
THE FREEMAN

IDEAS ON LIBERTY

VOLUME 62, NO 5

JUNE 2012

Features

- 8 **Living Economics** *by Peter J. Boettke*
- 12 **That's Not Kosher: How Four Jewish Butchers Brought Down the First New Deal**
by Steven Horwitz
- 18 **"I'm Smarter than Everyone Else"** *by Arthur E. Foulkes*
- 20 **Austrian Capital Theory: Why It Matters** *by Peter Lewin*
- 26 **The New Deal of World Trade** *by Aparicio Caicedo*
- 30 **On "Bourgeois Paternalism"** *by Sandy Ikeda*
- 35 **Argentina's Way to Decadence** *by Ariel Barbero*



Page 12

Columns

- 2 **Perspective ~ Is Serfdom an Executive Order Away?** *by Sheldon Richman*
- 4 **Ideas and Consequences ~ The Fallacy of Equality** *by Lawrence W. Reed*
- 6 **Speculators Are to Blame for High Gas Prices? It Just Ain't So!** *by Tyler Watts*
- 16 **Thoughts on Freedom ~ Imagine That** *by Donald J. Boudreaux*
- 24 **Our Economic Past ~ Middlemen and Markets** *by Stephen Davies*
- 33 **Peripatetics ~ The Ubiquity of Economic Phenomena** *by Sheldon Richman*
- 40 **Give Me a Break! ~ Complex Societies Need Simple Laws** *by John Stossel*
- 47 **The Pursuit of Happiness ~ Tear Down These Walls** *by David R. Henderson*



Page 6

Book Reviews

- 42 **The Great Stagnation: How America Ate All the Low-Hanging Fruit of Modern History, Got Sick, and Will (Eventually) Feel Better**
by Tyler Cowen *Reviewed by Kevin A. Carson*
- 43 **Bourgeois Dignity: Why Economics Can't Explain the Modern World**
by Deirdre N. McCloskey *Reviewed by Sandra Peart*
- 44 **The Morality of Capitalism: What Your Professors Won't Tell You**
edited by Tom G. Palmer *Reviewed by George Leef*
- 45 **Red Plenty: Inside the Fifties' Soviet Dream**
by Francis Spufford *Reviewed by Waldemar Ingdahl*



Page 45

THE FREEMAN

IDEAS ON LIBERTY

Published by
The Foundation for Economic Education
Irvington-on-Hudson, NY 10533
Phone: (914) 591-7230; E-mail: freeman@fee.org
www.fee.org

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

Columnists

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

Contributing Editors

Peter J. Boettke Wendy McElroy
James Bovard Tibor Machan
Thomas J. DiLorenzo Andrew P. Morriss
Bettina Bien Greaves James L. Payne
Steven Horwitz William H. Peterson
Raymond J. Keating Jane S. Shaw
Daniel B. Klein Richard H. Timberlake
Dwight R. Lee Lawrence H. White

Foundation for Economic Education

Board of Trustees, 2012–2013

Wayne Olson, Chairman
Harry Langenberg Frayda Levy
William Dunn Kris Mauren
Jeff Gieseae Roger Ream
Ethelmae Humphreys Donald Smith
Edward M. Kopko Harold J. Bowen, III
Peter J. Boettke Ingrid A. Gregg



The Foundation for Economic Education (FEE) is a nonpolitical, nonprofit educational champion of individual liberty, private property, the free market, and constitutionally limited government.

The Freeman is published monthly, except for combined January-February and July-August issues. Views expressed by the authors do not necessarily reflect those of FEE's officers and trustees. To receive a sample copy, or to have *The Freeman* come regularly to your door, call 800-960-4333, or e-mail mnolan@fee.org.

The Freeman is available electronically through products and services provided by ProQuest LLC, 789 East Eisenhower Parkway, PO Box 1346, Ann Arbor, Michigan 48106-1346. More information can be found at www.proquest.com or by calling 1-800-521-0600.

Copyright © 2012 Foundation for Economic Education, except for graphics material licensed under Creative Commons Agreement. Permission granted to reprint any article from this issue, with appropriate credit, except "Complex Societies Need Simple Laws."

Cover image Copyright Bettmann/Corbis / AP Images

Is Serfdom an Executive Order Away?

Sometimes a step back helps to provide perspective on a matter. President Obama provided such a step with his March 16 Executive Order, National Defense Resources Preparedness. In it we see in detail how completely the government may control our lives—euphemistically called the “industrial and technological base”—if the president were to declare a national emergency. It is instructive, if tedious, reading.

President Obama claims this authority under the Constitution and, vaguely, “the laws of the United States,” but he specifically names the Defense Production Act of 1950. As *Freeman* columnist and Independent Institute Senior Fellow Robert Higgs observed, “Under this statute, the president has lawful authority to control virtually the whole of the U.S. economy whenever he chooses to do so and states that the national defense requires such a government takeover.”

We shouldn't assume this is merely an academic exercise or that a third world war would need to break out. In the last decade, under circumstances representing no “existential threat” to our society, the executive branch has exercised extraordinary powers.

Reading the Executive Order, I was reminded of a quotation of Leonard Read's: “[A]nyone who even presumes an interest in economic affairs cannot let the subject of war, or the moral breakdown which underlies it, go untouched. To do so would be as absurd—indeed, as dishonest—as a cleric to avoid the Commandment ‘Thou shalt not steal’ simply because his parishioners had legalized and were practicing theft.”

The Executive Order begins by authorizing executive-branch officers to “assess on an ongoing basis the capability of the domestic industrial and technological base to satisfy requirements in peacetime [!] and times of national emergency, specifically evaluating the availability of the most critical resource and production sources, including subcontractors and suppliers, materials, skilled labor, and professional and technical personnel.”

But these officials are to do more than assess. They are to be prepared to “ensure the availability of adequate

resources and production capability,” to “improve the efficiency and responsiveness of the domestic industrial base to support national defense requirements,” and to “foster cooperation between the defense and commercial sectors. . . .”

Further, the President’s order notes his authority to “require acceptance and priority performance of contracts or orders (other than contracts of employment) to promote the national defense over performance of any other contracts or orders, and to allocate materials, services, and facilities as deemed necessary or appropriate to promote the national defense” (emphasis added).

That is, the executive branch is first in line for whatever it wants (except civilian labor—perhaps).

Under the section titled “EXPANSION OF PRODUCTIVE CAPACITY AND SUPPLY,” the heads of agencies engaged in procurement are authorized to “guarantee loans by private institutions,” “make loans,” and “make provision for purchases of, or commitments to purchase, an industrial resource or a critical technology item for Government use or resale, and to make provision for the development of production capabilities, and for the increased use of emerging technologies in security program applications, and to enable rapid transition of emerging technologies.”

Think of the potential for corporatist rent-seeking.

In the section on personnel we learn that the secretary of labor shall “collect and maintain data necessary to make a continuing appraisal of the Nation’s workforce needs for purposes of national defense and upon request by the Director of Selective Service, and in coordination with the Secretary of Defense, assist the Director of Selective Service in development of policies regulating the induction and deferment of persons for duty in the armed services.”

So along with the commandeering of private resources, there will be a draft, the commandeering of military (and other?) labor—that is, slavery by another name.

Advocates of the freedom philosophy have a dual concern: that the executive has virtually unchecked authority to declare an emergency and that in an emergency the private economy would be commandeered by government officers. The Executive Order is a

breathhtaking reminder that, as Higgs put it, “private control of economic life in the United States, to the extent that it survives, exists solely at the president’s pleasure and sufferance.”

Economics is not often thought of as something to fall in love with. But in his new book, *Living Economics*, that’s exactly what Peter Boettke describes. We’re pleased to present an excerpt.

A centerpiece of the original New Deal was brought down by several kosher butchers. Steven Horwitz tells the story.

Lord Acton famously said that “power tends to corrupt.” Arthur Foulkes says it also spreads the “I’m Smarter than Everyone Else” disease.

Fuzzy thinking about the housing bubble, the Great Recession, and what to do about it stems from poor understanding of capital, a point Austrian economists are well positioned to make. Peter Lewin explains what capital is and why understanding it is important.

As World War II wound down, the American power elite planned a postwar world that would consist of the New Deal writ large. Aparicio Caicedo explains.

It’s widely agreed that at least some communities are in decline. Many remedies—mostly involving government—are proposed, but Sandy Ikeda says too little attention is given to spontaneous order.

Argentina had a liberal and prosperous past. Then it came under the sway of statist ideas about progress. Decline followed. Ariel Barbero chronicles the sad story.

As for our columnists, here’s what they’ve come up with: Lawrence Reed examines the many natures of equality. Donald Boudreaux attributes bad thinking about economic policy to a lack of imagination. Stephen Davies has praise for middlemen. John Stossel says that complex societies don’t need reams of laws. David Henderson defends free immigration. And Tyler Watts, seeing rising gasoline prices once again blamed on speculators, responds, “It Just Ain’t So!”

Books on stagnation, commercial culture, morality and markets, and socialism engage our reviewers.

—Sheldon Richman
srichman@fee.org



The Fallacy of Equality

BY LAWRENCE W. REED

“Free people are not equal, and equal people are not free.”

I wish I could remember who first said that. It ought to rank as one of the great truths of all time, and one that is fraught with profound meaning.

Equality before the law—that is, being judged innocent or guilty based on whether or not you committed the crime, not on what color, sex, or creed you represent—is a noble ideal and not at issue here. The “equalness” to which the statement above refers pertains to economic income or material wealth.

Put another way, then, the statement might read, “Free people will earn different incomes. Where people have the same income, they cannot be free.”

Economic equality in a free society is a mirage that redistributionists envision—and too often are willing to shed both blood and treasure to accomplish. But *free* people are *different* people, so it should not come as a surprise that they earn different incomes. Our talents and abilities are not identical. We don’t all work as hard. And even if we all were magically made equal in wealth tonight, we’d be unequal in the morning because some of us would spend it and some of us would save it.

To produce even a rough measure of economic equality, governments must issue the following orders and back them up with firing squads and prisons: “Don’t excel or work harder than the next guy, don’t come up with any new ideas, don’t take any risks, and don’t do anything differently from what you did yesterday.” In other words, don’t be human.

The fact that free people are not equal in economic terms is not to be lamented. It is, rather, a cause for

rejoicing. Economic inequality, when it derives from the voluntary interaction of creative individuals and not from political power, testifies to the fact that people are *being themselves*, each putting his uniqueness to work in ways that are fulfilling to himself and of value to others. As the French would say in a different context, *Vive la difference!*

People obsessed with economic equality—egalitarianism, to employ the more clinical term—do strange things. They become envious of others. They covet. They divide society into two piles: villains and victims. They spend far more time dragging someone else down than they do pulling themselves up. They’re not fun to be around.

And if they make it to a legislature, they can do real harm. Then they not only call the cops, they *are* the cops.

Injurious Laws

Examples of injurious laws motivated by egalitarian sentiments are, of course, legion. They form the blueprint of the modern welfare state’s redistributive apparatus. A particularly classic case was the 1990 hike in excise taxes on boats, aircraft, and jewelry.

The sponsors of the bill in Congress presumed that only rich people buy boats, aircraft, and jewelry. Taxing those objects would teach the rich a lesson, help narrow the gap between the proverbial “haves” and “have-nots,” and raise a projected \$31 million in new revenues for the federal Treasury in 1991.

What really occurred was much different. A subsequent study by economists for the Joint Economic Committee of Congress showed that the rich did not

Lawrence Reed (lreed@fee.org) is the president of FEE. This article is reprinted from the December 1995 issue.

Even if we all were magically made equal in wealth tonight, we’d be unequal in the morning because some of us would spend it and some of us would save it.

line up by the flock to be sheared: Total revenue from the new taxes in 1991 was only \$16.6 million. Especially hard-hit was the boating industry, where a total of 7,600 jobs were wiped out. In the aircraft industry, 1,470 people were pink-slipped. And in jewelry manufacturing, 330 joined the jobless ranks just so congressmen could salve their egalitarian consciences.

Those lost jobs, the study revealed, prompted a \$24.2 million outlay for unemployment benefits. That's right—\$16.6 million came in, \$24.2 million went out, for a net loss to the deficit-ridden Treasury of \$7.6 million. To advance the cause of economic equality by a punitive measure, Congress succeeded in nothing more than making almost all of us a little bit poorer.

Indifference to Consequences

To the rabid egalitarian, however, intentions count for everything and consequences mean little. It's more important to pontificate and assail than it is to produce results that are constructive or that even live up to the stated objective. Getting Congress to undo the damage it does with bad ideas like this is always a daunting challenge.

In July 1995 economic inequality made the headlines again with the publication of a study by New York University economist Edward Wolff. The latest in a long line of screeds that purport to show that free markets are making the rich richer and the poor poorer, Wolff's work was celebrated in the mainstream media. "The most telling finding," the author wrote, "is that the share of marketable net worth held by the top 1 percent, which had fallen by 10 percentage points between 1945 and 1976, rose to 39 percent in 1989, compared

with 34 percent in 1983." Those at the bottom end of the income scale, meanwhile, saw their wealth erode over the period—if the Wolff study is to be believed.

On close and dispassionate inspection, however, it turns out that the study didn't tell the whole story, if indeed it told any of it. Not only did Wolff employ a very narrow measure that inherently exaggerates wealth disparity, he also ignored the mobility of individuals up and down the income scale. An editorial in the August 28, 1995, *Investor's Business Daily* laid it out straight: "Different people make up 'the wealthy' from year to year. The latest data from income-tax returns . . . show that most of 1979's top-earning 20 percent had fallen to a lower income bracket by 1988."

Of those who made up the bottom 20 percent in 1979, just 14.2 percent were still there in 1988. Some 20.7 percent had moved up one bracket, while 35 percent had moved up two, 25.3 percent had moved up three, and 14.7 percent had joined the top-earning 20 percent.

If economic inequality is an ailment, punishing effort and success is no cure in any event. Coercive measures that aim to redistribute wealth prompt the smart or politically well-connected "haves" to seek refuge in havens here or abroad, while the hapless "have-nots" bear the full brunt of economic decline. A more productive expenditure of time would be to work to erase the mass of intrusive government that assures that the "have-nots" are also the "can-nots."

This economic equality thing is not compassion. When it's just an idea, it's bunk. When it's public policy, it's illogic writ large. **FEE**

To the rabid egalitarian, however, intentions count for everything and consequences mean little.

Speculators Are to Blame for High Gas Prices? It Just Ain't So!

BY TYLER WATTS

It happens about this time every year: Kids across the land dust off their baseballs and Frisbees and flock to the park for some good old-fashioned fun. Strangely enough, the weather starts getting oppressively hot about the same time. The events have got to be related, no? Maybe if those darn kids would just stay home, we wouldn't have to suffer the heat!

Of course, kids playing outside do not cause summer weather. Rather, it's the summer weather that brings the kids out to play. The direction of cause and effect is so obvious here that even a U.S. senator can grasp it.

For one U.S. senator, however, the link between commodity prices and futures markets is not so obvious. In a CNN editorial, socialist Vermont Senator Bernie Sanders accuses vile "Wall Street speculators" of causing a steep recent increase in crude oil and gasoline prices, arguing that were it not for their antics, American consumers would be paying significantly less for this vital resource (tinyurl.com/cj9ahrc).

Sanders doesn't say outright what he thinks the market price of oil or gas should be, but he cites some numbers suggesting that prices are 20–40 percent above the true market equilibrium level. The difference, according to Sanders, is due strictly to the actions of speculative players in oil futures markets.

Sanders never explains exactly how speculators cause high prices, nor does he offer substantive evidence for his case. He reasons as follows: There are lots of oil-market speculators; the oil price increased sharply; ergo, speculators cause high prices! But like the foolish notion that kids playing outside cause summer

weather, Sanders has it backwards. In reality it's the fluctuation in oil prices that brings speculators to the market. An economic analysis of futures markets reveals that not only are speculators incapable of sustainable price manipulation, their actions generally encourage healthy market functioning by mitigating price movements, reducing risk, and preventing shortages of important goods.

To understand the flaws of the "blame the speculators" argument, let's first review how commodity futures markets work. Commodity prices are volatile, especially for goods like corn and oil, where supply can vary with the weather or the geopolitical situation. Producers and consumers would like some degree of price certainty so they can make reliable

plans. Futures markets allow sellers and buyers to hedge against the risk of price swings by locking in the future price of the good. For example, an oilman whose projected costs of production are \$100 per barrel could



Prices shot up, but inventories didn't. This isn't the fault of speculators.
Bev Sykes [flickr]

Tyler Watts (tawatts@bsu.edu) is an assistant professor of economics at Ball State University. He is the winner of the 2012 Beth A. Hoffman Memorial Prize for Economic Writing.

lock in a profit by selling a contract to deliver a thousand barrels in December for \$109 per barrel. Likewise, an oil refinery could buy the same futures contract to ensure that its cost of crude doesn't rise. We can think of futures markets as providing price insurance for such hedgers.

