in the first quarter of 2010, has done nothing to allay Chinese fears about the U.S. Treasury's precarious condition. Other foreign holders of U.S. government debt have expressed similar worries.

Late in 2009 mainland China reduced its holdings of Treasury securities somewhat, from a high of $940 billion in July 2009 to $889 billion in January 2010, a reduction of $51 billion, or 5.4 percent. Meanwhile, however, Hong Kong's holdings rose by $36 billion during these months, offsetting most of the reduction by mainland China. The overall Chinese holdings declined, then, by only $15 billion, which is scarcely enough to justify anyone's nightmares.

> The most likely scenario is for the Chinese to monitor the U.S. Treasury and Congress carefully and use diplomatic pressure as much as possible without inspiring a fit of nationalist pique.

Likely and Unlikely Scenarios

In any event, fear that the Chinese (or other large holders) might suddenly dump large quantities of Treasury debt is difficult to take seriously because, owing to the great amount of such debt they now hold, any such sell-off would cause a tremendous fall in the price of the securities and cause huge capital losses for the Chinese holders. Not being fools, the Chinese are unlikely to resort to such dumping. Instead, they have begun to warn the U.S. government that unless it gets its financial house in better order, it might provoke them to sell off more of their holdings—and certainly to refrain from adding to them, notwithstanding the enormous amount of such securities the Treasury will have to sell in order to finance the U.S. budget deficits projected for many years to come.

The most likely scenario, then, is for the Chinese to monitor the Treasury and Congress carefully and to use diplomatic pressure to try to discipline the wayward Americans as much as possible without angering them excessively and thereby tempting them to act rashly in a fit of nationalistic pique. Other large holders of U.S. government securities no doubt will also exert pressures to rein in the fiscally irresponsible U.S. government and the Fed, lest the latter resort to monetization of the government's huge deficits, thereby creating price inflation that reduces the real value of the nominal interest and principal payments the Treasury has committed itself to make on its outstanding debt. FEE

Are Profits Fit Only for Serfs and Slaves?

BY RICHARD W. FULMER

In their recent book, *From Poverty to Prosperity*, Arnold Kling and Nick Schulz relate that ancient Romans believed it honorable to gain wealth through battle and conquest, but dishonorable to profit by engaging in commerce. Such work was considered so demeaning that it was left to the children of freed slaves. Because of the associated disgrace, those involved in commerce tended to leave business as soon as they could afford to do so. Kling and Schulz suggest such attitudes explain why the invention of the steam engine by Hero of Alexandria (in what was then the Roman province of Egypt) was largely ignored. Romans regarded the engine as a curiosity or toy; no one thought of putting it to work. The European aristocracy clung to similar attitudes up until the twentieth century, as did many in the antebellum South. Productive work was considered dishonorable and to be left for serfs and slaves.

The belief that only plunder yielded honorable profits meant a 1,500-year wait for someone to put Hero's steam engine to work.
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Are we headed back to those same beliefs? In his State of the Union address President Obama proposed forgiving student loans to those going into (honorable) public service, but not to those going into (dishonorable) commerce. The idea that making a profit is morally tainted has become fashionable in recent years, as has the belief that those who earn profits must "give back to the community" to atone for doing so.

Yet making a profit is neither moral nor immoral—it is simply necessary to preserve life. Every living thing must make a net energy profit if it is to survive. If living creatures do not consume at least as many calories in the form of food as they expend procuring, preparing, and digesting that food, they will die. By analogy, if an oil company's actions are to be of use to anyone (whether the company is owned by the State or private individuals), it must produce more BTUs' worth of petroleum than it expends to find, produce, refine, and transport it.

Money Changes Everything

While the need for a net energy profit is obvious, the introduction of money clouds the issue. Energy profits may be all well and good, but monetary profits? Money is evil! Yet it is money that enables us to keep score. Without money and prices based on free exchange, it is impossible to determine whether any cooperative activity is worth the cost.

Suppose, for example, a company drills a well that will yield 100 barrels of oil a day. Is it worthwhile for the company to produce the oil, or should it cap the well and look for one that will flow at a higher rate? Theoretically, a net energy balance could be performed to decide the question—that is, the BTUs contained in the oil could be compared to those needed to produce it. Unfortunately, determining the energy cost of fabri-

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cating, transporting, and installing tanks, pumps, pipe, valves, fittings, nuts, bolts, and gaskets would be a monumental task, as would determining the energy needed to transport and refine the oil.

Suppose, however, that the necessary calculations could somehow be made, and it turns out that producing the oil would result in a net energy gain. What then? Should the company produce the maximum 100 barrels a day, or would that just leave it with a storage problem? An energy balance cannot answer this question because it does not indicate demand.

But there is still another problem. The only reason we could even consider performing a net energy balance to determine whether the oil should be produced is that energy appears on both sides of the equation. I am, for example, willing to invest 50 BTUs in order to obtain 100 BTUs' worth of oil in return, but how much energy should I expend to produce, say, a pound of copper?

In a free market, prices—generated by the free buying and selling of privately owned things—allow us to calculate the costs and benefits of production, to determine consumer demand, and to compare the relative values of different goods. The oil producer does not need to know how much energy was used to make a valve. All he needs to know is its price. The manufacturer's costs for materials, labor, overhead, and energy are all reflected in that price. Knowing the price of the equipment and of its transportation and installation enables the oil producer to determine his costs. Knowing his costs and knowing the price consumers are willing to pay for a barrel of oil enables him to calculate the monetary profit (or loss) that will result from recovering the oil. Because the prices the producer pays for equipment, parts, services, and labor include the value of energy expended, the producer can be reasonably sure that if he makes a net monetary profit, he will also be making a net energy profit.

Asking whether it is moral to make energy or monetary profits makes no more sense than asking whether it is moral to eat. Like eating, making a profit is neither moral nor immoral, it is simply necessary.

Fair Profits

That is not to say, however, that because making a profit is necessary, anything done in the name of profit is acceptable. Trading labor for food is one thing, snatching a crust of bread from a child's hand is quite another. The question of morality, then, lies in *how* a profit is made, not in the bare fact that a profit is made.

There are only two ways in which a person may obtain goods to ensure a net profit and sustain life: produce it himself or obtain it from someone else. There are only two ways to obtain a thing from another: Take it with or without the other's consent. If a good is obtained with consent (without either fraud or coercion), it must have either been exchanged for a service or another thing of value, or it must have been received as a gift or as charity. A thing obtained by consent is obtained morally.

> If a thing is taken without consent, even if it is taken legally, it is obtained immorally.

If a thing is taken without consent, it is obtained immorally. This is true even if it was taken legally. In most societies, outright theft and fraud are illegal but most societies have legalized some degree of "rent-seeking"—that is, manipulating government rules to obtain unearned profits. Such legalized plunder is minimized in states whose economies are based on the free market and maximized in those in which government intervenes heavily. Mercantilism, political (or "crony") capitalism, socialism, fascism, and communism are all based on varying degrees of nonconsensual exchange.

If we are to live, we have no choice but to make profits. We can choose, however, how we make them. Will we do so by producing and freely exchanging goods and services with others, or will we once more convince ourselves that such activities are beneath us, fit only for serfs and slaves? Will we, like the Romans, choose to believe that wealth is honorable only if it is gained by plunder? FEE

The Rise of Government and the Decline of Morality

BY JAMES A. DORN

The recent financial crisis has expanded the power of government. Tea parties have revealed the disillusion of millions of Americans with the rise of government and the decline of morality. The crisis has damaged, unfairly, the vision of market liberalism. It is essential, therefore, to reexamine and articulate the principles of a free society and to understand the danger to liberty that the new progressivism poses.

Since this essay was first presented at the historic Chautauqua Institution in 1995, the federal government has grown in size and scope. Today Congress spends nearly $4 trillion, the federal share of GDP has risen to 25 percent, and the U.S. debt exceeds $12 trillion. Washington has bailed out financial, insurance, and automobile firms while also taking control of the mortgage market. We are now more dependent on government for our health care, pensions, and future than ever before.

Politicians thrive on using other people's money and promising free lunches. The growth of government has politicized life and weakened the nation's moral fabric. Government intervention—in the economy, the community, and society—has increased the payoff from political action and reduced the scope of private action. People have become more dependent on the State and have sacrificed freedom for a false sense of security.

