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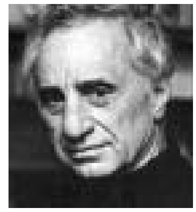
## Features





Page 37

## Columns



Page 15

## Book Reviews




Page 42

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Perspective

# Can Mutually Beneficial Exchanges Be Exploitative?

When two people not under duress enter into an exchange for goods or labor services, both must be expecting to benefit or the exchange would not occur. In any such exchange there necessarily exists a double inequality of value. Each trader gives up something to obtain what he or she prefers. Moreover, we have at least *prima facie* grounds for pronouncing the exchange legitimate since no compulsion is apparent.

This principle of sound economics (and moral theory) is unexceptionable. Indeed, we couldn't make sense of buying and selling were this not the case. We must take care, however, in applying the free-exchange principle. Knowing that parties enter into an exchange freely may be a necessary condition for our pronouncing it legitimate, but it is not a sufficient condition.

For example if you enter a post office and buy a first-class stamp for 45 cents, may we conclude that you prefer the services the stamp will buy to whatever else you might have spent the 45 cents on? If you were not ordered into the post office at gunpoint, I should think so.

Is the transaction therefore legitimate? I should think not—not entirely. Why not? Because a system supported by violence constricted your alternatives. The post office of course is a protected government monopoly. No one may compete with the State in the delivery of first-class mail.

Apparently it isn't enough to know that parties to a transaction entered it without duress. There are other criteria that a transaction must satisfy for it to be pronounced entirely legitimate.

Extending this analysis to private companies with monopolistic government privileges should incite no controversy. If the U.S. government outlawed competition with Federal Express for overnight delivery, the situation would be essentially the same as with the post office. No one would be forced to do business with FedEx. Likewise if government erects explicit or implicit barriers to entry in an industry. Transactions with the protected oligopolistic firms would still be mutually beneficial or they would not occur.

Exchanges therefore with a coercive monopoly are mutually beneficial, though we should be reluctant to call them legitimate. Any coercive monopoly will set its price low enough to produce the desired revenue. No sane monopolist would set a price so high that it would exceed consumers' subjective estimate of the utility of the product. What would be the point? But that means every sale entails a buyer who believes he or she is better off engaging in the transaction despite the lack of alternative sellers.

Thus even with a monopoly, subjective marginal utility plays a role in governing price. As Kevin Carson notes, "[M]onopoly pricing targets the price to the highest amount the consumer is able to pay and still get enough utility to make the exchange worthwhile."

And yet we libertarians don't want to declare the exchanges fully legitimate, do we? The seller is a coercive monopoly or protected firm, after all. (This does not necessarily mean the seller is culpable for the situation.)

The great thing about competitive markets is not that marginal utility sets prices but that rivalry among sellers sets prices at a point where more people can gain utility by buying the good than could do so at the higher monopoly price. We all have bought things at a price below that which we were prepared to pay. The difference is called the "consumer surplus." Ralph Hood put it nicely in *The Freeman* when discussing the falling price of electronic calculators: "[T]echnology allowed the price to drop. Competition made it drop" (tinyurl.com/863zms5). In a manner of speaking, competition *socializes* consumer surplus.

On the other hand, in the absence of competition a coercive monopoly is able to charge more than in a freed market, capturing some of the surplus that would have gone to consumers. That's exploitation through government privilege.

⋆ ⋆ ⋆

The clash of economic ideas over the last century has been a contest for the very nature and future of civilization. Lawrence White's new book, *The Clash of Economic Ideas*, has the blow-by-blow description—and we have an excerpt.

Beware free gifts from government. J. R. Clark and Dwight Lee tell you why.

A free society depends on civility and sympathy, as such thinkers as Adam Smith and Frédéric Bastiat knew well. Sarah Skwire shows how the humanities can promote these virtues.

Fifty years ago Rachel Carson's *Silent Spring*, which warned of pesticides like DDT, was published. How does it hold up? Andrew Morriss takes a fresh look.

JPMorgan Chase's big loss again shows that government-induced moral hazard still lives. Gerald O'Driscoll has the scoop.

The genocide Rwanda endured in the early 1990s is well known in the West. Far less well known is the economic liberalization and growth the country has experienced since the healing began. Ángel Martín Oro and Marc Bisbal Arias describe the remarkable progress.

You've got to hand it to the early classical liberals and libertarians. From the get-go they correctly foresaw the horror of state socialism. Philip Vander Elst surveys the record.

Elia Kazan directed such critically acclaimed movies as *On the Waterfront*, *A Streetcar Named Desire*, and *Gentleman's Agreement*. But his appearance before the House Un-American Activities Committee, which investigated Hollywood for communist connections in the 1950s, dogged his career to the end of his life. Bruce Edward Walker tells the story.

Here's what our columnists have set forth on the table: Lawrence Reed lauds Grover Cleveland for his character and statesmanship. Burton Folsom compares Woodrow Wilson to George Washington. John Stossel explains that an economy needs no conductor. Walter Williams counsels: Beware politicians' dreams. And Tyler Watts, hearing a Nobel Prize-winning economist say more inflation would be a good thing, responds, "It Just Ain't So!"

Books on freedom of contract, Iceland's financial collapse, adaptation to failure, and American militarism have occupied our reviewers.

—*Sheldon Richman*
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# Cleveland Passed the Test of Character and Statesmanship

BY LAWRENCE W. REED

As usual, this year's presidential campaign will test the popularity of two men. It will also tell us a lot about each man's character, even if we think we already know all there is to know about them both. At this writing, some pundits are predicting a photo finish, maybe even a repeat of the 2000 Bush-Gore cliffhanger. Whatever the next few months produce, every presidential contest gets me pining for my personal favorite of the 44 men who have held the office—Grover Cleveland, America's 22nd and 24th president.

Until 2000, the last time a close election produced a split decision in the popular vote and the Electoral College was 1888. Cleveland, the incumbent Democratic president, had been through a close one once before. In 1884 he won New York by just 1,200 votes—and with it, the presidency—but a switch of 601 votes in that one state alone would have swung the election to Republican James G. Blaine. Four years later Cleveland bested Benjamin Harrison by about 100,000 votes out of 11 million cast nationwide but he lost in the Electoral College 233–168. Because the contest was tight in a number of states, a slight shift in the popular vote plurality would have easily won it all for Cleveland.

While some people thought a surplus should be spent, Cleveland thought it was evidence that taxes were too high.

Alyn Brodsky, in a biography entitled *Grover Cleveland: A Study in Character*, records that when reporters asked to what he ascribed his defeat, Cleveland smiled and said, "It was mainly because the other party had the most votes." He did not equivocate. He did not whine and fret that he won more popular votes than Harrison. The "votes" to which he referred were the ones that really matter under the rules of the Constitution—Electoral College votes.

Cleveland handled his defeat with dignity. No recounts, no lawsuits, no spin, no acrimony. His grace in defeat was all the more remarkable considering that the loss meant he had to relinquish power he already possessed, not merely accept failure to attain it. He would not tolerate his political allies making an issue of the discrepancy between the popular and Electoral tallies. There was nary a hint of a "constitutional crisis" because the Constitution was Cleveland's "controlling legal authority." Cleveland retired to private life until he ran again in 1892, when he beat Harrison decisively, becoming the only American president to serve two nonconsecutive terms.

One reason the American people accepted the 1888 outcome in stride was that the federal government of that era just didn't matter like the one of today does. Cleveland famously vetoed a bill to send federal money to drought-stricken farmers in Texas with the admonition, "Though the people support the government, it is not the duty of the government to support the people."

In Cleveland's day chronic budget surpluses at the federal level of government animated many a political contest, in stark contrast to the massive and endless deficits of today. While some people thought a surplus should be spent, Cleveland thought it was evidence that taxes were too high: "When more of the people's sustenance is exacted through the form of taxation than is necessary to meet the just obligations of government, such exaction becomes ruthless extortion and a violation of the fundamental principles of a free government."

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Adjusted for inflation, the Obama administration spends more in one day than the first Cleveland administration spent in an entire year. Washington claims more than a quarter of national income now; in 1888, it managed to get by on about 3 percent. The two sides that will slug it out in the fall know that control of a gargantuan apparatus of money and power is at stake, and the temptations to pull out all the stops to win will be immense.

Even more emphatically, it was the character of Grover Cleveland that made the 1888 outcome a virtual nonevent. In so many ways he was a political oddity even for the Victorian times in which he served. Time and again he refused to do the politically expedient. For example, as a mayor, governor, and president, he rejected the spoils of victory and appointed the best people he could find—often earning the wrath of friends and party bigwigs because they didn't get the nod. As biographer Brodsky puts it, "Here, indeed, was that rarest of political animals: one who believed his ultimate allegiance was to the nation, not to the party."

Cleveland never lusted for public office. A prominent New York newspaper endorsed Cleveland for president in 1884 by declaring "three reasons" for voting for him: "1. He is an honest man. 2. He is an honest man. 3. He is an honest man." He was, by all accounts, as utterly incorruptible when he left office as he was when he first assumed it. "Public office is a public trust" was an original Cleveland maxim.

Cleveland didn't schmooze and slither his way through smoky backrooms to political power; nor did he exercise power as if he loved it for its own sake. He did the public's business honestly and frugally and otherwise left us alone. It would not have occurred to him to so covet power as to fear private life. Trashing either the system or a good man's character to obtain or hold on to public office was, to Grover Cleveland, unthinkable.

Cleveland didn't schmooze and slither his way through smoky backrooms to political power; nor did he exercise power as if he loved it for its own sake. He did the public's business honestly and frugally and otherwise left us alone.

Every statesman is also a politician but not every politician is a statesman. Cleveland was so quintessentially statesmanlike that it hardly seems appropriate to note that he was also a politician. He certainly didn't seek office for the thrill of it or for the power and notoriety it brings. Politics was not the meat grinder of principles for Cleveland that it is for so many others.

## The Statesman

What qualities define a statesman? He or she doesn't seek public office for personal gain or because it's the only job he or she knows how to do. Like ancient Rome's Cincinnatus or America's own George Washington, the statesman takes time out from a life of accomplishment to serve the general welfare. He stands for a principled vision, not for what he thinks citizens will fall for. He is well informed about the vicissitudes of human nature, the lessons of history, the role of ideas, and the economics of the marketplace.

The statesman is a truth-seeker, which means he is more likely to do what's right than what may be politically popular at the moment. You know where he stands because he says what he means and means what he says. He elevates public discussion because he knows what he's talking about. He does not engage in class warfare or in other divisive or partisan tactics that pull people apart. He does not cynically buy votes with the money his taxes take from others. He may even judge his success in office as much by how many laws he repealed or vetoed as by how many he passed. (Cleveland vetoed more bills than all his predecessors combined.)

Grover Cleveland is my model candidate and model president. I'm betting that this fall's campaign will only make me miss him all the more. FEE

# Not Enough Inflation? It Just Ain't So!

BY TYLER WATTS

Two wrongs may not make a right, but a second dose of poison might just cure the first dose. That's at least what Paul Krugman, America's most prominent left-wing economic pundit, is saying about an untapped remedy for our economic woes. In his April 5 *New York Times* column, "Not Enough Inflation" (tinyurl.com/7r27vl7), Krugman repeated his claim that "a bit more inflation would be a good thing, not a bad thing."

If you're wondering how progressively higher prices for everyday goods could help any household get ahead economically, let alone contribute to overall economic recovery, you're in good company. As all econ-principles students know, inflation is caused by an increase in the supply of money relative to money demand. The increase in consumer goods prices—that's how the layman defines and experiences inflation—is really just a symptom of the reduced purchasing power of money caused by the increase in its quantity. The higher prices for all goods in turn mean lower real incomes for consumers—which is all of us—not to mention that inflation is also typically symptomatic of the boom-bust business cycle and can cause significant widespread economic damage. In its most severe forms, inflation can wipe out people's monetary wealth and bring commerce to a halt.

What's not to love about this miracle elixir?

But smart guys like Professor Krugman aren't mere monetary cranks. They know that high inflation is economically dangerous. What they're asking for is just a small, temporary dose of fresh money to inject some new life into the economy. There is a kernel of truth to this inflationary prescription. As the Scottish philosopher David Hume explained in his 1752 essay *Of Money*, prices for different kinds of goods react differently to new money entering the economy. Generally speaking, commodities or consumer goods prices will rise faster than wages. So for a manufacturing entrepreneur, for instance, who employs many workers, inflation will cause output prices (revenue) to increase relative to wages (costs), bringing an increase in profits that will induce an increase in output. Therefore, in Hume's terms, an increase of money "must first quicken the diligence of every [entrepreneur], before it increase the price of labor."