Speculators, on the other hand, attempt to profit from a price movement. Suppose an analyst believes that escalating Mideast tensions will cause oil prices to spike to \$150 by December. She could earn a potential profit of \$41 per barrel by buying the \$109 contract—known as “going long”—and cashing it in for \$150 in December. Another analyst expects a large new pipeline to come into operation, thus increasing future supply and pushing prices back down to \$90. He could earn a \$19 profit by selling the contract—“going short”—and closing it out at the lower price. In each case one speculator's profit was another's loss; in the long run profits only accrue to speculators with better judgment about the future.


Such speculators are the focus of Sanders's wrath. His implicit argument is that they bid up the price of oil by buying lots of futures contracts, hoping to close out their speculative positions at inflated prices and take massive profits. But Sanders forgets that for every futures buyer there must be an equal and opposite seller, whether a hedging producer or a bearish speculator. Typically, because each side's bets on the future oil price offset the other's, there's no discernible effect on oil production, oil stocks, or the spot oil price.

Occasionally, extremely bullish sentiment or attempts at market manipulation could exert upward price pressure through the futures market. In this setting speculators must bid futures prices up sharply to find willing sellers. But if it's just speculation driving the price, and not supply and demand, the futures price will rise above the spot price—a situation known as “contango.” For example, say spot oil is \$107 per barrel, but speculative bidding has ratcheted the December futures price up to \$120. With futures prices elevated above spot prices, there is a clear profit opportunity in buying a few tanker loads of oil at \$107, *selling* the December contract at \$120, and pocketing \$13 per-barrel profit (less storage costs) when the contract expires. Therefore, the more successful bullish speculators are at pushing the price up to unrealistic heights,

the greater profit opportunity they present to offsetting bearish speculators to go short. And the more oil arbitrageurs stockpile now—reducing current supply to boost future supply—the lower the futures price will be. In any speculative market play, arbitrage ensures that the bears offset the bulls, leaving “market fundamentals” of supply and demand as the true culprit for any lasting price changes. As the classical economists indicated, markets are “self-correcting.”

The data back this up. Recall that hyper-bullish futures buying raises the futures price above spot (contango), which encourages stockpiling by short-side speculators. Yet with a significant 13 percent uptick in oil prices during February 2012, domestic inventories rose by a comparatively small 1.5 percent. More important, the fact that near-term futures were only slightly above the spot price, while longer-term futures were trading *below* spot, suggests a complete lack of an abnormal contango situation. In other words, there was no evidence of speculative fever in any direction.

To summarize: The futures price of oil expresses the market's opinion of future oil fundamentals of supply and demand, and not much else. Indeed, history has proven time and again that speculators who recklessly gamble by trying to manipulate futures markets tend to fail fast and lose big. Consider the Hunt brothers, heirs of a Texas oil fortune, who (allegedly) tried to “corner” the market in silver in 1980 by aggressively bidding up the futures price to increase the value of their holdings. While they were able to dramatically boost the price with massive, highly leveraged long positions, their actions invited “the big shorts,” whose counteraction quickly crashed the market, costing the Hunts billions (tinyurl.com/6x982h).

The only way to win at speculative trading is to have superior knowledge about future market conditions. Speculators are gamblers in a way, and they can lose big. But they perform a valuable function by taking the risk of price volatility off of hedgers' shoulders. Because arbitrage ensures that erroneous or manipulative bidding (or shorting) can't long endure, speculators typically move prices in the direction of long-run equilibrium, thus reducing overall volatility. This relative stability benefits consumers by saving them from roller-coaster prices. 

Living Economics

BY PETER J. BOETTKE

My love affair with economics began in the fall of 1979. The summer prior to that I had experienced the long lines for gasoline, and I was confused and frustrated by the experience for a variety of reasons. Economics erased my confusion and targeted my frustration on the cause of the shortages. I was hooked.

In many ways, the logic of economic reasoning came naturally to me once I started studying. My first readings in the field were Henry Hazlitt's *Economics in One Lesson* and *Free Market Economics: A Basic Reader*, edited by Bettina Bien Greaves (which included Leonard Read's "I, Pencil"). These were followed by various essays and excerpts from books by Ludwig von Mises related to the problems of socialism and interventionism and the benefits of the free-market economy, and then Milton and Rose Friedman's *Free to Choose*. By the time I finished *Free to Choose*, I would never think about the world around me the same way. I saw everything through the economic lens—from the most mundane human activities to the most profound. To me, economics is simultaneously the most entertaining discipline in the human sciences and the most important discipline in the policy sciences, as it ultimately answers fundamental questions about human life and death.

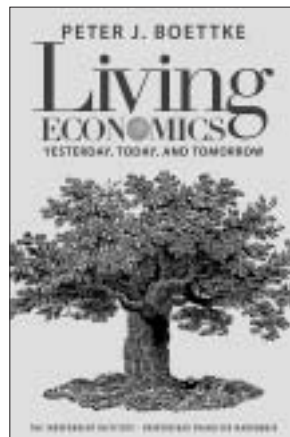
Getting Back on Track

I believe that much of modern economics has lost its way, and I am actively engaged in trying to get the teaching and doing of economics back on track. Following one of my teachers—Kenneth Boulding—I use

the term “mainline economics” to describe a set of propositions that were first significantly advanced in economics by Thomas Aquinas in the thirteenth century and then the Late Scholastics of the fifteenth and sixteenth centuries at the University of Salamanca in Spain. . . . These insights were further developed in economics from the Classical School of Economics (both in its Scottish Enlightenment version of Adam Smith and the French Liberal tradition of Jean-Baptiste Say

and Frédéric Bastiat), to the early Neoclassical School (especially the Austrian version of Carl Menger, Ludwig von Mises, and F. A. Hayek), and finally with the contemporary development of New Institutional Economics (as reflected in the property rights economics of Armen Alchian and Harold Demsetz; the new economic history of Douglass North; the law and economics of Ronald Coase; the Public Choice economics of James Buchanan and Gordon Tullock; the economics of governance associated with Oliver Williamson and Elinor

Ostrom; and the market process economics of Israel Kirzner). The core idea in this approach to economics is that there are two fundamental observations of commercial society: (1) individual pursuit of self-interest, and (2) complex social order that aligns individual interests with the general interest.



Contributing editor and FEE trustee Peter Boettke (pboettke@gmu.edu) is a University Professor of Economics and Philosophy at George Mason University and director of the F. A. Hayek Program for Advanced Study in Philosophy, Politics, and Economics at the Mercatus Center. Reprinted with permission from the book Living Economics: Yesterday, Today, and Tomorrow, by Peter J. Boettke, ©2012, The Independent Institute (www.independent.org) and Universidad Francisco Marroquín (www.ufm.edu).

In the mainline of economics, the “invisible hand postulate” reconciles self-interest with the general interest not by collapsing one into the other or by assuming super-human cognitive capabilities among the actors, but through the reconciliation process of exchange within specific institutional environments. It is the “higgling and bargaining” within the market economy, as Adam Smith argued, that produces social order. The “invisible hand” solution does not emerge because the mainline economist postulates a perfectly rational individual interacting with other perfectly rational individuals within a perfectly structured market, as many critics suppose. Such idealizations would be as alien to Adam Smith as they would be to F. A. Hayek. Instead, for those who “sit in the seat of Adam Smith,” man is a very imperfect being operating within a very imperfect world. Sound economic reasoning, by focusing on exchange, and the institutions within which exchange takes place, explains how complex social order emerges through the aid of prices and the entrepreneurial market process.

The mainline of economics, in my narrative, is to be contrasted with the “mainstream” of economic thought. Mainline is defined by a set of positive propositions about social order that were held in common from Adam Smith onward, but mainstream economics is a sociological concept related to what is currently fashionable among the scientific elite of the profession. Often the mainline and the mainstream dovetail, but at other times they deviate from one another. It is at these moments of deviation that acts of intellectual entrepreneurship are acutely needed by those working within the mainline of economics to recapture the imagination of mainstream economics, getting the discipline back on track.

Social Cooperation

Economics teaches us many things, but to me the most important is how social cooperation under the division of labor is realized. This is what determines whether nations are rich or poor; whether the individ-

uals in these nations live in poverty, ignorance, and squalor or live healthy and wealthy lives full of possibilities. If the institutions promote social cooperation under the division of labor, then the gains from trade and innovation will be realized. But if the institutions, in effect, hinder social cooperation under the division of labor, then life will devolve into a struggle for daily existence. Economics, in other words, gives us the key intellectual framework for understanding how we can live better together.

Teaching Economics

The teaching of economics . . . is not a trivial endeavor. The subject is illuminating and the stakes are high; if we fail in our task as economic educators, then we fail in our job as economists. There is no way

around this conclusion. Economics is not merely a game to be played by clever professionals, but a discipline that touches upon the most pressing practical issues at any historical juncture. . . . The discipline of economics illuminates all walks of human life, and as such it is an ambitious science. It explains the doings of man, whether in the marketplace, the voting booth, the church, the family, or any other human capacity. The economic way of thinking is not just one window on

The economic way of thinking is not just one window on the world; it is *the only window* that deals with man as a human actor.

the world; it is *the only window* that deals with man as a human actor. This may sound arrogant to the casual reader, but economics also teaches humility. As F. A. Hayek put it, “The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.”

The mainline of economic teaching from Adam Smith to Hayek taught not only what economics can tell us but more importantly what it *cannot* tell us. There are real limits to economic analysis and efforts at economic control. The main reasons economics got off track in the twentieth century are . . . a failure to recognize those limits and a confusion of the policy sciences with the engineering sciences. Based on the knowledge of the physical sciences, the engineering sciences created technological solutions unimaginable

to previous generations. My grandparents entered this world when most travel was conducted by horse and buggy; they departed this earth in a world which had not only experienced transatlantic flight but had placed a man on the moon. Since their passing, the Internet has developed and transformed not only the way we communicate but also the way we shop, the way we learn, and the way we form social bonds. These amazing technological advances tend to reinforce the idea that through science men can conquer any and all problems they face.

But even in this case of technological innovation, we tend to forget something vital to the story of progress. Technological knowledge was transformed into useful knowledge through the ordinary business of commerce. Without the guiding role of property, prices, and profit/loss accounting, the gains from innovation would not be realized. The reason for this is simple: Without the guiding signals and incentives of the price system, economic actors cannot sort out from the array of technologically feasible projects those that are most economical to pursue. And absent that economic knowledge, technological ventures will be plagued by a systemic waste of resources.

Description, Not Design

However, there is an even more subtle point to make than the necessity of commerce to guide technological innovation. Commercial life did not emerge through design but instead out of the human proclivity to truck, barter, and exchange with one another. Specialization in production and exchange existed well before economists came up with those terms to help explain that behavior. Economists, in other words, did not invent the economy but rather came to their study with the economy already operating and were tasked with the role of providing philosophic understanding of already existing practice. This is radically different from the civil engineer who designs the bridge to ease travel between Manhattan

and Brooklyn. The demand by politicians and the public that economics be more like engineering is perhaps the greatest corrupting force on the science.

But if we accept the judgment that economics cannot play the role of social engineering, we need not be content with economics being purely philosophical. Economics and political economy are capable of generating significant empirical information. The discipline can inform us about how alternative institutional frameworks will impact our ability to realize the gains from trade and innovation. If the institutional framework impedes trade and innovation, then those gains will go unrealized; if the institutional framework encourages those aspects of an economy, then those gains will be realized.

Two Propensities

I often tell students that humankind has demonstrated two natural propensities—to truck, barter, and exchange (as Adam Smith taught); and to rape, pillage, and plunder (as Thomas Hobbes taught us)—and which propensity is pursued is a function of the institutional framework within which individuals find themselves living and interacting. The life experience can be a virtuous cycle of wealth creation and healthier and wealthier lives, or it can be a nasty and brutish hell on earth. So

while economics cannot give us exact point predictions, it can, as a science, inform us of tendencies and directions of change as well as the wealth-creating or wealth-destroying capacity of the political economic system.

The mainline of economics explained the operation of the economy not by making heroic assumptions about the cognitive capability of individuals, nor did it describe politics by reference to benevolent despots. Instead, the political economy of Adam Smith to F. A. Hayek takes humans as they are and seeks to find the institutional framework that both constrains bad people so they do the least harm when in positions of power and uses the ordinary motivations of humans and their

Economists did not invent the economy but rather came to their study with the economy already operating and were tasked with the role of providing understanding of already existing practice.

limited cognitive capabilities to realize social cooperation under the division of labor. The mainline economists found that in the private-property market economy and a constitutionally limited government . . . individuals' unique knowledge of time and place could be marshaled to realize a peaceful and prosperous social order.

Hubris

What economics and political economy had to guard against was human hubris. Hubris can come in two forms: a hubris that one is of a higher moral character, and a hubris that one is of a higher intellectual caliber than one's fellow citizens. It is this hubris that Hayek called *The Fatal Conceit*. The intellectual culture in which Adam Smith wrote was sympathetic to such a critique of hubris. . . . The "man of system"—as Smith termed this hubris in *The Theory of Moral Sentiments*—was the object of ridicule. Only he would be "wise in his own conceit" or in possession of the "folly and presumption" to believe he should lord over other men in their affairs of commerce.

By the time that John Maynard Keynes wrote *The General Theory of Employment, Interest, and Money*, something had radically changed in the intellectual culture. Now rather than being an object of ridicule, the man of system was in demand to fix the problems of the vagaries of commercial life and the problems of modern industrial society with unemployment and business

fluctuations. Economics since that time has been derailed educationally and as a tool for public policy. It became the handmaiden of the man of system and not the reason to doubt the wisdom of that conceit of men. We have *The Economics of Control* and not the *Common Sense of Political Economy*.

Economists are tasked with speaking truth to power, not catering to power. The discipline, from Smith to Hayek, has taught us about the need to limit power to curb the predatory capabilities of mankind. And when we don't heed its teachings, we don't overturn the basic results that Adam Smith, J. B. Say, and F.A. Hayek arrived at about the power of the market to create wealth and of politics to destroy it. The twentieth-century experiment with communism reinforces this basic lesson of mainline economics. As Ludwig von Mises put it: "The body of economic knowledge is an essential element in the structure of human civilization; it is the foundation upon which modern industrialism and all the moral, intellectual, technological, and therapeutical

achievements of the last centuries have been built. It rests with men whether they will make the proper use of the rich treasure with which this knowledge provides them or whether they will leave it unused. But if they fail to take the best advantage of it and disregard its teachings and warnings, they will not annul economics; they will stamp out society and the human race." **FEE**

Economists are tasked with speaking truth to power, not catering to power. The discipline, from Smith to Hayek, has taught us about the need to limit power to curb the predatory capabilities of mankind.

That's Not Kosher: How Four Jewish Butchers Brought Down the First New Deal

BY STEVEN HORWITZ

Jewish-Americans have a long history of finding role models who broke barriers, accomplished great things, or engaged in more mundane acts of heroism. Jewish religious schools are full of discussions of athletes like Hank Greenberg and Sandy Koufax, or the legions of Jewish entertainers and scholars, as ways to demonstrate the accomplishments of American Jews.

But in all those stories many of us heard growing up, one set of brave heroes was never mentioned: the Schechter brothers of New York City. The Schechters were kosher butchers operating in the 1930s who stood fast to their commitment to the dietary laws of *kashrut* in the face of ferocious pressure and prosecution by a powerful government. They eventually took their case to the highest court in the land—and won—defeating one of the most popular and powerful administrations in American history.

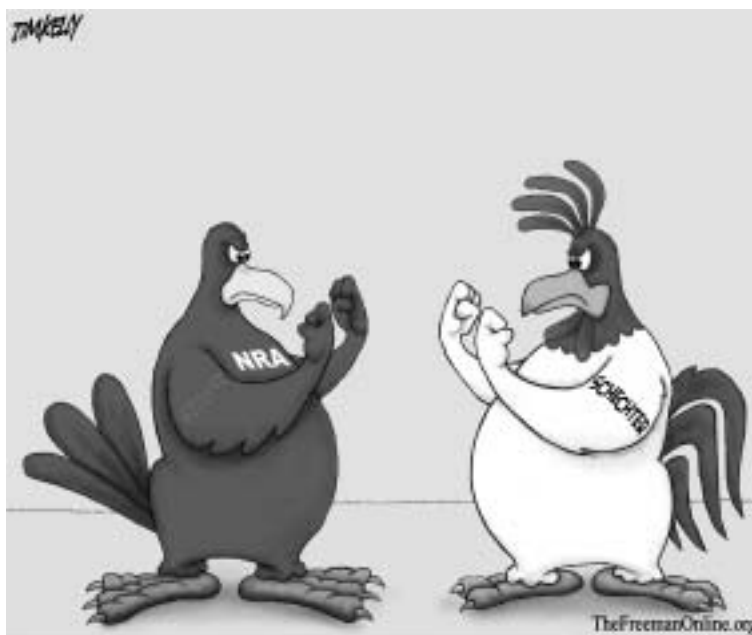
One would think this story of Jewish heroism and commitment to Jewish values would be inspirational for generations of young American Jews. But the Schechter brothers were up against Franklin Delano Roosevelt.

