THE FREEMAN
IDEAS ON LIBERTY

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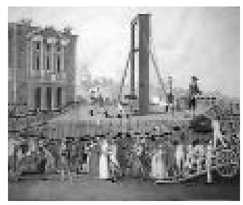

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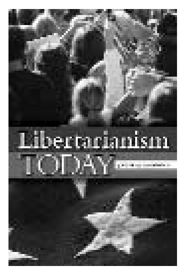

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Perspective

Progressive Intolerance

Television pundits increasingly express an attitude that is at once arrogant and ignorant: The people who oppose Keynesian economics—specifically an increase in government deficit spending to create jobs and jumpstart the economy—are the same kind of people who also believe that the earth is only several thousand years old (rather than 4.5 billion), that evolution is bunk, and that science is something to be feared. MSNBC's Chris Matthews takes the strongest version of this position.

TV hosts of course are not authorities on economics, so when they judge Keynesianism as the only truly scientific economics, they mean two things: That is what a Keynesian taught them in school and that is what all their Keynesian friend-guests assure them is the case. Since they never invite a non-Keynesian economist on their shows, they insulate themselves against informed dissent from their faith. Who's antiscience?

I know many people who (like me) reject Keynesian economics and embrace science (while realizing that scientists are prone like the rest of us to confirmation bias and career ambitions.) But Matthews & Co. say there are no such people.

This explains their intolerance to those who refuse to agree that in a recession government spending is indispensable to raising aggregate demand and restoring economic growth.

If you point out that every dollar government spends, whether taxed or borrowed, is a dollar removed from the private sector, the Keynesian pundit might agree but point out that business is not investing (true) and consumers are not spending (false)—so what's lost?

The pundits' blinders keep them from a broader perspective. Since all they know is the most vulgar rendition of Keynesian economics, they have no idea that two distinct factors now prevent economic growth. First, the boom (without which there's no bust) was created by monetary, housing, and financial policies that to a great extent still exist. Government officials are trying to resurrect the housing industry, indicating that the ruling elite still does not realize that the industry's pre-bust condition was the artificial result of misguided interventions. Widespread malinvestments—investments unjustified by real underlying conditions—have to be liquidated before economic growth can resume. Liquidation requires the costly but necessary adaptation and transfer of resources and labor to purposes for which there is genuine demand. This correction cannot take place if political responses to the recession get in the way by, say, discouraging saving.

Second, the government has created significant new regulatory uncertainties that chill the investment climate. With so many yet-to-be-written rules coming down the pike, why would anyone risk money now? A government regulatory regime is bad enough; one that can change at any moment is far worse.

Finally, the pundits are blind to the fact that *government can't create real jobs* by design. It's not that government can't pay people to do things. But in economic terms, a job is not merely exertion in return for a paycheck. It's activity that transforms resources from a less valued form to a more valued form in the eyes of consumers.

Keynesian pundits insist that a stimulus program to pay workers billions of dollars to repair schools, roads, and bridges *would* qualify as productive because people value those things. What's missed is that we live in a world of scarcity and tradeoffs, and that we always make choices at the margin. Repairing a school may sound good in a vacuum (Which school? How elaborate a repair?), but not so good when something more valuable must be given up in exchange.

We all make similar tradeoffs in the marketplace, and we can do so intelligently because goods and services have prices. But government-produced goods and services are not priced and sold in the market. Instead, government collects its revenues by threat of force, and politicians and bureaucrats dispose of them ostensibly in the interest of the people but more likely in the career interest of those same politicians and bureaucrats. Without prices and free exchange—without *entrepreneurship*—we cannot know if what government produces is worth the alternative goods and services forgone. Putting the infrastructure into the freed market would correct this defect.

The Keynesian pundits, then, are wrong. The government need *not* be the spender of last resort because 1) producers and consumers would spend just fine if it would get out of their way, and 2) the government can't be relied on to create, rather than destroy, value in its use of scarce resources.

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In a move reminiscent of medieval times, the government of Atlanta has told independent street vendors they now owe tribute to a new monopoly contractor. Bob Ewing describes this outrage against economic freedom.

"Infrastructure" is the magic word for those who want the government to spend ever-more amounts of the taxpayers' money. Richard Fulmer reminds them that this is no substitute for a free economy.

The American people continue to be plagued by unemployment. What is it exactly, and where does it come from? Warren Gibson starts a two-part series this month.

People favoring a tax-hike strategy for reducing the federal deficit point to the booming Clinton years for support. Arthur Foulkes takes a closer look at those years.

Russell Conwell was well known in the late nineteenth century for his inspirational speeches about entrepreneurship and self-help. Today he's forgotten, but Harold Jones, Jr., is trying to change that.

Fed Chairman Ben Bernanke promises to continue his near-zero-interest-rate policy for another two years. But Christopher Lingle says that would be a disaster.

Failure can be painful, but not as painful as what results from a public policy aimed at preventing failure. Jack Knych and Steven Horwitz explain.

Communitarian sociologist Amatai Etzioni has been railing against libertarianism for at least 30 years but refuses to respond to rebuttals. Aeon Skoble gives him one more chance.

Our columnists have had fun coming up with topics for their sharp observations. Lawrence Reed remembers Samuel Tilden. Donald Boudreaux finds fault with economists. Stephen Davies uses debt and taxes to gauge political failure. John Stossel looks at some historical myths. David Henderson traces the causes of the 1967 Detroit riot. And Tyler Watts, reading Paul Krugman's appeal for more government spending because it will create jobs, responds, "It Just Ain't So!"

Our book reviewers have been absorbed in works about the financial crisis, a champion of the freedom philosophy, libertarianism, and capitalism.

—*Sheldon Richman*
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Missing Samuel Tilden

BY LAWRENCE W. REED

If you're under 50 you probably don't remember when telephone "numbers" weren't all numbers. From the 1920s until the mid-1960s most phone "numbers" began with two letters corresponding to certain digits on a common telephone dial. KL7-1234, for example, was read as "Klondike 7-1234."

My family's number was TI3-8597. The letters were meant to honor a man I never knew of or appreciated until long after the switch to all digits—Samuel J. Tilden. He deserves to be much better remembered as something other than part of a defunct phone number. A strong case can be made that he was, as the subtitle of a recent book by screenwriter Nikki Oldaker suggests, "The Real 19th President."

Tilden was born nearly two centuries ago on February 9, 1814, in New Lebanon, New York. After studies at Yale and New York University, he became a successful lawyer, a shrewd investor, a wealthy man, and a promising politician in the Democratic Party. A crusader against the corruption of the infamous Tammany Hall political machine in New York City, Tilden was catapulted from the New York state assembly to the governorship in 1874. From that perch he quickly earned a national following and gained the Democratic Party's nomination for president in 1876.

No Democrat had occupied the White House since James Buchanan passed the office to Abraham Lincoln in 1861. Fifteen years later the country was ready for a change. Tilden comfortably beat Ohio Republican Rutherford B. Hayes in the popular vote, 51 to 47.9 percent, but a nasty political battle resulted in a dubious deal. Behind closed doors Hayes was awarded enough disputed votes in the Electoral College to edge Tilden there by one vote. In exchange the Republicans agreed to withdraw federal troops from the South and end Reconstruction. Tilden remains one of only four presidential candidates in U.S. history to win the popular vote but lose the Electoral tally—the others being Andrew Jackson (1824), Grover Cleveland (1888), and Al Gore (2000).

Tilden was known for assessing policy options according to right and wrong versus the typical political (and Machiavellian) rule of what can get you elected and reelected. "Successful wrong never appears so triumphant as on the very eve of its fall," he once said. "We must believe in the right and in the future. A great and noble nation will not sever its political from its moral life."

> Tilden just might have shined as one of our best presidents.

Hayes turned out to be a clean and decent one-term president, but Tilden just might have shined as one of our best. I've come to admire him because he was rigorously committed to all the right things: limited government, sound money, free trade, and low taxes—which is to say that he'd have a hard time getting to first base today, particularly within his own party. Most 21st-century libertarians would be very comfortable with the 1876 Democratic Party platform on which Tilden ran.

Money. The big money questions of the 1870s were 1) what to do with the hundreds of millions of paper dollars ("greenbacks") issued during the Civil War; and 2) whether to subsidize and re-monetize silver as a means of inflating the currency. Tilden and the Democrats were the country's leading advocates of fulfilling the original promise to redeem greenbacks in gold and in opposing subsidies for silver. As advocates of sound money they had no interest in monetary expansion to goose the economy and help debtors because they believed it was fundamentally dishonest.

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"Reform is necessary," asserted the Tilden platform, "to establish a sound currency, restore the public credit, and maintain the national honor. We denounce the failure for all these eleven years of peace to make good the promise of the legal tender notes (the greenbacks), which are a changing standard of value in the hands of the people, and the non-payment of which is a disregard of the plighted faith of the nation." Taking direct aim at the Republicans, it went on to declare: "We denounce the financial imbecility and immorality of that party which . . . has made no advance towards resumption—no preparation for resumption—but instead has obstructed resumption by wasting our resources and exhausting all our surplus income."

Tariffs: Taxes on imported goods were the primary source of federal revenue for most of the nineteenth century. Since Lincoln, the Republican Party stood for high tariffs not just for the revenue but also for the "protection" of domestic industries. The free-trade Democrats saw protectionism for what it really is: an attack on consumers for the benefit of producers with political connections. The Tilden platform's critique of it is as relevant today as it was in 1876:

> We denounce the present tariff, levied upon nearly four thousand articles, as a masterpiece of injustice, inequality, and false pretence. It yields a dwindling, not a yearly rising, revenue. It has impoverished many industries to subsidize a few. It prohibits imports that might purchase the products of American labor. It has degraded American commerce from the first to an inferior rank on the high seas. It has cut down the sales of American manufactures at home and abroad, and depleted the returns of American agriculture—an industry followed by half our people. It costs the people five times more than it produces to the treasury, obstructs the processes of production, and wastes the fruits of labor. It promotes fraud, fosters smuggling, enriches dishonest officials, and bankrupts honest merchants. We demand that all custom-house taxation shall be *only* for revenue.

Government spending: Virtual one-party (Republican) dominance since 1865 had produced huge increases in federal expenditures, largely for pork-barrel projects. Tilden denounced the spending explosion, and his people inserted strong language against it in the 1876 platform: "Since the peace, the people have paid to their tax-gatherers more than thrice the sum of the national debt, and more than twice that sum for the federal government alone. We demand a rigorous frugality in every department, and from every officer of the government." The Tilden Democrats were squarely in the tradition of their Jefferson-Jackson forebears and light-years apart from their Democratic descendants of today. It was a tradition that would continue through the last great Democratic president, Grover Cleveland, only to be thoroughly forsaken by the next (and arguably the worst) Democratic president, Woodrow Wilson.

> On many vital issues of the day Tilden and the Democrats staked out the moral high ground.

On many other vital issues of the day Tilden and the Democrats staked out the moral high ground. They opposed an imperialistic foreign policy and favored Civil Service reform to minimize political patronage and corruption. Because they respected the rights and sovereignty of free individuals, they fought against sumptuary laws to regulate personal behavior. They denounced the use of government power to advantage one group over another. And they pushed to treat the southern states once again as equal partners in the Union.

Today dozens of streets, townships, libraries, and schools from Wichita Falls, Texas, to Washington, D.C., bear the Tilden name. A statue of him and his home, both in New York City, still stand. But otherwise, sadly, the memory of this man who stood for liberty and should have been president is fading as surely as my old phone number. FEE

More Government Action Needed for Job Recovery? It Just Ain't So!

BY TYLER WATTS

Would it come as a shock to hear one of the best-known apologists for government intervention in the economy admitting that it hasn't worked (so far)? This is exactly what Nobel Prize-winning economist and uber-Keynesian Paul Krugman does in a *New York Times* column, stating, "[W]e are not now and have never been on the road to recovery" ("The Wrong Worries," August 4, tinyurl.com/3jnruye).

That's right: Despite record federal spending and unprecedented Federal Reserve intervention, the economy remains depressed. Beyond stating the obvious about the nonrecovery Krugman frets about the long-term implications of the stubbornly sour labor market. He also notes that consumers are "still burdened by the debt that they ran up during the housing bubble," which, to my Hayek-schooled mind, sounds an awful lot like the drawn-out bust phase of a credit-fueled business cycle.

Rather than concluding that deficit spending and printing money are the wrong cures for what ails us, Krugman complains that government is not doing enough. Citing the tea-party Republicans' "deficit obsession," Krugman complains that government has been "pulling back [rather than] supporting the economy in its time of need." He also cites lassitude at the Fed, claiming it's been "intimidated by the Ron Paul types" into overreacting against potential inflation. Krugman argues the federal government should be doing much more, and its top priority should be creating jobs, not reducing the deficit.

While Krugman avoids the specifics of what such grandiose federal jobs programs would entail, he's on the record supporting massive New Deal-style public-works spending, which would employ "armies of government workers." Krugman also favors more monetary stimulus by the Fed to boost spending throughout the economy. In brief Krugman is saying we have not yet begun to fight the Keynesian battle of stimulus on either the monetary or fiscal fronts.

Let's review the figures. Since September 2008 the Fed has more than tripled its balance sheet, printing roughly $2 trillion in new bank reserves, monetizing around $900 billion of U.S. government debt, and lending over $3 trillion to U.S. and foreign banks. As for federal spending—the real growth engine, in Krugman's mind—it increased by 40 percent (29 percent in real terms) from 2007 to 2011 to a record $3.8 trillion, with half that increase coming in the recession year 2009 alone. "Stimulus" spending by itself has amounted to $666 billion so far, and federal bailouts have racked up at least $150 billion in taxpayer costs. Since 2007 gross public debt has increased from 64 to 103 percent of GDP.

And Krugman's argument again? Government is not printing and spending enough. This fetish for unlimited spending juxtaposes strangely against a backdrop of perhaps the most fiscally profligate decade of American history, but I'll give Krugman credit for boldness. However, the figures themselves, shocking as they are, mask the real question: Can more government spending actually encourage productive employment that promotes overall economic welfare?

Stimulus enthusiasts like Krugman are sure it can. And their first big task for the new labor armies is to go

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forth and fix America's broken infrastructure. Haven't you heard? America's roads, bridges, sewers, airports, and more are in total disrepair—so says the infrastructure lobby. But these folks—an assortment of large construction, manufacturing, and transport companies, and their unions—have been carping about infrastructure being underfunded for the last 30 years. No surprise here: like any special-interest group, they want a continued and enlarged flow of federal funding. Hence my Public Choice nerves twitch at every mention of "crumbling infrastructure."

But let's concede that they're right: that our infrastructure is in a sad state and more federal spending would be a wise investment. Using the infrastructure lobby's figure of 18,000 new jobs for every $1 billion in government spending, doubling federal infrastructure spending would reduce the unemployment rate to 8.3 percent. And this ignores the matter of timing, as infrastructure projects require years of planning and regulatory hurdle-jumping before they're "shovel-ready." Nonetheless, even the most unrealistically generous assumptions about infrastructure spending indicate that if you want to get the economy back to full employment, it's going to take a lot more than just public works.

The government exists within the U.S. economy, not apart from it.

But stepping back from labor army fantasies, there's something absurd about using infrastructure "investment" as a jobs program. To the extent that federal funding of infrastructure is economically advisable, "good government" would require minimum expenditure (read: minimum employment), lest said public works turn into a black hole of rent-seeking—public spending to enrich private interests.

Infrastructure spending is not immune to the institutional inefficiencies that beset all government programs. But questioning the value and efficiency of public works is only half the matter. Call me a conservative stick in the mud, but the little question of how the government is going to pay for all this largess strikes me as relevant these days.

Krugman of course sees no problem here. He is on record favoring larger deficits, seeing historically low interest rates as a go-ahead for even more federal borrowing. Oddly enough, others in the economy, such as Standard & Poor's, see a quite large problem with continuing government debt growth. It's called insolvency: If you have too much debt and you can never pay it off, bad consequences ensue. (I wonder if Krugman would advise a family with $325,000 in credit card debt on an income of $50,000 a year to go ahead and open up a new credit card account simply because it came with a 0 percent teaser rate?) While Krugman, with his stale brand of vulgar Keynesianism, appears increasingly oblivious to it, other recent events have revealed in stark fashion what our real economic problem is—excessive government debt, a direct consequence of excessive government spending.