One cannot blame government for all of society's ills, but there is no doubt that economic and social legislation, especially since the mid-1960s, has had a negative impact on individual responsibility. Individuals lose their moral bearing when they become dependent on government. Subsidies, bailouts, and other aspects of the "nanny state" socialize risk and reduce individual accountability. The internal moral compass that normally guides individual behavior will no longer function when the State undermines incentives for moral conduct and blurs the distinction between right and wrong.

> There is no doubt that economic and social legislation, especially since the mid-1960s, has had a negative impact on individual responsibility.

More government spending is not the answer to our social, economic, or cultural problems. The task is not to reinvent government or to give politics meaning; the task is to limit government and revitalize civil society. Government meddling will only make matters worse.

If we want to help the disadvantaged, we do not do so by making poverty pay, restricting markets, prohibiting educational freedom, discouraging thrift, and sending the message that the principal function of government is to take care of us. We do so by eliminating social engineering and all kinds of welfare, cultivating free markets, and returning to our moral heritage.

At the beginning of the twentieth century there was no welfare state as we know it. Fraternal and religious organizations flourished. Total government spending

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was less than 10 percent of GDP, and the federal government's powers were limited.

Immigrants were faced with material poverty, true, but they were not wretched. There was a certain moral order in everyday life, which began in the home and spread to the outside community. Baltimore's Polish immigrants provide a good example. Like other immigrants, they arrived with virtually nothing except the desire to work hard and to live in a free country. Their ethos of liberty and responsibility is evident in a 1907 housing report describing the Polish community in Fells Point:

> A remembered Saturday evening inspection of five apartments in a house [on] Thames Street, with their whitened floors and shining cook stoves, with the dishes gleaming on the neatly ordered shelves, the piles of clean clothing laid out for Sunday, and the general atmosphere of preparation for the Sabbath, suggested standards that would not have disgraced a Puritan housekeeper.

Yet, according to the report, a typical Polish home consisted "of a crowded one- or two-room apartment, occupied by six or eight people, and located two floors above the common water supply."

Even though wages were low, Polish Americans sacrificed to save and pooled their resources to help each other by founding building and loan associations, as Linda Shopes noted in *The Baltimore Book*. By 1929, 60 percent of Polish families were homeowners—without any government assistance.

Dependent Not Self-Reliant

Today, after spending billions of dollars on antipoverty programs since the mid-1960s, Baltimore and other American cities are struggling for survival. Self-reliance has given way to dependence and a loss of respect for persons and property.

The inner-city landscape is cluttered with crime-infested public housing and public schools that are mostly dreadful, dangerous, and amoral—where one learns more about survival than virtue. And the way to survive is not to take responsibility for one's own life and family—which government intervention makes more difficult through occupational licensing, the minimum wage, and other impediments to self-help—but to vote for politicians who have the power to keep the welfare checks rolling.

Dysfunctional behavior now seems almost normal as people are shot daily and births out of wedlock are common. (The replacement of Aid to Families with Dependent Children with Temporary Assistance to Needy Families, as a result of the welfare reform during the Clinton administration, was a bipartisan recognition of the perverse incentives under AFDC.) In addition to the moral decay, high tax rates and regulatory overkill have driven businesses and taxpayers out of the city and slowed economic development. It's not a pretty picture.

In sum, the growth of government and the rise of the "transfer society" have undermined the work ethic and substituted an ethos of dependence for an ethos of liberty and responsibility. Virtue and civil society have suffered in the process, as has economic progress.

Self-reliance has given way to dependence and a loss of respect for persons and property.

The Founding Fathers recognized that the nature of government is force, and they sought to limit its use to the protection of life, liberty, and property. Markets, both formal and informal, could then be relied on to bring about economic prosperity and social harmony.

In a free society the relationship between the individual and the State is simple. Thomas Jefferson said it well: "Man is not made for the State but the State for man, and it derives its just powers from the consent of the governed." The fact that the Founders never fully realized their principles should not divert attention from the importance of those principles for a free society and for safeguarding the dignity of all people.

From a classical-liberal perspective, the primary functions of government are to secure "the blessings of liberty" and "establish justice"—not by mandating outcomes, but by setting minimum standards of just conduct and leaving individuals free to pursue their own values within the law. The "sum of good government,"

wrote Jefferson, is to "restrain men from injuring one another," to "leave them . . . free to regulate their own pursuits of industry and improvement," and to "not take from the mouth of labor the bread it has earned."

The Jeffersonian philosophy of good government was widely shared in nineteenth-century America. Indeed, Jeffersonian democracy became embodied in what John O'Sullivan, editor of the *United States Magazine and Democratic Review*, called the "voluntary principle" or the "principle of freedom." In 1837 he wrote, "The best government is that which governs least . . . . [Government] should be confined to the administration of justice, for the protection of the natural equal rights of the citizen, and the preservation of the social order. In all other respects, the voluntary principle, the principle of freedom . . . affords the true golden rule."

During the nineteenth century most Americans took it for granted that the federal government has no constitutional authority to engage in public charity (to legislate forced transfers to help some individuals at the expense of others). It was generally understood that the powers of the federal government are delegated, enumerated, and therefore limited, and that there is no explicit authority for the welfare state. From a classical-liberal, or market-liberal, perspective, then, the role of government is not to "do good at the taxpayers' expense," but "to prevent harm."

Doing good with other people's money without their consent is not a virtue but a vice—or, rather, a crime.

The general-welfare clause of the Constitution cannot be used to justify the welfare state. That clause simply states that the federal government, in exercising its enumerated powers, should exercise them to "promote the general welfare," not to promote particular interests. The clause was never meant to be an open invitation to expand government far beyond its primary role of night watchman.

Yet "Progressives" who sought to use government to do good (with other people's money) overtook the vision of limited government. "Public charity" gradually became the norm. Unlike private charity, however, government transfers always involve coercion or the threat of force. Doing good with other people's money without their consent is not a virtue but a vice—or, rather, a crime.

The transformation of the framers' constitutional vision began with the Progressive Era, accelerated with the New Deal, and mushroomed with the Great Society's war on poverty, which created new entitlements and enshrined welfare rights. Today, more than half the federal budget is spent on entitlements—the largest being Social Security, Medicare, and Medicaid. The newly passed health insurance legislation will add fuel to the fire of the welfare state. The $100 trillion in unfunded liabilities in Social Security and Medicare will place a heavy burden on future generations.

Freedom from Responsibility

During the transition from limited government to the welfare state, freedom has come to mean freedom from responsibility. Such freedom, however, is not true freedom but a form of tyranny, which creates moral and social chaos.

The modern liberal's vision of government is based on a twisted understanding of rights and justice—an understanding that clashes with the principle of freedom inherent in the higher law of the Constitution. Welfare rights, or entitlements, are "imperfect rights," or pseudo-rights; they can be exercised only by violating what legal scholars call the "perfect right" to private property. Rights to welfare—whether to food stamps, public housing, health care, or business subsidies—create a legal obligation to help others. In contrast, the right to property, understood in the Lockean sense, merely obligates individuals to refrain from taking what is not theirs. For the modern liberal, justice refers to "social (or distributive) justice"—an amorphous term, subject to all sorts of abuse if made the goal of public policy, as F. A. Hayek has aptly noted in *The Constitution of Liberty* and other writings. As a norm for action, the concept of "social justice" leads to uncertainty and competition for government favors. The result is bigger government and corruption. The cost of the pursuit of social justice is the loss of freedom. Instead of creating certainty by

limiting the range of government actions under a just rule of law, the modern "liberal" State has produced discord. Indeed, when the role of government is to do good with other people's money, there is no end to the mischief government can cause.

Many Americans seem to have lost sight of the idea that the role of government is not to instill values but to protect those rights that are consistent with a society of free and responsible individuals. Everyone has a right to pursue happiness, but no one has the right to do so by depriving others of their liberty and their property.

When democracy overreaches, there is no end to the demands on the public purse, and the power of government grows. The Founding Fathers sought to create a republic with limited government, not an unlimited democracy in which the "winners" are allowed to impose their will and vision of the good society on everyone else. In such a system politics becomes a fight of all against all, like the Hobbesian jungle, and nearly everyone is a net loser as taxes rise, deficits soar, and economic growth slows.

Many Americans seem to have lost sight of the idea that the role of government is not to instill values but to protect rights.

Bankrupt in Every Way

Most voters recognize that the welfare state is inefficient and has a built-in incentive to perpetuate poverty. It should be common sense that when government promises something for nothing, demand will grow and so will the welfare state. That has clearly been the case with health care spending under Medicaid and Medicare—and it will be the case with Obamacare. For all the money spent on fighting poverty since 1965, the official poverty rate has remained roughly the same, about 14 percent. Government waste is only part of the problem; the welfare state is also intellectually, morally, and constitutionally bankrupt.