It was the Roosevelt administration's prosecution of the Schechters for violating the National Industrial Recovery Act, one of the pillars of the New Deal, that led the Supreme Court to declare the act unconstitutional in 1935. FDR was, and remains, so beloved by American Jews that the heroism of the Schechters has been lost as a story of Jewish moral commitment in the face of power. In her history of the Great Depression,

The Forgotten Man, Amity Shlaes begins the process of rescuing the Schechter brothers from obscurity by spending an entire chapter on their challenge to the New Deal. In this article I build on Shlaes's account to provide some broader context for their story and draw some implications for Jewish Americans.

To understand the Schechters' story one

needs to understand how the Roosevelt administration understood the causes of the Great Depression and thus developed its policy solutions. The dominant theory at the time was that the Great Depression was caused by "underconsumptionism." Capitalism was supposedly



Contributing editor Steven Horwitz (sghorwitz@stlawu.edu) is the Charles A. Dana Professor of Economics at St. Lawrence University. He writes "The Calling" column each Thursday at TheFreemanOnline.org.

incapable of creating enough purchasing power to buy all that was being produced, and this claim was often tied to concerns about income inequality. The rich were thought to save too much and spend too little. Some argued this was due to excessive monopoly, others to excessive competition. We now know that these arguments are confused and incorrect, but at the time many saw the Great Depression as a fundamental failure of the coordinative features of market-based production, requiring a significant role for government to fix. The problems were seen not as “macroeconomic” but as much more fundamental structural failures of the market economy.

The advisers around Roosevelt, many of whom were academics familiar with these arguments, accepted that explanation and favored a radical reform of the economic system. They had in mind a much more extensive role for government in planning and organizing production, as opposed to relying (largely) on independent decision-making coordinated by prices and profits. Both agriculture and industry were to be fundamentally restructured by government.

The two pillars of FDR’s first hundred days—the Agricultural Adjustment Act (AAA) and the National Industrial Recovery Act (NIRA)—came from this thinking. Each was designed to impose order on the market through government-mandated cooperation among producers and labor. It wasn’t socialism, but it wasn’t capitalism either. It was much closer to the economic institutions of fascism than in place in Italy. As Shlaes and others have documented, Roosevelt’s advisers had been explicitly influenced by Mussolini, and he and Roosevelt had something of a mutual admiration society.

Roosevelt created the National Recovery Administration (NRA) to enforce the NIRA’s provisions. It wrote or helped industries and labor write “codes” that governed production, prices, and labor relations. The AAA was a similar attempt to plan agricultural production. In the name of keeping prices up for farmers, mil-

lions of piglets were slaughtered and millions of acres of cotton were plowed under—while large numbers of Americans were hungry and cold.

Stores displayed the NRA “Blue Eagle” sign to show they were abiding by the codes, and consumers were encouraged to patronize only companies that did so. Thousands of inspectors checked for code compliance and initiated prosecutions against violators. Enter the Schechters.

Central Casting

With heavily accented, broken English, they were right out of central casting for the oft-stereotyped immigrant Jewish rube—and the Roosevelt administration treated them that way.

The four brothers were born in Hungary before their parents made their way to the United States. With heavily accented, broken English, they were right out of central casting for the oft-stereotyped immigrant Jewish rube—and the Roosevelt administration treated them that way. The Yiddish version of their last name, *Shochet*, is also the word for their profession: butcher. More specifically, they were poultry middlemen, buying chickens from across the country, then butchering and selling them to the New York City market, mostly to retailers who then sold directly to consumers. Middlemen of course were exactly the sort of “problem” the NRA was designed to deal with, because in the eyes of the

FDR crowd they profited off consumers while providing little in return. Additionally, prejudice against middlemen has been historically difficult to disentangle from anti-Semitism, since Jews have long performed this role and borne the brunt of ignorance about how trade creates value.

Most important to the story is that the Schechters ran a kosher butcher business. The Jewish laws of *kashrut* serve many purposes. Among them they specify how to safely kill and dispose of animals so as to avoid a variety of possible diseases. Also, they enforce a set of ethical obligations about how to treat animals that we kill and eat. The provisions about how to kill animals and what can and cannot be eaten helped the community avoid potentially unhealthy practices (and animals)

and signaled that the animals sold had been inspected by recognized community authorities—namely rabbis trained to ensure that sellers followed the biblical rules. A certified kosher butcher has the equivalent of a Good Housekeeping Seal of Approval from the most respected members of the local community.

Tuberculosis was the major issue with chickens, making it crucial to inspect the lungs to make sure they were smooth and therefore healthy. The word *glatt* in the phrase *glatt kosher* means “smooth,” which assures buyers no signs of tuberculosis were found. Importantly, customers at kosher butcheries could choose the birds they bought, which gave them the ability to enforce *kashrut* through their buying choices. So even if the birds were certified kosher by a rabbinical authority, customers could still exercise their own judgment about the quality of the chickens. Kosher butchers allowed this as a way to attract customers.

Straight Killing or Prison

The problem for the Schechters was that Section 2, Article 7 of the NRA’s Code of Fair Competition for the Live Poultry Industry of the Metropolitan Area in and about the City of New York, which sounds like something out of *Atlas Shrugged*, mandated “straight killing,” which meant that customers *could not select specific birds out of a coop*. Instead they had to select a coop or half coop entirely. The code thus directly contradicted *kashrut*. This put the Schechters in an untenable position: Abide by the New Deal or abide by *kashrut*. Do the former and lose your customers. Do the latter and get arrested.

In June 1934 the Roosevelt administration expanded NRA inspections, and prosecutions began in earnest. The poultry industry was targeted because of alleged corruption. It is worth noting that corruption was not alleged to have caused the Great Depression,

and the law said little about it. As is often the case, power assumed by the government for one purpose is very easy to use for other, more nefarious purposes. That summer federal agents swarmed the Schechters’ business. In July a grand jury delivered a 60-count indictment against them, including “threatening violence against agents and inspectors” and violating code rules about hours and pay. Most important: They were charged with violating code rules about the selection of chickens and knowingly selling a chicken unfit for consumption to a customer. They were also charged with conducting a “conspiracy to violate the NRA code.” As Shlaes notes, once they were charged with selling a sick chicken, they were tagged as not just law breakers but also bad Jews.



The Schechter brothers celebrate their victory over FDR, who had them sentenced to prison for sticking to their religious beliefs.

Copyright Bettmann/Corbis / AP Images

During the original criminal trial, at which the brothers were each found guilty and sentenced to several months in jail, the prosecutors tried to play them as rubes. When they appealed, the media used the usual anti-Semitic tropes to make them look silly for bucking the all-powerful federal government, including invoking standard anti-Semitic stereotypes against their lawyer, Joseph Heller. Shlaes offers additional details in her chapter; most of the attempts

to make the Schechters look stupid backfired on the prosecutors since the attempts only served to demonstrate how much the brothers knew about their own market and how ignorant the NRA code enforcers were. The Schechters were hardly the only business targeted, but they were among the larger ones and had the most charges leveled against them.

At the same time, criticisms of the NRA grew, not the least from the African-American community, which correctly saw attempts to raise wages as a means of shutting black labor out of the market. Writers at the *Chicago Defender*, the local black paper, referred to the NRA as the “Negro Run Around” and the “Negro

Removal Act.” The NRA’s harm of black workers fits into a longer story how of labor market regulation was used for racist purposes. (See Art Carden and my October 2011 *Freeman* article, “Eugenics: Progressivism’s Ultimate Social Engineering”; tinyurl.com/7vzmg9r.)

On May 2, 1935, the Supreme Court heard the oral arguments. The federal government’s case rested largely on emergency powers: There was a national crisis, and the government should have whatever powers it needed to fight it. At stake were competing interpretations of the Commerce Clause, which supposedly limited Congress’s power to regulate commerce to interstate transactions. The government argued that the Schechters’ business should be seen as interstate commerce in light of the Depression, while the Schechters’ lawyer countered both that the business was not interstate commerce and, more powerfully, that the Schechters had never agreed to the NRA code, which interfered with their ability to best serve their customers. As Shlaes points out, attorney Heller was careful to explain the kosher practices in a way that avoided making them sound Jewish, again for fear of anti-Semitic backlash.

Part of the exchange between the Justices and Heller was over what “straight killing” meant for customers, leading to a discussion of reaching into chicken coops. The reaction in court was mostly amusement at the absurdity of the code, in both its level of detail and what it required of producers and consumers.

Unanimous Decision

On May 27 a unanimous Court ruled that the NIRA did indeed violate the Commerce Clause and that even in “extraordinary conditions” Congress may not exceed its constitutional limits. Specifically, Congress had no legitimate power to delegate what amounted to law-making power to the NRA.

This case and a related one that struck down the AAA ended the more radical provisions of what is often called the “First New Deal.” FDR’s reaction to the decision was his famous line about the Court taking the country “back to the horse and buggy age.” That sentiment was one reason Roosevelt later proposed his “court packing” plan to expand the Court. This case was one of the last Supreme Court decisions to uphold this narrow reading of the Commerce Clause. The same set of issues is at stake in the case against the Obama administration’s health care act.

There are many lessons one could draw from the story of the Schechter brothers, not the least of which

Back then Congress had to prove it constitutionally possessed the powers it exercised; the Court did not place the burden of proof on those who claimed the exercise of some power is unconstitutional.

is how much the Supreme Court’s jurisprudence has evolved over the years. Back then Congress had to prove it constitutionally possessed the powers it exercised; the Court did not place the burden of proof on those who claimed the exercise of some power is unconstitutional.

The Schechters’ story, however, raises other interesting questions. Why is it not better known, particularly among American Jews, that underdog immigrant small-business owners triumphed over a government that denied them the right to run their business according to their long-standing ethical-religious code? After all, this is the classic story of Jewish heroism: a group of Jews under siege

by the State demonstrating grace under pressure by standing up for their beliefs.

It would seem that the overwhelming love that American Jews have had for FDR is likely one explanation. It might be difficult to hold up as heroes the men who helped bring down the First New Deal. The American Jews’ love for FDR is also something of a mystery when one considers his administration’s refusal to help Jews escape Nazi Germany as the Holocaust began to unfold.

The story of the Schechter brothers raises important questions about the power of the State. It’s a story still waiting to be told in its entirety.

FBB



Imagine That

BY DONALD J. BOUDREAUX

Only human beings have imagination—or so I imagine. Dogs and cats have no imagination; nor do snails or streams; nor do robots or smart phones.

The only evidence I can offer for the truth of my claim is that we don't observe other creatures or things *becoming*. We don't observe Rover or Secretariat seeking to transform their existences in any fundamental way. Humans, however, *do* imagine futures different from today, and we seek to make these different futures real.

This fact means that society isn't a mechanism like a wristwatch or a microwave oven. The human economy is not a system infused with tight and unfailingly predictable reaction functions. Analogizing the economy to such a machine might have its benefits, but it also has its costs. And in the study of economics those costs have come to swamp the benefits.

I submit that human imagination and the open-endedness that such imagination imparts to the economy are relevant aspects of reality that economists largely and regrettably have too long ignored. Consider, for example, the economics of natural resources.

The very term “natural resources” sneaks in an assumption about the manner in which humankind relates to the natural environment, an assumption that hides the role of imagination by suggesting that we are much more passive and *reactive* than we really are.



It takes an act of imagination to make this pile of coal into a resource.
Joost J. Bakker

To describe a resource as “natural” is to imply that it has value to human beings—that it is useful—simply by its nature, simply by its existence. Therefore, with the likes of land, petroleum, and titanium being bestowed on us by nature, our job is merely to gather them up and use them in economically efficient ways.

While the role of entrepreneurial imagination is (sometimes) recognized in devising new products that might be made with natural resources, such imagination is almost never recognized in the

creation of the natural resources themselves. But in fact no substance is a truly *natural* resource. Each thing that we call a “natural resource” is something whose “resourceness” was created by human imagination.

The black smelly stuff that (I imagine) bubbled up into the creek waters of western Pennsylvania back in 1500 BC—and 1500 AD—likely was more of a nuisance than a resource to the people then living there. Petroleum’s “resourceness” required human imagination—someone to say to himself or herself, “Hey, what if I do this with that stuff?” or “I wonder if I can make that stuff perform this task for me.”

To impart “resourceness” to oil required myriad imaginations—imagining not only what useful outputs

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

the viscous, malodorous stuff can be used to make, but imagining also how to get it out of the creeks and ground and deep oceans. The number of imaginings that had to happen to make oil a “natural” *resource* is staggering.

While any one of these imaginings might not have altered human existence in any noticeable way, the full panoply of them certainly did do so.

Imaginings such as these are utterly foundational to human society. And when we recognize them for what they are, it becomes clear that in reality resources are never “given;” knowledge is never “given;” technology is never “given;” human wants and the ways in which we interpret and react to our reality are never “given.”

The Reverend Malthus committed the most infamous case of assuming to be given what human imagination has since demonstrated should not be so assumed. Malthus failed—as today’s Malthusians continue to fail—to appreciate the reality and the economic productivity of human imagination.

The primacy of human imagination means that resources are not defined strictly by volume, weight, mass, wave frequency, location on the periodic table, or any other category that features prominently in books on physics or engineering. Imagination adds another dimension—a uniquely economic dimension—to any physical “things” that might be regarded as resources.

Only human imagination reveals—or *creates*—economically central aspects of resources: how resources might be used to satisfy our desires; how they might be located, extracted, stored, processed, recycled; and how they might be made to serve purposes performed by different resources.

None of these indispensable aspects of resources is exclusively, or even chiefly, a function of their physical properties. Human imagination *must* be mixed with them.

Imagination is not, of course, magic pixie dust that, when sprinkled on a lump of inert physical stuff, transforms it into whatever the human heart desires. The

specifics of our physical world do matter. No amount of imagination is likely, for example, to turn cow manure into fine bourbon, or to create life everlasting for us mortal beings.


But . . . But . . . I pause here to confess to you how surprisingly difficult it was to write the previous paragraph—how challenging it was to list plausible examples of the highly implausible. I first wrote, “No amount of imagination will turn water into wine. That achievement really would be a miracle of biblical proportions!” But then I thought, “Why not turn water into wine? Is that prospect truly so unthinkable?”

Knowing of human imagination’s remarkable track record, who can dismiss the prospect that one day some imaginative person (or, more likely, a series of imaginative people) will, after much experimentation, create, say, a powder mix that turns ordinary tap water into a luscious Bordeaux-style wine?

If I—a middle-class American sitting in my office in Fairfax, Virginia—can pull from my pocket a little slab, press a few buttons in a certain sequence, and then video-chat in real time with a friend in New Orleans or Nairobi or, pressing yet another sequence of buttons, download into

my little slab a recording of a musical performance from 50 years ago by four lads from Liverpool, what basis have I, or anyone else, to suggest that an inexpensive powder that turns water into wine is a laughable impossibility?

I can easily imagine such a thing really happening, although I personally haven’t an imagination remotely powerful enough ever to enable me to imagine just how to make such an achievement a reality. What I do have—what we all have—is the great good fortune to live in a society that boasts people with such fertile imaginations *and* that motivates them to unleash their imaginations in ways that allow even those of us without imaginations so fertile to enjoy the fruits of productive, creative imagination.

Human imagination and creativity are, as the late Julian Simon taught, the ultimate resource. 

I pause here to
confess to you how
surprisingly difficult
it was to list plausible
examples of the
highly implausible.

“I’m Smarter than Everyone Else”

BY ARTHUR E. FOULKES

“It’s a sickness,” said a friend of mine who until recently was an elected official in our city. “It sets in after you’re elected the first time, or maybe even when you’re running for office.” That sickness is “thinking you’re smarter than everyone else.”

My friend made this statement after reading in our local paper that a newly elected member of the city council had questioned an entrepreneur’s decision to open a new outdoor multi-unit storage facility in our town. The councilman, a Republican, said that according to his “investigation,” the facility is not needed in that neighborhood.