The fixation on ever-bigger government stimulus programs to "fix the economy" reveals the basic fallacy with Krugman and the Keynesians. They view "the economy" and "the government" as distinct entities—as if poor little Johnny Economy would be just fine if only rich, stingy old Uncle Sam would open up his wallet and give Johnny a job! The reality is that the economy is us—the government exists within the U.S. economy, not apart from it. To "support" the economy the government must take resources from the very same economy. This can only confer a net increase in productive activity if government bureaucrats and politicians a) are truly benevolent, suppressing their representation of private interests in favor of "the general welfare" and b) know better than individual entrepreneurs throughout the country how to wisely invest scarce resources.

Since the days of Hume and Smith, economists have rightfully heaped skepticism on such assumptions. Politicians and bureaucrats are neither angelic nor omniscient; simply increasing their ability to print and spend is not a formula for prosperity. The fact that the United States is currently suffering the lingering effects of a complex recession and government debt crisis does not change these lessons, but confirms them. To adapt a phrase from a president who understood this (even if he couldn't quite enact it): In our present crisis government spending is not the solution to the problem; government spending is the problem. FEE

The Battle to Save American Street Vending

BY BOB EWING

Larry Miller and Stanley Hambrick are classic American entrepreneurs. Both men started their businesses from scratch, and for more than 20 years they've been living their American Dreams.

They each own and operate popular vending stands outside Turner Field in Atlanta, serving baseball fans with tasty snacks, fully licensed Braves merchandise, parody shirts, and other goodies at steep discounts. They pay all the required and varied taxes on sales and business to city and state officials.

Little did they know that in July 2011 they would find themselves at the center of a major effort to vindicate the rights of street vendors nationwide (tinyurl.com/3spvmyl).

Street vending has long allowed entrepreneurs to provide for themselves and their families while satisfying customer demands and creating jobs. Together Miller and Hambrick employ about a dozen people. They see vending not merely as work but as a way of life. As Miller puts it: "I've been able to develop a lifestyle around vending. I've been able to purchase me a home and raise children and grandchildren."

Hambrick takes pride that his business provides jobs, supports his entire family, and pays for his children's education: "I employ six people, and they are depending on me, and I'm depending on them now. I've been able to put my kids through college working here and being successful."

But a new law on the books in Atlanta is about to destroy both of these businesses, along with untold others throughout the city.

Unprecedented Monopoly

Vending is thousands of years old and has thrived in America since the 1600s. By 2007 street-vending businesses throughout the country generated revenues in excess of $40 billion. Vendors in Atlanta alone brought nearly $250 million to their local economy.

The recession in 2008 tightened consumer wallets and forced many out of work, which led to a street-vending boom. And, sure enough, new regulations followed.

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In 2009 Atlanta officials decided to create a citywide vending monopoly. The city signed off on a deal that hands over all vending on public property to a single multibillion-dollar corporation.

Atlanta Mayor Shirley Franklin signed an exclusive 20-year contract with a Chicago-based shopping-mall management company, General Growth Properties (GGP). While governments have long meddled with street vendors, this was the first time in American history that a city gave one company the "exclusive right to occupy and use all public property vending sites . . . including without limitation those vending sites currently occupied by public property vendors."

The GGP contract calls for the construction of vending kiosks around Atlanta. As the kiosks are built the existing vendors are forced to move out or else start paying up to $20,000 annually in rent and fees to work out of a cramped GGP kiosk. Vendors used to paying $250 a year for their vending site must now hand over $500 to $1,600 *every month* for the privilege of working for the monopoly. This makes it all but impossible for most Atlanta vendors to stay in business.

> This was the first time in American history that a city gave one company the "exclusive right to occupy and use all public property vending sites."

This is not the first time Atlanta legislation has had the effect of destroying vending businesses. When Atlanta hosted the Olympics in 1996 then-mayor Bill Campbell gave a personal associate the right to sublease out vending spots throughout the city. Thousands of vendors were pushed away, and many lost their businesses and life savings.

The GGP kiosks now popping up in Atlanta are designed for advertising rather than selling merchandise. They are covered with ads on three sides, limiting visibility and function while making it difficult to attract and interact with customers.

Further, the new Atlanta law absurdly requires GGP to prohibit their vendors from competing with nearby bricks-and-mortar businesses. The contract stipulates that GGP lessees may only sell products that "complement and not compete with existing 'bricks-and-mortar' retailers in the areas of the vending units."

The transition to kiosks is occurring in several phases. As soon as the first phase went up numerous vendors were forced into unemployment. The second phase includes the area around Turner Field, with construction scheduled to begin toward the end of this baseball season. Once phase two is implemented, Miller's and Hambrick's businesses will almost assuredly be destroyed.

On July 15 Miller came to work to find a spray-painted outline of a kiosk on the ground next to his vending location. At a press conference two weeks later he pointed to the outline and lamented, "That might as well be my coffin."

Trouble in Texas

Unfortunately, Atlanta vendors are not alone. Consider Yvonne Castenada.

Castenada is a proud Texan. Born and raised in El Paso, she created a successful vending business that provides for her daughter and injured husband. Castenada is a food vendor. By 5 o'clock in the morning she is already up and getting her food ready for the day. She cooks her popular burritos in a nearby commercial kitchen, loads them into warming trays in her food truck, and sets out into the El Paso streets to serve her customers.

Her business was thriving until city officials passed a law that turned El Paso into a no-vending zone—for the sole purpose of protecting bricks-and-mortar restaurants from competition.

The protectionist regulations made it illegal for mobile food vendors like Castenada to operate within a thousand feet of any restaurant, convenience store, or grocer. The city even prohibited vendors from parking to await customers, forcing vendors instead to constantly drive around the city until a customer flagged them down. Once the customer was served, the vendors had to leave immediately.

Vendors caught violating the new law faced thousands of dollars in fines.

City officials harassed and cited Castenada on multiple occasions. She said, "It has gotten to the point where I'm concerned about being able to pay my bills. I find myself constantly looking over my shoulder just because I might be too close to a restaurant."

A spokesperson for the El Paso Restaurant Association admitted in an interview by the local ABC affiliate that the law is purely protectionist: "We wanted this ordinance in place to help established restaurants keep their business."

Even the city's health inspector admitted before the El Paso city council that the law was put in place "to address concerns of the fixed food establishment. . . . [T]here's not a health reason or a Texas food rule that I can find that justifies that."

A National Problem, A Nationwide Initiative

In November 2010 *The Economist* wrote that "thanks to Twitter and the tough economy, some of the best food Americans eat may come from a food truck." Predicting that the recessionary street-vending boom would lead to "the biggest shift in America's culinary landscape in 2011," the magazine noted that new regulations were popping up in several cities, and in others there was pressure to ease restrictions so vending could flourish.

Atlanta decided to give Larry Miller's 20-year-old vending business to a multibillion-dollar corporation.
Photo courtesy Institute for Justice

A new national report released by the Institute for Justice (IJ), *Streets of Dreams* (tinyurl.com/3otbycj), evaluated the vending regulations in the 50 biggest cities in the United States. The results were disturbing. For instance:

- 33 cities have established no-vending zones, which often include potentially lucrative areas such as downtown or areas near sporting venues.
- 20 cities ban vendors from setting up near bricks-and-mortar businesses that sell the same or similar goods.
- 19 cities prohibit mobile vendors from staying in one spot, forcing them to spend much of their day moving instead of selling.
- 5 cities prevent mobile vendors from stopping and parking unless flagged by a customer.

In January IJ launched its National Street Vending Initiative, creating a nationwide litigation and activism effort aimed at vindicating the right of street vendors to earn an honest living. The first targets were El Paso and Atlanta.

"I'm fighting for my American Dream."

Thankfully, Castenada refused to let her competitors and their friends in government run her out of El Paso. Instead, in January she teamed up with other vendors and the Institute for Justice in a major federal lawsuit against the city. They argued that the vending regulations were anticompetitive and unconstitutional on the grounds that they violated the economic liberty of El Paso vendors.

And just weeks after the suit was filed, the city backed down and repealed its protectionist regulations.

Miller and Hambrick joined the vending initiative in July. Together with IJ they announced a lawsuit challenging Atlanta's vending monopoly. The *Wall Street Journal* editorialized that "the Atlanta case is one more example of the way that governments tend to collude with private interests to benefit the powerful. We hope Atlanta's new law is tossed out in court, so vendors like Messrs. Miller and Hambrick can get back to business."

Hambrick clarified why he brought the lawsuit: "I'm fighting for my American Dream. And I'm fighting for the rights of other vendors and small businesses."

Indeed, a victory by Miller and Hambrick could have national implications. A ruling in their favor would set a precedent for future challenges to restrictive vending laws in cities across the country.

Momentum is building. On August 17 vendors in Chicago joined forces with area law students and the IJ Clinic on Entrepreneurship in a grassroots street-vending campaign. The city has recently taken to ticketing and even arresting vendors simply for serving their customers. Regulations currently prohibit vendors from working within 200 feet of bricks-and-mortar restaurants. It's also illegal for vendors to put toppings on a hot dog from their cart or serve any food before 10 a.m. The grassroots campaign seeks to overturn these needlessly restrictive regulations.

For vendors and other Americans to fully enjoy their right to earn a living, the courts must decide that protectionism is not a constitutional exercise of government power.

Judicial Engagement

Importantly, such vending laws exist throughout the country today because the courts fail to protect economic liberty. In the name of "judicial deference" judges have largely abdicated their responsibility to protect this right and enforce limits on government power. Without meaningful judicial supervision, laws favoring special interests have proliferated to an almost unimaginable extent.

For instance, IJ challenged a blatantly protectionist law in Louisiana that made it illegal to arrange and sell flowers without first obtaining permission from the government—the only law of its kind in the country. Aspiring florists were forced to pass a subjective licensing exam . . . that was graded by existing florists! Remarkably, a court upheld the law on the grounds that it was theoretically possible that without a flower cartel the public could be harmed by "infected dirt."

Unless judges are engaged—taking our rights and the facts before them seriously—such abuses are inevitable. For vendors and other Americans to fully enjoy their right to earn a living, the courts must decide that protectionism is not a constitutional exercise of government power. Currently the federal circuit courts are split on this issue.

For their part, Miller and Hambrick are ready to fight all the way to the Supreme Court if that's what it takes to vindicate the right to earn a living for entrepreneurs nationwide. FEE

The Infrastructure Delusion: Getting Nowhere Faster

BY RICHARD W. FULMER

Infrastructure does not an economy make. Highways and railroads, airports and seaports, communications towers and fiber-optic cables are essential for the flow of commerce, but it is the people, goods, and information moving over and through this infrastructure that are the heart of an economy. Overinvestment in roads, bridges, and airports means underinvestment in the productive base that is an economy's life blood. Government spending means more than just an outlay of dollars; it means consuming scarce resources that cannot then be used for other things. Such spending does not increase production; it simply shifts resources into areas where they would not otherwise have gone.

Infrastructure spending does not increase production; it simply shifts resources into areas where they would not otherwise have gone.

As described in William J. Bernstein's book *The Birth of Plenty: How the Prosperity of the Modern World Was Created*, France's minister of finances under Louis XIV from 1665 to 1683, Jean-Baptiste Colbert, worked tirelessly to expand commerce by improving his country's roads and canals. Unfortunately, trade was hindered by more than potholes—a complex system of internal tariffs was throttling commerce. Colbert tried to dismantle the tariffs but was only partially successful. After his death, "all fiscal restraint was lost. By the end of Louis XIV's reign three decades later, the State had doubled the tolls on the roads and rivers it controlled, and the nation that had once been Europe's breadbasket . . . was bled white. . . ." Bad regulations trumped good roads.

During the Great Depression Franklin Roosevelt initiated massive public-works programs to improve the nation's infrastructure in hopes of putting people back to work and jump-starting the economy. The construction efforts were staggering. According to Conrad Black:

> The government hired about 60 percent of the unemployed in public-works and conservation projects that planted a billion trees, saved the whooping crane, modernized rural America, and built such diverse projects as the Cathedral of Learning in Pittsburgh, the Montana state capitol, much of the Chicago lakefront, New York City's Lincoln Tunnel and Triborough Bridge, the Tennessee Valley Authority, and the heroic aircraft carriers Enterprise and Yorktown. They also built or renovated 2,500 hospitals, 45,000 schools, 13,000 parks and playgrounds, 7,800 bridges, 700,000 miles of roads, and a thousand airfields.

Yet these extraordinary accomplishments were not enough to pull the nation out of the Depression. Neither were the millions of jobs generated by this monumental work.

At the same time as he was directing resources away from the private sector, Roosevelt also unleashed upon it a regulatory blizzard that significantly increased the risk of doing business. Higher personal, corporate, excise, and estate taxes; wage and price controls; pro-

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duction restrictions; antitrust lawsuits; and constant experimentation provided few incentives for companies to expand. As in Louis XIV's France, an improved infrastructure could not revive commerce in the face of stifling government regulations.

Enough Roads; Too Many Roadblocks

Today President Barack Obama is touting high-speed rail and other infrastructure improvements as keys to economic renewal. But if massive infrastructure investments were not enough to turn the economy around in the 1930s, they are far less likely to do so today. Because Roosevelt was starting from a lower base his improvements would have had a far greater impact on the economy of his day than would similar work done now. Also, the lighter regulatory burden in the 1930s meant there were projects then that truly were "shovel-ready." Today environmental impact studies, possible archeological finds, and nuisance lawsuits may stall construction for years or halt it completely.

The real roadblock to economic growth is the burgeoning regulatory burden that President Obama, like Roosevelt before him, has placed on business. According to a study by James Gattuso and Diane Katz, "[T]he Obama Administration imposed 75 new major regulations from January 2009 to mid-FY 2011, with annual costs of $38 billion." Hundreds of additional regulations will pour forth from Obamacare, Dodd-Frank, and proposed EPA greenhouse gas restrictions. All this on top of an already monumental regulatory burden imposed by government. A Small Business Administration report estimates the cost of regulatory compliance at over $1.75 trillion in 2008 alone.

Briefly, our current economic woes were triggered by the collapse of a housing bubble, produced by loose monetary policy together with federal pressure on mortgage companies to lend to bad credit risks. When the bubble burst, housing prices fell, causing many homeowners to default on their mortgages. Investment vehicles based on those mortgages lost much of their value, leading to huge investor losses and the failure of some major financial institutions.

Lost in Transition

Absent government interference industry would retool, shifting capital and labor out of home construction and into other areas. Because neither capital nor labor is homogeneous, this shift takes time. Equipment that can be put to other uses may have to be sold or physically moved. Other equipment may have to be modified or scrapped altogether. Workers may need to increase their market value by relocating or by gaining new knowledge and skills. In a recession consumers typically reduce spending and increase savings, thus freeing up the resources needed to complete the shift.

Keynesian programs to put malinvested capital back to work only hinder the needed transition.

Keynesian economists, however, see both labor and capital as homogeneous, aggregated lumps. Where Austrians see capital in transition Keynesians see "idle capital." Keynesian programs to put that capital back to work only hinder or halt the needed transition, either leaving capital in its malinvested state or forcing it into the very idleness they seek to remedy. For example, expanding credit may re-inflate the collapsed bubble for a time, leading industry to continue producing unneeded goods. Stimulus spending—whether for infrastructure or other things on the government's wish list—transfers scarce resources from industry to government, further impeding the transition. New laws, enacted to prevent future recessions, make businesses reluctant to invest until the associated regulatory structures are defined—a process that can take years. Once in place the regulations may inhibit capital flow, locking inefficiencies and malinvestment in place and propping up companies that should be allowed to fail. Unemployment insurance and other such programs eliminate or at least reduce workers' incentives to move or reeducate themselves.

The country's problems are not the fault of inadequate highways. They are the result of government intervention: loose monetary policies, programs that encourage unsustainable debt, explicit and implicit guarantees to financial institutions, massive spending that crowds out private investment, oppressive regulations, higher taxes with constant threats of more to come, and political payoffs to "friendly" companies and unions. Building high-speed railroads will not stop the malign effects of these policies; the solution is to stop the policies.