This "sticky wages" effect is what economists like Hume, John Maynard Keynes, and Krugman have in mind when advocating inflationary stimulus. Krugman also notes that "parts of the private sector continue to be crippled by the overhang of debt accumulated during the bubble years," and that "modest inflation . . . by eroding the real value of that debt . . . [would] help promote the private-sector recovery." So higher inflation not only increases the demand for labor, but can also help clean up companies' and individuals' balance sheets, giving them the ability to ramp up their hiring and spending. What's not to love about this miracle elixir?

There are two big problems with inflationary stimulus. The first involves the process dynamics of the market economy. The inflationists tend to omit the rest of the story, which involves the *long-run* effects of new

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money. New money will *eventually* increase all prices—even wages—meaning the stimulus effect can only be temporary. For if entrepreneurs read the price increases not as mere inflation, but higher demand for their products (as the inflationists hope), they are liable to make investments to expand their production capacity. Once the inflation effect peters out, once rising wages eventually push profits back down, they find that extra production is no longer profitable. The expansion can't be sustained without more inflationary stimulus.

In a rising inflation environment, moreover, people will eventually come to anticipate further price increases. Workers demand upward wage adjustments in advance, and entrepreneurs anticipate rising costs and thus scale back their expansion plans. Once people catch on to inflationary stimulus in this fashion, larger and larger money injections (that is, higher inflation rates) are needed to merely maintain output levels. At some point, the high, rising, and volatile inflation rate itself becomes a drag on the economy. Miscalculation of next year's, or even next month's, inflation rate could spell disaster for entrepreneur and worker alike. As inflation heats up, it can actually drag investment down, as people seek to shelter their wealth in "sterile" assets like gold. Inflation, instead of a stimulus factor, becomes a source of economic confusion and frustration. Iconic images of people hauling wheelbarrow loads of money to buy a loaf of bread in post-World War I Germany remind us of the potential economic turmoil of unchecked inflation. This of course is not what Krugman has in mind, but we should not forget that the mightiest river begins as a trickle.

The second big problem with inflation is a moral one. Along with causing economic confusion, inflation redistributes wealth. The key fact here, again, is that not all prices rise immediately when new money enters circulation. People who are first to receive the new money get to spend it before prices go up. Those last in line see prices go up before their own incomes do. Inflation also redistributes wealth from lenders to borrowers, as Krugman indicated, by reducing the real value of debt. But Krugman conveniently ignores the corresponding fact that, whenever a borrower's real debt burden is eased, a lender's asset value is eroded. Thus to use inflation as a partial bailout for borrowers is to harm lenders and investors. This is happening already—even at "mild" inflation rates that are too low for Krugman's tastes, real returns on investments like bank CDs are driven into negative territory.

Through these redistributions of purchasing power, inflation acts like a tax: a tax on savers, on investors, on those at the very end of the monetary policy food chain. Ironically for Progressives like Krugman, this inflation tax arguably hits the poor and uneducated hardest. Educated, economically sophisticated people know the warning signs of inflation and know how to shelter their assets—as attested by the flurry of gold bullion dealers' ads on cable news and AM radio. The poor are much more likely to be wage earners whose incomes tend to lag inflation, or pensioners who, even with annual cost-of-living adjustments, can still see consistent reductions in their purchasing power.

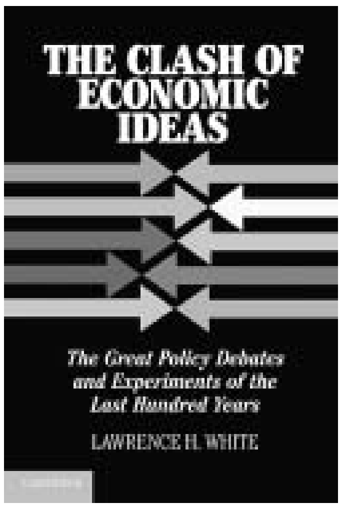
Through these redistributions of purchasing power, inflation acts like a tax: a tax on savers, on investors, on those at the very end of the monetary policy food chain.

Nonetheless, Krugman and the inflation party don't understand the free-market camp's arguments against inflation. He accuses us of "obsessing" over inflation, while he thinks the Fed should focus on curing unemployment. Even conceding that inflation can provide a temporary, halting employment stimulus, the objection remains strong. It comes down to the fact that inflation is a big lie—or, should we say, a million little lies, because inflation distorts all prices and thereby hinders their crucial function of giving entrepreneurs and workers the correct information and incentives on which to make the best economic decisions. Inflation's promises of faster growth and greater wealth are illusory. Like alcohol or drug abuse, every high begets a crash that demands larger and larger doses to maintain the effect. Inflation is a dangerous medicine that stands to do the patient more harm than good.

# The Clash of Economic Ideas

**BY LAWRENCE H. WHITE**

At England's stately University of Cambridge in fall 1905, a clever postgraduate mathematics student named John Maynard Keynes began his first and only course in economics. He would spend eight weeks studying under the renowned Professor Alfred Marshall. During the summer Keynes had read the then-current (third) edition of Marshall's *Principles of Economics,* a synthesis of classical and new doctrines that was the leading economics textbook in the English-speaking world. Marshall was soon impressed with Keynes's talent in economics. So was Keynes himself. "I think I am rather good at it," he confided to an intimate friend, adding, "It is so easy and fascinating to master the principle of these things." A week later he wrote: "Marshall is continually pestering me to turn professional Economist."



Courtesy Cambridge University Press

At an Austrian army encampment on the bank of the Piave River in northern Italy during the last months of the First World War, a lull in combat gave a young lieutenant named Friedrich August von Hayek the chance to open his first economics texts (not counting the socialist pamphlets he had read during college), two books lent to him by a fellow officer. He later wondered why the books had not given him "a permanent distaste for the subject" because they were "as poor specimens of economics as can be imagined." Returning to the University of Vienna after the war, the young veteran "really got hooked" on economics when he discovered a book by the retired professor Carl Menger. Menger's *Principles of Economics* (*Grundsätze der Volkswirtschaftslehre*) of 1871 had colaunched a marginalist-subjectivist revolution in economic theory, a revolution that provided the new ideas in Marshall's synthesis. Hayek found it "such a fascinating book, so satisfying."

Keynes and Hayek would come to play leading roles in the clash of economic ideas during the Great Depression. Their ideas have informed the fundamental debates in economic policy ever since. In 2010 and 2011 their intellectual rivalry even became the subject of two viral rap videos.

Keynes flatly rejected Adam Smith's doctrine of the invisible hand. In the opening paragraph of a 1924 lecture published in 1926 as an essay entitled "The End of Laissez-Faire," he declared: "The world is *not* so governed from above that private and social interest always coincide. It is *not* so managed here below that in practice they coincide. It is *not* a correct deduction from the principles of economics that enlightened self-interest always operates in the public interest." Specifically, Keynes denied that decentralized market forces were adequate for determining the volumes and allocations of saving and investment: "I do not think that these matters should be left entirely to the chances of private judgement and private profits, as they are at present." In

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his book *The General Theory of Employment, Interest, and Money* (1936) Keynes would emphasize his view that market forces could not be counted on to deliver a great enough volume of investment in the aggregate. An enlightened government should take control.

Keynes was a leading advocate of the view that government should take greater control over the economy. Hayek was a leading advocate of the view that government should interfere less with market forces. They serve as useful representatives of the opposing sides because of their wide influence, not because either took the most polar position available. Keynes did not want to abolish markets the way communist thinkers would. Keynes explicitly rejected Russian communism for three reasons: (1) It "destroys the liberty and security of daily life"; (2) its Marxian economic theory is "not only scientifically erroneous but without interest or application for the modern world" and its Marxist literature more generally is "turgid rubbish"; and (3) it "exalts the boorish proletariat above the bourgeois and the intelligentsia"—in other words, sneers at people like Keynes and his circle. Hayek did not want to abolish government the way anarcho-capitalist thinkers would. (Yes, there really are serious proponents of a stateless market economy.)

> Keynes and Hayek serve as useful representatives of the opposing sides because of their wide influence, not because either took the most polar position available.

For most of the twentieth century, Keynes's view that government should take on a greater role in the economy prevailed among opinion-makers. And the role of government grew. While Keynes was not an advocate of *complete* state planning, he did endorse *greater* planning. In a letter to Hayek, responding to Hayek's critique of state planning in *The Road to Serfdom* (1944), Keynes wrote: "I should say that what we want is not no planning, or even less planning, indeed I should say that what we almost certainly want is more."

## Political Economy in America's Progressive Era

Economic ideas supporting the expansion of government's role in the economy certainly did not begin with Keynes. Indeed, they did not even begin in the twentieth century. In the late nineteenth century the United States, for example, entered a period of ideological change toward more active government, a period now called the Progressive Era. Numerous economists played important roles in the ideological and political movement, developing arguments and promoting legislation to increase the role of the federal government in the economy, from the Sherman Antitrust Act (1890) to the Pure Food and Drug Act (1906) to the Federal Reserve Act (1913).

In the late 1870s and 1880s young American economists were returning from graduate training in Germany with ideas and approaches that they developed into a school of thought that came to be known as institutionalist economics. In 1885 the 31-year-old Richard T. Ely of Johns Hopkins University led a group of these economists in founding the American Economic Association (AEA). The AEA quickly became (and remains) the leading professional organization of economists, but among its original missions was to organize economists opposed to laissez-faire ideas. The AEA's initial Statement of Principles affirmed "the state as an agency whose positive assistance is one of the indispensable conditions of human progress."

Ely and his compatriots saw themselves as a "new school" of dissenters from classical or neoclassical economics and from the doctrine of laissez faire. He described the "new school" thinkers as scientific truth-seekers whose historical investigations had uncovered the benefits of labor unionization and strikes, had found in socialism "important and fruitful truths which have been unfortunately overlooked," and had "overthrow[n] many cherished dogmas" of orthodox finance. As a result there were now "political economists teaching different doctrines from the theories previously received by the more influential elements in society." Ely explicitly tied the new school in America to the teachings of German historical economists.

That many economists before 1930 developed anti-laissez-faire arguments and supported Progressive causes may surprise those who think that professional economists have almost always favored leaving the market free, or at least did so before Keynes. Fortunately or unfortunately, the devotion of economists to the doctrine of laissez faire has been grossly exaggerated, both for economists before the Great Depression and for economists today. Keynes himself exaggerated the views of the earlier economists, as did Nobel laureate (2009) and *New York Times* columnist Paul Krugman, when he wrote in 2007 that "Until John Maynard Keynes published *The General Theory of Employment, Interest, and Money* in 1936, economics—at least in the English-speaking world—was completely dominated by free-market orthodoxy. Heresies would occasionally pop up, but they were always suppressed."

In fact a large number of prominent English-speaking economists promoted "heresies" from free-market ideas during the five or six decades before 1936. They were not relegated to the fringes of the economics profession, and their ideas were not "always suppressed." (To be sure, the profession has always marginalized heretical amateurs, but more for their amateur status than for their policy views.) Ely and other American institutionalists were prominent in economics. Fred M. Taylor's 1928 presidential address to the AEA was even a proposal for "The Guidance of Production in a Socialist State." Nor were the leading neoclassical theorists—like Henry Sidgwick, Alfred Marshall, and Arthur Pigou at Cambridge or Irving Fisher at Yale—marginalized or suppressed when they criticized laissez faire. Marshall in a 1907 speech declared that "Economists generally desire increased intensity of State activities for social amelioration," while Fisher in the same year noted with satisfaction "the change from the extreme *laissez faire* doctrines of the classical economists to the modern doctrines of governmental regulation and social control" that had taken place over the previous decades.

The ongoing clash of economic ideas reflects not only deep-seated philosophical differences about the value of individual liberty but also theoretical differences about the relative merits of free markets and government for steering the economy. Are competitive markets, guided by impersonal forces of profit and loss, better than government command-and-control for directing investment toward the greatest prosperity? The key insight of economics as a discipline—its greatest contribution to understanding the social world and to avoiding harmful policies—is that, under the right conditions (property rights, rule of law, free entry), an economic order arises without central design that effectively serves the ends of its participants. In Adam Smith's analysis and famous phrase, investors are "led by an invisible hand" that aligns their private pursuit of profits with (what is no part of their intention) the greatest contribution to the economy's overall prosperity. This Smithian idea has ever since been reaffirmed and elaborated by a long line of economists. Though challenged by others, it has been repeatedly borne out by the experiences of the last hundred years. FEE

*Correction:* In the June 2012 issue, in Aparicio Caicedo's "The New Deal of World Trade," Cordell Hull was incorrectly identified as a U.S. senator in 1917. At that time Hull was still in the House of Representatives. Also, toward the end of the article the Atlantic Charter was referenced when it should have said "Havana Charter." This was an editorial, and not an author, error, for which we apologize.

# Just Wait Until It's Free

**BY J. R. CLARK AND DWIGHT R. LEE**

The quip "If you think it's expensive now, just wait until it is free" is funny because of the unfortunate truth it contains. The truth is unfortunate less because it's impossible to provide benefits without costs than because politicians constantly try to convince voters otherwise. To paraphrase Thomas Sowell: The first law of economics is that there's no such thing as a free lunch; the first law of politics is to disregard the first law of economics.