The extent of the councilman’s “investigation” was to ask the owners of nearby storage facilities how business was going. Since none was at 100 percent or even 90 percent capacity, the councilman reasoned that another facility would be a waste of resources in that part of town.

Just two months into his first term, this councilman had already caught the “sickness” of believing he knows best.

Quite apart from the arrogance of claiming to know (after just asking potential competitors!) which investments are good and which ones are bad, flaws in the councilman’s logic seem pretty clear. In the first place, not all storage facilities are the same. Some have more security, more lighting, paved driveways, or offices on site. And the very fact that they are not all in the same location makes them different from the point of view of consumers. To argue that the entrepreneur should

not be permitted to make the investment (the facility required a zoning change) because other facilities are not overrun with business is like arguing that no new restaurants should be permitted to open unless all nearby restaurants are turning away customers each night.

Worse than the flawed argument is the fact that the councilman seems to believe that it’s his place to determine what investments entrepreneurs should make.

Worse than the flawed argument is the fact that the councilman seems to believe that it’s his place to determine what investments entrepreneurs should make.

Even if an investment is a bad one, it is up to buyers and sellers within a market—not public officials—to make that choice in a free society. Only the signals of the market can help determine the best use of scarce resources in a way that is most likely to meet the most urgently felt demands of consumers.

Private property rights are vital to a free and prosperous society. Zoning laws place restrictions on private property rights. In theory they are designed to protect other property owners from undue harm. But zoning laws—as I’ve seen over the past several

years—can also be tools for politicians to impose their “plans” and values on others. Because free exchange is the backbone of economic growth, and what people exchange are really property rights, hampering those rights is necessarily counterproductive to growth and prosperity.

Arthur Foulkes is a journalist and freelance writer in Indiana. This article first appeared at TheFreemanOnline.org.

In four years of watching city government as a newspaper reporter, I've seen the "I'm smarter than everyone else" illness take several different forms. I've heard councilmen say they know they have the right to forbid bar owners from allowing smoking in their establishments in part because the Constitution "says nothing about having a right to smoke." I've heard officials demand that a private company be banned from providing rides home from local bars because those officials had not licensed the company to perform that role (even though no consumers had complained). And I've heard local officials argue against the opening of a small restaurant in a blighted neighborhood because the restaurant would be in a moveable trailer, not in a permanent building.

I've also noticed that the "I'm smarter than everyone else" disease often benefits the well-connected at the

The "I'm smarter than everyone else" disease often benefits the well-connected at the expense of everyone else.

expense of everyone else. For instance, I've seen government officials promise big tax breaks and outright taxpayer grants to new building projects because "the investments might not have happened" without these subsidies. I've also seen permitting requirements and new legal restrictions enthusiastically imposed on the mostly poor people who drive mopeds around town.

The symptoms come in many shapes and styles, but the "I'm smarter than everyone else" disease is a result of disrespect for individual freedom and private property rights combined with an overconfidence in one's own knowledge of what is best for everyone else. America became the wealthiest place on earth because it was also the most free place on earth. The "I'm smarter than everyone else" sickness—found at all levels of government—is antagonistic to individual freedom and a threat to future prosperity for everyone. **FEE**

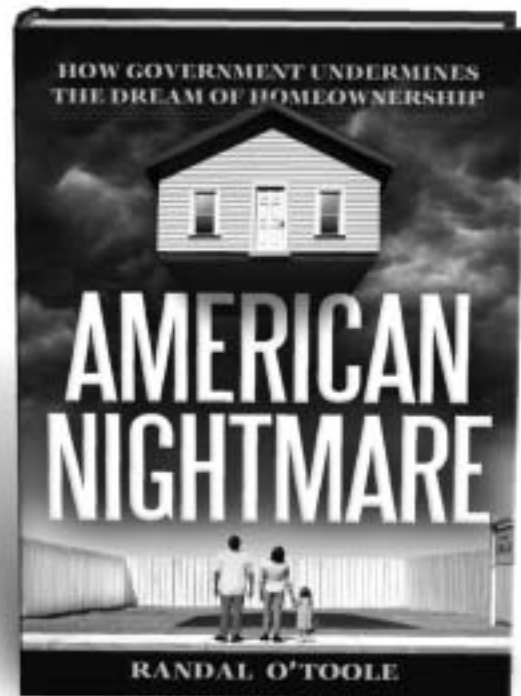
NEW BOOK FROM THE CATO INSTITUTE

“O’Toole does an outstanding job of putting the current state of the housing market in historical context and points a sharp finger at the policy distortions that got us here.”

—RANDALL POZDENA, President, QuantEcon, Inc., and author of *The Modern Economics of Housing*

The American dream of homeownership turned into a nightmare in the recent financial crisis. *American Nightmare* demonstrates how the clash between federal pro-homeownership policies and local anti-homeownership policies greatly increased the severity of the housing bubble and reveals how ending federal housing policies and dismantling state and local policies would have a significant impact on homeownership and on energizing the American Dream.

HARDBACK \$25.95 • E-BOOK \$12.99



Buy your copy at bookstores nationwide, call 800-767-1241, or visit Cato.org.

Austrian Capital Theory: Why It Matters

BY PETER LEWIN

With the resurgence of Keynesian economic policy as a response to the current crisis, echoes of past debates are being heard—in particular the debate from the 1930s between John Maynard Keynes and Friedrich Hayek. Keynes talked about the “capital stock” of the economy. He argued that by stimulating spending on outputs (consumption goods and services), one can increase productive investment to meet that spending, thus adding to the capital stock and increasing employment.

Hayek accused Keynes of insufficient attention to the nature of capital in production. (By “capital” I mean the physical production structure of the economy, including machinery, buildings, raw materials, and human capital—skills). Hayek pointed out that capital investment does not simply add to production in a general way but rather is embodied in concrete capital items. That is, the productive capital of the economy is not simply an amorphous “stock” of generalized production power; it is an intricate structure of specific interrelated complementary components. Stimulating spending and investment, then, amounts to stimulating specific sections and components of this intricate structure.

The “shape” of production is changed by stimulatory activist spending. And given that in a world of scarcity productive resources are not free, this change comes at the expense of productive effort elsewhere.

The “shape” of production is changed by stimulatory activist spending. And given that in a world of scarcity productive resources are not free, this change comes at the expense of productive effort elsewhere.

The pattern of production thus gets out of sync with the pattern of consumption, and eventually this must lead to a collapse. Productive sectors, like dot-com startups or residential housing, become “overbought” (while other sectors develop less), and eventually a “correction” must occur. Add this distortion to the fact that the original stimulus must somehow eventually be paid for, and we have a predictable bust.

These Hayekian criticisms are once again relevant. It is necessary therefore to return to the nature of capital to clarify the issues. Hayek was working from foundations that were developed by his intellectual forebears in the Austrian school of economics. Specifically, it is the Austrian theory of capital that is relevant, and we should begin with that.

The Austrian Theory

The best known Austrian capital theorist was Eugen von Böhm-Bawerk, though his teacher Carl Menger is the one who got the ball rolling, providing the central idea that Böhm-Bawerk elaborated. Böhm-Bawerk produced three volumes dedicated to the study of capital and interest, making the Austrian theory of capital his best-known theoretical contribution. He provided a detailed account of the fundamentals of capitalistic pro-

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

duction. Later contributors include Hayek, Ludwig Lachmann, and Israel Kirzner. They added to and enriched Böhm-Bawerk's account in crucial ways. The legacy we now have is a rich tapestry that accords amazingly well with the nature of production in the digital information age. Some current contributors along these lines include Peter Klein, Nicolai Foss, Howard Baetjer, and me.

The Austrians emphasize that production takes time: The more indirect it is, the more "time" it takes. Production today is much more "roundabout" (Böhm-Bawerk's term) than older, more rudimentary production processes. Rather than picking fruit in our backyard and eating it, most of us today get it from fruit farms that use complex picking, sorting, and packing machinery to process carefully engineered fruits. Consider the amount of "time" (for example in "people-hours") involved in setting up and assembling all the pieces of this complex production process from scratch—from before the manufacture of the machines and so on. This gives us some idea of what is meant by production methods that are "roundabout."

(The scare quotes around *time* are used because in fact there is no perfectly rigorous way to define the length of a production process in purely physical terms. But, intuitively, what is being asserted is that doing things in a more complicated, specialized way is more difficult; loosely speaking it takes more "time" because it is more "roundabout," more indirect.)

More Roundabout Production

Through countless self-interested individual production decisions, we have adopted more roundabout methods of production because they are more productive—they add more value—than less roundabout methods. Were this not the case, they would not be deemed worth the sacrifice and effort of the "time" involved—and would be abandoned in favor of more

direct production methods. What are at work here are the benefits of specialization—the division of labor to which Adam Smith referred. Modern economies comprise complex, specialized processes in which the many steps necessary to produce any product are connected in a sequentially specific network—some things have to be done before others. There is a time structure to the capital structure.

This intricate time structure is partially organized, partially spontaneous (organic). Every production process is the result of some multiperiod plan. Entrepreneurs envision the possibility of providing (new,

improved, cheaper) products to consumers whose expenditure on them will be more than sufficient to cover the cost of producing them. In pursuit of this vision the entrepreneur plans to assemble the necessary capital items in a synergistic combination. These capital combinations are structurally composed modules that are the ingredients of the industry-wide or economy-wide capital structure. The latter is the result then of the dynamic interaction of multiple entrepreneurial plans in the marketplace; it is what constitutes the market process. Some plans will prove more successful than others, some will have to be modified to some degree, some will fail. What emerges is a structure that is not

planned by anyone in its totality but is the result of many individual actions in the pursuit of profit. It is an unplanned structure that has a logic, a coherence, to it. It was not designed, and could not have been designed, by any human mind or committee of minds. Thinking that it is possible to design such a structure or even to micromanage it with macroeconomic policy is a fatal conceit.

The division of labor reflected by the capital structure is based on a *division of knowledge*. Within and across firms specialized tasks are accomplished by those who know best how to accomplish them. Such localized, often unconscious, knowledge could not be

The division of labor reflected by the capital structure is based on a *division of knowledge*. Such localized, often unconscious, knowledge could not be communicated to or collected by centralized decision-makers.

communicated to or collected by centralized decision-makers. The market process is responsible not only for discovering who should do what and how, but also how to organize it so that those best able to make decisions are motivated to do so. In other words, incentives and knowledge considerations tend to get balanced spontaneously in a way that could not be planned on a grand scale. The boundaries of firms expand and contract, and new forms of organization evolve. This too is part of the capital structure broadly understood.

Division of Knowledge

In addition, the heterogeneous capital goods that make up the cellular capital combinations also reflect the division of knowledge. Capital goods (like specialized machines) are employed because they “know” how to do certain important things; they embody the knowledge of their designers about how to perform the tasks for which they were designed. The entire production structure is thus based on an incredibly intricate extended division of knowledge, such knowledge being spread across its multiple physical and human capital components. Modern production management is more than ever *knowledge* management, whether involving human beings or machines—the key difference being that the latter can be owned and require no incentives to motivate their production, while the former depend on “relationships” but possess initiative and judgment in a way that machines do not.

The foregoing provides the barest account of the rich legacy of Austrian capital theory, but it should be sufficient to communicate the essential differences between the Austrian view of the economy and that of other schools of thought. For Austrians the whole macroeconomic approach is problematic, involving, as it does, the use of gross aggregates as targets for policy manipulation—aggregates like the economy’s “capital stock.” For Austrians there is no “capital stock.” Any

attempt to aggregate the multitude of diverse capital items involved in production into a single number is bound to result in a meaningless outcome: a number devoid of significance. Similarly the total of investment spending does not reflect in any accurate way the addition to value that can be produced by this “capital stock.” The values of capital goods and of capital combinations, or of the businesses in which they are employed, are determined only as the market process unfolds over time. They are based on the expectations of the entrepreneurs who hire them, and these expectations are diverse and often inconsistent. Not all of them will prove correct—indeed most will be, at least to some degree, proven false. Basing macroeconomic policy on an aggregate of values for assembled capital items as recorded or estimated at one point in time would seem to be a fool’s errand. What do the policymakers know that the entrepreneurs involved in the micro aspects of production do not?

Capital and Employment

The folly is compounded by connecting capital and investment aggregates to total employment under the assumption that stimulating the former will stimulate the latter. Such an assumption ignores the heterogeneity and structural nature of both capital and labor (human capital). Simply boosting expenditure on any kind of production will not guarantee the employment of people without jobs. How else to explain that our current economy is characterized by both sizeable unemployment numbers and job vacancies? Their coexistence is a result of a structural mismatch: The structure (that is, the pattern of skills) of the unemployed does not match those required to be able to work with the specific capital items that are currently unemployed.

In fact the current enduring recession is basically structural in nature. It is the bust of a credit-induced boom-bust cycle, augmented by far-reaching production-distorting regulation. The Austrian theory of the

For Austrians there is no “capital stock.” Any attempt to aggregate the multitude of diverse capital items involved in production into a single number is bound to result in a meaningless outcome.

business cycle was developed first by Ludwig von Mises, combining insights from the Austrian theory of capital with the nature of modern central-bank-led monetary policy. The theory was later used, with some differences, by Hayek in his debates with Keynes. Over the years its popularity and acceptance have waxed and waned, but it appears to be highly relevant to our current situation.

Dot-Com and Other Bubbles

The dot-com boom no doubt reflected the advent of a pervasive new technological environment: the arrival and expansion of the digital age. It was a time of great promise and uncertainty and of enhanced risk-taking. Astronomical book values reflected expectations that in total could not be realized. A shakeup was inevitable—and known to be so. It was part of the market process. As the boom expanded, interest rates started to rise, reflecting the increased demand for a limited supply of loanable funds. This, as Hayek would have put it, is the natural brake of the economy, the signal and the incentive to slow down. But the Federal Reserve, not wishing to spoil the party, expanded reserves to keep interest rates low, thus allowing the boom to progress beyond its “natural” life. When the bust came it was bigger than it would have been had the cycle been allowed to run its natural course.

Notice how this story accords with our understanding of the capital structure. The expanding boom reflected entrepreneurs’ expectations of profitably making new capital combinations, only some of which

would, in the event, prove to be profitable. But there was no way to know which they were ahead of time. That is why we need markets. Rising interest rates and the passage of time would tend to reveal the less viable ventures and weed them out. Keeping interest rates artificially low prevented this from happening, more so for those projects that were more interest-sensitive—namely, those that had a longer time horizon—or, loosely speaking in terms of our earlier discussion, contained more “time.”

When the bust came it was bigger than it would have been had the cycle been allowed to run its natural course.

But the dot-com collapse did not really mark the end of the cycle. Much of the extra liquidity was then directed into real estate, specifically into residential housing and into financial assets based on it. This investment channel was wide open as a result of a decades-long, recently intensified congressional and regulatory policy to expand homeownership in America. This is a familiar

story that need not be repeated here. The result was an unprecedented expansion of home building and home purchases riding the tsunami wave of home prices. Once again the production structure was pushed out of sync with any kind of sustainable pattern of consumption.

The solution, from this perspective, is to remove the distortions—to allow the market process to “restructure” production. This would mean a sustained period of consolidation in the housing market, not a policy that attempts to revive it (to revive the bubble?) of the kind we are currently witnessing. But then today’s policymakers do not have the benefit of knowing Austrian capital theory. FEE



Middlemen and Markets

BY STEPHEN DAVIES

One of the persistent features of politics and social life is the way that many insights of economics conflict with strongly held and widespread beliefs among both the general public and the business class. This contrast between the economic way of thinking and what we may call the “gut instincts” of many people makes economics seem counterintuitive much of the time. In many cases the principles of economics also conflict with moral intuitions or commonly held sentiments, and so the analysis is felt to be not only absurd but also immoral.

One example of this phenomenon is the widespread hostility to middlemen: people who speculate in commodities by buying them at a low price in order to sell them at a higher price. The popular intuition is that such people are simply parasites. That is, they do not create wealth or value because in the final analysis they do not actually create anything real such as a physical product or a direct service. A popular example of this is the intense hostility many people feel toward “scalpers” (or “touts,” as they are called in my own country), who buy tickets for events and concerts at face value and then resell them for more. The point of course is that the people who buy tickets from scalpers do so willingly; thus by definition it must have been worth their while to do so. Yet often these very customers complain the most bitterly. Hostility to scalpers means that in many jurisdictions it is a criminal offense to buy tickets and resell them to willing purchasers.

Thinking more carefully about this, however, reveals exactly what it is that the middleman offers and also

makes clearer the underlying (albeit mistaken) intuition that gives rise to the hostility. In fact the middleman does add value to both parties he transacts with, making both better off. Moreover the activity of the middleman—the connecting of willing buyers and sellers who do not know each other and would find it impossible or excessively costly to get to know each other—is essential to a functioning economy. Interfering with this by legislation or simple brute force has significant adverse effects. In cases such as tickets we may regard these as trivial, but in other ones the results can be deadly.