Goods, people, and information will not flow freely across a nation, regardless of the quality and extent of its infrastructure, if taxes and regulations block their flow. Trade perished in France as Colbert's improved roads and canals were made all but useless by high internal tariffs. Hundreds of thousands of miles of new and rebuilt roads were not enough to move commerce past the regulatory roadblocks that Roosevelt erected. President Obama's proposed high-speed trains—indeed, his latest nearly half-trillion-dollar jobs program—will not pull the country over the mountain of regulations that has been created in the decades since the Great Depression and that Obama has raised to new heights. FEE

Dangerous Political Naifs

BY DONALD J. BOUDREAUX

Being well past the age of 50 and having spent nearly all my adult life as an academic economist, I seize the privilege of doing what so many other economists of my age and rank do—namely, offer unsolicited speculations about what is right and what is wrong with modern economics.

First, something that is right.

With one major exception (discussed below), the typical economist, when doing economics (and regardless of political bent), doggedly avoids *ad hominem* explanations. That is, economists don't explain observed reality as resulting from specific human personalities or personality traits. Instead, economists (try to) identify the constraints and opportunities that confront decision-makers and then explain patterns of human activities as being predictable outcomes of the ways that individuals—*any* individuals—respond to identified constraints and opportunities.

This avoidance of *ad hominem* explanations is the source of one of the most important lessons that economists teach: *greed* explains nothing. Because greed—or, more accurately, "self-interestedness"—is largely unchanging across time, no observed changes in the economy can be explained by it.

Greed can't explain rising fuel prices, for example, given that fuel sellers (and also fuel *buyers*) are just as greedy when prices are lower as they are when prices are higher. Likewise with booms and busts. Because people's greed remains constant something else must explain booms and busts. And so too for any other economic phenomena you care to name—everything from the fact that Americans are richer than Armenians to the fact that, say, big-box retailers' market shares are growing while those of mom-'n'-pop retailers are shrinking.

Of course the particular constraints and opportunities identified by economist Doe as being most relevant for explaining some phenomenon often differ from those identified by economist Jones for explaining the same phenomenon. Doe, for example, might identify an increase in the rate of growth of the money supply as the most crucial factor for explaining an observed boom and bust, while Jones identifies an easing in government regulation of banks as the crucial factor. But neither Doe nor Jones explains the boom and bust as caused by the likes of greed or ignorance.

Economists' refusal to use always-popular (and often half-baked) romantic notions about human behavior to explain economic phenomena goes a long way toward making economics a genuine science, and it accounts for much of whatever good economists have managed to bestow on society.

Far too many economists persist in sloppy, unanalytical *ad hominem* thinking about government.

What's Wrong

Turning now to something that is wrong with economics, much of the harm that economists inflict on society is a direct result of the one area in which economists too often *embrace* such *ad hominem* explanations: analyzing government involvement in the economy.

Despite a long-established tradition in economics of studying the "public" sector using the same analytical tools that we use to study the private sector—and despite two founders of this Public Choice tradition being awarded Nobel Prizes (George Stigler in 1982 and James Buchanan in 1986)—far too many economists persist in sloppy, unanalytical *ad hominem* thinking about government.

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For too many economists government is assumed to be able to escape many of the constraints that unavoidably bind and trip up people in the private sector. Asymmetric information, moral hazard, and adverse selection, as well as confirmation bias and the legions of other alleged "irrationalities" identified by behavioral economists, are just some of the "imperfections" economists find in markets and then too frequently simply *assume* can be dealt with effectively by government.

Overlook here the fact that many of the problems alleged to be unavoidable in the private sector are in fact handled quite well by human beings acting without government who exhibit far more ingenuity than the typical economist believes is possible in private-sector settings. (It's notable that Elinor Ostrom, the first woman to win the Nobel Prize in economics, isn't a professor of economics but instead of political science. She won the prize in 2009 for her work showing how creative people in private settings often overcome obstacles—such as free-rider problems—that most economists naively assume can be overcome only by government.)

Economists mysteriously conclude that desirable public-sector outcomes follow from the praiseworthy intentions that economists assume motivate most public officials.

Unanalytical Assumptions

Focus instead on economists' bizarre stumble into an unanalytical assessment of government. That stumble goes like this: "Omigosh! There's an imperfection in this private-sector market! My textbooks and the many refereed journal articles I've read and written make quite clear—with lots of difficult mathematics—that this market will therefore fail. My textbooks and journal articles also imply, and in many cases explicitly state, the conclusion that the government—and only the government—can solve the problem. Models prove this conclusion."

Such stumbling is common. From today's insistence that America needs more stimulus spending, through the support that many economists express for the new Consumer Financial Protection Bureau, to economists' overwhelming belief that countries need central banks, too many economists unscientifically reach their conclusions about the alleged efficacy of government intervention without first asking how the information available to government officials, and how the incentives these officials face, will affect government decision-making.

In short, economists mysteriously conclude that desirable public-sector outcomes follow from the praiseworthy intentions that economists *assume* motivate most public officials.

Nowhere does this mystery run more deeply than in fiscal policy. Even *if* it were true that increased government spending can hasten an economy's escape from a recession, the large number of economists who today endorse such spending is discouraging. Seldom do these economists inquire into the incentives facing government officials in charge of spending. The assumption is that these officials will spend the money in ways sure to promote the public interest. Also, seldom do these economists inquire into the information asymmetries and other constraints that might hamper even well-meaning officials' efforts to carry out fiscal policy effectively.

Save for the relatively few economists steeped in Public Choice economics, the typical economist today remains a political naif—and a dangerous one at that. He is bloated with unjustified confidence in models which show that *if* government officials behave in the public interest and *if* these officials are immune to the same decision-making quirks and knowledge limitations that afflict decision-makers in private markets, *then* government can perform all manner of marvels. This economist then uses his authority to support interventions that are utterly unjustified by genuine scientific standards.

It's shameful. FEE

Unemployment: What Is It?

BY WARREN C. GIBSON

Unemployment has regained center stage now that the debt crisis has receded from that position, at least for a time. Unless things change dramatically over the next year unemployment will be the number one issue in the forthcoming presidential election. Hardly any proposal will escape being labeled "job-killing" or "job-creating" or both.

To begin with some basics, what is work and what is a job? For economists, work is any activity that we would not perform without tangible compensation, usually money. In our work lives almost all of us are also motivated by nonmonetary considerations, and to the extent we diverge from the most remunerative activity available to us, we are blending work and leisure. A retired person who takes up college lecturing may do the work primarily for the satisfaction it brings. If his salary were withdrawn and he continued to teach, he would be enjoying leisure.

Dorothea Lange

The goal of all economic activity is consumption, which to economists means not just mundane goods like faster cars but also "noble" ends like cathedrals. Jobs are therefore not ends in themselves, as much as public discussion would suggest otherwise. They are means to acquire income to be used for consumption and saving, in addition to personal satisfaction, learning opportunities, or socializing.

A person who lacks a job is unemployed if he or she wants work, has suitable skills, and has realistic expectations about compensation. These are vague terms; they make unemployment a murky concept. That goes double for underemployment, though both remain very real phenomena.

What is it about unemployment that makes it so problematic? Why can't markets cure labor surpluses with lower wages as coffee surpluses are cured by lower coffee prices? Is government interference to blame, or is there something about free markets that allows unemployment to persist?

Both. Let's look first at *natural unemployment*, which is unemployment not caused by government policies. Economists Milton Friedman and Edmund Phelps brought this concept to the fore during the 1960s even though, like most modern economic concepts, it had been recognized in various guises long before they wrote of it.

Labor markets, even when unhampered by government interference, are different from other markets. Nonmonetary considerations do not arise in other markets as much as in labor markets. Not just salary, but working conditions, job satisfaction, and advance-

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ment opportunities matter to most job seekers, often greatly.

A certain number of unemployed people are *holdouts*, people who might find some sort of job fairly quickly but are holding out for a higher salary, more job satisfaction, convenient location, and so on. Lumping all holdouts together is problematic. Some may harbor unrealistic expectations. Some feel constrained by their spouses' wishes. Some have ample savings and can afford to hold out more stubbornly than others.

Some holdouts are reluctant to relocate. Moving is usually expensive and often emotionally distressful, especially to children. The current lingering housing crisis makes moving especially unattractive to some. People who are not only unemployed but also "underwater" in their mortgages—and particularly those who have simply stopped making payments, knowing that their lenders may not get around to their case for months or even years—are strongly inclined to stay put rather than accept distant job offers.

Efficency Wages

Another form of natural unemployment is a bit subtle but very real. It goes by the name "efficiency wages," based on the fact that recruitment and training costs are quite significant for most firms. Employers want their new hires to stick around so that these costs can be amortized over a reasonably long and productive term of employment. To motivate valuable new and old employees to stay, firms tend to offer compensation somewhat higher than the going rate for workers in any particular category. If the going rate is the wage that balances supply and demand for a particular labor category and if most offers are somewhat above this rate—efficiency wages—the result must necessarily be some unemployment. No one exemplified this theory better than Henry Ford and his outlandishly high $5-per-day wage beginning in 1914. According to one report, the policy eliminated complaints and reduced absenteeism by 75 percent. Total labor costs actually fell. There was a long waiting list for Ford jobs, but those men had other opportunities in the growing Detroit economy.

Government-Caused Unemployment

Government policies contribute to unemployment above and beyond natural unemployment. The most notorious of these policies are minimum wage laws. These laws make it illegal, effectively, for low-skilled workers to accept employment. Anyone who cannot generate $8 worth of production per hour cannot expect to be paid more than $8. Such unfortunate people might be productive at $6 per hour but are forbidden to accept employment at this rate and are instead condemned to joblessness and all its attendant miseries. This burden falls most heavily on black teenagers, whose employment rate (based on those seeking work and excluding those who are in school) is well over 40 percent. The benefits accrue mainly to slightly higher-skilled workers, who have climbed onto the metaphorical ladder leading to better jobs and who are shielded from competition from those excluded by minimum-wage laws.

There is nothing wrong with unemployment insurance per se. The problem is that the government forces all workers to buy this insurance whether it suits them or not.

Unemployment insurance softens the impact of joblessness and reduces the incentives to find a job. Recipients are supposed to show that they are actively seeking work, but this rule is easily sidestepped. There is nothing wrong with unemployment insurance per se. The problem is that the government forces all workers to buy this insurance whether it suits them or not. (Though nominally paid by employers, in fact the burden falls partly on workers and partly on employers.) Some workers might prefer to take that portion of their compensation in cash, but that choice is forbidden. Private carriers that might offer this insurance would, like all insurance providers, take steps to minimize adverse selection (the tendency for riskier workers to buy insurance) and moral hazard (the incentive for those covered to take risks that could get them fired).

Labor unions, as voluntary associations bargaining freely with employers, are unobjectionable. They did a lot of good in the past when working conditions in many places were pretty bad. But now they are granted special privileges by law—basically the privilege to engage in violent or coercive activities. The result is often wage agreements that are above market-clearing levels. Those left out are of course unemployed.

While labor unions can boost their members' compensation at the expense of non-union workers, higher wages generally and higher living standards are due mainly to increased productivity, which in turn depends on high levels of capital investment. People are more willing to save and invest when they have confidence in the future, and that confidence comes from respect for property rights.

The Pain of Unemployment

Because unemployment, natural or government-caused, is such a personal matter, its impact is highly subjective, extending far behind lost wages.

A teenager looking for work may not be his family's main source of income, but finding a job could be crucial to his life path. In my day teenagers could earn money delivering papers, mowing lawns, raking leaves, and shoveling snow. The work was unregulated and the income untaxed. Were we exploited? Hardly. We learned to take pride in our work, save for the future, and in contrast to our allowances, savor the special significance of money that we had *earned*.

A family breadwinner who loses his job and remains unemployed for an extended period of time will surely become discouraged, a term that only begins to describe the psychological devastation that can ensue. Men especially begin to see themselves as failures not just as breadwinners, but as husbands and fathers and more generally. Marital problems often arise. Children pick up on the distress and at certain ages wonder if they are to blame. Domestic violence and suicides are not uncommon. But losing a job may be no big deal for the senior citizen who works mainly for pleasure.

Because unemployment, natural or government-caused, is such a personal matter, its impact is highly subjective, extending far behind lost wages.

If anguish could be measured we would probably say that one year's unemployment is more than twice as painful as six months'. As time goes by the jobless not only lose hope, but also suffer erosion of their work skills and attitude. Their former colleagues and clients tend to forget about them. Some without work turn to alcohol or worse in their despair.

Overqualification is a problem for many job-seekers. Employers are reluctant to hire people who are qualified to do better-paying work simply because those workers are likely to leave once they get a more lucrative offer. So some people simply "forget" to list that master's degree on their résumé.

Unemployment and Macroeconomic Policy

Returning to Friedman and Phelps, the phrase they actually used was the natural *rate* of unemployment, the rate that would prevail when the economy is operating at full potential. Economies can operate below potential, as ours is presently, and they can sometimes operate above potential. Correspondingly we can have unemployment above the natural rate or, rarely, below. In the latter situation, we might see seniors lured out of retirement or young people lured into jobs before they finish school. But this situation is not our focus here.

Friedman was known for his opposition to Keynesian policies and his championship of free-market ideas. But that one word *rate* hints at the fact that Friedman fits squarely into the Keynesian macroeconomic project. Friedman viewed economics as an empirical science, not fundamentally different from physics, in direct opposition to the Austrian approach. He and Phelps spawned a cottage industry of searchers for the natural rate. Without that one word his work might not have received the broad attention that it did.

Some economists define the natural rate as an average rate (technically, a moving ten-year average). By this definition the actual rate must always lie above the natural rate at some times and below at other times. But this is simplistic. There is nothing "natural" about a moving average. Natural unemployment lies in the intentions and expectations of the people involved and is not so easily measured.

While the natural rate may be difficult to quantify and the highly subjective *effects* of unemployment cannot be measured, what about the *amount* of unemployment? Can it be measured? The Bureau of Labor Statistics (BLS) has that responsibility, and the numbers it announces get more attention nowadays than any others, with the possible exception of GDP growth figures. How does the BLS arrive at its numbers?

BLS Categories

To begin with, it must decide who is in the labor force and who is not. Among those who don't hold jobs, infants, jail inmates, and people in nursing homes aren't expected to work and shouldn't be called unemployed. They are simply excluded from the labor force. Beyond that it starts to get fuzzy. Should that senior person who works mainly for nonmonetary reasons really be counted in the labor force? What about discouraged workers? A discouraged worker is one who wants work and has looked during the past 12 months, but not during the past four weeks. Do the statisticians really know who has looked and who hasn't, and whether the reason was discouragement or something else?

Because of these and other ambiguities the BLS estimates unemployment in six different ways. U-3 gets the most attention. It is the number of unemployed divided by the size of the labor force. That number was 9.1 percent at press time. The next most widely followed version is U-6, which adds "marginally attached" workers—those who are out of the labor force but want work and have looked within the previous 12 months. It also adds those with part-time jobs who would like full-time work (again, how do they know?). This figure was a whopping 16.2 percent.

So which is the *real* unemployment figure, U-3 or U-6? There is no right figure, and the emphasis on U-3 is not some sort of conspiracy to hide the "real" situation. The figures are what they are, and it's a mistake to read too much into them.

> The biggest problem with unemployment statistics is not their fuzziness but, like GDP, the implications they carry.

The biggest problem with unemployment statistics is not their fuzziness but, like GDP, the implications they carry: the idea that the government can and should proactively attempt to manage the unemployment rate. Such has been the presumption for at least 65 years.

Since 1948 the Federal Reserve System has operated under a dual mandate: maximize employment and stabilize prices. This is a direct reflection of the dominant macroeconomic theory of the time, which assumes the authorities could reduce unemployment by adding a little inflation, or vice versa. The theory seemed to work for awhile but fell apart in the 1970s, when the term "stagflation" appeared. We had the worst of both worlds for a time, and Friedman was ready with an explanation: Inflation could only temporarily boost unemployment—until such time as expectations caught up to reality. The Fed, as we all know, has injected massive amounts of reserves into the banking system with no discernible effect on growth or unemployment. So much for the dual mandate. More about this and other current conditions in part two, which will appear next month. FEE

Taxation Is the Lifeblood of the State

BY ARTHUR FOULKES

The cliffhanger debate over whether or not to raise the federal government's debt ceiling threw U.S. fiscal policy into brighter relief than it has been in recent memory.