Politicians convince only the naive that government can provide free benefits, but the political process creates a lot of naivety. This naivety in turn allows politicians to enact policies that make it rational for consumers to act *as if* they believe government has lowered the cost (often to zero) of goods even when they know better. As the joke suggests, however, the more the "as if" cost of a good is reduced, the more its real cost is increased. This can be explained by making use of the important distinction between the *total* cost consumers pay for a good and the *marginal* cost they pay—that is the additional amount they pay to buy one more unit of the good.

> Politicians convince only the naive that government can provide free benefits, but the political process creates a lot of naivety.

The most obvious way the government can make people act *as if* the cost of a good has been reduced is to lower its price. The most direct way to do that is by imposing a price ceiling below the market price. We mention a price ceiling briefly only to explain why we do not consider it in detail. When the price of a good is legally lowered, the amount supplied will decrease, so consumers cannot act as if the cost has been lowered by purchasing more, despite their desire to do so. Also, it quickly becomes clear to consumers, once the aggravation of longer lines, poorer service, and declining quality is considered, that the cost of the good has become higher, not lower.

A more lasting way for politicians to give the impression they have lowered the cost of a good is to subsidize its supply. This can be done by transferring an amount covering all or part of the cost to suppliers for every unit of a good sold to consumers. This per-unit subsidy would cause a corresponding drop in the cost of production and thus in the price of each unit of the good. We assume the supply curve is horizontal—that is, prices won't rise to offset increased consumer purchases in response to the price subsidy.

For example, the entire cost of providing a year of K-12 government schooling is subsidized, and parents can send all their children to a government school regardless of how many they have. There are, of course, restrictions on which school parents can send their children to, and they have little control over who teaches their children. Similarly, government medical care subsidies, whether provided through Medicaid, Medicare, or tax advantages bestowed by not taxing employer-provided insurance as income, lower the

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price paid directly for medical care. Here again, relatively few restrictions on the amount of medical care people demand have been imposed, but this is likely to change rather significantly in the future.

If they give it any thought, most people recognize that any market prices they pay directly for government schooling and medical care are far less than the total amount they actually pay for these services. But they seldom know how much they are paying over and above the direct out-of-pocket price, and even if they did, it would not influence how much of the subsidized services they demand. This begins the explanation of why subsidizing goods increases their cost.

When politicians subsidize the supply of a good, they reduce its marginal cost to consumers by increasing the amount they pay in taxes to finance the subsidy. The marginal cost—the additional amount paid when another unit is purchased, as determined by the now-lower price—is the only cost consumers pay attention to. The total subsidized cost, in the form of higher taxes and/or insurance premiums, also increases when a consumer buys another unit of the service, but that increase is spread over all consumers, often many millions of them. So the increase in this cost is effectively zero to a consumer deciding how much of a subsidized good to buy, and is therefore ignored.

In other words, subsidizing the supply of a good creates an external cost of the type that is referred to as a "market failure" when it results from private activity (think of pollution, which is really the result of the absence of markets), but is referred to as protecting consumers against market exploitation when intentionally created by government policy. The subsidy creates a situation in which each consumer can benefit by shifting much of the cost of her consumption to the rest of the population—the larger the subsidy the larger this external cost. The result is excessive consumption of the subsidized good as each consumer expands her consumption beyond the point where the marginal value she receives becomes less than the marginal cost of producing the good—that is, less value is received from additional units than is sacrificed to produce them.

Subsidizing the supply of a good creates an external cost of the type that is referred to as a "market failure" when it results from private activity.

Some argue that subsidizing certain goods is justified because their production and/or consumption generate external benefits and would therefore be underconsumed if not subsidized. It is possible that a government subsidy can increase consumption of a good by exactly enough to offset the underconsumption due to an external benefit that would otherwise exist. But a realistic view of the knowledge political authorities possess, and the incentives they face, raises serious doubt that such goods can be correctly identified, or the right subsidy applied if they were. For example, there are private firms that generate both external costs (say in the form of pollution) and external benefits when producing a good. It is easy to model a situation in which efficiency requires that such a firm's production should be subsidized despite the pollution it creates. However, we challenge any government agency to determine when such situations exist, as they surely do, and then accurately determine what the efficient subsidies are. And even if such information were available, it would be largely ignored since the political considerations that determine what goods are subsidized, and by how much, seldom have much if anything to do with economic efficiency.

The point is that no matter why government subsidizes a good, whether to improve economic efficiency or, more likely, to satisfy some constituency under the pretense of reducing the good's cost, the effect is invariably to increase its cost. Even though the immediate effect is to decrease the good's price by the subsidy's per-unit amount, with the per-unit cost (price plus the cost of the subsidy) remaining the same, the lower price will quickly motivate an increase in the amount demanded. This will cause the price, and therefore the per-unit cost, to increase for at least three reasons, even if, as we have assumed, the supply curve is horizontal.

First, consumers have little motivation to shop carefully because the price, or direct cost, is often a small percentage of the total cost. In some cases, such as government schools (where the price is zero), consumers typically are not allowed to compare alternatives, but are assigned to a particular supplier (school). Even when consumers can choose their suppliers, they have little motivation to ask about the cost of the good, as is the case of medical care—the direct cost of which is only about 13 percent of the total cost in the United States. With consumers paying little attention to the cost of the goods they consume, suppliers have less motivation to compete on price and greater latitude to direct their customers into costly options that add little if any value.

Second, the less of the total cost consumers pay directly for a good, the less control they have over its quality or the convenience with which it is delivered. The result is that the quality of subsidized goods declines relative to their increased cost. Indeed, government schools provide a clear example of declines in educational quality, particularly in the inner cities where parents are less able to afford private schools, while cost has increased significantly. By most measures the quality of American medical care has improved, as access to improved drugs and the availability of technically advanced medical devices have increased, but at a greater cost than necessary. And the extra cost has not resulted in life expectancies equal to those in some countries with lower per-capita spending on health care, although there are many factors other than such spending that affect life expectancy. And it should also be pointed out that in countries where medical care is provided by the State, there are longer waits for that care than in the United States.

The control people have over the medical care they receive is becoming more like the control pets have over the medical care they receive.

What can be said with confidence is that the control people have over the medical care they receive is becoming more like the control pets have over the medical care they receive. In both cases, the ones receiving the care are not the ones paying directly for it. Doctors consider those paying directly their customers, and primarily cater to their desires (and instructions). We might have some advantage over our pets in this regard since we still pay directly for a portion of our care. But when considering our diminishing control over health care decisions that affect our lives, we should ask ourselves: Are the bureaucrats representing those paying for most of our medical care as concerned with our well-being as we are for the well-being of our pets?

A third reason why subsidizing goods increases their cost is the burdensome red tape that invariably accompanies the production and consumption of such goods. It is customary for people to complain about the forms that have to be filled out and records that have to be kept by teachers and their students, and doctors and their patients. There is also the accompanying cost of the hoards of bureaucrats necessary to formulate, enforce, and keep records on all the rules and regulations, most of which have no obvious connection with doing a better job educating and healing. But such complaints, and the promises of politicians to reduce red tape, have no effect because there is a good reason for much if not all of it. One of the unappreciated advantages of market exchanges is that when consumers pay with their own money and suppliers have to compete for that money by producing value, people are motivated to make decisions that benefit others. This market accountability is destroyed when suppliers are being paid by third parties for most of the cost of making a good available to consumers. Red tape is a poor substitute for market accountability, as is evident from the fact that it does not prevent the cost of subsidized goods from increasing. But if markets are not allowed to function, the alternative to red tape would be an almost complete lack of accountability. The only way to reduce red tape is to eliminate the subsidies and restore the effective and efficient accountability that only a market can impose.

Even though most of the cost of a subsidized good is paid indirectly, it commonly increases to the point where there is a noticeable and negative public reaction. When this happens, the political response to public complaints about the escalating cost is almost always to increase the subsidy, not to reduce or eliminate it. This will be accompanied by political attempts to convince the vast majority that a relatively few rich taxpayers will pay the subsidy thanks to efforts to make them "pay their fair share." The reality is that almost everyone ends up paying more one way or another. The total cost continues to go up, as do the inconvenience and red tape imposed on consumers and suppliers by government, which then provides more jobs for both government and private-sector bureaucrats.

When the cost-increasing effects of ever larger subsidies overwhelm the ability of politicians to convince voters that the cost is being paid primarily by others, political efforts are made to reduce the cost. But these efforts typically involve more bureaucratic control, which imposes yet more restrictions on the types of goods and services available, who is eligible to receive particular types, and the amount of compensation received by suppliers.

This has clearly been the case with health care. Since government began to provide significant health care subsidies, reform has consistently meant increasing the size and scope of the subsidies and the legislative detail imposed on health care decisions. It is interesting to note that physicians experienced large income increases with the big boost in medical subsidies beginning in 1965 with Medicaid and Medicare. Their increased compensation was part of the general increase in medical costs as consumers became less concerned with the cost of their care and demanded more of it. Not surprisingly, physicians are less enthusiastic about the 2010 Affordable Care Act, which is threatening to reduce their incomes. But consumers have the most to lose from increased government control over health care decisions. Without market prices determined by free exchange and undistorted by government subsidies, goods will have to be rationed by government authorities. They won't be called death panels, but they will be making decisions that will result in shovel-ready action.

Without market prices determined by free exchange, goods will have to be rationed by government authorities. They won't be called death panels, but they will be making decisions that will result in shovel-ready action.

The experience in government education is different from that in medical care for the obvious reason that it has long been financed entirely by government subsidies. Therefore, cost increases in government education cannot be obscured with increased subsidies. Also, school choice has been far more limited than the choice of doctors and hospitals. This may be why providing consumers more choice has been recommended as the best way to reduce educational cost and improve its quality. Privatizing schools would be the most effective way of achieving these improvements by insuring that people are paying the full cost of education directly with their own money. A clearly second-best approach would be providing parents of school-age children educational vouchers that could be used to pay for tuition at any school, private or public, that parents chose. Even this second-best approach has been effectively resisted by the government-school lobby, which has so far been able to convince the public that competition would reduce the quality of education. Fortunately, more people are starting to see this lobby as the biggest obstacle to genuine educational reform.

Most people would like to have their purchases subsidized by government. Once we start down that road, however, it is hard to keep the subsidies from spreading to a wide variety of things almost everyone purchases. The result is we find ourselves heading toward the situation described by Frédéric Bastiat, the nineteenth-century economist, when he said, "The state is the great fictitious entity by which everyone seeks to live at the expense of everyone else." Such an attempt to reduce the cost to everyone is clearly a guaranteed way to increase the cost of everything. If you think it is expensive now, just wait as the politicians continue to disregard the first law of economics. FEE

# Should We Follow George Washington or Woodrow Wilson?

BY BURTON FOLSOM, JR.

George Washington believed that public morality and private morality were inseparable. If you were unethical in private situations, with family and friends, you would also be unethical in political life. Because the arena of political life was larger and more consequential, Americans should, Washington believed, elect to public office people of exemplary character in their private lives.

Woodrow Wilson disagreed. "There are so many men," Wilson argued, "who are good in their private lives who are unwise in public affairs and purposes." He concluded, "If there is a place where we must adjourn our morals, that place should be in what we call the private life. It is better to be unfaithful to a few people than to a considerable number of people."

**He didn't believe the private morality of the president mattered. He did believe in intervening in foreign wars.**
Harris & Ewing [Wikipedia]

Wilson assumes that someone could be unfaithful to his wife (as he was) and duplicitous in dealing with colleagues (as some of Wilson's Princeton colleagues accused him of being), but be virtuous, fair-minded, and full of integrity in public life. Did Wilson's presidency succeed in this respect? No.

First, Wilson flip-flopped on many issues, often for political expediency. For example, in 1914 he insisted that "no child labor law yet proposed has seemed to me constitutional," but he signed such a law when he needed to do so for his reelection campaign in 1916.

Second, Wilson promised to be president of all the people, but he allowed many government bureaus to be resegregated during his presidency. The Post Office, for example, fired many black Americans and insisted that those blacks who remained had to be segregated behind screens so that whites would not have to look at them.

Third, Wilson did not respect the right of prosperous Americans to life, liberty, and the pursuit of happiness. As we'll see, he believed wealthy Americans should pay extremely high taxes.

Wilson's disagreements with Washington went further. Washington believed that even if the Americans elected men of sterling character, their power should still be limited. Why? Because human nature was flawed and even good people could make huge mistakes or be corrupted by power. The best chance to secure and perpetuate freedom, Washington argued, was to divide power among several groups, and then elect (or appoint) men of good character as political leaders.