Work in itself does not create value. It is perfectly possible to work all day to make something, but if nobody wants it enough to exchange something for it, it has no value.

Work and Value

The mistaken intuition is the idea that value comes from work or effort and the act of trading something does not add or create value. This is simply wrong. Work in itself does not create value. It is perfectly possible to work all day to make something, but if nobody wants it enough to exchange something for it, it has no value. Value as a social phenomenon is created not by production but by exchange. The value of something for a person is defined by what

other things he is prepared to give up in exchange for it. When a good is transferred from one person to another the receiver (like his trading partner) has more value than when he started.

What then happens with tickets to events? There is a fixed supply of a good (seats) and a potentially high demand. The difficulty is how to find out who is willing to pay most for the seats and ensure that they get

Stephen Davies (sdavies@iea.org.uk) is academic director at the Institute of Economic Affairs in London.

them. One way would be to have an auction where people (or more likely their agents) bid for the tickets. The other way is to have middlemen—scalpers—who buy the tickets (often from the original promoters or venues) and then offer them for resale to people who are prepared to pay more for them. This benefits both sides. The ticket originators avoid the risk they would run if they set the price themselves, overestimated demand, and made a loss. They also avoid the cost of running an auction. The ultimate buyers do not have to do what they would otherwise do and spend a lot of (valuable) time either standing in line or seeking out willing sellers. Provided they are prepared and able to pay enough, they can be sure of getting the seats. In the process they evaluate just how much they are prepared to give up in other goods to get the ticket.

What middlemen do in other words is to align supply and demand by connecting suppliers and demanders. In doing this they make both parties better off and channel resources to where they are most in demand. Of course most people would rather get goods for less than the price asked, but in the real world that option is often unavailable. Either they will have to pay but in a different way (say, by standing in line for hours) or they will not get what they want.

High Stakes

In some cases this last point is trivial but in others it is vital. Take for example trade in grain carried out by speculative middlemen who buy where it is relatively cheap so as to sell where it is relatively dear. Historically people engaged in this highly speculative and risky trade attracted intense moral opprobrium. In fact, however, they were literal life savers. France is the best example. Under the *ancien régime* an array of legal con-

trols was intended to stop this kind of trade between different parts of the kingdom. There were many reasons for this, but the ultimate driver was the widely held belief that it was morally wrong for people to profit from hunger and dearth. As a result, grain did not move from areas of relative abundance to areas of shortage when famine struck.

In 1774 the chief minister and early classical-liberal economist Turgot swept away the controls on the grain trade, explicitly stating the economic reasoning for the edict. The harvest of 1774–75 was marked by wide-

Middlemen align supply and demand by connecting suppliers and demanders. In doing this they make both parties better off and channel resources to where they are most in demand.

spread failures. What followed in the spring of 1775 was both a triumph and disaster for Turgot. On the one hand, the economics worked: The price of bread rose but widespread famine was avoided. However, there was also an intense popular backlash against the price rise, which found expression in a wave of riots, the so-called *guerre de farines*. This contributed to Turgot's fall from power in 1776, when the King failed to support him in the face of opposition from vested interests to his reform program, the Six Edicts. Later on during the Terror, the Convention imposed price controls on foodstuffs with the infamous Law of the Maximum. This was so dis-

astrous that the policy was abandoned for good. Thereafter the French State went to a policy of increasingly free trade in grain (while still trying to manipulate the trade by “market interventions”), and by the early nineteenth century, famine and serious dearth had ceased to be problems.

The evidence of history is clear: Allowing middlemen to trade and speculate will maximize human well-being and in some cases save lives that would otherwise be lost. The job of economic educators is to show this and to undermine the persistent and misguided notion that middleman activities are exploitative and parasitic. **FEE**

The New Deal of World Trade

BY APARICIO CAICEDO

Much has been said about the ideological origins of the postwar world trade order, but few words have been written on the ideological background of its framers, a group of Progressive lawyers and economists working secretly on the postwar planning committees of the State Department during World War II. Their panacea had little in common with Richard Cobden's or Frédéric Bastiat's free-trade teachings. They wanted trade relations regulated through global bureaucratic agencies—in Murray Rothbard's words, through “the mercantilist-managerial apparatus of global economic control.” Their ideological footprint is still deeply embedded in the system.

Undoubtedly, their intention to curb commercial protectionism was sincere. Most of them grew up watching the direct relation between the “high Republican tariffs” and the power of trusts. (“The tariff is the mother of trusts,” it was said.) Moreover, they witnessed the devastating consequences of the Smoot-Hawley Act (1930) and saw with great hope the openness brought by the Reciprocal Trade Agreements Act of 1934. Nonetheless, they also idealized the federal leviathan as the main source of restraint of the power of trusts. Protectionism was for them just one part of a failing status quo. They envisaged an active government that would guarantee “freedom from want” to the “great mass.” The war, to use Robert Higgs's term, was the kind of crisis they were waiting for to take leviathan up to a supranational level.

This paradox is incarnated in the “father of the world trade system,” Roosevelt's secretary of state, Cordell

Hull. He was a southern Democrat whose whole life was devoted to curbing the power of the protectionist factions in the North. He is also known as the “father of the income tax,” which many hoped would replace the tariff as a source of revenue. In 1917 Hull, then in the Senate, had a decisive role in supporting the legal reform that brought the first permanent American income tax, which enabled President Woodrow Wilson to finance participation in World War I.

Under Hull's leadership the State Department formed secret committees at the beginning of World

The crisis of World War II allowed leviathan to be taken up to a supranational level.

War II to start planning the institutional order of the Pax Americana. These groups counted on financial support from the Rockefeller Foundation and logistic assistance from the Council on Foreign Relations. Their work was carefully documented by Harley A. Notter in *Postwar Foreign Policy Preparation, 1939–1945* (1949). As Notter wrote, the task was to consider the following questions: “What

does the United States want? What do other states want? How do we obtain what we want?”

One thing was certain for them: “the anticipated fact that this country—emerging from the victory with tremendous power—would have profound new responsibilities in connection with practically all vital problems of world affairs and would have to state a policy or at least express an attitude on such problems.”

Aparicio Caicedo (apacaicedo@gmail.com) is a member of the Instituto Juan de Mariana (Spain). He is author of the forthcoming book The Commercial New Deal: The Ideological Genesis of the Postwar Economic Order.

Back then “to state a policy” normally meant massive government intervention through regulatory bodies. At the international level this would mean, as Professor George A. Finch suggested in 1937, that “a ‘new deal’ in international relations . . . would seem to be worth trying.”

The committee planners saw the history of the international realm in terms analogous to the history of the United States. The question “How do we obtain what we want?” had a clear answer: Let’s give to the world a federal pact that would restrict protectionism among nations, as the Commerce Clause did among the states of the Union; moreover let’s also create a centralized international bureaucracy that would assure a harmonious economic order inspired by the New Deal.

A Global Commerce Clause

The Commerce Clause of the U.S. Constitution served as the perfect analogy. The “dormant commerce clause” doctrine permitted the commercial unity of the country. Traditionally the Supreme Court has interpreted article I, Section 8, Clause 3 as a mandate against discriminatory measures taken by the state governments that would imperil the free traffic of goods and services across their frontiers. In other words, that clause has worked as a free-trade charter. (It should be pointed out that the 13 states essentially had a free-trade zone under the Articles of Confederation.)

Why not try a global commerce clause then? The planners only had to take the same rationale one step further, to the international level. This position was clearly stated in 1943 by Charles Bunn, an adviser to the State Department and protégé of Supreme Court Justice Felix Frankfurter. In an address delivered to the American Political Science Association, Bunn quoted the words of the intellectual icon of Progressive jurists, Oliver Wendell Holmes:

I do not think the United States would come to an end if we lost our power to declare an Act of Con-

gress void. I do think the Union would be imperiled if we could not make that declaration as to the laws of the several States. For one in my place sees how often local policy prevails with those who are not trained for national view and how often action is taken that embodies what the Commerce Clause was meant to end.

Bunn then added, arguing in favor of the postwar plans: “The world has grown smaller since Holmes spoke. ‘What the Commerce Clause was meant to end’ has become a burning question between nations. The men who try to solve that question and the people who give them power and support must indeed be trained for more than local views.”

During those years the Commerce Clause was decisive in defining the spheres of exclusive jurisdiction between the states and the federal government. According to Progressive lawyers, the growing power of the corporations had to be controlled at the national level since local officials were not able to control the almighty trusts. They demanded from the Supreme Court a broader interpretation of the Commerce Clause to permit nationwide intervention in those realms that had been traditionally under the

power of state governments. A “living constitution” must evolve with the “economic reality” of industrial capitalism, they maintained. In that spirit the New Deal lawyer Robert L. Stern had written an influential piece in the *Harvard Law Review* defining the Commerce Clause as “the great unifying clause of the Constitution.”

We can find the same analogy Bunn drew in many works of the scholars who influenced the framing of the postwar project. Among the best known is Clarence K. Streit’s *Union Now* (1939), which had a huge impact on the foreign-policy establishment. Streit defended the idea of an Atlantic federation that would form a “union customs-free economy,” resembling the historical example of the American Constitution. In Streit’s own

Why not try a global commerce clause then? They only had to take the same rationale one step further, to the international level.

words: “It is the kind of interstate government that Lincoln, to distinguish it from the opposing type of government of, by and for states, called ‘government of the people, by the people, for the people.’ It is the way that I call Union.”

Economic Union

Directly influential on the designing of the world trade regime was Otto Todd Mallery’s book *Economic Union and Durable Peace* (1943). Mallery was among the leading advocates of interventionist federal policies. (See Murray N. Rothbard’s *America’s Great Depression*, chapter 7). Inspired by Streit, Mallery saw a clear analogy with the opus of the constitutional framers. His book advocated an economic union among nations, governed by an international board structured on the model of the International Labor Organization:

Let Economic Union become the American way of life. “Union” is a glorious word in American history. “The Union, it must be formed,” said the Founding Fathers. “The Union, it must be preserved,” said Andrew Jackson in glowing words. “The Union forever,” echoed the boys of 1861 with lusty fervor. To “Union” prefix “Economic.” Not yet is “Economic Union” charged with the same emotion, for it has not been died for, or even lived for.

The Progressive intelligentsia made crystal clear that they wanted a technocratic world government, modeled after the New Deal agencies. Max Lerner (many times adviser to the State Department and in later years a vocal opponent of what he called “the Mises-Hayek school”) could not have been clearer in a widely read 1941 essay:

The American Constitution, with its emphasis upon separate powers . . . is a poor model for a world state. . . . The essence of government today is to be found in a fusion between the consultative, the technical,

and the administrative. . . . [T]he measure of our capacity to survive has been our capacity to move away from our earlier Congressional government and our later government by judiciary, toward a newer executive and administrative process. What is true of the American national state must be even truer of the world centralism we are envisaging.

In 1934 Leland Rex Robinson, a member of the Tariff Commission, while writing in favor of Hull’s reforms of trade policy also summarized its underlying ideological consensus: “The so-called ‘liberal’ of a hundred years ago was busy repealing restrictions which limited the gainful activities and discouraged the enterprise of individuals. The ‘liberal’ of today is more likely to be busy thinking out new schemes of political control.”

This ideological environment surrounded the work of the postwar committees of the State Department. Major academic publications, such as the *American Journal of International Law* and the *American Political Science Review*, were in those days full of projects for international bureaucratic organizations. Many intellectuals involved in the debate were in close contact with the committees or became members themselves.

The conceptual reference for the work of the postwar planners was the Atlantic Charter of 1941. That treaty—signed by the U.S. and British governments as a prewar arrangement—was aimed, according to its own text, at securing “the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labor standards, economic advancement and social security.” As Elizabeth Borgwardt wrote in her book *A New Deal for the World* (2005), the “framing of the Atlantic Charter echoed [the] New Deal-inspired synthesis of political and economic provisions.”

The project for a new trade order saw the light of day in 1945 with the “Proposals for Consideration by an International Conference on International Trade and Employment,” known also as the “American Proposal.” Not surprisingly, the proposal called for the creation of

The Progressive intelligentsia made crystal clear that they wanted a technocratic world government, modeled after the New Deal agencies.

an international organization aimed not only at controlling commercial disputes between nations but also at “curbing the restrictive trade practices resulting from private international business arrangements.” The result was the Havana Charter of 1947, which mandated the creation of the International Trade Organization (ITO), something like a worldwide Federal Trade Commission. The American economist Clair Wilcox, chairman of the conference, put it boldly when he wrote that the principles of the Atlantic Charter were fully compatible with those of “the Sherman Act of 1890 as interpreted by the Supreme Court under the rule of reason.”

Fortunately, the Havana Charter was never ratified by the U.S. Congress and the ITO never was created. That saved us from a worldwide “fatal conceit,” as

Hayek would have put it. However, the members of GATT (the General Agreement on Tariffs and Trade) used this provisional protocol as a plan B for many decades, until the creation of the World Trade Organization (WTO) in 1995. The WTO was the final fulfillment of a suspended project. This international agency has served to foster corporate interests from the United States and the European Union, favoring free trade on occasion. More often it has been useful for imposing “intellectual property” protectionism on poor countries, while legitimizing agricultural protectionism in rich ones.

Instead of Cobden-Bastiat-Mises-Hayek free trade, we’ve had Hull-Mallery-Lerner managed trade, the fulfillment of the New Deal on an international level. **FEE**

The WTO was the final fulfillment of a suspended project to institute an international New Deal.

FREEDOM IN HD

Today's top issues
Liberty's top minds
Sharp analysis
High-definition streaming video
Visit FEE.tv today!

WWW.FEE.TV

FEE TV

On “Bourgeois Paternalism”

BY SANDY IKEDA

Last March the noted political scientist James Q. Wilson died at the age of 80. He is probably best known for developing, with George L. Kelling, the “broken-windows thesis” of law enforcement, which is not to be confused with Frédéric Bastiat’s similar-sounding “broken-window fallacy.” (I’ve written about the difference here: tinyurl.com/yb3yb2k.)

Wilson and Kelling’s thesis is based on the observation that “one unrepaired broken window is a signal that no one cares, and so breaking more windows costs nothing.” If that’s the message, then small violations of local social norms such as vandalism can pave the way for serious crimes such as robbery, or worse. To combat these perverse dynamics they recommended that local police shift their priorities away from crime-fighting as such and toward the protection of the community—its safety and well-being:

Above all, we must return to our long-abandoned view that the police ought to protect communities as well as individuals. Our crime statistics and victimization surveys measure individual losses, but they do not measure communal losses. Just as physicians now recognize the importance of fostering health rather than simply treating illness, so the police—and the rest of us—ought to recognize the importance of maintaining, intact, communities without broken windows.



A plea for more cops, more central planning or something more spontaneous?
hunter.gatherer [flickr]

I’ve used their now-famous *Atlantic* magazine article (tinyurl.com/3azl6k8) for years in my course on the economy and culture of cities, where I emphasize the importance of social capital as well as economic liberty for fostering economic development.

A few weeks before Wilson’s death David Brooks, the well-known writer and political commentator, wrote a column for the *New York Times*, “The Materialist Fallacy,” on a similar theme without, however, mentioning Wilson explicitly (tinyurl.com/7wnsf8). Actually, he was commenting on the latest book by the controversial sociologist Charles Murray, *Coming Apart*. I confess that I haven’t read the book, but from what I’ve read about it, including Brooks’s essay, Murray argues that the most ominous divide within American society is one not based on race (the subtitle of the book is *The State of White America, 1960–2010*) or on political ideology, but on culture. Today Americans who are working class and

white, for example, have babies out of wedlock and get divorced at rates far higher than Americans among the white elite.

Sandy Ikeda is an associate professor of economics at Purchase College, SUNY, and the author of The Dynamics of the Mixed Economy: Toward a Theory of Interventionism. He writes the “Wabi-sabi” column on alternate Tuesdays at TheFreemanOnline.org, where this first article appeared.

It wasn't always so, Murray argues. Looking back to the early 1960s, the material differences between the wealthy and the working class didn't translate so starkly into differences in behavior and moral values. He warns that today's cultural divide, "if it continues, will end what has made America America."