Intellectually bankrupt. It is intellectually bankrupt because increasing the scope of market exchange, not welfare, is the viable way to alleviate poverty. The best way to help the poor is not by redistributing income but by generating economic growth and removing impediments to self-help and mutual aid. Poverty rates fell more *before* the war on poverty when economic growth was higher.

The failure of communism shows that any attenuation of private property rights weakens markets and reduces choice. Individual welfare is lowered as a result. The welfare state has attenuated private property rights and weakened the social fabric. When people look to government to provide retirement income, health care, mortgage guarantees, and various business subsidies, private initiative gives way to collectivist thinking. Economic decisions become politicized, and people lean more and more on government.

Morally bankrupt. In addition to being inefficient and intellectually bankrupt, the welfare state is morally bankrupt. In a free society people are entitled to what they own, not to what others own. Yet under the pretense of morality politicians and advocacy groups have created rights out of thin air. The rights to education, health care, housing, a minimum wage, and other "necessities" are now deemed sacrosanct. Politicians have become the high priests of the new State religion of welfare rights and self-proclaimed "benefactors" of humanity. If there is a problem—any problem—Congress is there to solve it, regardless of whether the Constitution gives it the power to do so.

The truth is, "the emperor has no clothes." Politicians pretend to do good, but they do so through coercion not consent. Politicians put on their moral garb, but there is really nothing there. Government benevolence, in reality, is a naked taking. Public charity is forced charity, or what the great French liberal Frédéric Bastiat called "legal plunder."

Constitutionally bankrupt. The welfare state is also constitutionally bankrupt; it has no basis in the framers' constitution of liberty. By changing the role of government from a limited one of protecting persons and property to an unlimited one of achieving "social justice," Congress, the courts, and presidents have broken their oaths to uphold the Constitution.

In contrast Congressman Davy Crockett, who was elected in 1827, told his colleagues, "We have the right, as

individuals, to give away as much of our own money as we please in charity; but as members of Congress we have no right to appropriate a dollar of the public money."

Polls show that most Americans distrust government and that more young people believe in UFOs than in the future of Social Security. Those sentiments express a growing skepticism about the modern welfare state. President Obama's election does not mean most Americans have abandoned the principles of the Constitution and are in a rush to move toward a socialist state. What can be done to meet the challenge of safeguarding freedom?

What Can Be Done

First and foremost, we need to expose the intellectual, constitutional, and moral bankruptcy of the welfare state. We need to change the way we think about government and restore an ethos of liberty and responsibility. The political process will then be ready to begin rolling back the welfare state.

Although Americans have grown accustomed to the welfare state, its disappearance would strengthen the nation's moral fabric and reinvigorate civil society. We should end the parasitic State—not because we want to harm the poor, but because we want to help them help themselves.

The modern liberal's idea of "good government" has divorced freedom from responsibility and created a false sense of morality.

The federal government has become bloated and unable to perform even its rudimentary functions. It is awash with debt and is endangering America's future. The collapse of communism and the failure of socialism should have been warning enough that it is time to change direction.

It is time to limit the size and scope of government and to get the State out of the business of charity. Private virtue, responsibility, and benevolence can then grow naturally along with civil society—just as they did more than 150 years ago when Alexis de Tocqueville wrote in his classic *Democracy in America*:

> When an American asks for the cooperation of his fellow citizens it is seldom refused, and I have often seen it afforded spontaneously and with great good will. . . . If some great and sudden calamity befalls a family, the purses of a thousand strangers are at once willingly opened, and small but numerous donations pour in to relieve their distress.

The role of government in a free society is not to legislate morality—an impossible and dangerous goal—or even to "empower people"; the role of government is to allow people the freedom to grow into responsible citizens and to exercise their inalienable rights.

The modern liberal's idea of "good government" has divorced freedom from responsibility and created a false sense of morality. Good intentions have led to bad policy. The moral state of the union can be improved by following two simple rules: "Do no harm" and "Do good at your own expense." Those rules are perfectly consistent in the private moral universe. It is only when the second rule is replaced by "Do good at the expense of others" that social harmony turns into discord as interest groups compete for scarce resources at the public trough. FEE

Subsidizing More College Students Won't Help the Economy

BY GEORGE C. LEEF

Governments in the United States subsidize college education heavily. State universities charge students very low tuition rates, and the federal government has a host of grant and loan programs designed to make college affordable to most families. (As politicians make those programs more generous, schools have spent more and raised tuitions, thus creating an upward cost spiral—but that's another story.)

One of the simplest of all economic lessons is that when government subsidizes something, more of it is produced than otherwise. That's because subsidies upset the natural calculation of costs and benefits that people make. The subsidized thing becomes artificially more attractive to consumers; as they buy more of it, resources are drawn away from nonsubsidized things. Subsidies cause inefficiency.

In higher education, subsidies have led to a great surplus of young people going to college and a deterioration in academic standards. As higher education has expanded—at the end of World War II less than one high school graduate in ten enrolled in postsecondary education; now about 70 percent do—schools have increasingly drawn in weak and disengaged students. Rather than risk losing such students (and the money they bring in), many colleges have relaxed their admission standards, allowed or encouraged grade inflation, and dumbed down their curricula.

> Higher-education subsidies have led to a great surplus of young people going to college and a deterioration in academic standards.

Nevertheless, some politicians and education leaders claim that the nation badly needs to "produce" still more college graduates. In a speech to Congress in February 2009 President Obama declared a national goal of having the world's highest percentage of workers with college degrees by 2020. One of the nation's major educational foundations, Lumina Foundation, proclaims that its mission is to get more students through college and maintains that the United States is falling behind other countries in its level of "educational attainment."

That was the subject of a debate I participated in on February 26. Arguing for the resolution that the United States needs more college graduates to remain an economic power were former Secretary of Education Margaret Spellings and Michael Lomax, president of the United Negro College Fund. Ohio University economics professor Richard Vedder and I opposed it. If you care to watch the debate, which took about an hour and a half, you'll find it at www.tinyurl.com/yz6qk4o. For those who prefer a synopsis, read on.

The affirmative debaters contended that college education:

- raises people's incomes substantially; graduates on average earn nearly a million dollars more over their careers than nongraduates;

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- provides people with the skills they need to succeed in "the knowledge economy";
- opens up opportunities for people to advance, especially those from poor backgrounds; and
- will help America remain competitive with other nations.

Professor Vedder and I took issue with these claims.

First, we contended that the "earnings premium" argument is fallacious. Even though it's true *on average* that people with college degrees earn more, that isn't necessarily true *at the margin*. That people with college degrees (many of them earned decades ago when standards were higher) have high earnings on average tells us nothing about the next student who gets a degree. Since many people who obtain college degrees today wind up working in low-skill, low-paying jobs, there is no basis for the assumption that college education raises incomes.

Second, we argued that college coursework doesn't automatically improve an individual's skills and knowledge. Although some students benefit greatly from their studies, many others enter college with very poor capabilities and graduate with little or no improvement. Most employers aren't looking for in-depth knowledge that only a college-educated individual could have; rather they are looking for good basic skills and trainability—and they complain that many students are lacking in that respect.

That people with college degrees have high earnings on average tells us nothing about the next student who gets a degree.

Third, we argued that having a college degree doesn't necessarily open up any opportunities because bachelor's degrees are so common now that having one is no distinction. Moreover, there are other and often more effective ways for people to advance than going to college. Many vocational paths are less costly and offer better long-term prospects than a college degree.

Fourth, we argued that since we already have a glut of college graduates in the labor force, adding to it does nothing to make the United States more competitive. Furthermore, there is no causal link between increasing numbers of people holding college degrees and the creation of high-skill, high-paying jobs.

Finally, we argued that putting more and more people through college exacerbates the problem of credential inflation—that is, employers' insisting that applicants have college degrees to be considered for jobs that don't require any academic training. Credential inflation already shuts out individuals who don't have college degrees from many jobs they could easily do.

In response to our case against the resolution, the affirmative side said *nothing*.

Perhaps I should just leave the matter there, but there is more to be said against the idea of trying to increase college attendance and graduation through government action.