Suddenly people were calling for significant cuts in government spending in the face of a rapidly growing national debt.

As often happens, calls for cuts in government spending were met by competing calls for higher taxes, especially on higher-income earners and businesses. They can afford to pay the extra taxes, we were told. And what's more, higher taxes could actually help the economy.

In making this case, proponents of raising taxes pointed to the tax increases that came out of Washington under President Clinton in 1993. The U.S. economy, as measured by GDP growth, was strong in the years after those tax hikes while unemployment and inflation were relatively low. The argument now is that the 1993 tax increases did not inhibit the economic boom the country enjoyed in the last six or seven years of the twentieth century.

In April *New York Times* columnist Nicholas Kristof made this very argument. He wrote that while it's true higher taxes in general "tend to reduce incentives," this apparently "weak effect" is often overwhelmed by other factors. "Were Americans really lazier in the 1950s, when marginal tax rates peaked at more than 90 percent?" Kristof asked. "Are people in high-tax states like Massachusetts more lackadaisical than folks in a state like Florida that has no personal income tax at all?"

Like other observers, Kristof also contrasted the "golden period of high growth" after the Clinton tax hike with the "anemic economy" that followed George W. Bush's tax cuts.

But do higher taxes really spur (or at least not inhibit) prosperity? Looking at the data from the 1990s, one might believe so. After all, the 1993 tax hikes were followed by years of strong economic performance. *Post hoc ergo propter hoc* (after this, therefore because of this), many might believe.

Do higher taxes really spur (or at least not inhibit) prosperity? Looking at the data from the 1990s, one might believe so.

But not everyone agrees the data are quite so clear. The Heritage Foundation's J. D. Foster, for example, believes the data show that the U.S. economy was already expanding when the Clinton tax increases took effect. If anything, he believes, those tax hikes slowed overall growth for several years until 1997, when the Republican-led Congress passed a series of tax cuts, including a reduction in the capital gains tax rate from 28 to 20 percent.

The "real acceleration in the economy began in 1997, when economic growth should have cooled," Foster wrote. "This acceleration in growth coincided with a powerful pro-growth tax cut."

Foster also authored a 2008 Heritage Foundation summary of several scholarly studies showing tax hikes corresponding with slower or negative economic growth. In theory higher taxes could encourage greater

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levels of private investment through lower borrowing costs—if government used the money to retire debt and reduced its competition for lendable funds. But this potential "silver lining" is overshadowed by the negative effects of higher taxes, he stated. However plausible theoretically, in practice the argument runs into trouble, not least from the fact that governments seldom save any of their revenue, Foster notes.

Still, the idea that the 1993 tax increases spurred economic growth will not die easily. For instance, some people argue that those tax hikes provided much needed confidence in the U.S. economy. As Kristof put it: "Tax increases can also send a message of prudence that stimulates economic growth."

With this much disagreement it's hard to know what is really the truth. And this is always the case when looking at the effects of any single economic policy in a vast and complex system. Indeed, so much is happening at any given time in a modern economy—central-bank policy, trade policy, military spending, technological innovation, war or peace, and more—it's impossible to draw hard and fast conclusions from macroeconomic data alone.

The Austrian economist Ludwig von Mises made this point in his classic treatise, *Human Action*, in 1949. In discussing the role of historical data in economics, he wrote: "The champions of logically incompatible theories claim the same events as the proof that their point of view has been tested by experience. The truth is that the experience of a complex phenomenon—and there is no other experience in the realm of human action—can always be interpreted on the ground of various antithetic theories. . . . History cannot teach us any general rule, principle, or law."

Stepping back, therefore, it may be worthwhile to consider fairly uncontroversial economic propositions, such as the law of demand or the law of marginal utility, when trying to determine the likely effects of a tax increase.

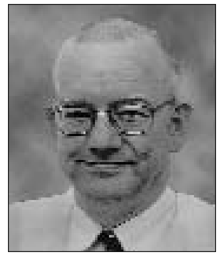
Basically, taxes alter relative prices. A tax on gasoline makes gasoline more expensive. A tax on whiskey makes whiskey more expensive. By the same token, a tax on income affects the "price" of leisure; that is, an income tax reduces the reward or "price" one receives for forgoing leisure in order to work. If you are willing to work for $10 an hour, you're essentially "selling" your leisure time for that price. You might not be willing to sell that leisure time for a lower price. Thus an income tax can be expected, on the margin, to reduce the willingness of some people to work.

While all this is important, it's probably more important to consider what happens to taxes after the government collects them. How government officials spend tax revenue can damage the economy as much as the tax itself can. That's because taxes are used for any number of things that distort markets and waste resources, such as providing subsidies to favored industries or strengthening bureaucracies.

How government officials spend tax revenue can damage the economy as much as the tax itself can.

As a newspaper reporter I have frequent opportunities to witness government decisions to spend taxpayer dollars. Often an argument in favor of a particular spending program is that it will only add a few dollars to any single individual's tax burden. Once a government program is in place, however, it's extremely difficult to reverse it because government spending benefits particular individuals and they are quite motivated to maintain it. When budget cuts are proposed, government officials have effective ways of fighting back. For example, a proposed cut in education spending is nearly always said to be taking teachers out of classrooms, and a proposed cut in police spending is nearly always said to be taking neighborhood cops off the streets. The "fat" in education and law-enforcement spending may be elsewhere. But those are the items placed on the public chopping block by clever bureaucrats and politicians.

So the real problem with taxes and tax increases may be that they simply feed the beast—the political and less-efficient government sector—while shrinking the voluntary, more-efficient private sector. For anyone concerned about liberty this is reason enough to oppose higher taxes. FEE



The Other Test: Debts and Taxes

BY STEPHEN DAVIES

States and polities—or rather the ruling classes that control them—face two great tests in the course of history. Failure to meet them typically leads to disaster and even the dissolution of the State. The first and most familiar is war, armed conflict with other States (or more accurately, other ruling groups). By analogy wars can be compared to examinations or timed tests; the test of war is relatively short, intense, and often sudden in onset, with the probable result obvious from the start and often dramatic.

The second kind of existential test can be likened rather to that of researching and writing a dissertation—longer, more drawn out, with less immediate drama but presenting in many ways a more thorough and searching examination. The consequences of failure, however, can often be just as severe, even if they take longer to arrive. This second test is that of managing taxation and public finance. As writers through the ages have recognized, failure at this can ruin a polity as surely as defeat in war.

Failure to manage public finances had dire consequences for France's rulers.
Wikipedia

What, though, is the nature of the test, and in what sense do ruling groups fail it? Historically, ruling groups draw incomes ("rents" in the economists' language) from the groups they control. They do this through various means, including taxes, fines, fees, tariffs, tolls, the selling of privileges and exemptions, and even outright expropriation. In return they typically provide services, most notably defense against irregular predators, a means of settling disputes, and a range of what are commonly described as "public goods," which can cover anything from public works and infrastructure to education. Ultimately all these services have to be funded out of the revenues the rulers can gain. It is true that a shortfall can be met by borrowing, but the money lent is secured against future income and so doing this is simply a way of spending income now in anticipation of its arrival in the future.

The failure of rulers to handle this can take two forms. The simplest is when the level of taxation and other exactions is simply too high and discourages productive labor to such a degree that wealth is destroyed rather than created. If taken too far, this can actually destroy the basis for the rulers' position. Just as a parasite that kills its host is a biological failure, so ruling classes that destroy their own productive base are clearly political failures. The more insidious failure, however, arrives when ruling groups spend more money than they take in and fund it through debt. This can go on for a long time, even indefinitely, provided the underlying economy is productive and dynamic enough and the spending is not too high. The evidence of history is that it cannot go on forever. Sooner or later a crunch will come, and the way the ruling group responds determines whether it passes or fails the test.

In 1783 the Treaty to Paris brought an end to a worldwide conflict. For Americans this was the American Revolution, when the colonies gained their independence from the British Empire. From a world perspective, however, this was only the latest round in a struggle for global leadership between Britain and France that could be traced back to the 1690s. Just as in

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previous episodes, the war had been financed mainly through the issuing of debt, which was added to the accumulated obligations of earlier conflicts. By 1783 the public finances of both France and Britain were in a desperate state. In many ways the British finances were in worse shape than those of the French: In 1784 total British debt amounted to 156 percent of GDP, comparable to French levels but with an economy not as large as that of France and so less able to support such a burden. However, the next six years saw the British elite address this problem. Their French counterparts did not and failed the test.

Diverging Paths

In Britain the new prime minister, William Pitt the Younger, brought the public finances under control through what was known as "economical reform." This was a combination of extensive tax increases and major cuts in government spending, most significantly through the abolition of a large number of useless government jobs or sinecures. This had significant political implications because access to these posts was a major form of patronage and central to the political system of the time. Even so, the cuts were made.

In France the new minister of finance, Charles Alexandre de Calonne, did not address the state of the French public finances in the same way, at least not initially. Instead he floated a series of loans to bridge the gap between income and expenditure. Despite its greater wealth, the French crown had to pay twice the interest rate of the British State, because its creditors (the so-called "financiers") had less confidence in its capacity to repay the debt and its willingness and ability to do what was necessary. Eventually Calonne proposed a series of reforms including tax increases (in particular taxes on the aristocracy and clergy), major cuts in government spending, and a move to internal free trade in France. To overcome opposition, in 1787 he persuaded the king to summon an Assembly of Notables. However, the elites opposed both the tax increases and spending cuts, and he was dismissed. The publicizing of the desperate state of the finances and the accelerating loss of confidence in France's rulers by their creditors meant the difficulties of the crown became even more acute until, in 1789, the king in desperation called a meeting of the Estates General for the first time in over 150 years to try to break the deadlock. What followed is, as they say, history.

Contemporary America

Contemporary Americans should look back at these events with increasing nervousness. As in Britain and France in 1783, the public finances are in a parlous state. The gap between revenue and expenditure has never been wider and is even worse than the headline figures suggest when the unfunded liabilities of Medicare and Social Security are taken into account. For a long time now the American political class has been funding expenditure through borrowing, depending ultimately on the confidence of their creditors and the underlying productivity of the American people. If this confidence should waver (and there are many signs of this) the cost of this borrowing is bound to rise. If the spending and liabilities exceed the capacity of even the most heroic future productive labor by American citizens (as they clearly do) then something has to give.

> The gap between revenue and expenditure has never been wider.

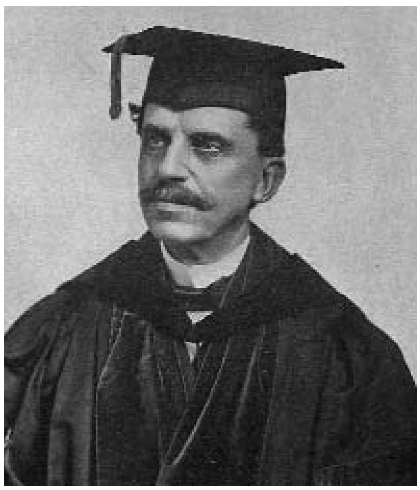
Ultimately it is clear that either spending must be cut or taxes and imposts increased or some combination of the two. Just as in France, however, this depends on the willingness of both elites and ordinary people to do what is necessary. That in turn depends on a broad agreement as to the proper role and size of government. In the absence of such an agreement, just as in France in 1787, tough decisions will be ducked and matters will go from bad to worse. Arguments about taxes and the deficit are thus proxies for a deeper debate. FEE

"Find Out What the People Want": The Russell Conwell Story

BY HAROLD B. JONES, JR.

"There is not a poor person in the United States who was not made poor by his own shortcomings. . . ."

Those words come, interestingly enough, from what is almost certainly the most successful charitable fundraising speech ever delivered. It was given over 6,000 times, provided almost 1,700 young people with the opportunity to go to college, and played a significant role in assisting 91,000 more to reach their educational goals. If the man who gave this speech had kept and invested the proceeds, an editor of the time observed, he would have had around $8 million (and this was back in 1917, when $8 million was still a lot of money). Virtually all the money was in fact used to provide a first-class education for people who would not otherwise have been able to afford it.



Russell Conwell
Wikipedia

The author of the speech had been a poor kid himself. He could remember being embarrassed, during his year at Yale, that he had to wear such cheap, shabby clothes. Looking back even further, he remembered that the diet of his youth had consisted almost entirely of Indian pudding and baked potatoes, supplemented occasionally by salt pork and cider-apple sauce. It took his father 12 years to pay off the $1,200 mortgage on their farm and another year to come up with enough for an Estey melodeon (a small reed organ). Rather than money each of the three children had been given a hen to feed; a cackle from the chicken house meant a toy or a piece of candy. And yet there was always an empty plate on the table, just in case anyone (even a tramp) stopped by.

This is not the background or the record of a man who would harbor a grudge against the unfortunate. To read his words about the nature of poverty as an attack on the poor is to read them wrongly. His speech was addressed to struggling entrepreneurs and people who were down on their luck, and he wanted them to know that it was well within their power to vastly improve on their present circumstances. More important, and in sharp contrast with the "leading intellectuals" of his time, he insisted that becoming wealthy was one of the most honorable things they could do.

His name was Russell H. Conwell. He was born in 1843 and showed an early penchant for public speaking. To provide the money needed for his last term at Wilbraham Academy he got permission to speak in nearby schools about the recently executed John Brown. The children went home to tell their parents, who were soon waiting in line to buy copies of the biography that young Conwell (with amazing foresight) just happened to have in ample supply. When the Civil War came he went around speaking about the causes, called on men to enlist, formed a company known as "The Mountain Boys," and at the age of 19 found himself one of the youngest captains in the United

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States Army. After the war he worked as, among other things, a newspaper correspondent and an attorney. He then took over a small, struggling church, which after a few years under his leadership was neither small nor struggling.

In 1882 he accepted a call to Grace Baptist Temple in Philadelphia. He had not been there long when he was approached by a young man who, with only 30 cents to his name, wanted to get an education. His efforts to put the boy off with descriptions of the difficulties involved failed, and Conwell agreed to spend three hours a week with him. The new student arrived for the first lesson with five of his friends. For the second lesson there were 40. By the end of the second year 250 were enrolled in the night school being conducted in the church's basement. The teachers were volunteers, attendance was mandatory, and examinations were notoriously difficult.

Students were required to pay tuition, but as the school expanded, the need for funds grew. Assistance from the wealthy of the surrounding community was not forthcoming. Employers were afraid that an education would turn their best workers to other pursuits, and the comfortably situated were unhappy with the idea of raising the poor above their proper station in life. There were no government assistance programs, but even if there had been, Conwell would not have applied. He believed it would be unjust to tax all of the people for something that would benefit only those with the ambition to take advantage of it. State-sponsored charities, he said, serve mainly to create a sense of entitlement and a great deal of petty fraud.

But there were now 590 enrolled at Temple, and it seemed to be faced with the necessity of a tuition increase that would close the door to some of its best students. Then Conwell had an idea. It had been bumping around in his mind since 1861, when he gave a lecture entitled "Heroes at Home" to a crowd of a few hundred in a Methodist church. Years of experience had ripened his thought on the subject and turned him into an excellent speaker. He decided to try his luck on the then-popular Chautauqua circuit, where Ralph Waldo Emerson had already made a name for himself. Before Conwell was done he had spoken to crowds as large as 15,000 and in places as famous as Madison Square Garden (back when it was still near Madison Square).

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"Acres of Diamonds"

He spoke without notes, and he never put his words on paper, so the speech has come down to us in various forms, four of which were consulted in the preparation of this article. (The author would be delighted to provide specific sources and page numbers for any who are interested.)