Now, against the theories of what ails America that are based on economic determinism ("liberal"), or that are government-centric (libertarian), or that center on the abandonment of traditional bourgeois norms (neo-conservative), Brooks offers important research from the last 25 years that he claims Murray and his mostly left-wing critics ignore completely. (Of the three theories, Brooks reserves his harshest words for the first—economic determinism—which is why I suppose he, or his editor, titled the column "The Materialist Fallacy.") Brooks writes:

The recent research details how disruption breeds disruption. . . . It includes the diverse work on self-control . . . which shows, among other things, that people raised in disrupted circumstances find it harder to control their impulses throughout their lives. It includes the work of Annette Lareau . . . [who] shows that different social classes have radically different child-rearing techniques, producing different outcomes.

So for Brooks the problems are more cognitive and behavioral than simply economic, governmental, or moral. We come then to the crux of the matter: What is to be done?

Toward the end of his essay Brooks briefly states his preferred solution: "It's not enough just to have economic growth policies. The country also needs to rebuild orderly communities. This requires bourgeois paternalism: Building organizations and structures that induce people to behave responsibly rather than irresponsibly and, yes, sometimes using government to do so."

He does not elaborate, although he may do so elsewhere.

Libertarians, as he notes, as well as neoconservatives like Nathan Glazer, think that government policies were the cause of the decline of the community ties and neighborly behavior that Glazer called the "fine structure of society." One thing I took away from reading Charles Murray's 1984 book, *Losing Ground*, is that sometimes the accumulated damage from government programs can be so profound that the underlying norms that support responsible behavior and social capital may not bounce back quickly after those programs

are removed. And they may never come back. I guess what Brooks is saying is that in many places the working class is so messed up cognitively and behaviorally that government must "rebuild orderly communities" and "[build] organizations and structures." But orderly by whose standard? And build by what methods?

It may seem that the Wilson-Kelling broken-windows thesis supports Brooks's position. After all, Wilson and Kelling were writing about effective policing, which in most contemporary contexts means police empowered by the State. But what they say is that the most successful policing, often in the form of cops walking and not driving a beat, is about finding out what the norms of civility in a particular community

are. In some neighborhoods, for example, it's okay to play music in the street, while in others it isn't. So they're talking about enforcing existing community norms, not imposing norms that a community doesn't have or no longer has.

Brooks doesn't spell out what he means by bourgeois paternalism other than that it promotes responsibility and we need government to enforce it. Deirdre McCloskey argues in her 2007 book, *Bourgeois Virtues: Ethics for an Age of Commerce*, that capitalism (or as I prefer to call it, the free market) promotes the tradi-

I guess what Brooks is saying is that in many places the working class is so messed up cognitively and behaviorally that government must "rebuild orderly communities." But orderly by whose standard? And build by what methods?

tional seven virtues of faith, hope, love, justice, courage, temperance, and prudence. So perhaps Brooks is thinking along those lines—I just don't know.

But here's what I do know. Not only do markets depend on certain norms associated with bourgeois virtues, such as reciprocity and extending trust to strangers, but markets *promote* those very norms as well. Recent research, for instance, supports this connection between markets and trust (tinyurl.com/bqej3na).

While it may be possible to help foster the formation of social capital and the fine structure of society by effective policing (governmental or nongovernmental) or by the design of public spaces or by government's getting out of the way and letting energetic people in the community repair the fine structures themselves, no government can create what can only emerge spontaneously. That includes genuine communities, warts and all, instead of unsustainable projects and "Disneyland neighborhoods."

Markets—free markets—thrive only in the absence of intrusive government, and paternalism, even Brooks's bourgeois paternalism, would be intrusive by definition.

No government can create what can only emerge spontaneously. That includes genuine communities, warts and all, instead of unsustainable projects and "Disneyland neighborhoods."

Paternalistic policies that promote an outsider's concept of order, aka the Nanny State, may produce measurable outcomes more quickly, such as lower measured unemployment, crime, and divorces. On the other hand, healing a community by enabling freedom may take longer to produce visible results; the invisible social infrastructure of social capital is often hard to see even when it's healthy. And what we do see may not look like our idea of "order" because sometimes it may entail having a baby outside marriage or getting a divorce or bowling alone.

But when it emerges from freedom, a living community stands a better chance of thriving and sustaining itself. That may take time, perhaps a very long time. But bourgeois virtues will reemerge only if people are left free to actually practice those virtues, or not, instead of having them paternalistically imposed on them. **FEE**

Start your weekday morning with

In brief

One click of the mouse ... and FEE's popular news e-commentary will come to your computer five days a week.

Subscribe online: www.thefreemanonline.org or e-mail: Inbrief@fee.org!



The Ubiquity of Economic Phenomena

BY SHELDON RICHMAN

Libertarianism and one of its pillars, free-market economics, get an unfair rap for their alleged preoccupation with the pursuit of wealth. It's unfair because, while wealth and economic growth are important, the philosophy is about much more: human flourishing through freedom and its natural product, social cooperation.

One source of confusion is the undoubted libertarian interest in economics. Unfortunately, economics is commonly understood to be narrowly concerned with the pursuit of material goods. Mainstream economics encourages this belief. Too bad.

This misconception may be traced to the classical economists, who otherwise made important contributions to the discipline. In *The Economic Point of View*, Israel Kirzner notes that “this ‘material’ approach to economics . . . seems to have held a fascination for a number of economists over an extended period of time, *viz.*, the view that saw economics as essentially concerned with the goods necessary to ensure the *physical subsistence* of mankind.”

The object of study was *homo economicus* (economic man; the term was first used by critics.) Kirzner continues: “This view seems to be the most extreme form of the materialistic outlook on economic affairs. The distinctive feature of all conceptions of economics as a science of wealth or of material goods, as against alternative conceptions of the discipline, consists in their identification of economics with some special *end* of human action. Not all action is subject to economic law, but only such action as is directed towards a more or less well-defined class of objects, *viz.*, wealth or material goods.”

So there we are. Economics is thought by many to be concerned exclusively with the individual's selfish

pursuit of maximum wealth or material goods. Other pursuits are thought to be beyond economics. Libertarians see economics as essential to understanding the world. Therefore libertarianism must largely be about the individual's selfish pursuit of wealth, or material goods.

But note that Kirzner said there are “alternative conceptions of the discipline.” The most prominent of these is the Austrian school. Another is the similar approach taken by the British economist Philip Wicksteed, known as the “British Austrian.” How does their approach differ from the classical school? In this context they differ by assigning a far broader scope to economics. For them economics is about the pursuit of ends *per se*. All purposeful action—along with the spontaneous orderly process it generates—is the subject of economic analysis.

Wicksteed (1844–1927) was the author of *The Common Sense of Political Economy* (1910). According to Kirzner (in *Great Austrian Economists*), Wicksteed seems not to have affected or been influenced by the Austrians.

Yet there is remarkable overlap in their approaches to economics, most relevantly in the matter of scope. Right out of the box, in his introduction, Wicksteed stated:

We shall find that the economic relations constitute a machinery by which men devote their energies to the immediate accomplishment of each other's purposes in order to secure the ultimate accomplish-

All purposeful action—along with the spontaneous orderly process it generates—is the subject of economic analysis.

Sheldon Richman is the editor of The Freeman. This article first appeared as a TGIF column, which appears every Friday at TheFreemanOnline.org.

ment of their own, irrespective of what those purposes of their own may be, and therefore irrespective of the egoistic or altruistic nature of the motives which dictate them and which stimulate efforts to accomplish them.

In his first chapter, while discussing the ubiquity of human beings' choosing among alternatives, Wicksteed observed:

Insensibly we have passed from the confined conception of price as so much money, to the generalised conception of price as representing the terms on which *anything* we want may be had or anything we shun avoided. Current phraseology recognises this wider application of the language of the market and of pecuniary expenditure.

“Spend,” “afford,” “waste,” “worth,” “price,” are terms universally applicable to all kinds of material and *immaterial* resources and objects of desire or aversion, whether milk, money, time, pain, or vital energies. . . . “Price,” then, in the narrower sense of “the money for which a material thing, a service, or a privilege can be obtained,” is simply a special case of “price” in the wider sense of “the terms on which alternatives are offered to us”; and to consider whether a thing is worth the price that is asked for it, is to consider whether the possession of it is more to be desired than anything we can have instead of it, and whether it will compensate us for everything we must take along with it. Selection between alternatives, then, is the most generalised form under which we can contemplate the ordinary acts of administration of resources, whether in the marketplace, the home, or elsewhere; and, obviously, price or the terms on which the alternatives are offered (how much of this against how much of that?) must often be a determining consideration in our choice between them. [Emphasis added.]

Economic analysis, then, is not confined to the pursuit of material goods, much less to self-interest, or “selfishness.”

Kirzner is unsurprised that Ludwig von Mises cited Wicksteed on this point “when, in 1933, Mises first comprehensively laid out his view of economics as simply a branch of a ‘universally valid science of human action’ [praxeology], and argued that the ‘laws of catallactics that economics expounds are valid for every exchange regardless of whether those involved in it have acted wisely or unwisely or whether they were actuated by economic or non-economic motives. . . .”

The book Kirzner had in mind was *Epistemological Problems of Economics*, in which Mises wrote:

Everything that we say about action is independent of the motives that cause it and of the goals toward which it strives in the individual case. *It*

makes no difference whether action springs from altruistic or from egoistic motives, from a noble or from a base disposition; whether it is directed toward the attainment of materialistic or idealistic ends; whether it arises from exhaustive and painstaking deliberation or follows fleeting impulses and passions. [Emphasis added.]

Economic analysis, then, is not confined to the pursuit of material goods, much less to self-interest, or “selfishness.” (Not that there’s anything wrong with pursuing self-interest.) In a world of scarce resources and limited time, everyone must make choices at every turn, striving to achieve more important ends, subjectively assessed, before less important ends, determined to minimize costs (money and otherwise) so that more of his or her most important ends can be obtained. This was as true for Mother Teresa as it is for Donald Trump.

At the center of libertarianism and free-market economics, then, lies not wealth but liberty—the freedom of people to cooperate in the pursuit of diverse values, some self-regarding, some not. Wealth is merely one part of a much larger story. Critics will have to find another line of attack. **FEE**

Argentina's Way to Decadence

BY ARIEL BARBERO

Argentina's former president Eduardo Duhalde—elected by Congress in 2002 after a coup toppled the candidate who had defeated him in the regular elections—once said that Argentina was *condemned to success*. Indeed a country with fertile land, a mild climate, mighty rivers, a small population that used to be well educated, no major conflicts, and no racial rifts would seem difficult to sink. It must inevitably rise. Nevertheless, we Argentines have demonstrated a rare ability to avoid success. Fortunately destiny—good or bad—is never inevitable.

People often point out that the two Koreas provide (as the two Germanys once did) good examples of what the rule of law means for the life of a nation. Argentina provides yet another example of the changes that take place when respect for rights—including property—is no longer considered relevant. Except that in the case of Argentina, the division doesn't concern space but time.

We Argentines started very well. People tend to forget that by 1928 Argentina had the sixth-highest gross domestic product (GDP) in the world. Income per capita was similar to Germany's. Literature and music flourished.

Immigrants viewed Argentina as a place where hard work made people prosper. It was considered as promising as Canada but with a milder climate. People voted with their feet—the most honest and thoughtful way of voting—and they came to Argentina by the thousands. They came from Spain and Italy, but also from Wales

and Denmark. Jews arrived and found that they enjoyed equal protection under the law. One of their sons wrote a novel describing the lives of what he called “gauchos judíos,” Jewish gauchos. They could buy land like anyone else and work it. Colombian poet Rubén Darío dedicated a poem to Argentina, in which he admired the Jewish settlers: “youth of strong figure, and sweet Rebecas of honest eyes.”

What made that flourishing possible? Good land and hard work, of course. But also wise principles and noble ideals. After a period of civil wars, Argentina adopted a reasonable Constitution, largely copied from that of the United States. In fact when the Constitution was amended in 1860, it was considered necessary to add some provisions that “ignorant hands”—as it was said at the Convention—had forgotten to copy from the model.

Since then Argentina's Constitution has declared property “invulnerable.” Now that these principles have been abandoned, few people realize that this Constitution today is still more open to free trade than the U.S. Constitution. It declares that Argentine rivers are open to all ships, no matter the flag. That constitutional clause is the result of a lesson from history. Years before the Constitution was adopted, the tyrant General Rosas—who once executed a pregnant girl—had closed the rivers to those nations willing to trade with provinces that defied his orders. The tool he had used for strangling the economy of some

We Argentines have demonstrated a rare ability to avoid success. Fortunately destiny—good or bad—is never inevitable.

Ariel Barbero (arielbarbero@yahoo.com) is a lawyer in Buenos Aires. He blogs at rule-of-law-not-men.blogspot.com.ar.

regions and favoring that of others was banned by the Constitution.

We copied from other nations, but we chose good models. Why reinvent the wheel? It was said at the Constitutional Convention in 1860: Why should we design again the institutions that protect freedom when we have the example of the United States? Today you won't find similar declarations in the mouths of Argentine politicians.

But the copying wasn't blind: It was always in favor of liberty. For instance, in 1871 Congress adopted a Civil Code based on the French one. However, the rules about torts were completely different, and for many years they secured Argentines against the whims of judges fond of being generous at the expense of others. Unfortunately, in the 1930s we started to copy bad ideas, and Argentine law professors began a relentless fight against those restrictions on the powers of judges. They won. The wise rules about torts are still in the code, but nobody cares about them.

Before that ideological shift, the men who governed and educated Argentina had embraced free trade and had thought that no progress was possible without respect for property rights. They read Tocqueville and *The Federalist*. Debate was free too, and sometimes fierce, but these men no longer exchanged blows, only ideas.

Discretionary Authority

Let's have a look at the present—so different a picture! At the beginning of 2012 the Argentine government replaced the general rules previously applied to imports with discretionary authorization from the government applied on an individual basis. A government official can ban an international deal without providing any explanation. Authorization is often subject to odd conditions: A company may import engines, but only if it promises to export some local product that might be outside its line of business, like wine.

As for exports, the government has banned and allowed and then banned again exports of wheat, meat, cheese, and many other products, to keep prices low for the local market. That is popular with voters, but cripples the prospects for the production of these goods.

In 2002, after the civilian coup that toppled President Fernando de la Rúa, the new government—presided over by the candidate who had lost the elections—seized the dollars in all bank accounts and forcibly exchanged them for bonds or pesos less than half the market value of the dollar. For a short time there was another choice: You could use your money to

buy a car and get an exchange rate a bit less ruinous. That was meant to boost the local automobile industry. In all these schemes people's rights to their savings counted for nothing. The money could be used to promote an industry or be destined to serve any other plan that grabbed the imagination of government officials.

Some people attacked bank employees, who of course had nothing to do with the decisions of the government. Others sued the government, and that was criticized as unpatriotic. But they started winning their cases and recovering their savings. Even the much-reviled Supreme

Court declared that if the Constitution says that property is "inviolable," then bank accounts must not be seized. The federal government had taken even the dollars possessed by the provinces—the equivalent of U.S. states. One of these, San Luis, also sued, and won.

The federal government solved this problem by removing judges and replacing them with others who were more pliable. The old judges were accused of countenancing abuses committed by *previous* governments. The new majority on the Supreme Court declared that taking the dollars was in accordance with the Constitution.

The currency has derailed. Most sources say inflation was between 25 percent and 30 percent in 2011. It can't be said for sure because the government has

Rules for imports
have been replaced
with arbitrary govern-
ment discretion.
A government official
can ban an inter-
national deal without
providing any
explanation.

sacked those in the National Institute of Statistics who failed to produce good numbers. And private institutes that dared to say that the new figures don't reflect the real level of inflation have been fined heavy sums.

We must realize that the majority of the Argentine population looks at these events with indifference. They won't be bothered with these minor details about confiscations and inflation when the only relevant thing—so they have been taught—is to have a leader in control ready to fight the wicked capitalists who are always plotting against the national interest with the help of foreign nations. Unlike our founding fathers, today a large number of Argentines see the world as a ruthless struggle between nations. Principles and laws are merely weapons to be used or discarded in that fight. General Juan Perón expressed that conviction in his motto: To the enemy, not even justice.

A large number of Argentines are always ready to pardon injustices done to (other) individuals. What counts is the country as a whole and the struggle for social justice. As Perón used to say, you cannot make a tortilla without breaking some eggs. The eggs broken were journalists and union leaders tortured by his government. From then on, people have learned to see the big picture and look with indulgent eyes on those minor accidents.

It is clear that without some colossal confusion about basic notions of law, most of what happens in Argentina could have never taken place.

Evolution of (or Away from) Rights

Argentine constitutional scholars adhere to what they call *social* constitutionalism. They teach that the evolution of rights is similar to technical progress: You have first-generation rights (classic rights like property and free speech), second-generation rights (such as a right to a job and a salary), and third-generation rights (among others, a right to a sustainable environment and to the enjoyment of culture). To stop somewhere in that progression is simply to reject

progress, a proposal that only ignorant people could suggest. The parallel between technical improvements and the new generations of rights reminds us of the many warnings Friedrich Hayek made about the use of technical or engineering images in social issues.