For one thing, the notion that the country would be better off if it put more people through college is cut from the same bolt of cloth as the notion that the country would be better off if it increased the percentage of people who own their own home. That is another noble-sounding idea that politicians tried to achieve through subsidies and manipulations. Eventually, it proved to be harmful to many individuals who were persuaded to take out mortgages they couldn't pay off. Similarly, numerous young Americans are today struggling to make the payments on their college loan debt out of incomes far below what they were all but promised. Government planning schemes always have a lot of collateral damage.

For another, if we are serious about improving the productivity of the economy, a marginal increase in the percentage of workers with college credentials is a diversion from policies that would actually matter. Like what? Well, governments channel resources away from productive, competitively determined uses and into wasteful, politically determined uses. Governments' innumerable laws and regulations interfere with efficiency, the minimum wage and occupational licensing being examples. And governments drive away investors and entrepreneurs with high taxes.

Many policy changes would increase the vitality of our economy. Pushing a few more young people through college is not one of them. FEE

Government as Consumer

BY SHELDON RICHMAN

Destutt de Tracy, as I discussed in the June issue (www.tinyurl.com/24jggno), was a French economist whom Thomas Jefferson did his utmost to bring to the attention of America. The first part of Tracy's *A Treatise on Political Economy* (1817), the translation of which Jefferson arranged, is a primer in economics that will satisfy any aficionado of Austrian economics. It builds up a theory of exchange and commercial society beginning with a notion of value rooted in subjective utility and using a praxeological method.

Tracy's book also discussed the nature and economic effect of government. And how refreshingly lucid is his treatment! It makes most modern descriptions of government look childish by comparison.

Government Consumes Wealth

Today mainstream observers regard government as a source of *investment* in society. Across the political spectrum, overlooking differences in detail, one finds agreement that government spending, at least at some level, creates value.

Tracy did not see it that way. Like other liberal, free-market economists of early nineteenth-century France, Tracy saw the State essentially as a predator, a destroyer of value, and the source of class conflict. (Which is not to say he thought government should be abolished.)

"In every society the government is the greatest of consumers," he wrote. This puts him at odds with most of what is believed about government now. Government spending, he insisted, does not create wealth.

Nor does it stimulate others to create wealth, a belief that is dominant today. Prosperity cannot be achieved through consumption, he held, and he didn't buy the "multiplier."

"[T]hose who persuade themselves that consumptions can be a cause of direct riches, maintain that the levies made by government, on the fortunes of individuals, powerfully stimulate industry; that its expenses are very useful, by augmenting consumption; that they animate circulation; and that all this is very favourable to the public prosperity. To see clearly the vice of these sophisms, we must always follow the same track, and commence by well establishing the facts."

He then proceeded to refute Keynes—a mere 119 years before publication of *The General Theory of Employment, Investment, and Money*.

Tracy saw the State essentially as a predator, a destroyer of value, and the source of class conflict.

"The expenditure [government] makes does not return into its hands with an increase of value. It does not support itself on the profits it makes. I conclude, then, that its consumption is very real and definitive; that nothing remains from the labour which it pays; and that the riches which it employs, and which were existing, are consumed and *destroyed* when it has availed itself of them. . . ." (This and all other emphases are added.)

In other words, real investment in a free market, which is driven by entrepreneurs' attempts to satisfy consumers who—crucially—are free to say *no*, produces value, as indicated by the resulting profit. Thus we know that the output is esteemed more highly than the untransformed inputs. Government spending is not of that nature.

But what about government spending on infrastructure, those "shovel-ready projects" so beloved by the champions of government "stimulus"? Tracy cleverly pulls the rug out from under the argument by seeming at first to approve of such spending. Unlike the waste of other government spending, he says,

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"It is quite otherwise with funds employed in public labours of a general utility, such as bridges, ports, roads, canals, and useful establishments and monuments. These expenses are always favourably regarded, when not excessive. They contribute in effect very powerfully to public prosperity."

And yet, "they cannot be regarded as directly productive, in the hands of government, since they do not return to it with profit and do not create for it a revenue which represents the interest of the funds they have absorbed. . . ."

Besides, Tracy wrote, even government projects aiming at valued outcomes crowd out private efforts that would have been more efficient.

"[W]e must conclude that individuals could have done the same things, on the same conditions, if they had been permitted to retain the disposal of the sums taken from them for this same use; and it is even probable that they would have employed them with more intelligence and economy."

Even government projects aiming at valued outcomes crowd out private efforts that would have been more efficient.

Even spending on science would be better left to private entrepreneurs.

"Finally, we may say the same things of what the government expends, on different encouragements of the sciences and arts. These sums are always small enough and their utility is most frequently very questionable. For it is very certain that in general the most powerful encouragement that can be given to industry of every kind, is to *let it alone, and not to meddle with it*. The human mind would advance very rapidly if only not restrained; and it would be led, by the force of things to do always what is most essential on every occurrence. To direct it artificially on one side rather than on another, is commonly to lead it astray instead of guiding it."

Sterile and Unproductive

Now Tracy goes in for the kill:

"From all this I conclude, that the whole of the public expenses ought to be ranged in the class of expenses justly called *sterile and unproductive*, and consequently that whatever is paid to the state, either under the title of a tax or even of a loan, is a result of productive labour previously executed, which ought to be considered as *entirely consumed and annihilated the day it enters the national treasury*. Once more I repeat it, this is not saying that this sacrifice is not necessary, and even indispensable. . . . But [every citizen] should know that it is a sacrifice he makes; that what he gives is immediately lost, to the public riches, as to his own; in a word, that it is an expense and not an investment."

The upshot? For Tracy it is that government should be kept small and inexpensive. Note the jab he gives to "the greatest politicians":

"Finally, no one should be so blind as to believe that expenses of any kind are a direct cause of the augmentation of fortune; and that every person should know well that for political societies, as well as for commercial ones, an expensive regimen is ruinous, and that the best is the most economical. On the whole, this is one of those truths which the good sense of the people had perceived for a long time before it was clear to the greatest politicians." FEE

More Border-Picture Economics

BY T. NORMAN VAN COTT

I suggested in the May issue that an aerial photograph of the border between barren Haiti and the heavily forested Dominican Republic was a predictor of the recent Haitian earthquake devastation (www.tinyurl.com/33w8du7). Not the earthquake, mind you, but the devastation that followed.

The property-rights vacuum that encouraged Haitians to cut trees down without replanting also motivated them to skimp on construction durability. When the "big one" came, buildings collapsed and tens of thousands died. Incentives mattered, big time.

A satellite photo of the Korean peninsula provides a similar border-economics lesson. Taken at night, the photo shows South Korea lit up like a Christmas tree. To the southeast, Japan is much the same and, to the north and west, China's glowing, too. But North Korea has just one isolated dot of light. The message: In a vibrant region, North Korea is a failure, especially compared to its brethren just over the DMZ.

North Korea remains an island of darkness in a vibrant region.

Economic statistics confirm the message. South Korea is the world's 15th largest economy. North Korea is an economic coffin, at or near the bottom of all national economic rankings except misery. Things were not always this way, however. Some 60 years ago living standards were actually higher in the north.

What happened? The short answer is that the South Koreans accepted private property rights as an organizing principle for economic activity. The North Koreans shunned such rights, opting for the seeming sureness of top-down economic decision-making. Institutional choices trumped Koreans' common cultural heritage and language to produce a disparity in living standards surely unimaginable to those who made the choices.

The Heritage Foundation publishes an Index of Economic Freedom, of which the security of private property is an important component. Of the 179 countries in the 2010 index, South Korea is 31st and North Korea is . . . you guessed it, 179th. Economic data for closed societies like North Korea are sketchy. Nevertheless, Heritage estimates South Koreans' average income to be a double-digit multiple of that of their northern counterparts.

The contrast is sobering. But before we get too gushy about South Korean economic institutions, a note of caution is in order. South Korea has long pursued "crony capitalism," where a number of *chaebol*—large industrial conglomerates, usually controlled by a

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single family—enjoy preferential status with the government. Samsung, Hyundai, and LG are three of the better-known *chaebol*. Among the special privileges of *chaebol* is access to government finance not open to others. The effect of such "privileges" is to limit entry of non-*chaebol* competitors. It also lets them deploy various tariffs and subsidies to keep imports—especially those from politically unpopular countries—artificially expensive.

Attempts at market closure are certainly not unique to South Korea, but it does make it difficult to label South Korea a wide-open, free-market economy. That South Korea has experienced prosperity in the presence of such impediments leads statist-types to assert that its government officials must have "picked the winners." How myopic, risk-averse bureaucrats, largely immune from the consequences of their decisions, can have such insight goes unexplained.