Again, Wilson disagreed. As a Progressive he believed more in the perfectibility of man. Presidents, therefore, should be trusted with more power—so that they could overcome fragmented government, and thereby do more good for humanity. "[T]he only fruit of dividing power," Wilson argued, "was to make it irresponsible."

What Wilson wanted was a strong president who could translate his view of the interests of the people into public policy. Unlike in the founding era, Wilson

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believed that with the increase of knowledge in the 1800s and the training of experts, the modern State of the early 1900s was "beneficent."

Thus once Wilson was in the White House he wanted to be bound only by what is now called a "living Constitution," a document he could stretch to do good works. The written Constitution, for example, favors liberty of contract, the right of employer and employee to set wages and hours mutually agreeable to both sides. Wilson, however, liked the idea that he and other experts sometimes knew best the hours and wages workers should have. Thus he signed the Adamson Act, which required an eight-hour day for railroad workers.

He also signed the Revenue Act, creating a graduated income tax with a top rate of 7 percent. He saw this as an entering wedge for higher taxes later. In this case, rather than stretching the Constitution, he took advantage of an amendment to it that was ratified right before he took office. In 1916 he supported a hike in the top rate to 15 percent. By the end of his presidency, two years after World War I, the top rate was 73 percent. The limit on what some Americans had to pay in taxes was now determined by politicians, who weighed the programs they wanted against the income some Americans were seen as capable of paying.

Wilson eventually led the United States into war.

In foreign policy Washington argued that Americans should always be neutral in European wars, but Wilson disagreed. To him World War I was a chance to intervene and do good—and perhaps, since man was increasingly perfectible, to put an end to war for all time. Once the war began, Wilson pretended to follow Washington and argued for U.S. neutrality. But behind the scenes Wilson sided with the British and even sent advisers to London to assure them of that.

When Britain barred ships from entering the North Sea—as part of a plan to starve Germany—Wilson never complained. The United States would oblige the British and avoid the North Sea. But when Germany retaliated by using submarines to sink British ships, Wilson protested vigorously that American passengers had the right to travel anywhere on British ships, even ships carrying arms and munitions. As the frustrated Germans starved under the British blockade, they began to sink armed British ships, some of which were carrying Americans. Wilson eventually led the United States into war.

Wilson believed American intervention was essential to fight the war to end all wars. He believed he would be the ultimate world peacemaker. But it didn't work the way he planned. After more than 10 million deaths (over 100,000 of which were Americans), a vindictive peace treaty, and a flawed League of Nations, the world of the 1920s and 1930s became a more dangerous place.

Most American historians seem to agree that the U.S. government could have avoided World War I. George Washington would have at least tried to do so. If that had happened, the European nations perhaps would have negotiated a more stable peace—as they did after the Napoleonic wars a century earlier. If so, perhaps the world would have been spared the rise of Hitler and the expansion of both fascism and communism.

What we can say for certain is that World War I dramatically shaped American life. In the economy, for example, the national debt, which had steadily fallen for 50 years, skyrocketed from $1.2 billion in 1916 to $25.5 billion in 1919. And the taxes needed to pay just the annual interest charges on this new debt were so high they discouraged investment. Farmers, who had been urged to plant fencerow to fencerow during the war, watched helplessly as prices for their crops plummeted worldwide after the war. The Allied nations, which owed the United States about $10 billion in war loans, were soon in default. Unemployment in 1921 was almost 12 percent. The United States was in economic crisis. And much of this crisis came because we had followed Woodrow Wilson, not George Washington. FEE

# Reading Each Other

**BY SARAH SKWIRE**

National Endowment for the Humanities Chair Jim Leach spent most of 2010 on a Civility Tour of America, hosting events and discussions about the importance of the humanities for reintroducing civil discourse to American culture. Leach sees civility as a key part of a functioning society, and I agree. But whatever we mean when we talk about how the humanities can encourage civility, I think we have to mean something more than their ability to provide simple moral instruction.

Rules are good things to have. We need to learn not to wipe our noses on our sleeves, not to take stuff that isn't ours, not to scream at people when we're debating them on television, not to shout abuse at politicians even if they deserve it. But as useful as rules like that can be, they're limited in significant ways. Anyone who has read Edith Wharton's *House of Mirth* probably has a few choice words for societies in which everyone obeys the technical rules of civilized behavior and where no one's voice is ever raised—and where all these perfect manners simply serve to cloak the viciousness with which people treat one another.

If that sort of rule is all the humanities can offer, there's no reason to value them any more than or any differently from how we do etiquette manuals or advice columns or the barrage of rules for meaningless politeness that Alice gets from the Red Queen. The interactions of politics, of business, of the adult world are too complicated for simple rules to be useful. To learn to deal with these things civilly, we need to get past thinking about civility as social rules that everyone can agree on. We need to talk about more than good manners. We need to talk about what the humanities do best. We need to talk about learning how to be a grownup.

We need to talk about what the humanities do best. We need to talk about learning how to be a grownup.

It is, perhaps, another Alice who can help lead the way. In 1921 Booth Tarkington published his Pulitzer Prize-winning and now much-neglected novel, *Alice Adams*, which contains the most horrifying description of a dinner party since Grendel slaughtered and ate Beowulf's men in the mead hall. Alice Adams is just about to age out of the marriage market in her Indiana town. Her social class is marginal. She stayed at home while other local girls of "good" families went away to school, and she became something of the town belle, but did not manage to "secure a husband." She has now attracted the attentions of Arthur Russell, a wealthy and handsome out-of-towner. Throughout the summer, Arthur and Alice have spent the evenings talking in the romantic twilight of Alice's front porch. But now the relationship has come to the tipping point and Arthur must be invited in to dinner.

We've all done it, right? Dinner for the boss? For the prospective in-laws? For the man or woman we want to impress? We all know how it feels—that fear that what we have and what we are isn't good enough. And we all begin to die a little inside when things go wrong for Alice. There's the heavy, pretentious meal that her

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mother decides to serve: from canned caviar sandwiches and hot soup to larded beef fillet and Brussels sprouts. There's the intoxicated waitress hired to make it appear that Alice and her mother don't engage in housework. There's Alice's bewildered father, who can't understand why they have to pretend to be fancy since "If they get things settled between 'em he'll be around the house and to meals most any time, won't he? . . . Well he'll see then that this kind of thing was all show-off and bluff, won't he?" There's Alice's mother, whose desperation to charm Alice's suitor sends him running. And there's the heat "like an affliction sent upon an accursed people"—that renders the heavy food, the reek of boiled Brussels sprouts, and the endless social pressure even more torturous.

The first time I read *Alice Adams* I was a teenager, and I thought the dinner scene was heartbreaking. It seemed unfair for Alice to have worked so hard and gotten nothing. And didn't this Tarkington guy know anything about romance? Everyone knows the pretty girl and the handsome young man are supposed to get together at the end. I suffered for Alice, but I suffered childishly.

The second time I read *Alice Adams* I was in college. This time, I thought the scene was hilarious. Alice and her mother were such hopeless, desperate social climbers! I felt very sophisticated getting Tarkington's joke.

> This fellow-feeling is something we have to work at, something we have to practice. Left to ourselves, we're not inclined to sympathize much with things that do not directly affect us.

## Practicing Sympathy

Reading *Alice Adams* as an adult, I realized how callous I was as a college student and how sentimental I was as a teenager. Today the scene strikes me as a masterpiece of literary balance. It is tragic. I wasn't wrong at 15. And it is hilarious. I wasn't wrong at 20. But it took time and life experience for me to realize that Alice's dinner party could be both of those things at once—and that when it was, it was a better, richer, more realistic piece of fiction than my earlier readings had indicated.

What I was doing with my repeated readings of *Alice Adams*, though I didn't know it, was practicing what the eighteenth-century moral philosopher, economist, and rhetorician Adam Smith called "sympathy." And I was using the humanities to do it.

When Adam Smith talks about sympathy, he is talking about our ability to have "fellow-feeling" with the experiences and emotions of others. One thing I like about Smith is that he doesn't assume that this fellow-feeling is always easy or natural. It's something we have to work at, something we have to practice. Left to ourselves, he says, we're not inclined to sympathize much with things that do not directly affect us:

> Let us suppose that the great empire of China, with all its myriads of inhabitants, was suddenly swallowed up by an earthquake, and let us consider how a man of humanity in Europe, who had no sort of connection with that part of the world, would be affected upon receiving intelligence of this dreadful calamity. He would, I imagine, first of all, express very strongly his sorrow for the misfortune of that unhappy people, he would make many melancholy reflections upon the precariousness of human life, and the vanity of all the labours of man, which could thus be annihilated in a moment. . . . And when all this fine philosophy was over, when all these humane sentiments had been once fairly expressed, he would pursue his business or his pleasure, take his repose or his diversion, with the same ease and tranquility, as if no such accident had happened. The most frivolous disaster which could befall himself would occasion a more real disturbance. If he was to lose his little finger to-morrow, he would not sleep to-night; but, provided he never saw them, he will snore with the most profound security over the ruin of a hundred millions of his brethren, and the destruction of that immense multitude seems plainly an object less interesting to

him, than this paltry misfortune of his own. [*The Theory of Moral Sentiments*, III.3]

Taken by itself, this paints a fairly bleak picture of human nature. But Smith doesn't stop here. He adds that we don't actually behave this way. We certainly wouldn't be willing to sacrifice the population of China to save our finger, no matter how caught up we might get in our own misfortunes. So what makes us better than this? Reason, says Smith. Reason, and the ability it gives us to sympathize with others and to view our own conduct dispassionately. And, Smith argues, we learn to exercise those skills in a variety of ways, including contact with the humanities:

> Our joy for the deliverance of those heroes of tragedy or romance who interest us, is as sincere as our grief for their distress, and our fellow-feeling with their misery is not more real than that with their happiness. We enter into their gratitude towards those faithful friends who did not desert them in their difficulties; and we heartily go along with their resentment against those perfidious traitors who injured, abandoned, or deceived them. [*TMS* I.1]

What Adam Smith and I would call sympathy, or moral imagination, is what saves us from having to learn everything through direct and painful experience.

The humanities—perhaps literature in particular, but art and music and philosophy and film, all the humanities—give us a way to practice sympathy. We look at the agony of a tormented saint in an El Greco painting. We listen to the manic patriotism of Shostakovitch's Fifth Symphony, written at the height of Stalin's rule. We puzzle through Socrates's debate about whether to drink hemlock. We think about the way they make us feel, and the way their creators must have felt, and we work to understand the people, events, and emotions they portray. And because the works are great and beautiful and endlessly compelling, we come back to them again and again to think some more, and to find new ways to understand them, just as I've done with *Alice Adams* for more than 20 years.

Like almost anything worth learning, sympathy is hard, and learning it is a lifelong enterprise. The reason to devote time and energy to developing it in ourselves and our children, to practicing the fellow-feeling that Smith praises, is not simply to learn to cry when someone else stubs his toe. The point is to use this skill to think more intelligently about how we can understand each other and to capitalize on that understanding to create the kind of world we want for ourselves and our families.

## Learning from (Others') Experience

The nineteenth-century economic journalist Frédéric Bastiat carried Smith's ideas about sympathy further in this direction when he wrote about political and economic issues in terms of "what is seen and what is not seen." Actions have consequences, and those consequences take two forms: those that are immediately visible and those that are not. Bastiat writes,

> This explains man's necessarily painful evolution. Ignorance surrounds him at his cradle; therefore, he regulates his acts according to their first consequences, the only ones that, in his infancy, he can see. It is only after a long time that he learns to take account of the others. Two very different masters teach him this lesson: experience and foresight. Experience teaches efficaciously but brutally. It instructs us in all the effects of an act by making us feel them, and we cannot fail to learn eventually, from having been burned ourselves, that fire burns.

What Bastiat calls "foresight" and Smith and I would call sympathy, or moral imagination, is what saves us from having to learn everything through direct and painful experience. Bastiat shows us how this foresight, or sympathy, works in his discussion of "The Broken Window." A man whose window has been broken is comforted by his neighbors with the reflection that "It's an ill wind that blows nobody some good. Such accidents keep industry going. Everybody has to make a living. What would become of the glaziers if no one ever broke a window?" Bastiat points out that the profit made by the glazier is "what is seen." What is not seen, however, is that, if he hadn't had to replace his window, our hero might have decided to buy books or shoes with the money instead. So a bookseller or shoemaker would have gotten the profit. What is not seen is that, when our hero's window is broken and he pays to fix it, his money buys him only what he had before. When the window is not broken, his money buys him all the additional pleasure he gets from the book or shoes that he purchases.

The humanities can teach us civility and sympathy, but they can't make us perfect and they can't fix our problems for us. They can help us be more aware of the "unseen," but they cannot help us predict unintended consequences.