Ignoring Hayek's advice, one of the most influential law professors of the last decades, Augusto Morello, wrote that judges must see themselves as social engineers. More than that, in one of his last books Professor Morello pointed out that the Supreme Court must act like a spearhead breaking the path for reforms whenever legislators might feel reluctant to pass a law against the opinion of their constituencies.

The tool to apply for these purposes is a *dynamic* interpretation of the laws, and especially of the Constitution. This is no abstract issue. When in 2006 the new Supreme Court needed to show that the constitutional clause declaring property "inviolable" doesn't prevent the government from taking people's dollars and exchanging them for bonds or devaluated pesos, the judges argued that what is inviolable is the *essence* of property—but not necessarily its *extent*. And the Court found that if the taking was reduced a little, it actually respected the "essence" of the savings. So the judges modified a number of laws and presidential decrees that confiscated dollars and

declared that they took a considerable portion of the *extent* of the accounts, but not their *essence*.

That decision was less remarkable than the reaction—or rather lack of reaction—from Argentine law scholars. Just compare: If you tell an American law professor—even a "liberal" in the American meaning of the word—that the government has seized dollars in private accounts and that the Supreme Court (after the necessary changes in its composition) has justified everything, you would expect to see him raising an eyebrow. In Argentina a broad and benevolent view was considered wiser. The Court's decision was described by experts as a good balance between the rights of individuals and the rights of the community.

It is clear that without some colossal confusion about basic notions of law, most of what happens in Argentina could have never taken place.

Trying to find something positive to commend, most law scholars wrote that the Supreme Court brought tranquility by putting an end to the uncertainty that surrounded the issue. But even that soothing argument required a major twisting of the facts. The issue had already been resolved by the previous Court that declared the taking unconstitutional. The uncertainty—or rather certainty—came from the surmise that the new Court, after a prudential interval, would declare that the judges sacked by the government had been wrong. So they did.

The great expounders of the rule of law A. V. Dicey and F. A. Hayek have described its progress as a long struggle against discretionary rule. In Argentina generations of lawyers have studied books and heard professors that praised every expansion of discretionary powers as the main vehicle for progress. It is better, so they have said, if judges can decide every question on its merits, without being encumbered by precise rules. Professor Morello has written that the “glorious ambiguities” in laws and the Constitution are not defects but great advantages.

New Civil Code

The Civil Code is still a legacy from a time when the lessons given to law students were different. Since the 1930s, Argentine law scholars have pushed for its abrogation and replacement with a new code. Finally, last March, President Cristina F. de Kirchner announced that a new code had been sent to Congress. She had the votes to make it law.

The project stands legality on its head. It is an old principle shared by all free nations that nobody can be punished or forced to pay damages for doing what the law does not forbid. I may cause losses to a competitor by selling better goods, but losses alone are no cause for compensation. That great principle has been our Constitution since it was sanctioned in the nineteenth century. Damage counts in law only if it was caused by doing what the law forbids.

However, according to the new code drafted by President Kirchner’s advisers, damage is claim enough. The requisite “doing what the law forbids” is dropped. Even prejudice to someone’s legitimate “interests” (whatever that may mean) makes one liable to pay compensation. Of course, a Civil Code that allows a grocer to sue another on such a basis cannot be applied consistently. Indeed, inconsistency is what Argentine law professors suggest as the way out of the legal maze: Each one of the thousands of judges will have to decide which interests deserve protection, judging each case “on its merits.”

The fact that the main changes to the liberal code in the twentieth century were made by a military junta should give the lie to leftist propaganda that has tried to associate the juntas with liberalism and free markets.

The abrogation of the old code with its archaic notions about freedom of contract and security of property will mark the final triumph of the doctrines that Argentine law scholars have been promoting for more than seven decades. In the past they even took advantage of the dictatorial powers of military juntas to impose their ideas. Indeed, before the present attack against the code, the biggest one was made in 1968, when Argentina was ruled by a military junta. Then the code was amended by the decree of a general, who followed the draft written by a law professor he had appointed as his minister. The new articles provided many discretionary exceptions to the rules in the code. But though that reform created

many cracks and drilled deep holes in the structure of the code, it still retained a considerable part of its noble frame.

There have been exceptions to the ideological trend that dominates in the universities. The brightest light in Argentine jurisprudence, Sebastián Soler, explained decades ago the vices of collectivistic tendencies in the clearest of terms. His book *Faith in Law* is today out of print—a sign of the ideological shift.

Juntas and State Corporations

The fact that the main changes to the liberal code in the twentieth century were made by a military

junta should give the lie to leftist propaganda that has tried to associate the juntas with liberalism and free markets. Moreover, all military governments kept intact the big State enterprises and corporations, and even enlarged them. For decades the extraction of oil, carbon, gas, iron, and uranium was performed by State-owned companies. Another State company owned the ships. Two big corporations, the JNG and the JNC, were in charge of the exports of grains and meat. Water, electricity, railways, and telecommunications were in the hands of the State. Finance was highly regulated and dominated by State-owned banks.

In truth privatization started with democratic governments, in the 1980s and '90s, timidly by President Raúl Alfonsín and more decisively by his successor, President Carlos Menem.

Today the tendency has been reversed, and "privatization" is a bad word. Youngsters feel nostalgic for a country they never knew, ruled by powerful State corporations—they have read it was a wonderful world.

The State has kept moving in that direction. After forcing oil companies to sell below the market price, the government has found—to its anger and surprise—

that investment in that industry has stalled. So it used force again to take the shares a Spanish company had in YPF, a State corporation privatized more than ten years ago.

In a curious step in the same direction, the government has decided to finance football. In 2009, announcing this new governmental endeavor, President Kirchner compared the tragedy of the disappearance of gratis

football from our TV sets with the disappearance of people at the time of the military juntas. Her government often links its policies—no matter the area—with the fight for human rights, and she often makes her proclamations to the nation surrounded by an honor guard of prominent NGO (nongovernmental organization) activists. Nobel Prize-winner Pérez Esquivel protested, saying that this was political exploitation of death and sorrow. However, the CEO of an Argentine human rights NGO with strong financial links to the govern-

ment, Enriqueta Estela Barnes Carlotto, declared that the comparison between a denial of gratis football and political murder was quite right. Like many others in Argentina, she must have thought that you can't make a tortilla without breaking some principles. **FEE**

Youngsters feel nostalgic for a country they never knew, ruled by powerful State corporations—they have read it was a wonderful world.

In his May article "Money Market Funds: Success Must Not Go Unpunished," Warren Gibson quoted a spokesperson for the Investment Company Institute, a mutual fund trade group, as saying that new regulations on money market funds did nothing to improve their soundness, and that the last four years have been "a long tortured history" for money market funds. In a follow-up comment to the online article, Gibson wrote: "The spokesperson I quoted now says I misquoted her when I said the new regulations did nothing to improve the soundness of money funds. She sent me links to past speeches and publications which praised the new regulations. I regret any misinterpretation of her telephone comments on my part."



Complex Societies Need Simple Laws

BY JOHN STOSSEL

If you have 10,000 regulations,” Winston Churchill said, “you destroy all respect for law.”

He was right. But Churchill never imagined a government that would add 10,000 year after year. That’s what we have in America. We have 160,000 pages of rules from the feds alone. States and localities have probably doubled that. We have so many rules that legal specialists can’t keep up. Criminal lawyers call the rules “incomprehensible.” They are. They are also “uncountable.” Congress has created so many criminal offenses that the American Bar Association says it would be futile to even attempt to estimate the total.

So what do the politicians and bureaucrats of the permanent government do? They pass more rules.

That’s not good. It paralyzes life.

Politicians sometimes say they understand the problem. They promise to “simplify.” But they rarely do. Mostly, they come up with new rules. It’s just natural. It’s how the public measures politicians. Schoolchildren on Washington tours ask, “What laws did you pass?” If they don’t pass new laws, the media whine about the “do-nothing Congress.”

This is also not good.

When so much is illegal, common sense dies. Out of fear of breaking rules, people stop innovating, trying, helping.

Think I exaggerate? Consider what happened in Britain, a country even more rule-bound than America. A man had an epileptic seizure and fell into a shallow pond. Rescue workers might have saved him, but they wouldn’t enter the three-foot-deep pond. Why? Because “safety” rules passed after rescuers drowned in a river now prohibited “emergency workers” from entering water above their ankles (tinyurl.com/4ky7xtf). Only 30 minutes later, when rescue workers with “stage 2 training” arrived, did they enter the water, discover that the man was dead, and carry him to the approved

inflatable medical tent. Twenty other cops, firemen, and “rescuers” stood next to the pond and watched.

The ancient Chinese philosopher Lao Tzu, sometimes called the first libertarian thinker, said, “The more artificial taboos and restrictions there are in the world, the more the people are impoverished. . . . The more that laws and regulations are given prominence, the more thieves and robbers there will be.” He complained that there were “laws and regulations more numerous than the hairs of an ox.” What would he have thought of our world?

Big-government advocates will say that as society grows more complex, laws must multiply to keep up. The opposite is true. It is precisely because society is unfathomably complex that laws must be kept simple. No legislature can possibly prescribe rules for the complex network of uncountable transactions and acts of cooperation that take place every day. Not only is the knowledge that would be required to make such a regulatory regime work unavailable to the planners, it doesn’t actually exist, because people don’t know what they will want or do until they confront alternatives in the real world. Any attempt to manage a modern society is more like a bull in a darkened china shop than a finely tuned machine. No wonder the schemes of politicians go awry.

Nobel laureate James M. Buchanan put it this way: “Economics is the art of putting parameters on our utopias.”

I wish our politicians knew that. I wish they’d stop their presumptuous schemes.

We need to end the orgy of rule-making at once.

FEE

John Stossel hosts Stossel on Fox Business and is the author of No, They Can't: Why Government Fails—But Individuals Succeed. Copyright 2012 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.

Learn about *liberty* this summer. Foundation for Economic Education Summer Seminars

Have a life-changing summer experience.

High School Seminars

July 9-14 Freedom Academy I - Salt Lake City, UT

July 16-21 Freedom Academy II - Salt Lake City, UT

College and Graduate Seminars

June 4-8 Freedom University: Austrian Economics - Atlanta, GA

June 11-16 Freedom University: History - Atlanta, GA

June 18-23 Freedom University: Current Events - Atlanta, GA

June 25-29 Communicating Liberty - Atlanta, GA (Alumni only)

July 30-August 3 Advanced Austrian Economics - Irvington, NY

Visit fee.org/seminars to apply.



FEE

FOUNDATION FOR
ECONOMIC EDUCATION



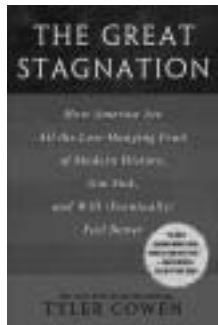
Book Reviews

The Great Stagnation: How America Ate All the Low-Hanging Fruit of Modern History, Got Sick, and Will (Eventually) Feel Better

by Tyler Cowen

Dutton Adult • 2011 • 128 pages • \$12.95

Reviewed by Kevin A. Carson



Tyler Cowen’s thesis is that economic growth is leveling off and rates of return decreasing because we’ve already picked the “low-hanging fruit” (meaning innovations and investments that have high returns). The stagnation in GDP and median income in recent decades means “the pace of technological development has slowed down,” and the general population is benefiting less from new ideas.

I would argue, rather, that measured economic growth and income have slowed down precisely *because* of the increased pace of technological development.

The important trend behind the disappearance of “low-hanging fruit” is the decoupling of improved material quality of life from monetized measures of economic growth and income. Improvements in quality of life—although very real—don’t show up in conventional econometric terms.

Intensive development—increased efficiency in the use of inputs—isn’t necessarily reflected in increased money returns. Unless they’re turned into a source of rents by restrictions on competition, innovations that reduce production costs will benefit consumers in lower prices and better products.

Such rents are central to the business model of “cognitive capitalism”—the “progressive” model of capitalism pushed by Bill Gates and Warren Buffett. The most profitable industries in recent years have been those that depend on returns from “intellectual property.” But such artificial scarcities are fast becoming unenforceable, and technologies of abundance are growing so

rapidly that they can’t be enclosed as a source of rents.

If anything, we can expect an implosion in metrics like GDP in the coming years, even as quality of life improves enormously.

Cowen almost gets it at one point. “[I]f our food supply chain harvests, retails and sells an apple for \$1, that adds a dollar to measured national income.” Exactly: GDP measures value produced in terms of the total cost of inputs consumed—not the use-value we consume, but how much stuff was used up producing it. So anything that reduces the input costs of our standard of living seems to show up as negative growth.

Actually, Cowen contradicts his own thesis. He argues that official GDP figures exaggerate growth because so much of it is simply waste. But that undermines his treatment of reduced money incomes as a proxy for reduced growth in standard of living. If the additional portion of the GDP we spend on waste—and the hours we worked to pay for it—simply disappeared, we’d be better off by that much. He can’t argue both that economic growth is the best measure of technical progress and that the levels of growth that *have* occurred have too little to do with real productivity.

To be sure, Cowen does address the supposed diminishing returns of technological progress in terms of personal use-value. The blockbuster innovations with the biggest effect on our daily lives, he says, have already been adopted: antibiotics, automobiles, refrigerators, television, air conditioning. There’s been far less change in the character of daily life since 1960 than before. Aside from the Internet, recent innovations have been mostly incremental.

The Internet itself, Cowen argues, may be important in terms of personal happiness, but not of generating either revenue or employment. But to treat revenue generation and employment as ends in themselves—rather than a way to pay for stuff—is perverse. If the price of what we need falls because the amount of labor and capital needed to produce it falls, then we need less revenue—and less labor—for the same standard of living. The real significance of what Cowen mistakenly calls “stagnation” is that a growing share of our needs is being decoupled from revenue by technologies of abundance.

The reduced wage employment needed to produce our standard of living, as such, is a good thing. What's bad is when artificial property rights enable rentier classes to appropriate the benefits of increased productivity for themselves. Our goal should not be to increase the number of "full-time jobs," but to make sure that the productivity of the hours we do work is fully internalized.

Cowen focuses mainly on the Internet as part of the furniture of daily life—the fun of web surfing—to the neglect of a far more important benefit: the basic way society itself is organized, the relative power of the individual and networks versus large institutions, and the declining ability of hierarchies to enforce their will on us.

His focus on the objects of daily life ignores revolutionary changes in the way they're made and on the structure of the economy. There's not such a revolutionary change in going from picture tubes to gel panels, or from carburetors to fuel injectors. But there's an enormous difference between John Kenneth Galbraith's mass-production oligopoly economy and one of networked garage shops using cheap machine tools. **FEE**

Kevin Carson (free.market.anticapitalist@gmail.com) is a research fellow at the Center for a Stateless Society.

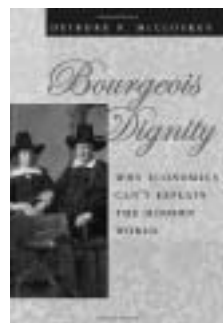
Bourgeois Dignity: Why Economics Can't Explain the Modern World

by Deirdre N. McCloskey

University of Chicago Press • 2010/2011 • 592 pages

\$35.00 hardcover; \$22.50 paperback

Reviewed by Sandra Peart



Deirdre McCloskey's second installment in her "bourgeois" series tackles the question in her subtitle: Why economists can't explain the modern world. She first reviews major explanations for modern economic growth (beginning with the Industrial Revolution) that have been floated in the work of other economic historians, including trade-as-an-engine, imperialism and slavery, commercialism, Darwinian struggles, and institutions. None of those quite gets it right, she argues.

The alternative McCloskey posits forms the core of her book. According to McCloskey, the association of "dignity" with commerce and commercial endeavors is the primary reason for the extraordinary economic growth that has occurred in the West since roughly 1800. That is to say, there was a general change in attitudes (beginning in Holland and England in the seventeenth century) toward business activities. Whereas they had been widely regarded as "undignified" before, people came to see commerce as not merely a tolerable occupation, but a dignified one. That change in attitudes was the catalyst that began the Industrial Revolution.

Just as Adam Smith wrote first about moral sentiments and the desire for well-deserved praise in 1759, before writing about the wealth of nations in 1776, so too in McCloskey's analysis: Dignity preceded and material wealth followed. It was not merely "discovery" and "creativity" (although those were important) that brought about the tremendous growth in production and trade, but discovery and creativity "supported by novel words—words that have nothing to do with utility maximization problems. What I am claiming here," she writes, "is that discovery and creativity depended also on other virtues, in particular on Courage and Hope." McCloskey tells a story of interrelated steps in which the bourgeois virtues, supported by "commercial Courage and Hope," disrupted old routines and gave rise to new inputs, new practices, and new goods and services. No other economic model explains the disruption and the magnitude of the wealth creation that followed.