The notion that market closure somehow promotes economic advancement is fatuous and at odds with all economic logic and evidence.

Success Despite Cronyism

The more important point, however, is that the notion that market closure somehow promotes economic advancement is fatuous and at odds with all economic logic and evidence. The adage about correlation not implying causation certainly applies here. Market closure, with or without a miraculous ability to "pick winners," stunts advance, reducing living standards below what they otherwise would be. South Koreans enjoy relatively high living standards *despite* their government's crony capitalist practices, *not* because of the practices, though the families in charge of the *chaebol* and people pursuing lifetime employment as salarymen certainly get some extra benefits. Absent such practices, overall living standards would be even higher.

At the same time, the fact that the two Koreas are so far apart in economic institutions and economic outcomes is a useful reminder that living standards don't just happen. The goods and services responsible for our survival and enjoyment of life must be produced. They don't spontaneously appear like Old Testament manna or multiply like New Testament loaves and fishes.

The problem is that there's not enough land, labor, and capital to produce everything people want. Consequently, every society must have processes that determine what gets produced and who produces it. The yardsticks for measuring the effectiveness of these processes are the extent to which people value what is produced and that this production occurs at minimum cost or sacrifice.

For example, raising beef cattle in downtown Boston for American Vegetarian Society conventions fails on both counts. Not only would the beef be of no value to its intended users, it would also be exceedingly costly in terms of other things that could have been produced on the Boston real estate. It would destroy wealth.

Raising cattle on, say, Montana ranches for National Football League training camps would be at the other end of the spectrum. Low opportunity cost and high consumption value translate into wealth creation.

Private property in a truly free market harnesses self-interested sellers and buyers to act as wealth creators not destroyers. First, such sellers will seek out the buyers who value their products most highly, since they will be willing to pay the most. Second, self-interested buyers will be drawn to lower-cost producers, since they will be most willing to sell at lower prices. The result is high consumption value at low cost—more wealth.

Smile Like You Mean It

Lest you think that this process begins and ends in self-interested behavior, note that self-interested sellers are also constrained to act as if they cared about buyers. To wit, they must offer buyers terms that benefit buyers. Otherwise, buyers don't buy. Likewise, self-interested buyers must act as if they cared about sellers by offering terms that benefit sellers, or sellers don't sell. Wealth accrues to people on both sides of the transaction.

My idealistic students tell me that acting *as if* you care about your counterparts in the marketplace isn't good enough. It's so shallow; we need to *really* care, say

these students. Put differently, my students are telling me that economic actions should be grounded in benevolence and love. It's a fair comment. What's the answer?

Interestingly, Adam Smith noted in his 1776 masterpiece, *The Wealth of Nations*, that "In civilized society [man] stands at all times in need of the co-operation and assistance of great multitudes, while his whole life is scarce sufficient to gain the friendship of a few persons." It's not that benevolence and love are incapable of motivating our actions. It's just that their operative range is limited by the extent we want to live in an economy with the high living standards that follow on a substantial division of labor and its accompanying anonymity.

So I tell my students that if they want to *really care*, join a commune. Not surprisingly, they take a rain check.

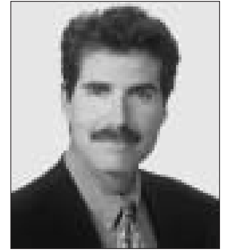
To think that top-down, czar-like government directives could even remotely approximate the market's assignments of production tasks and consumption benefits is wrongheaded. There is no way so-called economic czars could ever command the millions upon millions upon millions of bits of information about buyer valuations and producer opportunity costs for countless numbers of goods and services. It simply cannot be done. And if a society tries? Lights out! Look again at that satellite photo.

Individual sellers and buyers in free markets have no need for information on such a cosmic scale. Readily observed prices provide each, individually, with the economic equivalent of green lights and red lights to guide their activities in wealth-creating directions. The lights flash green when selling prices rise relative to costs; they flash red when costs rise relative to selling prices.

Moreover, and this is key, each seller only needs to know the price of what *he* sells and *his* costs, just as each buyer only needs to know the price of what *she* buys relative to the value *she* places on the item. Do sellers have to know why prices are what they are, or why their costs are what they are? No. Do buyers have to know why prices are what they are, or why their consumption valuations are what they are? No.

> Do buyers or sellers have to know why prices are what they are? No.

Sellers and buyers responding individually to the green and red lights embodied in prices permit these millions of bits of information about potential sellers and buyers to get processed into market outcomes. Production assignments for a vast array of goods and services go to their lower-cost producers and the corresponding consumption benefits go to their higher-valued users. No one knows a lot, but lots of lights go on. Look at that photo again. FEE



Politicians Smother Cities

BY JOHN STOSSEL

I like my hometown, but I must admit that New York has problems: high taxes, noise, traffic. *Forbes* magazine ranks my city the 16th most miserable in America. Ouch! Of course, that makes me wonder: What's America's most miserable city?

Cleveland, says *Forbes*. People call it "the Mistake by the Lake." Cleveland, once America's sixth-largest city, has been going downhill for decades.

Why do some cities thrive while others decay? One reason is that some politicians smother their cities with the unintended consequences of their grand visions, while others have the good sense to limit government power.

In a state that already taxes its citizens heavily, Cleveland's politicians drown businesses in taxes.

One result: Since 2000, 50,000 people have left the city. Half of Cleveland's population has left since 1950.

Cleveland controls zoning and subsidizes the wealthy by funding big construction projects. It's lost half its population since 1950.
flickr.com/sarah606/

But the politicians haven't learned. They still think government is the key to revitalization. While Indianapolis privatized services, Cleveland prefers state capitalism. It owns and operates a big grocery store, the West Side Market. Typical of government, it's open only four days a week, and two of those days it closes at 4 p.m. The city doesn't maintain the market very well. Despite those cost savings, the city manages to *lose* money running the market. It also loses money running golf courses—$400,000 last year.

Another way that cities like Cleveland cause their own decline is through regulations that make building anything a long, drawn-out affair. Cleveland has 22 different zoning designations and 673 pages of zoning guidelines.

Houston, We Have a Solution

By contrast, Houston has almost no zoning. This permits a mix of uses and styles that gives the city vitality. And the paperwork in Houston is so light that a business can get going in a single afternoon. In Cleveland one politician bragged that he helped a business get though the red tape in "just 18 months."

Randall O'Toole, author of *The Best-Laid Plans: How Government Planning Harms Your Quality of Life, Your Pocketbook, and Your Future*, says Houston does have rules, but they are more flexible and responsive to citizens' needs because they are set by neighborhood associations based on protective covenants written by developers.

Politicians' rules rarely change because the politicians don't have their own money on the line. Cleveland's managers thought that funding gleaming new sports stadiums (which subsidize wealthy team owners) and other prestigious attractions like the Rock and Roll Hall of Fame would revitalize their city.

John Stossel hosts Stossel *on Fox Business Network and is the author of* Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know Is Wrong. *Copyright 2010 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

Urban policy expert Joel Kotkin says, "This whole tendency to put what are scarce public funds into convention centers and . . . ephemeral projects is delusional."

Stadium Strikeouts

But politicians claim that stadiums increase the number of jobs.

Not so, says J. C. Bradbury, author of *The Baseball Economist: The Real Game Exposed*. "There's a huge consensus among economists that there is no economic development benefit to having these stadiums," he says.

Houston lets neighborhoods control their zoning rules. It has almost four times as many people as in 1950.

The stadiums do create jobs for construction workers and some vendors. But "it's a case of the seen and the unseen," Bradbury says, alluding to the nineteenth-century French economist Frédéric Bastiat. "It's very easy to see a new stadium going up. . . . But what you don't see is that something else didn't get built across town. . . . It's just transferring from one place to the other.

"People don't bury their entertainment dollars in a coffee can in their backyard and then dig it up when a baseball team comes to town. They switch it from something else."

Stadiums are among the more foolish of politicians' boondoggles. There are only 81 home baseball games a year and 41 basketball games. How does that sustain a neighborhood economy?

But the arrogance of city planners knows no end. Now Cleveland is spending taxpayers' money on a medical convention center that the planners say will turn Cleveland into a "Disney World" for doctors. Well, Chicago's $1 billion expansion of the country's biggest convention center—McCormick Place—was unable to prevent an annual drop in conventions, and analysts say America already has 40 percent more convention space than it needs.