### What Is Not Seen

When we're practiced in sympathy it is easier for us to notice "what is not seen." When we have tried, over and over again, to put ourselves into others' places and to see the world from where they are standing, we're better people, living in a more civil world. Because we've read *Alice Adams*, we might not go over the top trying to impress people the next time we're under great social pressure and we might not be so harsh on those who do. Because our children have read, and have had read to them, stories that help them think about the perils of greed, or the importance of kindness, or the dangers of drinking from bottles marked "Drink me," they will grow up to be more considerate and more careful of themselves and others.

It's tempting to close with promises about how if we all just read a few more books—better books—support our local arts scene, visit museums, attend concerts, read to our children and make them take piano lessons, our problems will be solved. Surely, a society that's grounded in civility and sympathy and learned in the humanities would not be plagued with financial irresponsibility and ethical misconduct. Surely it wouldn't be run by politicians and reported on by journalists who use language that would have shocked Lady Chatterley. Unfortunately people who offer easy answers to complicated questions are usually trying to sell you something.

The humanities can teach us civility and sympathy, but they can't make us perfect and they can't fix our problems for us. They can help us be more aware of the "unseen," but they cannot help us predict unintended consequences. There isn't a philosophical theory or a novel or a painting or a piece of music in the world that can solve the Middle East or clean up an oil spill or make the economy recover. The best the humanities can do is to remind us that, as Auden put it, "We must love one another or die," and then show us how to do it. FEE

# *Silent Spring* After 50 Years

**BY ANDREW P. MORRISS**

This year marks the 50th anniversary of a foundational document in modern environmentalism: Rachel Carson's *Silent Spring*. Today, when Carson's book is often mentioned but rarely read, it is easy to forget how important it was in shaping American attitudes about the environment. Serialized in *The New Yorker*, featured as a Book of the Month Club selection, given a CBS TV special, and praised by President John F. Kennedy, *Silent Spring* was a national sensation in the early 1960s. The book led to Carson's testimony before a Senate subcommittee, which, together with her 1964 death from cancer, established the book's iconic status and placed Carson on a pedestal as the "mother of the environmental movement."

Cato Institute

It is difficult to justify *Silent Spring*'s reputation as crusading investigative reporting. Carson was a longtime critic of DDT rather than a scientist who discovered pesticide problems in research. She edited 1940s reports by her boss at the Fish and Wildlife Service, Clarence Cottam, which were critical of DDT's use to control mosquitoes in marshlands. Indeed, in the anniversary volume I coedited for the Cato Institute, Pierre Desrochers and Hiroko Shimizu report that Carson herself unsuccessfully pitched an article attacking DDT to *Reader's Digest* in 1945.

Unfortunately, the legacy of *Silent Spring* is—at best—mixed. Carson rightly pointed to abuses by government pesticide-spraying programs that ignored private property rights and caused significant harm. But Carson also embraced strands of what University of Maryland economist Robert Nelson has labeled "environmental religion." Indeed, as Desrochers and Shimizu show, the intellectual "groundwaters" for *Silent Spring* included sources such as her friend William Vogt's 1948 best-seller *Road to Survival*, which praised pests such as tsetse flies and malaria-carrying mosquitoes as "blessings in disguise" for reducing populations in poor countries, whose "greatest national assets" included high death rates. And Carson's message that chemicals posed an existential threat—she termed pesticides like DDT "biocides"—helped legitimize the long-standing strain of apocalyptic thinking that environmentalists have ever since invoked to justify measures restricting liberty. Indeed, Carson's original title for the book, *Man Against the Earth*, embodied the apocalyptic theme.

Carson was not the first to write about the dangers of pesticides, nor was she the first to sound the alarm over environmental issues. As early as 1948 Fairfield Osborne's *Our Plundered Planet,* which warned of bird death from pesticide spraying, was a bestseller. Even Carson's metaphor of a "silent spring" was foreshadowed by a 1946 *New Republic* article, "Dynamite in DDT," which reported "the silence of total death" after aerial spraying of a forest in Pennsylvania. Six months before *Silent Spring*, a major publisher issued Murray Bookchin's *Our Synthetic Environment* (although it used the pseudonym Lewis Herber to avoid Bookchin's radical reputation). In 1959 Robert Rudd published two

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articles in *The Nation* that formed the basis for his 1964 book *Pesticides and the Living Landscape*, which contained many of Carson's themes. Indeed, Desrochers and Shimizu conclude that Carson's work was not at all original but "vintage technophobic muckraking in quality literary clothing." Yet *Silent Spring* was, and remains, far more important than any of its contemporaries.

There are two reasons for its success. First, when the book came out Carson was established as a major popular American writer. In the forthcoming Cato collection environmental writer Wallace Kaufman notes that Carson's first books—*Under the Sea-Wind* (1941), *The Sea Around Us* (1951), and *The Edge of the Sea* (1955)—lyrically portrayed ocean life to the American public as part of a wider popular literature on the oceans that included Thor Heyerdahl's description of a trip across the Pacific on a balsa raft, *Kon Tiki* (1951). These books established her reputation as a gifted writer, opening readers' eyes to the wonders of the natural world.

**Rachel Carson could have made *Silent Spring* the capstone of a series of lyrical, thoughtful treatments of the environment's complexity. She chose polemic instead.**

*Silent Spring* was a departure from this work. As Kaufman notes, *New Yorker* editor Wallace Shawn encouraged her to take on an adversarial role, writing in a letter to her: "After all there are some things one doesn't have to be objective and unbiased about—one doesn't condone murder!" Carson embraced the mission she was given, noting that it allowed her to be "pulling no punches." Although *Silent Spring* was a work of advocacy, Carson had credibility with the reading public based on her earlier work, a credibility that authors like Bookchin lacked.

Second, Carson's literary skill allowed her to link her message to deeply held religious themes in American thinking. As Robert Nelson notes, Carson was brought up in the Presbyterian Church—as were other key environmentalists, including John Muir, David Brower, Edward Abbey, and Dave Foreman. In his writings, including *The New Holy Wars: Economic versus Environmental Religion,* Nelson argues that Presbyterianism's connections to Calvinism helped shape much American environmental thinking. He quotes environmental historian Mark Stoll: "The moral urgency that animates the environmental movement is also a direct legacy of Calvinism and Puritanism. . . . The activist wing of environmentalism traces its roots through the Puritans directly to God's holy self-appointed instruments, the committed Calvinists." Whether consciously or not, Carson connected with this religious legacy; her vision resonated with Americans seeking a spiritual connection with nature. Just as in the biblical story of the Garden of Eden, Carson's tale of rampant poisoning of nature was a morality tale of mankind's hubris. Indeed, Nelson notes that Carson begins *Silent Spring* with an Eden-like image of "a town in the heart of America where all life seemed in harmony with its surroundings." Like the *Book of Revelation*, Carson offered an apocalyptic vision of the consequences of that hubris—the vision of a spring when "no birds sang" and children "would be stricken suddenly while at play and die within a few hours" as a result of man's arrogant efforts to assume a God-like role in creation. Although most Americans in the early 1960s still believed in what Nelson terms the economic religion of progress, the combination of rapid social change after World War II and the nuclear arms race made many receptive to an apocalyptic message.

Carson's reputation, writing skill, and connection with deep religious themes in American life thus positioned *Silent Spring* to have a major impact on Americans' thinking about the environment. Unfortunately its message was deeply flawed.

Although today writers often portray her as a scientist, Carson had only a master's degree, working professionally as a popular science writer for the federal government and as a freelance writer. Measured against the scientific standards of her day, her work is deficient. In particular, three important flaws mar Carson's argument and persist in much environmental thinking.

First, as an advocate, Carson made no effort at a balanced presentation. She ignored important evidence—including evidence that she must have known about—that contradicted her story. For example, Carson was active in the Audubon Society and served on its board of directors. Audubon conducted a regular Christmas bird census count across the United States. Carson surely knew not only that the census failed to show declining populations of many of the birds she discussed, but also that even those with declining populations began their declines well before the introduction of organic pesticides. This unwillingness to consider evidence that does not fit "the narrative" remains a problem for environmentalists today, as the "Climategate" emails illustrate in the debate over climate change.

> Measured against the scientific standards of her day, Carson's work is deficient.

Second, Carson embraced the ideas of a cancer expert, Dr. William Hueper, who did not consider tobacco use a significant factor in cancer incidence. While most Americans today would be skeptical of the credentials of a scientist who denied such a link, there was considerable controversy over the issue in the 1950s, and so Hueper's position was not ridiculous. Yet despite the controversy and significant public discussion of tobacco's impact, Carson paid no attention to the effect of increasing smoking rates on cancer incidence, instead associating all increases in cancer with chemical use. In the period leading up to the publication of the 1964 Surgeon General's report *Smoking and Health*, ignoring the topic could only have been a deliberate choice. Failing to even acknowledge such an important alternative explanation undercuts any claim that Carson was presenting "science" in *Silent Spring.*

Similarly, Carson did not adjust her cancer numbers for differences in life expectancy or declines in other causes of death. Between 1900 and 1958 Americans' life expectancy rose from 47.3 to 69.6 years. Of course more Americans were dying of cancer in 1958 than in 1900 because many of those who might have died of cancer in 1900 died of something else before they had a chance for a cancer to develop. Similar oversights remain important for environmentalists today.

Third, Carson paid little attention to the benefits of chemical pesticides. These were (and are) significant. One key benefit was the vast increase in agricultural productivity that pesticides allowed, making food cheaper and more widely available. Another was disease control, with DDT in particular saving millions of people from malaria and other insect-borne diseases. This was a key factor in the presentation of the Nobel Prize in Medicine to DDT's discoverer, Dr. Paul Müller. Moreover, most of the new pesticides like DDT were substitutes for dangerous arsenical pesticides in widespread use before World War II. And substituting chemicals for labor not only freed people from backbreaking farm work but helped the environment by limiting the need to plow to control weeds, which reduces erosion.

There were serious abuses of chemical pesticides in the 1950s and early 1960s, often funded by government agencies on missions to eradicate pests. Carson rightly pointed out the dangers these mass spraying programs posed to the environment. But, like modern environmentalists confronted with destructive government programs, her remedy was more government, not greater respect for landowners' property rights. In this, *Silent Spring* marked an important turning point away from earlier environmental writers like Aldo Leopold, who emphasized development of a "land ethic" and attention to incentives over coercion in *A Sand County Almanac.* While there are certainly statist tendencies in Leopold and other early writers, those writers paid much more attention to changing hearts and minds than to creating bureaucracies. After *Silent Spring*, that strand of American environmental thinking vanished for decades.

One of the legacies of *Silent Spring* was the federalization of environmental law. Carson's efforts and untimely death helped catalyze a movement to restrict the use of chemical pesticides, including DDT. Despite all the heat and controversy the campaign against DDT generated, few chemical manufacturers mourned its loss, as DDT was cheap and unprotected by patents. Chemical companies much preferred their more lucrative—and often more hazardous—alternative products. What they did not want was a patchwork of state-level regulation of their products. Thus pesticide manufacturers embraced federal regulation as a means of preempting state regulatory efforts. *Silent Spring* thus deserves some of the credit (or blame) for the conversion of environmental law from a matter largely left to state governments in 1960 to one that Richard Nixon happily federalized in the early 1970s. Today's environmentalists ought to revere Nixon as a hero, since he not only created the Environmental Protection Agency by executive order but also signed several major environmental laws, including the Clean Air Act Amendments of 1970. Indeed, environmental regulation fit nicely into the Nixon agenda of greater federal control of many aspects of American life, from drug prohibition to wage and price controls.

In his contribution to the Cato volume, federalism scholar Jonathan Adler terms the 1970s' federalization of pesticides the creation of a "broad, untargeted regulatory structure" rather than an effort to "match federal efforts to truly national problems." Moreover, the new federal regulatory structure was "overly centralized and inflexible." Environmental pressure groups obtained a place at the table in Washington, but they joined, rather than displaced, the existing special interests from the agricultural and chemical industries. Federalizing regulation of pesticides, as with federalization of environmental law generally, served to shift government interventions to a location far from most citizens, where decisions were made behind closed doors.

This may in part account for *Silent Spring*'s continued iconic status. The first efforts against mass spraying programs were trespass suits against the government agencies. The courts rejected these, finding that the government's claim to be upholding the public interest trumped landowners' property rights. Rebuffed by the courts, antispraying activists turned to a struggle for control of the federal government that was funding the programs. Their victory over DDT was a key early victory by environmental organizations, and contributes to the treatment of *Silent Spring* as holy writ rather than as a dated, flawed—if extraordinarily well-written—piece of advocacy. That in turn has led to bitter resistance to the use of DDT to save lives in Africa and Asia. Despite mounting evidence—detailed by anti-malaria campaigners Donald Roberts and Richard Tren both in the Cato volume and their book *The Excellent Powder* (2010)—that indoor spraying of DDT is an essential tool against malaria with few environmental effects, Western environmental groups have fought for decades to deny it to developing countries to use against malarial mosquitoes.