Conwell's introduction is the story of one al Hafed (given in some versions as Ali-Hafed), who was contentedly prosperous until a visiting Buddhist priest told him about the concentrated wealth of diamonds. Al Hafed inquired about the kind of place in which these might be found, sold his farm, and went off to search for them. Unsuccessful after many years, he threw himself into the ocean. The person who bought his farm had in the meantime come across a curious black stone that seemed somehow to catch the light. He set it on the mantle, and the next time the priest came by he recognized it as a diamond. "Had Al-Hafed remained at home and dug in his own cellar or his own garden, instead of wretchedness, starvation, poverty and death in a strange land, he would have had acres of diamonds," Conwell said. The farm was in fact the scene of what would later come to be known as the Golconda Diamond Mines (in Conwell's time, the word was often spelled Golkonda and was a synonym for incredible wealth).

The motivational speaker Earl Nightingale built one of his best presentations around this introduction; the point, he said, is that the grass on the other side of the fence may be greener because it is getting better care. While Conwell would have agreed with this observation, he was interested primarily in wider themes. He told several other tales about people who had missed the prosperity waiting on the doorstep, but his first major point was the development of a mindset for the discovery of opportunities. He was a voracious reader with a photographic memory and may have been familiar with Adam Smith. Even if he was not, his thoughts suggest a more than passing familiarity with the principles of economics.

To those who wanted to become wealthy he gave this advice: Find out what people want and get it for them. It seems obvious enough, but Conwell could remember a time in his life when he had yet to grasp it. As a boy he had on several occasions been left in charge of his father's country store. Once a man came in and asked, "Do you have any jackknives?" (What was then called a jackknife is now referred to as a pocket knife.) No, he did not, Conwell replied. Another farmer came in with same question and received the same reply. A third was met with this somewhat more emphatic response: "No. Why is everyone around here asking for jackknives? Do you suppose we are keeping this store to supply the whole neighborhood with jackknives?" Looking back, Conwell realized that if they had kept the store for that purpose it might have been more profitable.

He told about how John Jacob Astor, having foreclosed on a millinery store, went into partnership with the man who had just failed. Astor did not put a nickel of new money into the deal. He just went out to sit on a park bench and see what the ladies were wearing. He wanted to learn which styles had the most positive effect on a woman's feelings about herself. Conwell said that when Astor saw "a lady pass, with her shoulders back and her head up, as if she did not care if the whole world looked at her, he studied the bonnet" and went back with instructions for the hat maker. Then he repeated the process. The store was soon flourishing.

Conwell did not say Astor liked all the hats that seemed to have such an impact on the feelings of those wearing them. The point was not Astor's feelings but those of the women in the park. Both parties felt better off as a result of the transaction.

"I say you ought to be rich," he told the members of his audience. If they were not getting a little richer with each passing year, he said, it was only because they were not paying attention to what other people wanted. "If you will just take only four blocks around you, and find out what the people want and what you ought to supply and set them down with your pencil, and figure up the profits you would make if you did supply them, you would very soon see it. There is wealth right within the sound of your voice." He told the story of a man who provided so well for people of his neighborhood that when they learned of his plans to move and build a warehouse, they petitioned him to stay.

There is nothing even slightly cutthroat about economic success, Conwell said. It is a matter simply of giving people what they want and letting them reward you for it. The true businessperson is the one who has found a way to serve and let himself or herself be served in return. The dishonest are a minority who might retain employees and customers for long enough to do some damage but not for long enough to build a business. Lasting success, he insisted, is always the result of serving others as you yourself would like to be served.

There is nothing even slightly cutthroat about economic success, Conwell said. It is a matter simply of giving people what they want and letting them reward you for it.

He had no patience with ministers who condemned the "filthy lucre" of material prosperity. They only talk like that, he said, until they pass the collection plate. "Money printed your Bible, money builds your churches, money sends your missionaries, and money pays your preachers, and you would not have many of them, either, if you did not pay them." Significant material accomplishment is not only honorable in its own right but the means to much else that we honor.

Defending Prosperity

Conwell understood that in thus exalting the nature and consequences of the economic process he was swimming against the intellectual current of his time. "The age," he said, "is prejudiced against advising a Christian man . . . from attaining unto wealth." What he had to say about the nature of this prejudice is something early twenty-first century America badly needs to hear.

He pointed out that not everything in print agrees with the facts: "How little we can tell what is true nowadays when newspapers try to sell their papers entirely on sensation." Neil Postman observed that in the case of television the effect of this sensationalism is compounded by the need to break everything up into 45-second bits. The program does not need to tell the whole story, but it does need to be entertaining. Television producers, like the yellow journalists of Conwell's time, are more interested in getting our attention than in giving us the truth.

That, however, is the smaller part of the problem. The greater part is malicious jealousy. "If a man knows more than I know, don't I incline to criticize his learning? . . . We always do that to the man who gets ahead of us."

Even as he spoke, Germany's Max Scheler, borrowing a term from Nietzsche, was writing a book entitled *Ressentiment*. Nothing so excites public indignation, he observed, as remarkable success. There is a great deal that is easily forgiven, but the thought of any impressive achievement that might just as well have been our own seems to fester. The one who is merely envious wants whatever the object of his envy has gained and may even confess to such a desire. The person who is consumed with *ressentiment*, on the other hand, is no longer conscious of where the feelings come from and is therefore incapable of admitting to them. He or she no longer cares about the accomplishment itself but longs to harm the person it belongs to.

There is much about Conwell's world that has passed into history. Lies about the crimes of the successful and the *ressentiment* that gives birth to them remain. They are a central fact of American politics and the real issue in the debate over tax increases. Whatever else Barack Obama may be, he is not stupid. He knows perfectly well that even if all the loopholes could be closed and even if the marginal tax rate on incomes greater than $250,000 were 100 percent, there still would not be enough to put the government's books in the black. His driving motive is not a desire to balance the budget but his unadmitted need to punish the successful.

Lies about the crimes of the successful and the *ressentiment* that gives birth to them remain. They are a central fact of American politics and the real issue in the debate over tax increases.

It is by pointing to such motives that Russell H. Conwell makes his greatest contribution to modern America. There is a seminary that bears his name, and Grace Temple Baptist Church continues to carry on the ministry he began there. Temple University, no longer just for students who have to come in the evening, has become a leading institution of higher learning, complete with a hospital and a law school. More important than these, however, is Conwell's reminder about the nature of the attack on prosperity and individual achievement. We need to keep it in mind whenever politicians represent themselves as our saviors and the real sources of national prosperity. They are the ones from whom we need to be protected. FEE

Quantitative Easing Forever?

BY CHRISTOPHER LINGLE

Despite assertions that it has ended its policy of quantitative easing (QE), the Fed is unlikely to be able to do so until it also ends its zero-interest-rate policy (ZIRP). This deadly policy duo has had terrible consequences for the American economy and every country using U.S. dollars.

It is as though the Fed were riding on the back of a double-headed monster. It cannot hang on forever, but it cannot dismount the beast without being devoured. As it is, the U.S. Treasury depends on ZIRP to fund America's ballooning debt. When investors flee an enfeebled dollar the Fed is likely to be the "buyer of first resort" so that the price of Treasurys does not fall, pushing up interest rates. (So far Treasurys with low yields are still in high demand.) So with the Fed insisting that short-term interest rates will remain near zero "for an extended period," a phrase used for the past two years, a new round of QE is almost inevitable.

It is as though the Fed were riding on the back of a double-headed monster. It cannot hang on forever, but it cannot dismount the beast without being devoured.

For its part, QE involves flooding financial institutions with excess liquidity to try to flatten out the yield curve and depress long-term interest rates in hopes of sparking a recovery. But QE has created a massive overhang of excess reserves in the banking system that constitute repressed price inflation. And the sums involved are truly staggering: The Fed has injected at least $2.3 trillion into the financial system since Lehman Brothers collapsed in September 2008.

From late 2008 through March 2010 the Fed bought longer-term securities worth $1.7 trillion (QE1). This included purchases of $500 billion in mortgage securities and $100 billion in agency debentures with a target of $1.25 trillion for mortgage debt. Purchasing mortgage-backed securities and bailing out AIG and Bear Stearns, as well as buying other securities, led to a 140 percent increase in the monetary base.

In November 2010 the Fed began QE2 by buying an additional $600 billion in longer-term Treasury securities, a program that officially expired at the end of June. Yet the Fed has indicated it will continue buying Treasurys using proceeds from maturing debt it already owns.

Stealth Easing

With over $112 billion of the Fed's government bond holdings maturing over the coming 12 months, replacement alone would involve purchasing over $9 billion of Treasurys each month. It also has more than $914 billion of mortgage-backed debt and $118 billion of debentures issued by government-sponsored enterprises (Fannie Mae and Freddie Mac). As such this is a "stealth" continuation of QE with only a limited, if any, decrease in the money-creation process.

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For all the fanfare about QE, it must be said that it constitutes a last-gasp step and admission of the failure of other monetary policy tools. Consider the case of Japan. Its central bank, the Bank of Japan (BoJ), began asset purchases under QE to offset deflation and stimulate its ailing economy in early 2001. After nearly a decade of setting interest rates near zero the BoJ realized it had been unable to conjure up an economic recovery. Then after five years of gradually expanding its bond purchases, the BoJ exercised an exit strategy from QE in 2006, only to begin again.

Last March the BoJ increased its QE program from ¥5 trillion to ¥10 trillion (about $130 billion) scheduled until the end of 2012. Recently it announced another expansion to ¥15 trillion ($183 billion).

Incentives vs. Growth

A child untutored in economics might think it makes no sense to continue massive increases of liquidity into the economy that have been ineffective for so long. But most central bankers and many economists argue that previous amounts were too little and more is needed.

The incentives that QE and ZIRP create for commercial banks make it easy to see why these policies cannot promote economic growth. On the one hand, low interest rates reduce the cost of borrowing, which should encourage more investment spending. But on the other, commercial banks pay almost nothing to borrow yet receive interest payments from the Fed to hold excess reserves, making them unlikely to extend new loans.

A sufficiently high interest rate paid on bank reserves will induce banks to choose a risk-free interest-bearing asset rather than lending to private-sector borrowers. And so it is that commercial banks are earning record profits while making very few new loans.

Quantitative Easing and associated central-bank policies are diverting credit away from newly forming firms.

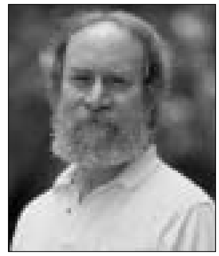
Exit Strategy?

The question of whether the Fed or the BoJ has an effective "exit strategy" from monetary expansion using near-zero interest rates and quantitative easing remains open. One possibility for the Fed is to engage in repurchase agreements (repos) to remove some of the excess liquidity that it pumped into the financial system.

These repos involve selling securities to commercial banks with the Fed agreeing to buy them back at a higher price at a later date. But once again commercial banks will find holding risk-free interest-bearing assets a much better bet than issuing new commercial loans.

In the end both QE and ZIRP have been ineffective in restoring economic vitality while also creating a massive overhang of repressed inflation. Most economists view business startups, especially small and medium-sized enterprises, as the key to economic recovery and growth. Yet QE and associated central-bank policies are diverting credit away from newly forming firms.

The Fed has now announced it will continue the "exceptionally" low short-term interest rates until the middle of 2013. This indicates that U.S. central bankers are unconvinced of the errors of their ways in their policy choices. That they are unwilling or unable to change course means the U.S. and Japanese economies are doomed to painfully slow economic growth for the foreseeable future. FEE



Social Cooperation

BY SHELDON RICHMAN

At FEE's Advanced Austrian Economics Seminar last summer, more than one speaker mentioned that Ludwig von Mises considered a different title for the book we know as *Human Action*. The other title? *Social Cooperation*.

I've heard that story before, but this time it got me thinking: Would the free-market movement have been perceived differently by the outside world if Mises had used the other title? With the question phrased so narrowly, the answer is probably no. So let's broaden it: Would the free-market movement be perceived differently if its dominant theme was social cooperation rather than (rugged) individualism, self-reliance, independence, and other synonyms we're so fond of?

Would the free-market movement be perceived differently if its dominant theme was social cooperation rather than (rugged) individualism?

Maybe.

There's no mystery why that other title occurred to Mises. I haven't tried to make a count, but I would guess that "social cooperation" (or "human cooperation") is the second most-used phrase in the book. The first is probably "division of labor," which is another way of saying "social cooperation." *Human Action* is *about* social cooperation or it isn't about anything at all. The first matter Mises takes up after his opening disquisition on the nature of action itself is . . . cooperation. He begins, "Society is concerted action, cooperation. . . . It substitutes collaboration for the—at least conceivable—isolated life of individuals. Society is division of labor and combination of labor. In his capacity as an acting animal man becomes a social animal."

It is through cooperation and the division of labor that we all can live better lives. Naturally, Mises laid great stress on the need for peace, since the absence of peace is the breakdown of that vital cooperation. This put Mises squarely in the pacifistic classical-liberal tradition as exemplified by Richard Cobden, John Bright, Frédéric Bastiat, Herbert Spencer, and William Graham Sumner. Mises wrote in *Liberalism*:

> The liberal critique of the argument in favor of war is fundamentally different from that of the humanitarians. It starts from the premise that not war, but peace, is the father of all things. . . . War only destroys; it cannot create. . . . The liberal abhors war, not, like the humanitarian, in spite of the fact that it has beneficial consequences, but because it has only harmful ones.

Given Mises's orientation it is unsurprising to see him attach so much importance to what he calls the Ricardian Law of Association. This is known as the law of comparative advantage (or cost), which states that two parties can gain from trade even if one is more efficient at making every product they both want.

The key is opportunity cost. A \$500-an-hour lawyer who is also the fastest, most accurate typist in the world will likely find it advantageous to hire a typist. Why? Because every hour the lawyer spends typing instead of practicing law costs him \$500 minus what he would have paid a typist. The typist faces no such opportunity cost. So lawyer and typist both benefit by cooperating. This is true of groups (countries) too. People will discover the benefits of concentrating on what, comparatively, they make most efficiently (or least inefficiently) and trading with others. As a result more total goods will be produced.

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This law is an important part of the argument for free international trade because it answers the objection that a national group that can't make anything as efficiently (absolutely) as others will be left out of the world economy. But Mises understood that the law of comparative advantage was merely an application of the broader *law of association*. As he wrote in *Human Action*:

> The law of association makes us comprehend the tendencies which resulted in the progressive intensification of human cooperation. We conceive what incentive induced people not to consider themselves simply as rivals in a struggle for the appropriation of the limited supply of means of subsistence made available by nature. We realize what has impelled them and permanently impels them to consort with one another for the sake of cooperation. Every step forward on the way to a more developed mode of the division of labor serves the interests of all participants. . . . The factor that brought about primitive society and daily works toward its progressive intensification is human action that is animated by the insight into the higher productivity of labor achieved under the division of labor.

This seemingly simple idea leads to counterintuitive conclusions. As a result of expanding cooperation, human beings compete to *produce*, not to *consume*. Mises expressed this with my favorite sentence in *Human Action*: "The fact that my fellow man wants to acquire shoes as I do, does not make it harder for me to get shoes, but easier." The expansion of cooperation also means dealing with strangers at great distance—a further incentive for peace.

Unfortunately the emphasis on cooperation is not what nonlibertarians are likely to "know" about free-market economics and the normative freedom philosophy. They are more apt to associate these with "rugged individualism" than "social cooperation." I have no doubt that a major reason for this is that our opponents who know better *want* the public to have a distorted sense of the genuinely liberal worldview. When President Bill Clinton declared (disingenuously) in his 1996 state of the union address, "The era of big government is over," he followed up that sentence with this: "But we can't go back to the era of fending for yourself." But human beings have always been social/political animals. There was no era when men and women fended for themselves individually. The choice is between free and forced association.

Of course libertarians and free-market advocates do emphasize the importance of the division of labor. Nevertheless we are partly responsible for the public misperception. Our rhetoric too often implies atomism, however inadvertently. (The appropriate individualism is *molecular* individualism.) I understand the value of the terms "individualism," "self-reliance," and "independence," but we should realize that they can easily lead to undesirable caricatures. Let's not encourage anyone to think that the libertarian ideal is Ted Kaczynski minus the mail bombs.