Politicians would be better stewards of their cities if they set simple rules and then just got out of the way. I won't hold my breath. FEE

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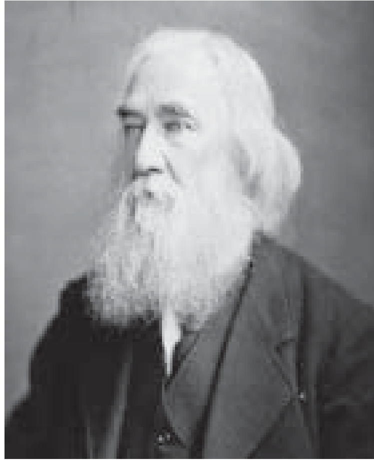

The Lysander Spooner Reader

Lysander Spooner (1808—1887) was one of the great individualists of his era. He practiced law in violation of state law and then successfully petitioned to change the law. When the United States Post Office claimed a monopoly on first-class mail, Spooner opened a competiting agency which forced the post office to lower their rates. Spooner was a great opponent of slavery, but at odds with many abolitionists of his day. He defended reason, natural law, and individual freedom. Included in this volume are his essays: *Natural Law*, *Vices Are Not Crimes*, *No Treason*, *Letter to Thomas F. Bayard,* and the full text of his famous book, *Trial by Jury*.
Also included is an introduction by George H. Smith, along with an obituary written by Spooner's compatriot, Benjamin Tucker (1854—1939) that was published in Tucker's newspaper, *Liberty*, May 28, 1887. Lysander Spooner was one of the most important, early libertarian thinkers in the individualist tradition. Even after a full century his working is amazing relevant to today. This paperback edition is about 350 pages with an index included. Published by Laissez Faire's own Cobden Press, thanks to the generous donations of our supporters. List price $18.95, our special $16.95.

Libertarianism from A to Z

Libertarian principles seem basic enough—keep government out of boardrooms, bedrooms, and wallets, and let markets work the way they should. But what reasoning justifies those stances, and how can they be elucidated clearly and applied consistently? In *Libertarianism from A to Z*, acclaimed Harvard economist Jeffrey Miron sets the record straight with a dictionary that takes the reader beyond the mere surface of libertarian thought to reveal the philosophy's underlying and compelling logic.

Tackling subjects as diverse as prostitution and drugs, the financial crises and the government bailouts, the legality of abortion, and the War on Terror, Miron takes the reader on a tour of libertarian thought. He draws on consequentialist principles that balance the costs and benefits of any given government intervention, emphasizing personal liberty and free markets. Miron never flinches from following those principles to their logical and sometimes controversial ends. Along the way, readers get a charming and engaging lesson in how to think like a libertarian.

Principled, surprising, and thought provoking, *Libertarianism from A to Z*, has everything a bourgeoning libertarian—or any responsible citizen-needs to know. Hardback, 224 pages, list price $24.95; Amazon price, $16.47; Laissez Faire price, $15.95.

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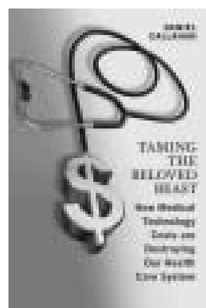
Book Reviews

Taming the Beloved Beast: How Medical Technology Costs Are Destroying Our Health Care System

by Daniel Callahan

Princeton University Press • 2009 • 288 pages • $29.95

Reviewed by Arnold Kling



Daniel Callahan has written a bracing and exasperating book on health care policy. It is bracing in its realistic assessment of the tradeoffs and dilemmas facing U.S. policymakers, but exasperating in its assessment of the relative merits of using market processes or government intervention to resolve these issues.

Callahan, a senior scholar at Yale, makes the following major points:

1. Americans spend an ever-increasing share of national income on health care.
2. Much of that increased spending goes for procedures that use advanced medical technology.
3. Medicare recipients are participating in this spending surge; as a result Medicare cannot be sustained financially without substantial changes.
4. European governments control health spending by restricting supply in the health care industry.
5. To incorporate supply restrictions in the United States, our cultural values would have to change.

On the last point, Callahan elaborates:

> American health care is radically American: individualistic, scientifically ambitious, market intoxicated, suspicious of government, and profit-driven. I put changing those values within health care in the class of a cultural revolution . . . .
>
> The medical model that needs change encompasses a combination of Manichean and utopian values: that suffering . . . is inherently evil; that death is intrinsically wrong . . . and that endless medical progress should be pursued.

Overall, this makes for a much more sober view of the health care issue than what was reflected in the recent debate over health care reform. During that debate policy wonks made frequent references to "bending the cost curve," promising to make this a painless process with reforms such as electronic medical records and crackdowns on Medicare fraud.

Callahan argues that "such efforts can be likened to one of the endemic problems of end-of-life care, that of embracing hope and unlikely treatments and of refusing to grant the obvious fact that the patient is dying." That is, we don't know when to give up. Callahan does.

Although Callahan sees it as a serious failing that many Americans lack health insurance, he also believes that those who are insured have excessive coverage. His preference, to be imposed by law, would be to ban insurance coverage for many drugs and medical procedures he deems wasteful, such as reproductive assistance for women over 35 and joint surgery for individuals over 65 who want to continue an athletically active life. Callahan views the issue of insurance coverage as a concern for public policy—saving resources for the things he regards as most important—not a matter for personal choice based on market prices.

In Callahan's opinion, we Americans spend too much of our health care money on the elderly and not enough on younger people. As he puts it, "[A] health care system should help young people to become old, but not to help the old to become even older." He recognizes the role that Medicare plays in distorting the distribution of health care, by taking income away from working-age families and using it to subsidize health care for the elderly. Rather than recommend eliminating or reducing this distortion, however, his approach would be to use government policy to steer health resources in his preferred direction.

Unsurprisingly, Callahan has minimal faith in markets and maximum faith in government. He writes, "A regulation-free, unfettered competition offers no reasonable possibility of controlling costs. The attraction of technology for patients and physicians, abetted by energetic and relentless industry marketing, has shown itself capable of overwhelming the private sector's control efforts." He continues that the trouble with the free market is that it allows individuals to maximize their

own well-being rather than the well-being of "the system," therefore compelling government to force "an accountability that is absent in private sector medicine."

Thus Callahan paints a picture of the private sector as a brutal jungle, with suppliers relentlessly forcing their expensive technologies on helpless consumers. Adam Smith's famous observation that we do not need the benevolence of the baker to put bread on our table seems to have eluded Callahan. He certainly fails to perceive its relevance to health care.

Meanwhile he takes it for granted that government actors are sensitive to the general interest and accountable to the public. I would instead argue that accountability works better in the private sector, where workers are fired for making mistakes, unsuccessful businesses have to shut down, and investors who make unwise decisions suffer losses. I'd also note that when politicians make wasteful and harmful decisions, they rarely suffer any adverse consequences.

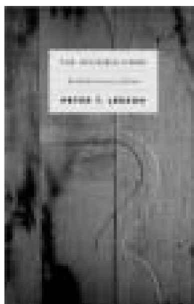
Taming the Wild Beast shows that market advocates and interventionists can agree on many features of the diagnosis of the health care dilemma. Still, our prescriptions are diametrically opposed, reflecting differences in our understanding of how markets and government operate and the importance of liberty. FEE

Arnold Kling (arnold@arnoldkling.com) is the author of Crisis of Abundance: Rethinking How We Pay for Health Care.

The Invisible Hook: The Hidden Economics of Pirates

By Peter T. Leeson
Princeton University Press • 2009 • 296 pages • $24.95

Reviewed by E. Frank Stephenson



If you had a childhood interest in pirates and a teenage love for economics, what would you do as an adult?

If you are George Mason University economics professor Peter Leeson, you write a book on the economics of piracy. That book, *The Invisible Hook*, is a rollicking good read—more fun than any person should be allowed to have without a parrot, a hook, and an eye patch. Leeson's goal, however, is more than merely collecting entertaining pirate anecdotes.

Instead, he argues that the "rational choice [framework of economics] is the *only* way to truly understand flamboyant, bizarre, and downright shocking pirate practices." Accordingly, as indicated by the subtitle, this book is part of Leeson's larger and impressive research agenda on privately created law and order. That pirates are a suitable part of such an agenda becomes apparent, Leeson explains, once one realizes that pirates were stateless (and often violent) people who nonetheless organized crews of 80 or more for plundering expeditions.