Unlike many of her contemporaries among early environmental writers, Carson never explicitly advocated ending disease-control efforts although, shockingly, quite a few did. Nonetheless, Carson's failure to credit the public-health benefits of pesticides is a major

Federalizing regulation of pesticides, as with federalization of environmental law generally, served to shift government interventions to a location far from most citizens, where decisions were made behind closed doors.

failing in the book, since the *Silent Spring*-inspired anti-DDT crusade led to the deaths of millions in Africa and Asia.

Carson never advocated a total ban on pesticides, calling instead for restrictions on their use. She was undoubtedly right that there was excessive pesticide use—partly because expanding New Deal agricultural subsidy programs pushed U.S. farmers toward ever-more intensive agriculture, partly because the federal government subsidized aerial spraying for pest control. Carson's main solution was a proposal for expanded biological controls of pests through the introduction of species that prey on harmful insects. As conservation biologist Nathan Gregory notes in the Cato volume, this was a solution "as rife with hubris as the technological solutions Carson condemns." Indeed today the deliberate introduction of invasive species would be viewed by most environmentalists and biologists as problematic at best and catastrophic at worst. Gregory points out that Carson does not deserve blame for her failure to anticipate two decades of development of understanding of conservation biology that undermined her proposed approach. But today's environmentalists can be held accountable for their continued advocacy of unrealistic alternatives.

From wind farms to biofuels, environmentalists today are just as likely to embrace environmentally damaging and ineffective solutions as Rachel Carson was. Ironically, wind farms today may pose a greater threat to bird populations than pesticides ever did, and misguided U.S. efforts to force domestic production of corn-based ethanol have played havoc with groundwater supplies and soil quality throughout the Midwest. Despite their nominal commitment to "science," many environmentalists embrace the Rachel Carson notion of science: a popularized version of ideas whose real-life complexity defies simple solutions to problems. Moreover, like Carson, they often advocate government programs whose unintended consequences can be as deleterious as the problems they are intended to solve.

Man's interaction with his environment is a complex subject, one we are only beginning to understand. Unfortunately modern environmentalism too often focuses on only a fraction of those interactions and turns too hastily to statist solutions. Had Carson written a book like her first three rather than a polemic, she would have produced a careful and thoughtful work that presented the complexity of the environment, incorporated the readily available data on bird populations she ignored, adjusted her cancer statistics for the increase in life expectancies, paid attention to tobacco's role, and been as critical of invasive species-based solutions as she was of chemical ones. That book might have launched a different environmental movement from the one that now claims her as its intellectual mother.

Man's interaction with his environment is a complex subject, one we are only beginning to understand.

Rachel Carson was uniquely positioned in the early 1960s to affect the future direction of American environmentalism, and it is unfortunate that she chose the path she did. Of course a careful, thoughtful weighing of the health and environmental benefits of pesticide use that took into account the lives saved in Africa and Asia and the benefits of no-till agriculture on soil erosion might not have sold quite as many copies as a sensationalist portrayal of a spring without songbirds.

What might such an alternative environmentalism look like? It would value the lives saved from the ravages of malaria, celebrating human beings as what Julian Simon termed "the ultimate resource." It would counsel against massive government interventions like the gypsy-moth and fire-ant eradication programs Carson decried, focusing instead on developing incentives for landowners to encourage responsible behavior. It would emphasize local knowledge of particular ecosystems, not grand pronouncements by bureaucrats from Washington. It would emphasize the need to understand tradeoffs, not proclaim absolutes. FEE

# Casino Banking

BY GERALD P. O'DRISCOLL, JR.

JPMorgan Chase & Co., one of the nation's leading banks, revealed in May that a London trader racked up losses reportedly amounting to $2.3 billion over a 15-day period. The losses averaged over $150 million per day, sometimes hitting $200 million daily. The bank originally stated the trades were done to hedge possible losses on assets that might suffer due to Europe's economic woes. There is now doubt whether it was a hedge or just a risky financial bet.

A hedge is a financial transaction designed to offset possible losses in an asset or good already owned. The classic hedge occurs when a farmer sells his crop in a futures market for delivery at a specified date after harvesting. He sells today what he will only produce tomorrow, and locks in the price. If the price at harvest time is lower than today's price, he makes money on the forward contract, while losing a corresponding amount of money on the crops in the ground. In a perfect hedge the gains and losses should exactly offset each other.

> How did JPMorgan suffer such large losses on its hedges, and what are the lessons?

How did JPMorgan suffer such large losses on its hedges, and what are the lessons?

It appears the London trader entered into financial transactions on the basis of observed relationships among various bond indices. The market relationships broke down. The indices moved differently from what historical patterns or financial models predicted. Such a breakdown has been at the heart of a number of spectacular financial collapses, notably that of Long-Term Capital Management (LTCM) in 1998 and a number of others during the financial meltdown of 2007–08.

LTCM invested the money of rich clients in financial bets based on the expected relationships among the prices of various assets. According to Nicole Gelinas in *After the Fall: Saving Capitalism from Wall Street—and Washington,* at the time of its collapse LTCM had $2.3 billion of client money. By borrowing, it leveraged that investment 53 to 1. Further, it employed derivatives to further magnify its bets so that its total obligations were a fantastic $1.25 trillion.

A derivative is any security whose price movements depend on (are derived from) movements in an underlying asset. "Puts" and "calls" on equity shares are relatively simple derivatives familiar to many. Asset prices, like various bonds, move in predictable ways with respect to each other, and values of derivatives linked to the assets similarly move in a predictable fashion with respect to the prices of the underlying assets—*in normal times*.

But the summer of 1998 was not a normal time. There was turmoil in Asian financial markets, then Russia threatened to default on its domestic debt. Global credit and liquidity dried up, and LTCM could not fund itself. It collapsed spectacularly.

A decade later there was turmoil in housing finance. The housing bubble was bursting. Mortgage lenders were under pressure, and some were failing. Many mortgages had been packed together in mortgage-

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backed securities, which were sold to or guaranteed by Fannie Mae and Freddie Mac. Fannie and Freddie, allegedly private entities but in reality guaranteed by the government, were failing. Lehman Brothers, an investment bank, was heavily involved in housing finance; it borrowed short-term, even overnight, to finance long-term holdings; it employed heavy leverage; and it made liberal use of derivatives contracts. It declared bankruptcy on September 15, 2008.

The specifics varied between 1998 and 2008, and between LTCM and Lehman. But the reliance on certain asset prices moving in predictable fashion was one shared element. So, too, was the heavy use of borrowed money (leverage) and the reliance on derivatives contracts. The volatility of complex derivatives contracts led legendary investor Warren Buffett to characterize them as "financial weapons of mass destruction."

## The Usual Suspects

In short there is nothing new in what happened to JPMorgan. It claimed it was not trying to make risky financial bets, but hedge risks already booked on its balance sheet. While details of the trades that led to losses are sketchy at this writing, they apparently employed both leverage and derivatives. As documented here, these are elements present in major financial blowups and collapses going back decades (and further). LTCM, Lehman, and Fannie and Freddie all thought they had at least some of their risks hedged. But hedges have a tendency to unravel just when needed most: in times of financial turmoil. Even so, financial institutions permit their traders to make the same kinds of dangerous bets over and over again. We used to have financial crises every decade or so. Now the cycle seems to be halved.

In the past I have dubbed today's banking practice of placing dangerous financial bets "casino banking." It differs little from the activities conducted at gaming tables in Las Vegas and has little or no reference to the fundamentally healthy activity of matching viable businesses with capital and credit.

In a Cato *Policy Analysis* (tinyurl.com/7n8br64), "Capital Inadequacies: The Dismal Failure of the Basel Regime of Bank Capital Regulation," Kevin Dowd and three coauthors examined some of the technical problems with standard risk models used by large banks. It is an exhaustive analysis, and I commend it to those interested. The authors delve into many issues, but concentrate on the many flaws of the complex mathematical models used by banks to control risks.

In August 2007 Goldman Sachs Chief Financial Officer David Viniar puzzled over a series of "25-standard deviation moves" in financial markets affecting Goldman. (Returns deviated from their expected values by 25 standard deviations, a measure of volatility.) Such moves should occur once every 10-to-the-137th-power years if the assumptions of the risk model were correct (a Gaussian, or "normal," distribution of returns). As Dowd and his coauthors put it, "Such an event is about as likely as Hell freezing over. The occurrence of even a single such event is therefore conclusive proof that financial returns are not Gaussian—or even remotely so." And yet there were several in a matter of days. In Dowd & Co.'s telling, the models lie, the banks swear to it, and the regulators pretend to believe them. All of this goes to answer how the losses at Morgan might have happened. Traders rely on flawed models to execute their trades.

> The models lie, the banks swear to it, and the regulators pretend to believe them.

## Now to the Lessons

Major financial institutions continue to take on large risks. Why? Assume the trades made by Morgan really were to hedge the bank's exposure to events in Europe. That implies, of course, that risky investments had already been put in place (since they then needed to be hedged). Additionally, the risks were so complex that even a highly skilled staff (which Morgan certainly employs) could not successfully execute hedges on them.

Reports indicate that senior management and the board of directors were aware of the trades and exercising oversight. The fact that the losses were incurred anyway confirms what many of us have been arguing. Major financial institutions are at once very large and very complex. They are too large and too complex to manage. That is in part what beset Citigroup in the

2000s and now Morgan, which has until now been recognized as a well-managed institution.

If ordinary market forces were at work, these institutions would shrink to manageable sizes and levels of complexity. Ordinary market forces are not at work, however. Public policy rewards size (and the complexity that accompanies it). Major financial institutions know from experience that they will be bailed out when they incur losses that threaten their survival. Morgan's losses do not appear to fall into that category, but they illustrate how bad incentives lead to bad outcomes.

## Minding Our Business

Some commentators have argued that politicians and the public have no business in Morgan's losses. Only Morgan's stockholders, who saw its share price drop over 9 percent in one day, and senior management and traders who lost their jobs should have an interest. But in fact losses incurred at major financial institutions *are* the business of taxpayers because government policy has made them their business.

Losses incurred at major financial institutions are the business of taxpayers because government policy has made them their business.

Large financial institutions will continue taking on excessive risks so long as they know they can offload the losses onto taxpayers if needed. That is the policy summarized as "too big to fail." Let us not forget the Troubled Asset Relief Program (TARP), signed into law by President George W. Bush in October 2008. It was a $700 billion boondoggle to transfer taxpayer money to stockholders and creditors of major banks—and to their senior management; don't forget the bonuses paid out of the funds.

Banks may be too big and complex to close immediately, but no institution is too big to fail. Failure means the stockholders and possibly the bondholders are wiped out. Until that discipline is reintroduced (having once existed), there will be more big financial bets going bad at these banks.

Changing the bailout policy will not be easy because of what is known as the time-inconsistency problem. Having bailed out so many companies so many times, the federal government cannot credibly commit in advance not to do so in the future. It can say no to future bailouts today, but people know that when financial collapse hits tomorrow, government will say yes once again. The promises made today will not match the government's future actions. There is inconsistency between words and deeds across time.

What to do in the meantime? The Volcker Rule was a modest attempt to rein in risk-taking. Former Fed Chairman Paul Volcker wanted to stop banks from making risky trades on their own books (as opposed to executing trades for customers). Industry lobbying has hopelessly complicated the rule and delayed its issuance.

Morgan's chief executive officer, James Dimon, asserted the London trades would not have violated the rule. If true, it suggests that an even stronger rule needs to be in place. Various suggestions have been made to address excessive risk-taking by financial firms backed by the taxpayers. It is time to take them more seriously. FEE

# Rwanda's Economic Success: How Free Markets Are Good for Poor Africans

BY ÁNGEL MARTÍN ORO AND MARC BISBAL ARIAS

Societies have turned around and succeeded after passing through a period of vicious conflict and ruthless violence. Rwanda is an example.

Since the brutal genocide of 1994, when about 20 percent of the population was killed, the political and social situation has stabilized, making possible, together with free-market reforms, a sustained economic expansion in a relatively peaceful environment.

Rwanda is a small landlocked country located in east-central Africa with a population of about 11 million inhabitants. Its two major ethnic groups—the minority Tutsi and the majority Hutu—had been clashing with each other since before the Belgians took control of the country after World War I. (The country became independent from Belgium in 1962.) The constant social and ethnic tensions ended in a genocide that took the lives of some 800,000 people—mainly Tutsi.

**Liberalizing the coffee trade and other free-market reforms have helped Rwanda recover from genocide.**
Evan-Amos

In consequence, the economy sharply contracted—by about 50 percent—that year, but the recovery was quite fast and solid, with GDP growing at 35 percent in 1995 (tinyurl.com/d9fw9yn). It has managed to sustain high growth rates ever since, not even losing steam in the last decade. The economy grew an average 6.6 percent per year from 1994 to 2010, substantially higher than the sub-Saharan African average. In 2001 Rwandan inhabitants lived on an average of 50 cents a day; today this figure has risen to $1.50 a day.