Let's not encourage anyone to think that the libertarian ideal is Ted Kaczynski minus the mail bombs.

We're all grappling with an uncertain future. Social cooperation unquestionably makes that task easier than if we attempted to go it alone. That's why individuals formed mutual-aid (fraternal) organizations. Besides camaraderie, these groups provided what the welfare state feebly and coercively supposes to provide today: islands of relative security in a sea of uncertainty.

If people support the welfare state, don't be puzzled. It's because they cannot see a better voluntarist alternative. That's where libertarians come in.

We libertarians might have an easier time persuading others if we emphasized that freedom produces ever-more innovative ways to cooperate for mutual benefit and that when government dominates life, social cooperation is imperiled. FEE

The Importance of Failure

BY JACK KNYCH AND STEVEN HORWITZ

In today's society failure has become something to fear, avoid, and therefore prevent at all costs. Whether it is unemployment compensation, farm subsidies, or bailouts for failing companies, the world seems to view failure as having no redeeming social value. If success is *all* good and failure is *all* bad, then it seems as though we should do *everything we can* to remedy or prevent failure.

But is that so? Without denying the value of perseverance, and recognizing that the slogan "never give up" can be useful in overcoming certain obstacles, we must keep in mind that failure can act as a *guide to more worthwhile activities.* For example, in 1921 Walt Disney started a company called the Laugh-O-Gram Corporation, which went bankrupt two years later. If a friend of Disney or the government hadn't let him fail and move on, he might never have become the Walt Disney we know today.

Failure plays a crucial role in discovering and disseminating knowledge.
Studio Lévy and Sons [Wikipedia]

More important than this individual learning process is the irreplaceable role failure plays in the social learning process of the competitive market. When we refuse to allow failure to happen, or we cushion its blow, we ultimately harm not only the person who failed but also all of society by denying ourselves a key way to learn how best to allocate resources. Without failure there's no economic growth or improved human well-being.

Economists, especially those of the Austrian school, often emphasize how entrepreneurs discover new knowledge and better ways of producing things. But entrepreneurial endeavors frequently fail and the profits thought to be in hand often don't materialize. According to the U.S. Small Business Administration, over half of small businesses fail within the first five years. But failed entrepreneurial activity is just as important as successful entrepreneurial activity. Markets are desirable not because they lead smoothly to improved knowledge and better coordination, but because they provide a process for learning from our mistakes and the incentive to correct them. It's not that entrepreneurs are just good at getting it right; it's also that they (like all of us) can know when they've got it wrong and can obtain the information necessary to get it right next time.

On this view failure drives change. While success is the engine that accelerates us toward our goals, it is failure that steers us toward the most valuable goals possible. Once failure is recognized as being just as important as success in the

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market process, it should be clear that the goal of a society should be to create an environment that not only allows people to succeed freely but to fail freely as well.

The Knowledge Problem

Understanding this point requires a broader vision of the market process. For Austrian economists the fundamental economic problem is not the efficient allocation of given resources to our most valued ends at a given time, but rather how we overcome the "knowledge problem"—the division of knowledge that characterizes the social world. It is more important to figure this out than to master the problem of resource allocation because new knowledge drives economic growth and creates prosperity. If the main task of the market were merely to allocate known resources to their most efficient uses, economic growth would seem impossible, since we would be stuck in a primitive world. Where is there any room for the innovation or change that drives progress and improves our lives? If a plow is deemed the most efficient use of iron and all iron is constantly allocated to making plows, how could iron ever be allocated for a new invention such as a tractor? The answer is that entrepreneurs *change* the most efficient use of resources by discovering new uses. By understanding the economic problem posed by limited, unique, and dispersed knowledge, we can better understand the role failure plays in coping with this problem.

Competition figures prominently in this system. Competition promotes entrepreneurial activity and the discovery of knowledge by empowering a variety of decision-makers to try to find new and better ways of using resources as well as new ends to achieve. This decentralization ensures that what F. A. Hayek called the local knowledge of time and place will be best used. Centralized planning, like other forms of government allocation, necessarily relies on the knowledge of fewer people, limiting discovery and restricting knowledge-dissemination to fewer channels. Competition is a better way to overcome the knowledge problem.

Failure and Opportunity

We can understand the role of failure if we recognize, as Ludwig von Mises did, that all human action intends to "remove felt uneasiness." We are always striving to improve ourselves by achieving our highest valued ends as often as we can. On these terms, failure is all around us because no human ever achieves a complete lack of felt uneasiness. We always have unsatisfied ends. Israel Kirzner uses the term "alertness" to describe how the entrepreneurial element of human action identifies which ends to strive for and which means are available. Kirzner says that for market action to occur, entrepreneurs must first be alert to opportunities for profit. The possibility of profit keeps entrepreneurs alert to the ways people strive for ends or make use of means that *fail* to remove felt uneasiness. Once they've noticed this failure in human knowledge, the same opportunity for profit spurs entrepreneurial activity to find a new way to achieve those ends, or to find better ends themselves. So *a failure in human knowledge* becomes the catalyst for producing new knowledge via the entrepreneurial process.

When entrepreneurs attempt to correct a particular failure in knowledge, they often fail themselves and incur losses because of competition. Although bankruptcy is painful in the short term, such failure is an integral part of how entrepreneurial activity and the market function. Failure in a competitive society informs market participants about which activities or jobs to strive for and which to avoid, lest they waste time and money. Jobs that add value to society should be pursued, while those that fail to add value should be eliminated. Markets help guide market participants far better than any bureaucracy can because bureaucracies lack the market's key components of competition, profit, and loss, which reveal failures and allow for their correction.

Although bankruptcy is painful in the short term, such failure is an integral part of how entrepreneurial activity and the market function.

Because competition is a voyage into the unknown, we can only know after the fact what works and what does not. Thus economic failure is not "waste." Calling entrepreneurial failure a "waste" implicitly assumes that one knew ahead of time what the best use of resources was. Such knowledge is not available to anyone, which is why failure is necessary to provide the needed signals.

The subsidies, bailouts, stimulus packages, and other interventions that now increasingly characterize the U.S. economy disrupt this process. Farm subsidies (including cheap water out west), for example, prevent entrepreneurs from finding and capitalizing on failures of knowledge in farming. While there may be new and better ways to grow food, it is difficult for entrepreneurs to find this out if farmers are kept afloat by the government. Perhaps decentralized, local farming would be discovered as more profitable if larger monoculture farms that are possibly damaging the environment were allowed to fail. By preventing inefficient methods of production from suffering losses, subsidies reduce the degree of failure in agricultural markets and make it harder to know that misallocation has taken place and to correct it.

Not letting Chrysler and General Motors fail during the Great Recession prevented an entrepreneurial response to this misuse of resources. The bailouts created two types of negative incentives. First, the companies were encouraged to keep making cars when their losses showed the resources and labor could better be used elsewhere. Second, the government deterred any new entrepreneur from entering the industry and doing things better. Many politicians defended the bailout because they did not want the hundreds of thousands of autoworkers to become unemployed. But when hundreds of thousands of workers become unemployed they do not disappear. They find different jobs that would contribute to society in a better way than working for a bankrupt auto company. The physical assets of bankrupt companies also get reallocated to alert entrepreneurs looking for bargains. Failure is necessary for learning and for success.

The Keynesian argument for government jobs programs is that any sort of work will restart spending in a recession, even hiring people to dig ditches and fill them up. But do a higher GDP and a job *by themselves* make society better off? Would it be better to have a 2 percent unemployment rate with 8 percent of the employed population doing jobs that don't add real value (so around 10 percent of the labor force is not adding real value) or more unemployment with everyone who is working really adding value?

Unemployment

Unemployment is a form of failure, and it involves the same considerations as when businesses fail. If a job no longer contributes value this needs to be made clear so that those workers can find jobs that actually do. Imagine if the disemployment of farmers had been prevented during the transition to an industrial economy. In 1941, 41 percent of the U.S. workforce was in agriculture. In 2011 the portion was 3 percent. Where would industry be today if we had prevented the majority of the 41 percent from losing their jobs and finding new ones? It is right that this sort of "failure" was allowed to occur because the displaced farmers found new jobs in the cities and elsewhere. Those new jobs helped society transition from agriculture to industry to services, creating even newer jobs all along the way. This is strong evidence that learning from failure takes place in labor markets.

If a job no longer contributes value this needs to be made clear so that those workers can find jobs that actually do.

Autopoiesis (life's continuous production of itself) is one of the principal characteristics of life, and constant change is its essence. This applies to the economy as well. For us to maintain or increase a high standard of living we must constantly change how we do things. This change won't be fueled by lucky guesses or by bureaucratic decrees, but instead often by entrepreneurial activity in the face of failure in the market. Since that activity drives the train of progress, it is in society's interest that the tracks be cleared of governmental obstacles. FEE

The Individual and the Community

BY AEON J. SKOBLE

Last May sociologist Amitai Etzioni participated in a debate hosted by the Cato Institute in which he argued against the classical-liberal theory as being too atomistic, excessively concerned with selfish individualism, and neglectful of the importance of community. He's been making this point for 20 years, which is strange for two reasons: First, it isn't true, and second, I have been refuting it for 20 years.

Okay, perhaps I shouldn't be surprised that Etzioni does not read my work. He's a "celebrity" academic whose writings are discussed in *The New York Review of Books* and who is generally regarded as one of the leaders of the communitarian movement. He need not bother reading obscure philosophers. On the other hand, his arguments have also been rebutted by Stephen Holmes in *The New Republic*, as well as *The Economist*. So if writers of far greater prominence than me also engaged his arguments and he remains unwilling even to acknowledge this, one is led to believe he is deliberately caricaturing.

The communitarian movement was at its most popular in the mid-to-late nineties, although it has not gone away; it continues to repackage itself and appears like clockwork whenever classical liberalism comes up. Its flagship journal, *The Responsive Community*, went by the slogan "Rights *and* Responsibilities" and now uses "For Individual Rights and Social Responsibility." With slogans like these, one might be forgiven for wondering why communitarians don't like liberalism. The answer is, while classical liberals argue for negative rights and limited government, communitarians argue for positive rights and an expansive government that can limit rights on behalf of the common good.

"Negative rights" is another name for liberties, the sort of rights-claims that impose on others a duty of noninterference. "Positive rights" is another name for the sort of rights-claims that impose on others a duty to provide or perform, sometimes called entitlements. A key concept of classical liberalism is that a system of negative rights is internally consistent and does not lead to conflicts of rights, whereas positive rights can generate such conflict. If Smith has a right to be provided with something, then Jones must have a duty to provide it. If this is not a consensual arrangement, then Jones's right to liberty is now in conflict with Smith's right to be provided with the thing in question. Since liberalism (by definition) takes liberty seriously, this sort of conflict is a problem. For a nonliberal it is not necessarily a problem: Simply announce that other values trump liberty—equality, for example, or security, or salvation.

One interesting conundrum raised by the positive-rights model is, who exactly bears the corresponding duties?

One interesting conundrum raised by the positive-rights model is, who exactly bears the corresponding duties? With negative rights this is easy: Everyone can *abstain* from interfering with a person's pursuits. But if there is a right to be given food or a car, who has to provide it? If the positive right is the result of a contract, the contract will specify who has what obliga-

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tions, but this won't entail any conflict with negative rights since the arrangement is consensual. If the right is simply stipulated as part of "the common good," then all members of the community must bear the duty of provision jointly (but nonconsensually).

The communitarian critique of liberalism gets its traction from a combination of a true observation and a false one. The true observation—hardly novel, Aristotle noted it two millennia ago—is that we are social creatures. We require social living to flourish. In a purely economic sense, it is obvious we cannot do everything ourselves if we're to do much of anything at all. The division of labor and our capacity for specialization and trade allow us each to benefit from the talents of others and prosper far above the mere subsistence of other creatures. Beyond that there is a psychological dimension to our sociality as well. As Aristotle noted, we require friends to attain the happiness we're capable of attaining. We require families within which to develop. As we mature we form distinct personalities as a result of the many relationships we have. "The self" does not emerge fully formed *ex nihilo* but rather is the result of many influences and relational associations and affiliations. When communitarians like Etzioni make this point, they're noting something true.

The market *is* a social phenomenon.

The part of the equation that is false is the claim that classical liberals either disbelieve or are indifferent to the preceding account. Communitarians claim that liberalism presupposes an atomistic individualism—that it neglects the value of community and fails to see that there is a social component to the formation of the self and to human flourishing. None of this is true. Classical liberalism does not ignore these claims; it depends on them. It's as if one tried to argue against pizza by claiming that cheese is good, but since pizza has no cheese, pizza must be bad.

Economically speaking, the straw man being employed here is virtually self-evident: The market *is* a social phenomenon. So you can't have a theory about the ways in which the market benefits people and at the same time regard sociality as unimportant. The classical-liberal position is that we all benefit from our participation in the social phenomenon of the market—not merely financially, but in terms of the great diversity of our kind. Cooperation in a market system promotes, and in a way presupposes, heterogeneity and pluralism. This expands people's horizons and shows them new ways to derive and create value.

Of course, for a particular sort of communitarian the heterogeneity and pluralism of the market are considered bad things. Karl Marx claimed that our identities are constituted entirely by our socioeconomic class and that autonomy was an illusion. The prevailing economic system *determines* how you think. The liberal project is flawed, Marx said, because it caused people to have false ideas about labor, capital, society, and even our own selves. Mussolini also claimed that the liberal project was flawed because it caused people to have false ideas about labor, capital, society, and our own selves, but his claim was that our identity was constituted and determined not by class but by our ethnicity. Communitarians today distance themselves from fascists and communists, and make the more generic claim that "the community" determines our identity, while still coming to the same conclusion: that liberalism is a flawed project. This enables them to defend some liberties while arguing for positive rights and for the right of the community to infringe on liberty.

Of course, we're all members of many different communities simultaneously: family, town, ethnicity, region, nation, religion. In addition to these, we become members of communities through our interests and affiliations—professions, hobbies, sports loyalties, and other manifestations of preference. To be sure, all these different things play a role in helping shape who we become, but it's a stretch to say that any one of them trumps the others, or that the process is deterministic. Communitarianism seems to elide the distinction between influencing and determining. We still make choices about our values and actions, despite the many influences on our thinking.

In his 1996 book, *The New Golden Rule: Community and Morality in a Democratic Society,* Etzioni makes the same criticisms of a liberalism that "neglects the role of community" that he made at Cato in May. But he also praises autonomy and explains that his ideal society wouldn't be coercive. But a noncoercive community that respects individual autonomy sounds like liberalism, so this may be a case of wanting to have it both ways. Worse, it suggests that the best way to have a good life is to live in a community (which is true, but uncontroversial) and that individualism won't allow for this (which is false).

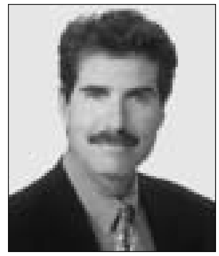
In many cases, Etzioni's prescriptions are vague and almost contradictory: We shouldn't have too much autonomy because that's bad for community; but we shouldn't enforce community plans in tyrannical ways because that's bad for autonomy. He explicitly calls for compulsory national service, which is hard to reconcile with a noncoercive society. He even invokes the expression "voluntary social order," but is clearly not making a Hayekian argument: He explicitly rejects the free-market approach to economics. He specifically praises "symbolic displays" that promote community solidarity—does that mean requiring religious dissenters to recite the Pledge of Allegiance? It is true of course that some "community values" are incompatible with liberal individualism. Self-appointed spokesmen for the community might have an interest in suppression of dissent (mustn't offend community sensibilities) or the subjugation of minority religious practices (mustn't promote excessive individualism). But Etzioni stops short of taking his argument to this conclusion.

Even a cursory overview of liberal authors shows respect for human sociality and a recognition of the importance of community. This is evident in Locke and Smith, Ricardo and Hayek, Nozick and Rothbard. Etzioni's reliance on such obvious straw-man conceptions of liberalism suggests it is tactical rather than intellectual: How can we maintain some recognizably liberal framework, yet support positive rights and government control? By suggesting that the liberal project is based on a mistake. If the proponents of classical-liberal individualism and free markets are shown to be people who neglect the value of community, then communitarianism can gain traction. But there's no easy way around what J. S. Mill called the "tyranny of the majority": That a majority of the people want things a certain way is not enough to justify coercing the minority. Classical liberalism embraces social cooperation—indeed presupposes it—but distinguishes itself from its competitors by insisting that the communal projects and social arrangements be consensual. In Etzioni's characterization this means we do not care about the community.