Leeson presents his argument in six main chapters sandwiched between introductory and concluding chapters cleverly framed as a management course taught by Professor Blackbeard. Chapter two explains that pirate ships' leaders were democratically elected and were constrained by a system of checks and balances. Lest one think rogues and sea dogs were principled Madisonians, Leeson explains that the organization of ships arose out of pirates' prior experience on merchant ships. Such ships had autocratic, often predatory, captains to protect the investment of the vessels' absentee owners from crew shirking or theft. By contrast, stolen pirate ships had no concern about absentee owners and were therefore free to create an organizational structure that minimized captains' abusiveness.

Chapter three explores pirate codes, the constitutional framework underlying pirate societies. These codes, which had to be agreed to by all pirates on a ship, aligned incentives among pirates and their leaders by having egalitarian pay structures; sought to minimize conflict on ships by proscribing activities such as gambling, bringing women aboard, or drinking below decks after 8 p.m.; and specified penalties for transgressions. Remarkably, pirates established puritanical rules to increase crew cohesion in the pursuit of profit, albeit ill-gotten.

Leeson next applies the economics of signaling to explain pirates' use of the "Jolly Roger" flag. Although pirates were willing and capable fighters, conflict risked bodily harm, damage to their ships, or destruction of the pirates' booty. Hence skull-and-bones flags, which distinguished pirate ships from less fearsome state-spon-

sored vessels flying national flags, and signaled to potential prey that resistance would be met with death. The flag thereby served as a cost-minimizing device by inducing merchant crews to surrender rather than fight.

Signaling and reputation-building also help explain the practice of torture. Beyond scaring merchant ships into surrendering, pirates also sought the cooperation of their officers and crew, rather than passive resistance such as hiding valuable lucre. They carefully cultivated reputations for barbarous treatment, which terrified crews into making pirates' profit-seeking easier. Besides using torture to weaken the passive resistance of captives (and occasional acts of arbitrary sadism), pirates also tortured would-be captors sent by the government and abusive merchant captains.

In chapter six Leeson turns his attention to pirate crews, arguing that pirates relied much less on conscription than popular portrayal would have us believe. Conscription, after all, would threaten the cohesiveness that pirates sought. It was also unnecessary: The combination of captain cruelty on legitimate ships and high remuneration on pirate ships produced a steady stream of would-be swashbucklers. The reason for the misinterpretation, Leeson suggests, is that pirates deliberately sought to make their voluntary participation appear to be conscription in order to minimize the legal consequences (likely hanging) should they be captured. As part of this ruse pirates even staged shows intended to fool onlookers into thinking that captives who were willingly joining them were instead being impressed.

Leeson also describes another surprising feature of pirate ships: Though slavery remained common and discrimination the norm, pirate crews contained a substantial contingent of black sailors. Not that they were paragons of tolerance—some of the black sailors were slaves. Many, though, were free and equal members of pirate democracies. Leeson explains that slaves, like conscripts, endanger crew cohesion. The Public Choice logic of dispersed benefits and concentrated costs made racial tolerance preferable to slavery. While each pirate would have to divide any surplus generated by slaves with his crewmates, the costs—increased likelihood of capture and hanging if slaves hampered crew unity—were fully borne by each crew member.

Leeson's book is magnificent. It also carries an important implication: If rogue pirates could organize themselves into relatively peaceful societies, then perhaps modern people should look less to coercive State solutions and more toward emergent order arising from voluntary human interactions. FEE

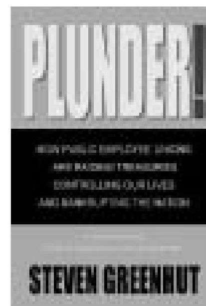
Frank Stephenson (efstephenson@berry.edu) chairs the department of economics at Berry College in Rome, Ga.

Plunder! How Public Employee Unions Are Raiding Treasuries, Controlling Our Lives and Bankrupting the Nation

by Steven Greenhut

The Forum Press • 2009 • 316 pages • $18.95

Reviewed by George Leef



Karl Marx was right—sort of. He was right in saying that society is riven by class warfare, but he got the classes wrong. It's not the case that capitalists exploit workers, but rather that tax consumers exploit taxpayers.

That truth has long been kept hidden from the average American by deceptive propaganda about the workings of democracy and the supposed nobility of "public service." But people are starting to comprehend. Articles in major newspapers have recently disclosed the crucial fact that government employees are generally paid substantially more than comparable private-sector workers and enjoy more generous and secure benefits. And now Steven Greenhut's *Plunder!* will no doubt fan the flames of resentment against the political class for its constant and stepped-up picking of the pockets of productive people.

Greenhut, a California-based writer (whose previous book, *Abuse of Power*, I reviewed in the July 2005 *Freeman,* www.tinyurl.com/33b3zu4) shows that government employees, especially unionized ones in states where unions have great political clout, are living it up on wealth extracted from the rest of the population via taxation. To make matters worse, politicians keep granting them pay and benefit increases even when the current levels clearly will lead to unmanageable deficits.

For some places the wolf is already at the door. The city of Vallejo, California, recently declared bankruptcy because tax revenues no longer cover its extremely heavy personnel costs, including a city manger whose total compensation package is $400,000 and a 190-person fire department, half of whom earn more than $170,000 per year. The city is decrepit, but the "public servants" go on bleeding the taxpayers white.

Not only are these people paid astoundingly high salaries, but they also can retire at an early age and collect 90 percent of their final salary for life. On top of that, many claim purportedly work-related disabilities, shielding half their generous benefits from taxation. There are public boards to evaluate those claims, but (naturally) they are dominated by the public unions and rubberstamp nearly every one.

Politicians of both major parties go along with the plunder. Democrats, who receive vast campaign "contributions" (unionized workers actually have no choice; their money goes wherever union officials dictate) have long favored schemes to redistribute wealth as long as it leads to votes. Republicans have more recently gotten aboard. Most of them can't resist the "law and order" cachet that comes from helping police, firefighter, and prison-guard unions get what they want. Both parties treat the rare politician who dares to buck the system like a leper.

Greenhut gives his readers a superb lesson in Public Choice theory. The subject of overpaid, coddled government employees is a pure case of concentrated benefits triumphing over dispersed costs in a democracy.

Whenever the gravy train comes under attack, the unions and their political allies counterattack with a powerful arsenal. A particularly egregious lie they resort to is that their high, early pensions are justified because police officers and firefighters tend to die at an early age. Greenhut produces evidence conclusively refuting that claim. Truth, however, doesn't matter. The unions and their allies go right on making this and other false statements to keep the public complacent. Another devious tactic is to seek out auditors who will use creative accounting to mask the extent of the underfunding problem.

Greenhut specifically targets the public education system, so high in cost and so low in productivity. Taxpayers are forced to pay huge amounts of money to prop up a socialistic monstrosity that many of them have never had anything to do with. The education establishment and teachers' unions never stop demanding more, with syrupy messages that it's all "for the kids."

The outrages are not just financial, either. Greenhut shows that our "public servants" don't just live high on the hog at everyone else's expense. They also connive to put themselves above the law. In California, for example, many government employees are eligible for special license plates that identify them as part of the "family" and thus immune to punishment for traffic violations. Moreover, there is something akin to the Mafia's code of silence that lets police and guards get away with acts of violence that ought to land them in jail.

Greenhut sums matters up, writing, "We've seen a massive transfer of wealth from the private sector to the public sector, from taxpayers to tax consumers. The result is a class of coddled, overpaid and underworked public 'servants' whose pay and retirement levels cannot be sustained without cutbacks in public services and higher taxes." FEE

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Whatever Happened to Thrift? Why Americans Don't Save and What to Do about It

by Ronald T. Wilcox

Yale University Press • 2008/2009 • 176 pages • $30.00 hardcover; $20.00 paperback

Reviewed by Robert P. Murphy

Keynesianism is back in vogue, and prominent economists are dusting off their discussions of the "paradox of thrift." So amid the apologies for bigger government deficits, it is refreshing to read Ronald Wilcox's *Whatever Happened to Thrift?* For those interested in the subject of saving, this volume is a good read.

Too often when I have read handwringing over "the" savings rate, the worrier doesn't feel the need to

explain *why* we should care about savings in the first place. After all, the consumption/saving tradeoff is a reflection of individual preferences. If you want to save more, fine, go ahead—but don't force your views on the rest of us!