Hers is an enormously optimistic telling, filled with rhetorically powerful examples and sweeping reminders about just how lucky we are. Notwithstanding the economic and financial turmoil of the past four years, which have led most recently to protests in New York City, the message is that we are rich—*really rich*—compared to our ancestors of only a short time ago. McCloskey writes, "What was different after 1800, and with unstoppable force after 1900, was a novel and immense and sustained, almost lunatic, regime of innovation, finally breaking the Malthusian curse." Economic well-being had remained approximately the same for centuries, and then, suddenly, unprecedented

economic growth occurred after 1800, raising incomes by a factor of “ten or sixteen or higher.”

McCloskey’s is a highly original account. Not only does she find a new and plausible explanation for hitherto unexplained economic growth, but she also reminds economists (and all of us who take an interest in levels of and improvements in human prosperity) that talk is important. It was free and unencumbered talk that elevated the dignity of commerce and caused the rush to modern levels of prosperity and well-being. The spillover effects were enormous, and they were more than strictly economic, including “commercial prudence and family love” as well as “an almost insane inventive courage fueled by hope.” Moreover, the working classes, “ancestors of all the rest of us,” came to “partake of the citizenly, bourgeois dignity of a vote, a house, a car, an education,” and became the “‘gentlemanly’ middle class.” In short we have enjoyed immense social and economic change because some people in northwestern Europe decided that those who engaged in commerce *were actually good people*.

McCloskey finishes her story with some important speculations. She asks the question that comes to mind as YouTube offers videos of the protesters in New York City and elsewhere who are disenchanted with bourgeois virtues and markets: Is it possible that “losing the ideology” of bourgeois dignity “can lose the modern world?” (McCloskey, incidentally, sees dangers to liberty on both sides of the political spectrum.) Her answer to staving off the attacks on free-market capitalism and bourgeois dignity lies in “a new, more idea-oriented economics, which would admit, for example, that language shapes an economy.”

That is well put. Some of us see economics as a set of ideas—new or old—that require attention and discussion before we can ascertain which ones deserve to survive. In this work, the second in a planned six-volume project, McCloskey continues her crusade for a new sort of economics, an economics that takes us back to Adam Smith’s preoccupations with approbation, generosity, and ethics. And the all-important: talk.

I strongly recommend *Bourgeois Dignity* and eagerly await McCloskey’s next volume. **FREE**

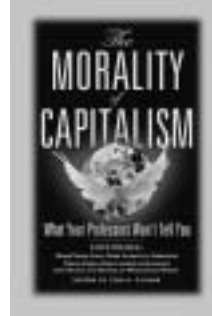
Sandra Peart (speart@richmond.edu) is dean of the Jepson School of Leadership Studies at the University of Richmond.

The Morality of Capitalism: What Your Professors Won't Tell You

edited by Tom G. Palmer

Jameson Books • 2011 • 129 pages • \$8.95

Reviewed by George C. Leef



During the numerous “Occupy” protests in 2011, many of the signs on display declared that capitalism was to blame for the nation’s ills. Obviously, the protesters had not read this book.

The Morality of Capitalism is aimed especially at young people who have gotten a negative impression of capitalism—as the subtitle accurately suggests, college students are likely to hear little that’s good or accurate about it in their courses—but even veterans of the battle for liberty will find a lot of fresh, intriguing material here.

As Tom Palmer emphasizes in his introduction, capitalism (by which he means the pure free market) “is a system of cultural, spiritual, and ethical values,” and the essays that follow show that those values can and do operate to improve the lives of people around the globe. The global aspect of the book is one of its most effective features. Readers learn from writers of extraordinarily diverse backgrounds that capitalism is what their countries lack and that its absence is the reason that their people remain poor and oppressed. Someone skeptical about arguments for capitalism presented by white American men might sit up and pay attention when, for example, they are made by an African woman.

June Arunga, a citizen of Kenya, argues in her essay, “Global Capitalism and Justice,” that free trade, far from harming the poor of Africa, has made them much better off. They enjoy higher incomes, better products, and easier lives because capitalism (to the extent that it is allowed) enables them to earn more and trade for better goods. She further observes that the coercive and corrupt governments in most African countries inhibit the expansion of capitalism. “Our own governments,” she writes, “are hurting us; they steal from us, they stop us from trading, and they keep the poor down. Local

investors are not allowed to compete because of the lack of the rule of law.” Too bad that June Arunga was not around to explain to those wealthy American protesters that laissez-faire capitalism is crucial to human flourishing.

In his essay Peruvian novelist (and Nobel Prize winner) Mario Vargas Llosa rebuts the idea, common among those who demonize capitalism, that it undermines indigenous cultures. He writes, “The allegations against globalization and in favor of cultural identity reveal a static conception of culture that has no historical basis. What cultures have ever remained static over time?” The fears expressed about capitalism leading to the Americanization of the planet are nothing more than “ideological paranoia.” Vargas Llosa shows that people are enriched in their standard of living and through the cultural exchanges capitalism makes possible.

Probably the most common complaint lodged against capitalism is that it is inconsistent with “social justice.” In his essay, David Kelley confronts that idea, arguing that both the “welfarist” and the “egalitarian” cases for overturning capitalism are ethical failures. He contends that Ayn Rand’s “trader principle” of peaceful exchange is the proper moral foundation for any society. That principle, of course, is only compatible with capitalism.

Most critics believe that capitalism is based on greed, but John Mackey, founder and CEO of Whole Foods Market, shows the charge is false. The wealth that his successful company has created, starting from nothing more than an idea and achieving a current market capitalization in excess of \$10 billion, does not just mean profits for stockholders. It also makes possible Mackey’s donations to the Whole Planet Foundation, which extends microloans to poor people around the world so that they can make capitalist investments of their own. The wealth created by capitalists is not confined just to themselves, but spreads in countless ways. Mackey also stresses that capitalism is “a healthier outlet for energy than militarism, political conflict, and wealth destruction.” Just think of the lives lost, property destroyed, and misery caused by the anticapitalist regimes of the twentieth century.

The big, inescapable lesson of the book is that advocates of capitalism have the moral high ground. Unfor-

tunately, they often cede it to their opponents, forcing advocates of capitalism to make defensive, “yes, but . . .” arguments. That is a terrible mistake. After reading this book, you will be well prepared to do battle with those who, as Ludwig von Mises put it, are imbued with “the anti-capitalist mentality.”

Palmer’s book is a project of the Atlas Economic Research Foundation. He and Atlas deserve three cheers (at least) for it and their continuing efforts at making the case for capitalism and liberty around the world. **FEE**

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

Red Plenty: Inside the Fifties’ Soviet Dream

by Francis Spufford

Graywolf Press • 2012 • 448 pages • \$16.00 paperback

Reviewed by Waldemar Ingdahl



Cultural historian Francis Spufford’s *Red Plenty* is a novel about the reform of the planned economy in the Soviet Union during the years of the Khrushchev thaw. It is one of the oddest books written about economics—a fictional approach peopled by computer researchers, planning bureaucrats, Communist Party apparatchiks, and factory managers. While fact and fiction in *Red Plenty* can initially be difficult for the reader to distinguish, the fictional parts breathe life into the economic reasoning. The author provides an extensive set of notes explaining the historical facts and also where his poetic license diverges from them.

Spufford’s vivid storytelling—the book is very intriguing historical fiction—explores this counterfactual: Could the Soviet Union’s planned economy have delivered plenty to its citizens as well as a market economy would? The idea of prosperity under communism certainly did not seem as preposterous in the late 1950s as it does today. The Soviets took the lead in the space race, and their official statistics showed an annual 5 percent growth in GDP, apparently higher than the United States’ at the time.

The Soviet economy was, despite those growth statistics, enormously ineffective, consuming far too much capital for little output. Communist Party leader Nikita Khrushchev was prepared to open up the economy to reforms and received new ideas from economist Leonid Kantorovich and computer engineer Sergey Lebedev. They are among the real people the reader encounters. Of course, their dialogues are imaginary, but they're also believable.

Their idea was to replace centrally determined production quotas with a pricing system based on opportunity costs. Linear programming, a mathematical method that could supposedly determine the optimal allocation of resources, would be used instead of bureaucratic output goals. The new, more powerful computers would perform all the necessary calculations. Kantorovich, incidentally, was the only Soviet to receive the Nobel Prize in economics.

But could it work? Readers of *The Freeman* will recognize here the arguments from the socialist calculation debate in the first half of the twentieth century. Economist Oskar Lange stated that prices are merely rates of exchange of one good for another. Whether they are provided by a central planner or by a market is irrelevant, he maintained, as long as managers of State enterprises were instructed to act as cost-minimizers. "Market socialism" would work. So said Lange's theory, anyway.

Reality caught up with theory in the Novocherkassk hunger riots in 1962, a key episode dramatized in the book. The introduction of a price mechanism also led to a reduction of food subsidies, and citizens suddenly were made aware of the true extent of their deprivations. The riots led to a coup that ousted Khrushchev; afterward, the conservative Leonid Brezhnev opted for stagnation of the economy and paying the bills by public debt and the export of oil.

Spufford's story shows why socialism (even "market socialism") is bound to fail. That great unpre-

dictable—human nature—will foil the best bureaucratic plans. Besides the food riots, central planning led to many other debacles Spufford includes, such as the environmental disaster of the Aral Sea (which dried up owing to the diversion of water for collective farms) and the demise of the Soviet computer industry (wiped out by a decree from the Ministry for Radio Production).

Reading *Red Plenty*, one has a hard time seeing how market socialism's practical shortcomings would not lead people to doubt the system's underlying ideas. That goes for the author too. Despite awareness of its failure, however, he still seems to be gripped by the fascination so many intellectuals have with Kantorovich's market socialism theory. Without going into detail, Spufford seems to imply that it could be done right, in spite of all the arguments and historical evidence he presents to the contrary.

Planned economies are mostly gone, but *Red Plenty* tells us a lot about the ideas behind the political steering and commandeering of resources in the 21st century, ideas that are still very much alive. Politicians may tolerate or even use market mechanisms, but only if those mechanisms achieve certain politically predetermined results. This is particularly visible in the subsidies for "green jobs" in Europe and the Solyndra scandal in the United States.

The last Soviet leader, Mikhail Gorbachev, put it right, saying, "The most puzzling development in politics during the last decade is the apparent determination of Western European leaders to re-create the Soviet Union in Western Europe." *Red Plenty* inadvertently gives an explanation for this lingering attachment. The free market threatens the power of the politicians by taking away their control over society. They cherish control, not plenty for the masses. FEE

Waldemar Ingdahl (waldemar.ingdahl@eudoxa.se) is director of Eudoxa, a liberal think tank in Stockholm, Sweden.



Tear Down These Walls

BY DAVID R. HENDERSON

Is there some action a government of India could take that would lead the Indian economy to grow like Indonesia's or Egypt's? If so, what, exactly? If not, what is it about the "nature of India" that makes it so? The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them, it is hard to think about anything else.

—Economist and Nobel Laureate Robert Lucas

Robert Lucas and I both have our obsessions when it comes to economic policy. His, as the quote indicates, is economic growth, while mine has lately become immigration policy. Interestingly, what Lucas and I obsess *about* is closely connected. If the rich countries of the world ended, or substantially relaxed, their immigration restrictions, the subsequent migration would cause world output to approximately double. To reach that doubling, most countries would necessarily experience a much higher growth rate. Relaxing immigration laws is the most pro-growth measure the rich countries' governments could take. Not only would it enhance well-being in the rich countries, but it would also be the most effective antipoverty measure any wealthy country's government could take.

My obsession began with my recent trip to Chiang Mai, Thailand, to visit my daughter and her boyfriend. Usually when I visit a relatively poor country, I enjoy the people, do fun things, and go home. I did all that of course and had a great time.

But in Thailand I noticed that something had switched for me. Rather than simply taking the situation as given, I imagined what the famous early-nine-

teenth-century economist Frédéric Bastiat called "the unseen." I met a lot of fine people in Thailand, mainly young Thais, and I imagined what life would be like for them if they were able to move to the United States, Japan, Germany, Canada, or any of a dozen or so richer countries. I pictured many of them moving to the United States and tripling their income within a short time by producing the Thai meals and massages that are priced so low in Chiang Mai. As an economist who has practiced my trade for almost 40 years, I have long understood the efficiency of resources going to those willing to pay the most for them.

I've always favored a huge relaxation of the U.S. government's restrictions on immigration. But in part due to my trip and mainly due to the influence of my co-blogger, Bryan Caplan, a passionate and articulate advocate of open borders, I now view immigration reform much more *urgently*.

There is copious evidence that people in poor countries—from engineers down to unskilled laborers—could earn three to ten times as much in the United States as they do in their home countries. If they were allowed to come to the United States, they would

clearly benefit themselves. So, for example, there are people near starvation in Sudan, Haiti, and Cambodia who in the United States would earn what many of us would regard as a pittance but many of them would regard as riches.

If the rich countries of the world ended, or substantially relaxed, their immigration restrictions, the subsequent migration would cause world output to approximately double.

David Henderson (drhenderson1950@gmail.com) is a research fellow with the Hoover Institution and an economics professor in the Graduate School of Business and Public Policy at the Naval Postgraduate School in Monterey, California. He is editor of The Concise Encyclopedia of Economics (Liberty Fund) and blogs at www.econlib.org.

So the urgency comes from the need to eliminate barriers that governments place in the way of extremely poor people rising out of poverty.

What upsets many Americans when they contemplate more immigrants is the loss of American income and jobs. Fortunately, that's a nonissue. The reason: gains from trade.

When an American buys a service from an immigrant, it is not just the immigrant who gains. The American gains too, or else he wouldn't have bought the service. Boston University economist Patricia Cortes, in a study published in the *Journal of Political Economy*, found that cities with larger influxes of low-skilled immigrants had lower prices for labor-intensive services such as dry cleaning, childcare, housework, and gardening. In a later study, Cortes and coauthor Jose Tessa found that these low-price services allowed Americans, especially women, to spend more hours working in high-skilled, high-paying jobs.

The gains from eliminating barriers to immigration are huge. In a recent article in the *Journal of Economic Perspectives*, economist Michael Clemens finds that getting rid of all immigration restrictions worldwide would approximately *double* world GDP.

Even people who understand the labor market, though, worry that high welfare benefits will attract immigrants to the United States. I admit that I have shared this worry. But the evidence strikingly refutes this piece of conventional wisdom. In a recent *Cato Journal* article, former Cato Institute economist Dan Griswold points out that in 2010, foreign-born adult residents of the United States had a *higher* labor-force participation rate (67.9 percent) than native-born Americans (64.1 percent.) Moreover, he noted, in 2009 the ten states with the largest-percentage increase in foreign-born population in the previous nine years spent far less on government assistance per capita than the ten with the slowest-growing foreign-born popula-

tions: \$35 versus \$166. How big was the difference in growth rates of the immigrant population during those years? In the states with the lowest per capita spending on government assistance, the immigrant population grew 31 percent versus only 13 percent in the states with the highest per capita government assistance. So much for the welfare-magnet problem.

What about the danger that immigrants would vote away the system that attracted them to the United States in the first place? There's an easy fix: Instead of having the current requirement that an immigrant be a permanent resident for at least five years before becoming a citizen, raise the minimum residency requirement to 20 years.

Immigration reform would dwarf any other measure economists have considered to help people in poor countries. Take microcredit, the lending of small amounts to small businesses. In his recent book, *Borderless Economics*, Robert Guest notes Harvard University economist Lant Pritchett's observation that the average gain from a lifetime of microcredit in Bangladesh, such as that provided by Nobel Peace Prize winner Mohammed Yunus's Grameen Bank, is about the same as the gain

The average gain from a lifetime of microcredit in Bangladesh is about the same as the gain from eight weeks working in the United States.

from *eight weeks* working in the United States. Asks Pritchett, "If I get 3,000 Bangladeshi workers into the US, do I get the Nobel Peace Prize?"

Let's say that I fail to convince Americans that the U.S. government should eliminate immigration barriers. Okay. Then how about tripling or quadrupling the number of immigrants allowed? Pritchett found that if rich countries allowed just a 3 percent increase in their labor forces through immigration, the world's have-nots would benefit by \$300 billion a year, and the residents of the rich countries would benefit by \$51 billion a year. I think Americans would be surprised, mainly pleasantly, by how much more vibrant an already vibrant United States would become with three or four times the current annual number of immigrants. **FEE**