Classical liberalism embraces social cooperation—indeed presupposes it—but distinguishes itself from its competitors by insisting that the communal projects and social arrangements be consensual.

But caring about the community and respecting individuals as individuals are not contradictory aims. Yes, we're social creatures, but one reason society has so much to offer is that we're all a little different. The great diversity of human interests and preferences and talents is a testimony to our individualism, and "society" is just the manifestation of these differences as they are brought together. If everyone thought the same way and liked all the same things, society would be a much less interesting place. So the idea that, to protect community, we need to stop thinking of people as autonomous individuals gets it backwards. If we really care about the well-being of communities and preserving the way society contributes to human flourishing, we ought to keep in mind the unique and autonomous individuals that make it up, and respect them. FEE

What We Don't Know about History Can Hurt Us



BY JOHN STOSSEL

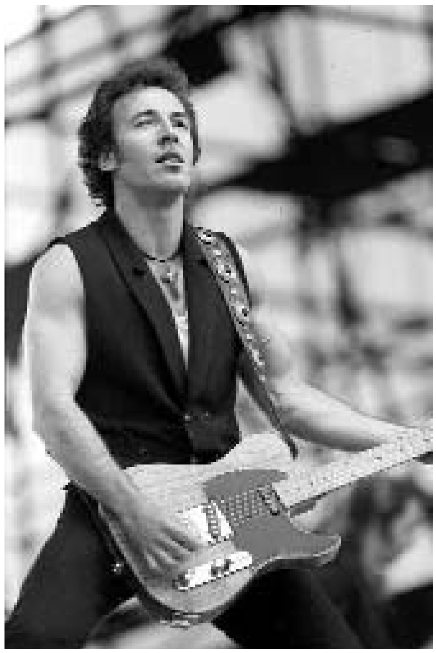
"It ain't so much the things we don't know that get us into trouble. It's the things we know that just ain't so."

That famous line, attributed to many authors but apparently said by humorist Henry Wheeler Shaw (aka Josh Billings), applies to history as much as anything.

What liberates oppressed people? I was taught it's often American power. Just the threat of our military buildup defeated the Soviet Union, and our troops in the Middle East will create islands of freedom.

Unlikely, says historian Thaddeus Russell, author of *A Renegade History of the United States*.

"As a matter of fact," Russell told me, "in general American military intervention has increased anti-Americanism and hardened repressive regimes. On the other hand, American popular culture—what was often called the worst of our culture in many cases—has actually done more for liberation and our national security than anything that the 82nd Airborne could do."



Bruce Springsteen, Cold War hero?
German Federal Archive

I told him that I thought that the Soviet Union collapsed because the Soviets spent so much trying to keep pace with Ronald Reagan's military buildup.

Pop Culture Revolution

On the contrary, Russell said. "It collapsed from within. . . . People simply walked away from the ideology of communism. And that began especially when American popular culture—jazz and rock and roll—began infiltrating those countries after World War II."

I demanded evidence.

"American soldiers brought jazz during World War II to the Eastern front. Soviet soldiers brought it back. Eastern European soldiers brought it and spread it across those countries. . . . Stalin was hysterical about this."

The authorities were particularly concerned about young people performing and enjoying sensual music.

"Any regime at all depends on social order to maintain its power. Social order and sensuality, pleasures of the body, are often at odds. Stalin and his commissars understood that," Russell said.

American authorities 30 years earlier also feared the sensuality of black music, said Russell, attacking jazz "as primitive jungle music that was bringing down American youth. Stalin and his commissars across Eastern Europe said exactly the same things with the same words later."

Then rock 'n' roll came.

"That was even more threatening," Russell said. "By the 1980s, disco and rock were enormously popular throughout the communist world."

The communists realized they had to relax the rules or risk losing everything, but it was too late. One of the most amazing and significant spectacles was Bruce Springsteen's concert in East Germany in 1988, when a crowd of 160,000 people who lived behind the Iron Curtain sang "Born in the USA."

John Stossel hosts Stossel *on Fox Business and is the author of* Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong. *Copyright 2011 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

Make Nikes, Not Guns

I'm skeptical. I don't know how much effect Reagan's military buildup had versus rock 'n' roll, but I bet ordinary consumer goods had an even bigger effect. People trapped behind communist lines wanted the stuff we had. When I was in Red Square before the fall of communism, I sold my Nikes and jeans to eager buyers.

People want choices, and you can't indoctrinate that out of them.

Which leads me to the most destructive myth about history: the idea that if we are to prosper, government must make smart plans for us. I was taught that in college, and despite the failure of the Soviet Union, many government leaders still believe it.

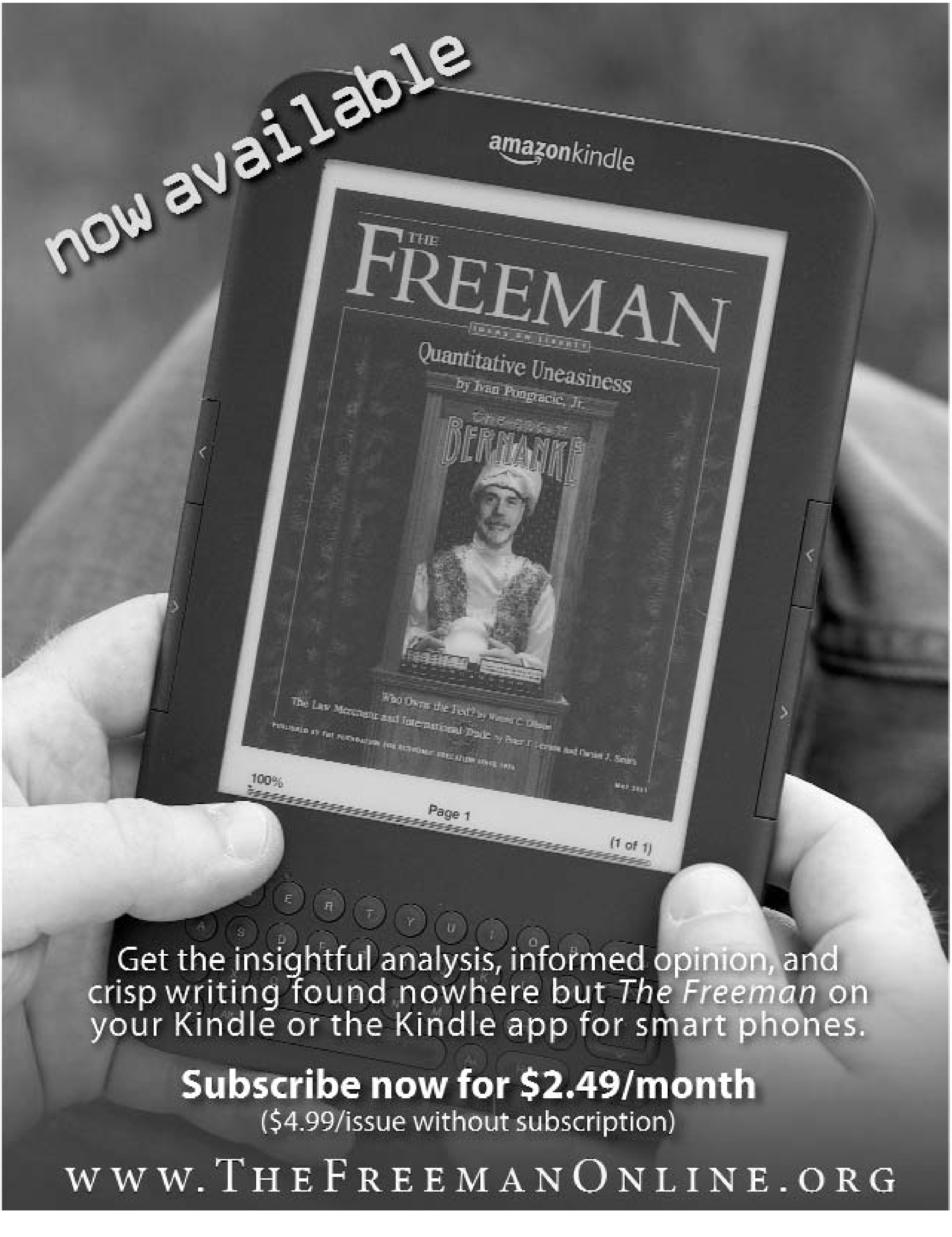
> It's no coincidence that the countries with the least economic freedom are the worst places to live.

It's no coincidence that the countries with the least economic freedom, according to the Heritage Foundation—Cuba, Zimbabwe, North Korea—are the worst places to live. They not only lack freedom, they are also poor.

Who's at the top of the economic freedom list? Hong Kong. (The United States is ninth.) Hong Kong has low taxes, and as I demonstrated in an ABC special years ago, the government makes it easy to become an entrepreneur. I got permission to open a business there in one day. In my hometown, New York City, it takes months.

Hong Kong doesn't even have democracy, but because its rulers protected people's personal safety and property and left them otherwise free, Hong Kong thrived. In 50 years it went from horrible poverty to income levels that are among the highest in world. Prosperity, thanks to economic freedom.

We should try that here. FEE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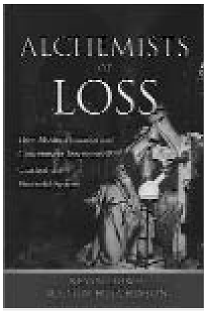
Book Reviews

Alchemists of Loss: How Modern Finance and Government Intervention Crashed the Financial System
by Kevin Dowd and Martin Hutchinson
Wiley • 2010 • 432 pages • $27.95

Reviewed by Roger W. Garrison



The subprime crisis and financial meltdown have spawned dozens of books, some aimed at re-enshrining John Maynard Keynes, others at laying him to rest once more; some aimed at praising the Federal Reserve for staving off another Great Depression, others at blaming it for treating the economy to another cyclical episode. In Kevin Dowd and Martin Hutchinson's reckoning the blame is assigned to government intervention (especially housing policy), fiscal irresponsibility, and interest-rate manipulation, all of which gave scope for short-run profit-taking based on modern finance theory. The incisiveness of this well-integrated tale derives from a mutual leveraging of the coauthors' perspectives and experiences.

Dowd offers a classical-liberal perspective on macroeconomic policy and specifically central-bank policy. Having written extensively on free banking, he concludes that a thorough *de*centralization of the banking business is essential to enduring macroeconomic stability. Hutchinson is a seasoned investment banker turned financial journalist. His firsthand, nuts-and-bolts knowledge of modern financial markets undergirds his broader perspective. Together, they provide an enlightening account of the long-run trends and short-sighted policy actions that culminated in the worst financial crisis since the Great Depression.

The "alchemists" in their story are the architects and practitioners of modern finance. Given the perverse regulatory environment, buying and selling derivatives can yield short-run profits to hedge funds and other traders while virtually guaranteeing that in the longer run the owners of the underlying real assets will suffer losses if not bankruptcy. The careful reader will understand that speculation, whether on a long-term or short-term basis, is an essential and healthy feature of a market economy. But, if anything, the authors' likening of speculation to alchemy *when it is based on the techniques of modern finance and carried out in the context of a regulated economy* understates the perversity. On reflection we can see that turning future long-run losses (of other people) into current short-run profits (for yourself) is triply more disruptive than trying to turn lead into gold. We can note 1) that lead, unlike long-run losses, has a positive, though modest, value; 2) that it *is* your own lead; and 3) that given the laws of nature, you're unable to turn the trick.

But if the laws of nature keep people from turning lead into gold, why don't the laws of the marketplace preclude the financial alchemy that characterized most of this century's first decade? The answer, our authors make clear, is government intervention. A toxic mix of interventions (regulatory, fiscal, and monetary) perverted the coordinating market forces by removing considerations of long-run systemic risk. The result was a systemic discoordination whose increasing severity eventually turned systemic risk into a crisis. The laws of the marketplace, if allowed to exert themselves, *can* preclude financial alchemy (or at least put strict limits on it). But government intervention, including loan guarantees and the too-big-to-fail doctrine, open a window in which short-run profit-taking in financial markets is pitted against long-run viability of the financial institutions.

While the Federal Reserve is recognized as an essential accommodating element in the most recent episode of boom and bust, Dowd and Hutchinson focus on the inherent perversity of modern finance theory in the context of the long-running efforts of the government to redistribute income and to encourage homeownership. Since the 1930s the government has used the tax code to redistribute incomes downward. Over the years the income tax—and over the generations the inheritance tax—has reduced the number of families that oversee their long-run business interests. The old partnerships (Dowd and Hutchinson's term), which kept the owners' skins in the game, have been supplanted by limited-liability corporations, which effectively separate management and ownership. This critical separation, which left-leaning authors take to be characteristic of capitalism, is shown by the authors to be a consequence of government systematically overriding the market-governed distribution of income. Whereas we once had business families that were in it for the long run, we now have financial managers and traders in derivatives markets who are in it for the short run, ultimately to the detriment of the financial system and the real economy.

Alchemists of Loss provides a multidimensional account of the nature and magnitude of our long-brewing economic woes. But the book provides us with little hope for the future. The authors' suggestions for reform range from the radical (reinstating the gold standard and eliminating the central bank) to the not-so-radical (redrafting the Fed's mandate to exclude concern about unemployment) to the superficial (moving the Fed's headquarters to St. Louis). Even the casual reader will see that this extends from the virtually impossible to the not-worth-doing, with no promising midrange option. The implicit conclusion is that we should brace ourselves for more booms and busts. FEE

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The Relentless Revolution: A History of Capitalism

by Joyce Appleby
W. W. Norton • 2010/2011 • 494 pages • $29.95 hardcover; $17.95 paperback

Reviewed by Leonard Liggio

The eminent UCLA historian Joyce Appleby concludes *The Relentless Revolution: A History of Capitalism* by referring to the persistent nostalgia for socialism: "As one sufferer from Yugonostalgia explained it, 'in Yugoslavia people had fun. It was a system for lazy people; if you were good or bad, you still got paid. Now, everything is about money and this is not good for small people.'"

In my view that sentiment is badly mistaken, and while Appleby recognizes the advantages of capitalism, in sum she is ambivalent: "Worldwide life expectancy went from forty-eight years at mid-twentieth century to sixty-six years in 1999 and it's still continuing to rise! Still, it would be nice to eat cake while keeping lazy ways too." Her often engaging and informative book is undermined by sympathy for the precapitalist lifestyle.

Appleby describes the book as being not a general study of capitalism, but instead "a narrative that follows the shaping of the economic system that we live in today." One of the greatest changes capitalism made possible was to free men and women from the work of producing food. In traditional societies around 80 percent of the people labored just to produce enough food to meagerly feed the population. It had always been that way, and the human outlook was mostly static. Appleby emphasizes that the vast increase in productivity which capitalism made possible brought about a reversal of people's attitudes toward the future. "At a very personal level," she writes, "men and women began making plans for themselves that would once have appeared ludicrous in their ambitious reach."

One of Appleby's central themes is change and innovation, which had been objects of hostility in earlier societies. She observes that Adam Smith's *Wealth of Nations* frequently testifies to the new view that capitalism brought about. "The principle which prompts us to save is the desire of bettering our condition," she quotes Smith as writing, "a desire which tho generally calm and dispassionate, comes with us from the womb and never leaves us til we go into the grave." Where, Appleby wonders, had Smith gotten that view of humans as naturally inclined to rational self-improvement?

She explains that to find the answer, she became "a permanent fixture at the British Museum" reading "a new genre, the writings about commerce that began appearing in pamphlets, economic tracts, broadsides, and advice books from the 1620s onwards." From that research she learned how uncapitalistic life had been for the typical Englishman. She quotes a scholar who wrote that he lived "in a house built with monopoly bricks . . . heated by monopoly coal. His clothes are held up by monopoly belts, monopoly buttons, monopoly pins. . . . He ate monopoly butter, monopoly herrings, monopoly salmon. . . ." Opposition to all those monopolies, granted by kings starting with James I, led to revolution—politically and philosophically. Appleby notes that pamphlet writers like Thomas Mun argued that the economy should not be under the control of the sovereign. "Breaching the wall of paternalism in the 1620s," she writes, "marked a significant moment in the history of capitalism."