Wilcox, a professor at the University of Virginia's Darden School of Business, easily handles such an objection from standard economic theory. He cites a survey which found that 68 percent of workers thought their savings rate was too low, then says, "Even if we take [the economist's view], the fact that many people report feeling uncomfortable with their level of savings and seek ways to increase it should give us pause." If the reader gives him a chance, Wilcox shows that he is not some bossy sermonizer. On the contrary, he shows that there are reasonable senses in which we can say, "Americans don't save enough."

Take the issue of Americans' financial literacy. In a survey Americans over the age of 50 were asked to evaluate this claim: "Buying a single company stock usually provides a safer return than a stock mutual fund." Only 52 percent considered the statement false. One doesn't have to be a paternalistic busybody to be disturbed by such findings.

If we concede that many Americans are financially illiterate, then it is a simple step to concluding that they probably don't save enough. After all, the cost of saving—forgone consumption in the present—is obvious, whereas the benefit (higher consumption in the future) is remote. The virtues of discipline, abstinence, and thrift all work together. Someone who is ignorant of basic finance is likely to err on the side of saving too little.

Of course, even if one thinks Americans ought to save more, it doesn't follow that the government should tinker with tax policy to *encourage* a change in behavior. Sure, switching to a consumption tax might help people save more, but is that really any business of the government?

Yet that's too glib a dismissal of the problem, for the income tax really *does* introduce a bias into the consumption/savings decision. After receiving his take-home pay, a worker can either spend the money now "at par" *or* use the after-tax income to buy an investment such as a bond or share of stock. The return on these investments reflects the tradeoff between present and future consumption. And yet the income tax mutes the attractiveness of future consumption because any dividends from the investment are taxed anew in the following period. For tax and psychological reasons, Wilcox declares, "[S]upplanting the current federal income tax system with a broad-based consumption tax is the single most potent policy tool for increasing the savings rate of U.S. households."

Of course, it would be naïve to think that a mere technical adjustment to the tax code can provide a sound footing to the economy. The real threat to the economy is how *much* the government seizes in resources year in, year out. Moreover, it is highly unrealistic to think that politicians would leave incomes alone in exchange for a new federal tax on consumption. We should get rid of the income tax, with its anti-saving bias, and replace it with no new or increased taxes.

Another problem with the book is that Wilcox's suggestions "start with the government because sound policies there can pave the way for enlightened private-sector solutions as well." For example, he recommends that the government "reinvigorate the marketing of U.S. Savings Bonds." But why devise new or improved schemes to increase lending to the federal government, which squanders any resources it touches? Rather than focusing so much attention on government, Wilcox should have devoted his efforts to persuading his fellow citizens that a higher rate of saving would be beneficial.

All in all, Wilcox's book provides a quick yet nuanced summary of the relevant ideas and statistics in various fields in order to gain perspective on the American "savings problem." Although its proposed solutions often fall short, the book identifies an important national problem. FEE

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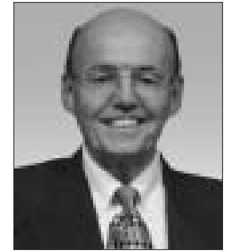

Unions Lose Respect

BY CHARLES W. BAIRD

I have often argued that American labor unions enjoy much more respect than they deserve. In February the Pew Research Center released the results of its latest nationwide survey of public opinion regarding labor unions (www.tinyurl.com/y4vuv2s [PDF]). It seems that, at last, labor unions are suffering significant losses of respect.

Table 1 shows the percentage of Americans who gave unions favorable and unfavorable ratings in the years 2001, 2005, 2007, and 2010. These results are consistent with earlier Gallup polls that showed that in 2008, 59 percent of Americans approved of unions while in 2009, only 48 percent approved. They are also consistent with a Rasmussen poll released in March 2009 that showed that only 9 percent of union-free workers would prefer to unionize.

Table 2 shows the percentage of Americans who agreed and disagreed with the proposition that "unions are necessary to protect workers" in the years 2003, 2007, and 2009. While the figures for 2009 show that more study is needed on this question, the trends are encouraging.

Table 1: Americans' Opinions of Unions

Year	Favorable	Unfavorable
2001	63%	28%
2005	56	33
2007	58	31
2010	42	41

Table 2: "Unions are necessary to protect workers."

Year	Agreed	Disagreed
2003	74%	23%
2007	68	28
2009	61	34

Table 3 shows the percentage of Americans who agreed and disagreed with the proposition that "unions have too much power" in the years 1999 and 2009. This trend is also encouraging. The perception that government has too much power is growing. Since government-employee unions (GEUs) are becoming the dominant face of American unionism, I expect even more people to conclude that unions have too much power.

Table 3: "Unions have too much power."

Year	Agreed	Disagreed
1999	52%	40%
2009	61	33

The Winter 2010 issue of *The Cato Journal* (www.tinyurl.com/y4d4mc7) provides excellent reading on this matter. It consists of 12 articles addressing the question "Are Unions Good for America?" The authors argue persuasively that the answer is no. In the concluding article I imagine what might replace the National Labor Relations Act (NLRA) when unions have lost enough respect to make it possible to repeal that law. What follows are some highlights of the other papers.

Armand Thieblot surveys American union history and concludes that, because labor law bestowed coercive powers on unions, "many individual union members simply found themselves beholden to a different set of bosses, who took part of their pay for dues." Under current union law, unions have almost run out of rent-seeking opportunities in the private sector. They now have turned to two types of political rent-seeking. They have diverted most of their organizing energy to the capture of government employees (51.3

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percent of all union members are now government employees), and they lobby for even more coercive power over private-sector workers—for example, card check. Thieblot wonders "whether there can be any way to stop or divert substantive union control over the economic activities of the entire country." In my view, President Obama's appointment of Andy Stern, former president of the SEIU, to his National Commission on Fiscal Responsibility and Reform makes Thieblot's point.

Project labor agreements (PLAs) and prevailing-wage laws are two other forms of political rent-seeking. PLAs are schemes to strip away any advantages that union-free construction firms have over their union-impaired rivals when bidding on construction projects by requiring union-free firms to pay union wages and benefits, use union hiring halls to obtain workers (even workers who are already their employees), and submit to union work rules. PLAs also force all workers to pay union dues and to contribute to union pension plans. They are usually imposed by state and local governments, but by executive order Obama has forced them on federal construction projects. David Tuerck critically examines the arguments unions use to justify PLAs and finds them all spurious. On average they raise the cost of government construction projects 12–18 percent.

Unions lobby for ever more coercive power over private-sector workers.

Prevailing-wage laws also apply to taxpayer-funded construction projects. The federal Davis-Bacon Act (1931) was the first such imposition. Since then 31 states have adopted their own versions. These laws require all firms that work on government construction projects to pay union wages and benefits. Thus union-free firms cannot compete on the basis of worker compensation. *Freeman* book review editor George Leef dissects all the arguments that unions have used to lobby for such laws and examines the historical record of their effects. He concludes that they all should be repealed.

Randall Holcomb and Jim Gwartney explain how American labor law has resulted in significant declines of economic freedom and prosperity. The authors explain the precipitous decline of private-sector union density and the disastrous effects of American unions in the auto and railroad industries, and they provide useful international comparisons.

Opportunistic behavior by private-sector unions eventually results in capital flight from heavily unionized cities. Capital flight causes declines in both population and real income in such cities. Stephen Walters analyzes the carnage, paying particular attention to Detroit.

According to the Pew survey, the demographic group most supportive of unions in America is blacks. Paul Moreno gives an extensive account of how unions have long "used racial discrimination as an economic weapon." While blacks are no longer excluded from unions, many of them are subjected to more subtle forms of discrimination through such union-based institutions as seniority rules.

The "high-wage doctrine" is the belief that unemployment comes from lack of spending, which is in turn the result of insufficient money wages. So when faced with unemployment the remedy is to increase money wages. Those who believe this silliness and also think that unions increase money wages are likely to approve of unions. Lowell Gallaway destroys the high-wage doctrine and in doing so eliminates one of the most effective arguments in favor of unions.

Unions used to endorse free trade because it lowers workers' cost of living. Now unions oppose it ostensibly to protect American jobs. Daniel Griswold explains how free trade actually increases jobs and worker compensation. The problem for unions, of course, is that under free trade "unionized firms just fade away."

Unions abhor right-to-work laws because in those states that have them, unions cannot force workers to pay union dues. Moreover, unions find it more difficult to organize in those states. Richard Vedder explains how right-to-work laws promote liberty, prosperity, and quality of life. FEE