Recent poverty and welfare indicators—taken from the Third Household Living Conditions Survey—are also encouraging. For the last five years poverty has been drastically reduced, from almost 57 percent to 45 percent of the population. In contrast the drop was only 2 percentage points in the previous five years. What's more, extreme poverty has registered an unprecedented fall, from 37 percent to 24 percent. Improvements have also taken place beyond the poverty figures, including maternal and infant mortality.

According to British development economist Paul Collier, the results of the survey were "deeply impressive." Collier also acknowledged that Rwanda had been able to achieve three key goals: rapid growth, sharp poverty reduction, and reduced inequality.

Fortunately, Rwanda is not an exception in Africa. The International Monetary Fund estimates that sub-Saharan African GDP will expand by 5.4 percent and 5.3 percent in 2012 and 2013, respectively. In contrast, advanced economies are unlikely to grow at rates higher than 2 percent in the next couple of years.

Furthermore, poverty on the continent as a whole is diminishing more quickly than is commonly believed,

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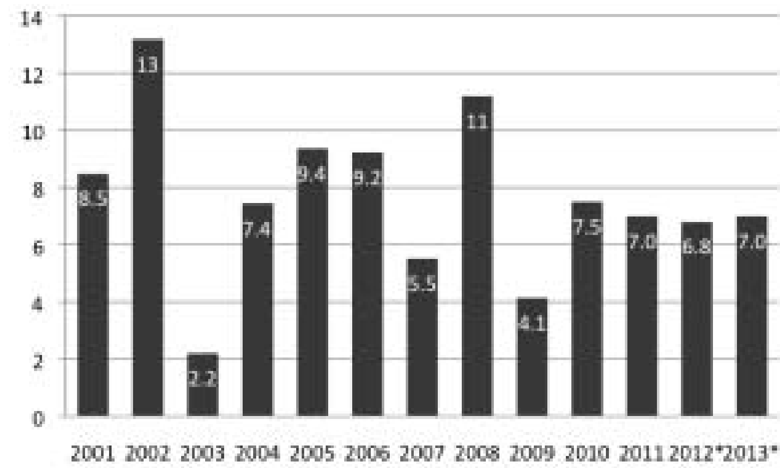
as economists Maxim Pinkovskiy and Xavier Sala i Martín concluded in a 2010 paper, "African Poverty Is Falling . . . Much Faster than You Think." The last update of the World Bank's poverty estimations indicated that between 2005 and 2008 the absolute number of poor sub-Saharan African people had fallen for the first time in recent history, despite the region's remarkably high population growth.

The economic growth in Rwanda has been primarily driven by liberalization in the agricultural sector—mainly coffee and tea, the country's main exports. These reforms allowed producers to greatly benefit from an export boom, increasing incomes and boosting productivity through capital investments. Dynamic tourism and industrial sectors—mining and construction—have also contributed to the recent economic success.

**Rwandan GDP growth (%), 2001–2013**




*Source: World Economic Outlook Database (International Monetary Fund).*
**Note: 2012 and 2013 are forecasts.*

However, the country's economy is still vulnerable and unstable. To progress faster Rwanda would need to move toward production of high-value-added products, since the potential increases in productivity and exports in the traditional sectors are limited.

Entrepreneurship, usually the main driver of economic growth, and innovation should lead this transition. In the Rwandan case there has been noteworthy dynamism in household enterprises, which are dedicated to nonagricultural activities and usually located in rural areas. Even though they only employ 10 percent of the labor force, more than 30 percent of families relied on these enterprises for income in 2006.

Despite being low-productivity activities (such as styling hair or manufacturing simple products), these enterprises play an important social role given the country's high levels of illiteracy and poverty. Moreover, wages in these household enterprises are higher than those offered in agriculture, which explains why they are attracting workers out of the primary sector. In this regard, the development of the financial market and banking system is important since these initiatives need access to loans.

On the other hand, regional trade integration has facilitated a shift in imports from Europe to neighboring countries, which benefit from lower prices and increased exports. Yet landlocked Rwanda's poor roads and nonexistent railway system mean transport costs are too high. This is improving: While in 2006, 11 percent of the roads were considered to be in good condition, this figure rose to 52 percent in 2009.

The country's relative business dynamism would not have been possible without an improvement in the regulatory and institutional framework. In the latest *Doing Business* report (2012), Rwanda ranked 45th in business regulation; only four years ago it was 148th. The country also ranks third among African nations in the Heritage Foundation/*Wall Street Journal* Index of Economic Freedom. While its overall score was less than 40 in 1997, this year it is 64.9, with notable improvements in business and trade freedom. (The closer to 100, the more economic freedom.) No wonder Rwanda is considered the country with the most-improved economic environment. The reason is widespread liberalization, with the most significant areas of change being the registry of property, protection of investors, trade openness among African countries, and access to credit.

## Coffee Sector: Free Markets Are Good for the Poor

The benefit of economic liberalization is best illustrated by Rwanda's coffee sector, on which more than half a million families depend. (We draw on Karol Boudreaux's Mercatus Center paper "State Power, Entrepreneurship, and Coffee: The Rwandan Experience," tinyurl.com/dxe5hky.)

Only two decades ago this sector was tightly regulated and controlled by the government; it was the key source of revenue. Farmers were forced to devote at least a quarter of their land to growing coffee, which a government agency bought at a below-market price. The government then sold the coffee on the markets at the higher price and kept the difference. On top of this implicit tax, farmers had to pay an export tax.

This unjust interventionist scheme supported the corrupt government and enriched its cronies. The farmers were legally plundered. However, because of its inherent unsustainability and the destructive effects of the genocide, the scheme finally broke down.

It was not until the late 1990s that Paul Kagame's government liberated the coffee sector. The reform removed legal requirements and made it possible for farmers to freely trade with buyers from any part of the world. That of course increased incentives to invest and innovate. The Rwandan people—partly helped by the West—focused on increasing quality rather than quantity, raising efficiency and productivity. This fostered farmers' and entrepreneurs' business relationships and opportunities to trade, encouraging them to acquire better skills.

Thanks to these improvements, prices soared. Consequently, about 50,000 households saw their incomes from coffee production double. For the first time, families could afford to pay school fees for their children, pay medical bills, buy clothing, fix their homes, or invest in their small businesses.

As Karol Boudreaux highlights, liberalization not only improved the economic opportunities and potential of the people, it also enhanced social cooperation and cohesion among Tutsi and Hutu, which was desperately needed after the genocide.

## The Curse of Foreign Aid

The country still has severe problems, some of which are common to other low-income economies. These mainly consist of high rates of malaria and AIDS, lack of access to safe drinking water and electricity, and a strong dependence on subsistence agriculture, a sector that employs about 70 percent of the labor force.

Furthermore, the Rwandan economy suffers from a number of vulnerabilities that may hinder its growth. First, the country depends excessively on foreign aid, which covers as much as 40 percent of the government's budget and amounts to 18 percent to 20 percent of GDP. Second, the poorly diversified economy—primarily coffee and tea, and other agricultural products—makes Rwanda more vulnerable to particular shocks. Third, chronic budget and trade deficits (symptoms of other problems) have created high levels of government and external debt that will have to be repaid.

Rwanda's debt problem may be partly caused by the increasing levels of development aid. The fact that about three-fourths of Rwanda's total debt is owed to the World Bank illustrates this point.

Although at first sight these three issues may seem independent of one another, the truth is that they are interrelated. For instance, the debt problem may be partly caused by the increasing levels of development aid. The fact that about three-fourths of Rwanda's total debt is owed to the World Bank illustrates this point. As African economists Dambisa Moyo and George Ayittey claim—echoing the great development economist Peter Bauer—and as President Kagame believes, foreign aid may actually be hurting the very countries and communities it is intended to help. First, the resources are often used in nonproductive or even destructive ways, with perverse social consequences. Second, even if the money reaches the poor, it creates a pernicious dependency—similar to that which welfare-state handouts create in developed countries. Poor countries need productive investment and entrepreneurship, not handouts.

Nevertheless, no country has ever developed overnight. Rather, economic development is a long-term process of sustained growth that requires good doses of patience and the people's ability to overcome numerous bumps in the road, like natural disasters or political instability.

## Rwanda Vision 2020

With this in mind, the Rwandan government recently launched an initiative called Rwanda Vision 2020. It focuses on long-term development goals, such as the transformation of the current agricultural and subsistence economy into a more solid and diversified economy, less dependent on foreign aid. The government appears to understand that the solution to poverty must come through free markets, not government activism.

Thus, as explained in the outline of Rwanda Vision 2020, the government will not get involved in providing goods and services that can be offered more efficiently and competitively by the private sector. Assets will be privatized to help reduce the prices of goods and services, widen supply for consumers, and attract foreign investors. In addition, the free movement of people and goods will be promoted.

Despite Rwanda's difficulties, pro-market economic policies are already bearing fruit. Besides strong growth and reductions in poverty, Standard & Poor's showed a positive outlook for Rwanda in 2011.

For Rwanda's success to be sustained in the long run, the country will need to keep increasing economic freedom and removing barriers to productive activity. Moreover, Western countries should abolish trade barriers that hurt African producers.

If the Rwandan government continues to be limited, the private sector will flourish and the Rwandan people will further benefit from global markets. FEE

# Socialism's Prescient Critics

BY PHILIP VANDER ELST

There is a good case to be made that the birth and spread of totalitarian socialism defines the twentieth century more than anything else. That is not what most schoolchildren are taught or what most people in the West believe, but it is a justifiable conclusion. Not only was totalitarian socialism directly responsible for provoking the bloodiest war in history; it has also been the biggest single cause of internal repression and mass murder in modern times.

According to *The Black Book of Communism* (1999), at least 94 million people were slaughtered by communist regimes during the twentieth century. This is a truly colossal figure, yet that's the lowest estimate. Professor R. J. Rummel, in his landmark study, *Death by Government* (1996), puts the death toll from communism at over 105 million—and his detailed calculations do not include the human cost of communism in most of Eastern Europe or in Third World countries like Cuba and Mozambique. Even so, his figure is double the total number of casualties (military and civilian) killed on all sides during World War II.

The full horror of this totalitarian socialist holocaust cannot, of course, be adequately conveyed by these grim statistics. Behind them lies a desolate landscape of economic collapse, mass poverty, physical and mental torture, and broken lives and communities. In fact nothing illustrates the destructive impact of totalitarian socialism more vividly than the tsunami of refugees it has generated in every continent on which it has taken root. Between 1945 and 1990 *over 29 million men, women, and children* voted against communism with their feet in Asia, Africa, Europe, and Latin America (For details and sources see my book *Idealism Without Illusions: A Foreign Policy for Freedom,* 1989). Had it not been for the land mines, border guards, and barbed wire lining their frontiers, the world's communist states would have been emptied of their populations long before the fall of the Berlin Wall in 1989.

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## Totalitarian Logic

What provoked this vast tide of human despair? What was it that made life intolerable for most of the inhabitants of these socialist countries? The greatest Russian writer of the last century has given us the answer. To quote Alexander Solzhenitsyn: "Socialism begins by making all men equal in material matters. . . . However the logical progression towards so-called 'ideal' equality inevitably implies the use of force. Furthermore it means that the basic element of personality—those elements which display too much variety in terms of education, ability, thought and feeling—must themselves be leveled out. . . . Let me

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remind you that 'forced labour' is part of the programme of all prophets of Socialism, including the *Communist Manifesto* [1848]. There is no need to think of the Gulag Archipelago as an Asiatic distortion of a noble ideal. It is an irrevocable law" (*Warning to the Western World*).

It was therefore always predictable that by requiring the abolition of private property and the family, and monopolistic State ownership of agriculture and industry, the socialist pursuit of equality would necessarily produce the evil fruit of totalitarianism. One-party rule, the secret police, the imprisonment and torture of dissidents, concentration camps, mass executions, the political indoctrination of the young, the persecution of religious minorities—all these horrors have been the inevitable result of that concentration and monopolization of power that invariably corrupts the ruling elites and bureaucracies of all full-blown socialist societies. As an eminent Russian-born political scientist, the late Tibor Szamuely, wrote a generation ago in a pamphlet that should be read by the citizens of every civilized democracy: "How could it be otherwise? . . . How can there be any freedom when one's livelihood from cradle to grave depends totally upon the State, which can with one hand give and with the other take away?" (*Socialism and Liberty,* 1977).

The great classical-liberal thinkers of the nineteenth century discerned the incompatibility of state socialism with the maintenance of free and democratic institutions.