Meanwhile, the oceanic sailing and trade that began with the Portuguese and Spanish was expanded by the Dutch and English. The availability of goods produced abroad led to great improvements in living standards for common people, underscoring the fact that capitalism made economic progress possible. Similarly, the revolution in agriculture at the same time, especially in England and the Netherlands, was another advance made possible by capitalism. For the first time the prospect of widespread famine ceased to be a worry.

In her treatment of capitalism in the nineteenth and twentieth centuries, Appleby is interested in the processes of innovation and change. She emphasizes the tide of innovations rather than the political reactions to economic development that occurred in those centuries. While she remains positive about capitalism's impact, Appleby does not take on the ferocious critics of capitalism and their claims that it fosters all manner of social and economic evils. No doubt some readers will be disappointed in the book for that reason. After all, if the author is going to bring up Marxian criticisms of capitalism, why not also bring up the rejoinders that defenders of the free market have made to them?

Appleby's concluding chapter, "Of Crises and Critics," deals with our present economic troubles. Again, readers are apt to find her discussion disappointing in its ambivalence.

There is much to recommend in this book, especially the author's work on changing economic thought in the seventeenth and eighteenth centuries and the consequent emergence of market concepts. When Appleby reaches further afield of her area of specialization, however, the book is weakened by observations that I do not believe are justified. FEE

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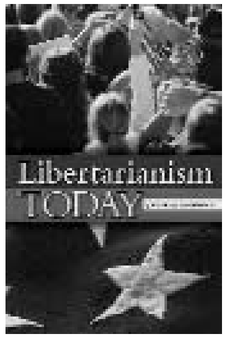
Libertarianism Today

by Jacob Huebert
Praeger • 2010 • 254 pages • $44.95

Reviewed by George Leef



Libertarianism is attracting more attention than ever. As the economic and social damage done by Leviathan increases exponentially Americans are coming to understand that government power is the root of our many troubles. The idea that a consistent philosophy based on freedom and peaceful cooperation among all people is the only path out of the wilderness is spreading.

That has defenders of the mega-state worried. For them it would be catastrophic if people began thinking that they'd be better off with a minimal state. In recent months they've written several vicious, intellectually dishonest attacks on libertarianism. Those are desperate rearguard actions, however. The case for libertarianism has always been overwhelming, and in *Libertarianism Today*, Jacob Huebert advances it in a remarkably effective way.

Huebert, a lawyer and former FEE intern, understands that the libertarian philosophy will only spread through persuasion, and every page of the book is written with that in mind. He wants readers who are uncertain about libertarianism (or hostile to it) to see that it is nothing more than the consistent application of rules for living that nearly all of us accept in our relationships with others. "In everyday life," he writes, "people understand and follow this basic libertarian rule. If you want something and it belongs to someone else, you have to persuade him or her to give or sell it to you—you cannot steal it or threaten to hit the other person over the head if they refuse to part with it. If you do not like the books your neighbor is reading, or the religion he is practicing, or most anything else he is doing in the privacy of his own home, too bad—you cannot go force others to do what you want them to do."

Exactly. FEE's founder Leonard E. Read stated it clearly in the title of one of his books, *Anything That's Peaceful*. Huebert gives much credit to Read for helping to keep the libertarian philosophy alive during the period of government idolatry after World War II.

Most of the book is devoted to specific issues in which people are (or at least ought to be) fed up with the mega-state and receptive to libertarian alternatives. But before getting into those issues, Huebert clears up some serious misunderstandings. Political writers often convey the notion that libertarianism is "an extreme form of conservatism," and Huebert takes pains to show that libertarians are not conservatives of any sort. Nor are they liberals, as that term is now used. Both conservatives and liberals eagerly turn to government coercion on a wide array of policies. As a matter of principle, libertarians insist on keeping the Pandora's Box of aggression locked.

Another source of confusion is the common idea that libertarian thinking is unworkable. We often hear something like: "Capitalism sounds good in theory, but in practice it leads to all kinds of trouble." Libertarians do indeed favor free-market capitalism, but Huebert argues that our economy is far, far from that unknown ideal. "The U.S. economy is hampered by countless interventions: trade barriers, corporate welfare, wage controls, regulation, occupational licensure, antitrust laws, compulsory unionism, taxes, and much else." It makes no sense to blame libertarianism for problems created by a host of government blunders that it opposes.

Now let's look at some of those sore spots where Americans should be receptive—where they should be demanding libertarianism *today.*

One of them is war. Americans are finally getting sick of military escapades around the globe. Democrats and Republicans, liberals and conservatives—all are eager to send troops into foreign countries and involve them in conflicts under euphemisms like "nation building" or "humanitarian intervention." The only consistent opposition to these bloody, costly, endless wars comes from libertarians, Huebert notes.

What about the ridiculous mania for security? The Republicrats have fastened the dictatorial Transportation Security Administration (TSA) on us. Almost everyone loathes the bossy, harassing attitude of the TSA's "public servants" but, Huebert writes, "Despite all these intrusions, there is little evidence that the TSA has made anyone safer by scanning shoes or confiscating fingernail clippers, shampoo, and the like." He then takes the libertarian analysis further than the unpleasantness of airport checkpoints: "Libertarians find the TSA disturbing in part because it accustoms Americans to obeying orders from uniformed agents without question and submitting to gross violations of privacy and dignity."

The book covers many other current sore spots with Americans and shows how the problems would either disappear or be greatly diminished if we adopted libertarian thinking: the mess that statism has made of the economy, the terrible prospect of politicized health care, the woefully ineffective education system, and more.

If you want to undermine statist beliefs, pass this book around. FEE

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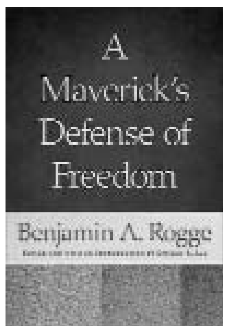
A Maverick's Defense of Freedom

by Benjamin A. Rogge, edited by Dwight R. Lee
Liberty Fund • 2010 • 440 pages • $25.00 hardcover; $15.00 paperback

Reviewed by Joshua Hall



The Liberty Fund catalog is filled with excellent books on American history, economics, and philosophy. As a Public Choice economist I have benefited tremendously from its publication of the collected works of James Buchanan. While I already owned several of his books, the opportunity to purchase all his books and articles at once saved me time hunting them down.

Benjamin Rogge's *A Maverick's Defense of Freedom* is valuable for a different reason. Absent Dwight Lee's decision to edit the volume and Liberty Fund's to publish it, I probably would have had no way to read most of this material. That is, assuming I even knew of its existence, which is unlikely because most of the 57 articles, essays, and speeches in this book have never been published before. Given the important role Rogge played in classical liberalism in America during his lifetime (he served on the boards of both FEE and Liberty Fund), the value of this volume to students of liberty is tremendous.

First and foremost, Rogge was a teacher. He began teaching at Wabash College in 1949 and taught there until his untimely death in 1980. Rogge took seriously the notion that academics should try to educate beyond the classroom. He wrote opinion pieces in the *Wall Street Journal* and *Indianapolis Star*, gave speeches at home and abroad, and even narrated the film *The Incredible Bread Machine*. The wide variety of speeches—given to different audiences—contained in this volume provide the reader a great sense of Rogge's abilities as a communicator of economic ideas. I will frequently look to these speeches for inspiration and insight into how to best reach an audience.

Lee has superbly organized these pieces into six broad areas: liberty and personal responsibility, the role of economists in a free society, the connection between education and liberty, microeconomics, macroeconomics, and foreign policy. The final three sections are primarily useful as excellent illustrations of basic economic thinking applied to policy issues such as inflation, unemployment, and energy security. Although the details today may be different, the solutions are still the same. Rogge's clarity in making the case for sound economics and limited government is without peer and thus ripe for imitation.

The first three sections are indispensable reading for anyone interested in "the freedom philosophy." In them Rogge deals with core issues related to liberty, and a common theme is the importance of personal responsibility in building and maintaining a free society. For example, in an undated speech titled "Voluntary Organizations in a Free Society," Rogge makes the case that voluntary organizations are an important bulwark against the growth of the government. As he puts it, "Every function well handled by private, voluntary action is an island of defense against further government encroachment in our lives."

For me the best part of the book was the section on the role of education in a free society. In addition to including the entirety of Rogge's classic essay with Pierre Goodrich on "Education in a Free Society," this section also includes Rogge's views on the financing and administration of higher education and the role of students, businessmen, and public intellectuals in the educational process. Anyone interested in today's higher education reform debates would benefit from reading this section, which highlights an important issue rarely discussed today: personal responsibility by consumers of education.

At the center of Rogge's view of education is a student who is developing and taking more and more responsibility for his or her actions. For example, in a convocation speech at a private school in Indianapolis, Rogge pointed out the importance of student agency: "Each student controls the doors to his own mind, and if he keeps those doors closed, there is little the teacher can do to penetrate into the interior." He then goes on to argue that the school's success will be defined by whether it can get students to take responsibility for their own education. I suspect that today's "helicopter parents" and infantilized teenagers would recoil at the practical implications of Rogge's message. It is a message, however, that parents and students need to understand if colleges and universities are going to return to being places of learning and open inquiry, not just nice places to spend four (or six) years of your life.

I have only briefly touched on the large number of topics and themes covered in this volume. All that I can say is that Rogge's articulation and application of economics toward our understanding of a free society is as clear and important as it was when he first wrote each piece. I cannot recommend this book enough. FEE

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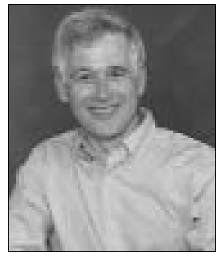
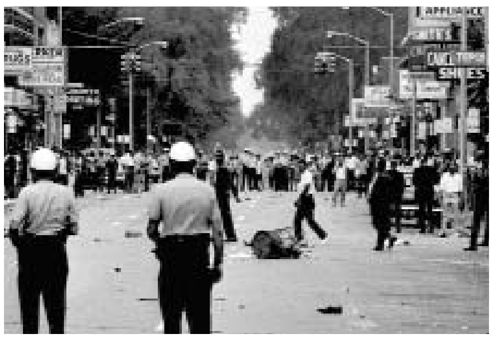
Henderson's Iron Law of Government Intervention: The 1967 Detroit Riot



BY DAVID R. HENDERSON

The more I have studied government policy over the last 40 or so years, the more strongly I have come to believe that whatever problem you name, some government intervention—a tax, a subsidy, a spending program, or a government regulation—was an important cause or, at a minimum, made the problem worse. The evidence for this view is so strong that I think it merits being called Henderson's Iron Law of Government Intervention.

One instance of this law is the famous, or infamous, Detroit riot of 1967. After the riot various pundits "informed" the public that it had happened because so many of Detroit's black inner-city residents were poor and hopeless. That became the accepted explanation and, to the extent that anyone remembers it, probably still is. But a close look at the record reveals a much more interesting story—of a government's police force oppressing people who simply wanted to live their lives peacefully. This is not to say that the people who rioted bore no responsibility—everyone is responsible for his own actions. However, without the police force's intrusion and without a previous federal program that had destroyed a community, the riot probably would not have occurred. And the evidence for this is hidden in plain sight.



Police watch rioters at 12th & Claremont, Detroit.
The Detroit News archives

During a five-day period in July 1967, 43 people were killed during the riot in Detroit's inner city. Shortly after that, President Lyndon B. Johnson created the National Advisory Commission on Civil Disorders—the so-called Kerner Commission, named after its head, then-governor of Illinois Otto Kerner. (Kerner was later convicted of having taken a bribe while governor and served time in prison.) The Commission was tasked with determining the causes of that and other riots during the summer of 1967 and with making recommendations to prevent such riots in the future.

Its 1968 *Report of the National Advisory Commission on Civil Disorders* made a big splash, selling about two million copies. The report stated that black poverty was a big cause of the Detroit riots, and its recommendations for more government jobs and housing programs for inner-city residents were explicitly based on that assumption. These recommendations, plus the charge of white racism, received much of the publicity at the time and are what most people took away from the report. Publishers make a distinction between book buyers and book readers: The latter tends to be a small subset of the former. That distinction seems to apply here. It's too bad that more people didn't actually *read* the report. The Commission's own account of the details of the Detroit riot tells a story that is fundamentally inconsistent with the Commission's own conclusions and recommendations. Here's the report's first paragraph on Detroit: "On Saturday evening, July 22, the Detroit Police Department raided five 'blind pigs.' The blind pigs had their origin in prohibition days, and survived as private social clubs. Often, they were after-hours drinking and gambling spots."

These "blind pigs" were places that inner-city black people went to be with their friends, to drink, and to gamble; in other words, they were places where people peacefully enjoyed themselves and one another. The police had a policy of raiding these places, presumably

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because the gambling and the unlicensed alcohol were illegal. The police expected only two dozen people to be at the fifth blind pig, the United Community and Civic League on 12th Street, but instead found 82 people gathered to welcome home two Vietnam veterans. The police proceeded to arrest them. "Some," says the Commission report, "voiced resentment at the police intrusion." Who'd have thunk it? The resentment spread and the riot began.

In short the triggering cause of the Detroit riot, in which more people were killed than in any other riot that summer, was the government crackdown on people who were going about their lives peacefully. For the rioters the last straw was the government's suppression of peaceful, albeit illegal, black capitalism. Interestingly, in its many pages of recommendations for more government programs, the Commission never suggested that the government should end its policy of preventing black people from peacefully drinking and gambling.

> The triggering cause of the Detroit riot was the government crackdown on people who were going about their lives peacefully.

This is par for the course. When a government intervention helps cause a problem, even those people who recognize that the intervention was somewhat to blame rarely call for an end to, or even a scaling down of, such intervention.

The government's fingerprints show up elsewhere in the Commission's report. Urban renewal "had changed 12th Street [where the riot began] from an integrated community into an almost totally black one," says the report. It tells of another area of the inner city to which the rioting had not spread: "As the rioting waxed and waned, one area of the ghetto remained insulated." The 21,000 residents of a 150-square-block area on the northeast side had previously banded together in the Positive Neighborhood Action Committee (PNAC) and had formed neighborhood block clubs. These block clubs were quickly mobilized to prevent the riot from spreading to this area. "Youngsters," wrote the Commission, "agreeing to stay in the neighborhood, participated in detouring traffic." The result: no riots, no deaths, no injuries, and only two small fires, one of which was set in an empty building.

What made this area different was obviously the close-knit community the residents had formed. But *why* had a community developed there and not elsewhere? The report's authors unwittingly hint at the answer: "Although opposed to urban renewal, they [the PNAC] had agreed to co-sponsor with the Archdiocese of Detroit a housing project to be controlled jointly by the archdiocese and PNAC." In other words, the area that had avoided rioting had also successfully resisted urban renewal, the federal government's program of tearing down urban housing in which poor people lived and replacing it with fewer housing units aimed at a more-upscale market. Economist Martin Anderson, in his 1964 book, *The Federal Bulldozer*, had shown many of the problems with urban renewal. Even some of Anderson's harshest critics at the time admitted that urban renewal could be called "Negro clearance." Indeed, at the time, an even blunter term, also beginning with the letter "n," was used.

But the Kerner Commission, even in the face of its own evidence, refused to admit that urban renewal was a contributing factor to the riots. Indeed, the Commission recommended *more* urban renewal. The Commission's phrasing is interesting, though, because it admits so much about the sorry history of the program:

> Urban renewal has been an extremely controversial program since its inception. We recognize that in many cities it has demolished more housing than it has erected, and that it has often caused dislocation among disadvantaged groups.
>
> Nevertheless, we believe that a greatly expanded but reoriented urban renewal program is necessary to the health of our cities.

In short the commission's antidote to poison was to increase the dose. FEE