Unfortunately, left-wing intellectuals and other critics of free enterprise have always been reluctant to acknowledge the totalitarian logic of socialism, wedded as they are to a benevolent vision of the State and the dream of using its power to create a more just society. Consequently, despite all the evidence to date, many of them still pursue the phantom of "democratic socialism," believing that democratic institutions can be relied on to prevent socialism from degenerating into tyranny. The great classical-liberal thinkers of the nineteenth century, by contrast, harbored no such illusions. Every single one of them discerned the incompatibility of state socialism with the maintenance of free and democratic institutions. They did so, moreover, long before the advent of the socialist tyrannies of the twentieth century.

One of the earliest warnings was sounded by John Stuart Mill (1806–1873) more than 50 years before the Russian Revolution. In a now-famous passage in his essay *On Liberty* (1859), Mill declared: "If the roads, the railways, the banks, the insurance offices, the great joint-stock companies, the universities and the public charities, were all of them branches of the government; if, in addition, the municipal corporations and local boards, with all that now devolves on them, became departments of the central administration; if the employees of all these different enterprises were appointed and paid by the government, and looked to the government for every rise in life; not all the freedom of the press and popular constitution of the legislature would make this or any other country free other than in name."

As Mill understood, you cannot maintain freedom of speech and of the press, or freedom of assembly and association, if all the means of communication—newsprint, meeting halls, radio stations, and more—are in the hands of the State. It is equally impossible, in such conditions, for opposition parties to win elections, particularly since a State-controlled economy prevents them, in any case, from acquiring the capital to finance their campaigns. That is why democratic socialism is a contradiction in terms. Either socialism must be diluted or abandoned for the sake of democracy, or democracy (as well as liberty) will be sacrificed on the altar of socialism.

### The Truth about Pre-Revolutionary Russia

What is so tragic about the Russian Revolution is that the triumph of communism in October 1917 aborted the embryo of a developing liberal society. As Szamuely points out, "[F]ew people in the West are aware of the extent of freedom in Tsarist Russia before the Revolution, in the early part of our century. It enjoyed full freedom of the press—censorship had been abolished, and even Bolshevik publications appeared without restrictions—full freedom of foreign travel, independent trade unions, independent courts, trial by jury . . . a parliament, a Duma with MPs representing parties of every political shade, including the Bolsheviks."

By the early 1920s, by contrast, all this had been swept away. To quote Solzhenitsyn's summary of the first period of communist rule under Lenin: "It dispersed the [democratically elected] Constituent Assembly. . . . It introduced execution without trial. It crushed workers' strikes. It plundered the villagers to such an unbelievable extent that the peasants revolted, and when this happened it crushed the peasants in the bloodiest possible way. It shattered the Church. It reduced 20 provinces of our country to a condition of famine" (*Solzhenitsyn: The Voice of Freedom*, 1975).

Democratic socialists may object at this point that prerevolutionary Russia was not as free and democratic as Britain or the United States, and that the cause of socialism was compromised by the Bolsheviks' violent seizure of power. But even if Lenin had triumphed in a peaceful election, his subsequent takeover of the economy and nationalization of all previously independent institutions would eventually have produced the same totalitarian outcome.

The inherently despotic nature of socialism, so vividly confirmed by the history of the Russian Revolution and all subsequent socialist revolutions, was clearly perceived by Mill's great Italian liberal contemporary, Joseph Mazzini (1805–1872). In an essay on "The Economic Question" written in 1858 and addressed to the workers of Italy, Mazzini not only defended private property as an institution essential to human progress and well-being; he also denounced socialism with passion: "The liberty, the dignity, the conscience of the individual would all disappear in an organization of productive machines. Physical life might be satisfied by it, but moral and intellectual life would perish, and with it emulation, free choice of work, free association, stimulus to production, joys of property, and all incentives to progress. Under such a system the human family would become a herd. . . . Which of you would resign himself to such a system?" (*The Duties of Man*, 1961).

In addition, Mazzini pointed out, the establishment of a socialist society would, ironically, create the very worst form of inequality, because universal State ownership would require the establishment of an all-powerful ruling bureaucracy. "Working-men, my Brothers," he asked, "are you disposed to accept a hierarchy of lords and masters of the common property? . . . Is not this a return to ancient slavery?"

The prophetic discernment of the nineteenth-century classical-liberal critics of socialism is again very apparent in the writings of Frédéric Bastiat (1801–1850), the leading French economist and free-trade activist of his generation. A constant critic of statism in general, and socialism in particular, Bastiat summarized his objections in *The Law,* a short but lucid pamphlet published in 1850—the same decade, curiously enough, during which Mill and Mazzini raised their warning voices.

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In this comprehensive analysis, Bastiat offered many valuable insights, of which three deserve particular mention. The first drew attention to a fatal contradiction within the ideology of democratic socialism, one which continues to characterize many of the attitudes of present-day European leftists and American "liberals." On the one hand, complained Bastiat, socialists are passionately committed to the cause of democracy, insisting that all adults are responsible individuals who should have the vote and an equal share in all political decision-making; yet on the other, they consider the same sovereign people incapable of running their own lives without the intervention and supervision of all-powerful State officials. "When it is time to vote," wrote Bastiat, "apparently the voter is not to be asked for any guarantee of his wisdom. His will and capacity to choose wisely are taken for granted. . . . But when the [socialist] legislator is finally elected—ah! then indeed does the tone of his speech undergo a radical change. The people are returned to passiveness, inertness, and unconsciousness; the legislator enters into omnipotence. Now it is for him to initiate, to direct, to propel, and to organize."

As well as being arrogant, socialists were also deeply misguided, argued Bastiat, because they confused society with the State, and altruism with collectivism. As a result, he predicted, their economic program would only undermine the spirit of true fraternity and impoverish society, since moral and social progress depend on individual creativity and voluntary cooperation, not government planning and coercion. Finally, Bastiat pointed out, by concentrating all resources and decision-making in the State, socialism only offered a recipe for permanent social conflict and revolution, since it would arouse expectations that could never be satisfied, and encourage everyone to live at each other's expense through the tax and benefit system.

## The Second Generation of Anti-Socialist Critics

The intellectual assault on socialism mounted by Bastiat, Mazzini, and Mill in the middle of the nineteenth century was renewed by the next generation of classical-liberal thinkers in response to the rapid growth of socialist militancy throughout Europe during the 1880s and 1890s. During this period, its four leading figures in Britain—Herbert Spencer (1820–1903), Charles Bradlaugh (1833–1891), Auberon Herbert (1838–1906), and William E. H. Lecky (1838–1903)—condemned socialism with unsparing severity and prophetic insight.

"We object that the organization of all industry under State control must paralyze industrial energy and discourage and neutralize individual effort," wrote Bradlaugh in 1884 (*A Selection of the Political Pamphlets of Charles Bradlaugh,* 1970). Lecky agreed with him. "The desire of each man to improve his circumstances, to reap the full reward of superior talent, or energy, or thrift," he wrote in 1896, "is the very mainspring of the production of the world. Take these motives away . . . cut off all the hopes that stimulate, among ordinary men, ambition, enterprise, invention, and self-sacrifice, and the whole level of production will rapidly and inevitably sink" (*Democracy and Liberty*).

And so it has proved in the twentieth century, as anyone who reads David Osterfeld's "Socialism and Incentives" (*The Freeman,* November 1986, tinyurl.com/kprtfn) or Kevin Williamson's book *The Politically Incorrect Guide to Socialism* (2011) can see.

Bradlaugh's and Lecky's objections to socialism were of course not confined to its material destructiveness. They, too, like their classical-liberal predecessors, perceived its hostility to freedom and the family. Bradlaugh even predicted that the imposition of socialism would require the ideological reconditioning of the entire population—a phenomenon that has proved characteristic of all communist regimes, notably China before and during the Cultural Revolution, and North Korea today.

Herbert Spencer and Auberon Herbert showed equal foresight in their wide-ranging critiques of socialism. They not only underlined its incompatibility with liberty as eloquently as all their other comrades-in-arms; they also anticipated the terrible violence and cruelty to which it would give rise. In a passage horribly vindicated by the seemingly endless pattern of socialist revolution, dictatorship, and civil war in so much of the post-colonial Third World, Herbert declared in 1885: "In presence of unlimited power lodged in the hands of those who govern . . . the stakes for which men played would be so terribly great that they would shrink from no means to keep power out of the hands of their opponents" (*The Right and Wrong of Compulsion by the State*).

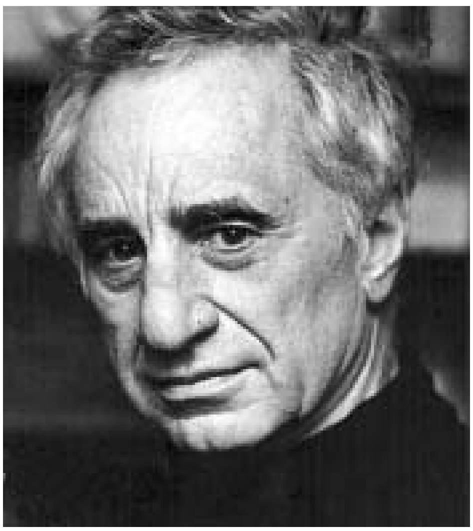
With similar prescience, Spencer wrote in 1891: "The fanatical adherents of a social theory are capable of taking any measures, no matter how extreme, for carrying out their views: holding, like the merciless priesthoods of past times, that the end justifies the means. And when a general socialistic organization has been established, the vast, ramified, and consolidated body of those who direct its activities, using without check whatever coercion seems to them needful . . . [will exercise] a tyranny more gigantic and more terrible than any which the world has seen" (*The Man versus the State*).

It is a historic tragedy that all these warnings fell on deaf ears. Will they be heeded by those pressing for world government in the 21st century? FEE

# Elia Kazan Reconsidered

**BY BRUCE EDWARD WALKER**

The short list of best American film directors will forever include Elia Kazan, whose cinematic efforts include many good films, several great ones, and a couple of immense quality that have fallen through the cracks due to poor timing, comparison to his other landmark accomplishments, or perhaps critical negligence. Identified by none other than Stanley Kubrick as "without question, the best director we have in America," Kazan rebounded from the public relations disaster of testifying as a friendly witness before the House Committee on Un-American Activities in 1952, where he gave up the names of eight former associates with whom he shared Communist Party affiliations nearly 20 years earlier. Whatever his regrets and explanations, they were never sufficient to assuage the left's anger, and many used his testimony as a cause célèbre, choosing to sit on their hands rather than applaud when Martin Scorsese and Robert De Niro presented him with a Lifetime Achievement Academy Award in 1998.



**Elia Kazan**
Wikipedia

By 1952 Kazan's film resume already boasted early noirs (*Boomerang*!, 1947; *Panic in the Streets*, 1950); his auspicious Hollywood debut, *A Tree Grows in Brooklyn* (1945); an Irish-American *bildungsroman*; *Pinky* (1949), a film about racial relations; and an Academy Award for Best Director for 1947's *Gentleman's Agreement*, which dealt with the prevalence of anti-Semitism. Another film, *Sea of Grass* (1947), was his only misfire of the period—featuring Katherine Hepburn and Spencer Tracy in what is certainly their only unwatchable onscreen collaboration.

After 1952 many of Kazan's films can be viewed as, alternately, an apologia for choosing to inform on his former Communist Party (CP) comrades, expressions of an immigrant's love of the American ideal, and illustrations of his distrust of centralized government control. Along the way, he managed to direct Marlon Brando in some of his finest film performances: *Viva Zapata!* (1952) and *On the Waterfront* (1954), as well as 1951's *A Streetcar Named Desire*; James Dean and Julie Harris in *East of Eden* (1955); Andy Griffith, Lee Remick, and Walter Matthau in *A Face in the Crowd* (1957); and Warren Beatty and Natalie Wood in *Splendor in the Grass* (1961).

Note the prevalence of avowedly leftist thespians eager to hitch their talent to informant Kazan's wagon. Beatty, in particular, was confrontational with Kazan about the director's testimony, and went on to star in and direct *Reds*, his cinematic homage to communist John Reed. It's telling that a 2008 American Film Institute poll of 1,500 members determined *Reds* as the ninth-best epic film of all time. And hardly surprising. No sooner had the art form been established than cinema became an expression of

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the political, social, and economic views of filmmakers. The rise of cinema as an affordable and portable art and entertainment medium in the first decades of the twentieth century coincided with the political upheavals and revolutions occurring throughout the world, including World War I and the Russian Revolution. Early masters such as D. W. Griffith and Sergei Eisenstein stirred in heavy dollops of their respective—and sometimes repulsive—worldviews in films such as *The Birth of a Nation* and *Battleship Potemkin*.

By the advent of the talkies in the late 1920s and during the Great Depression, the movies increasingly reflected a decidedly statist worldview. Seemingly no world problem existed that couldn't be solved by smart government employees. Implicit throughout many of the films of this era was tacit approval if not outright championing of President Franklin Roosevelt's New Deal programs—in essence, propaganda that, eventually, FDR's policies would right the ship by returning the country to untold prosperity. The films of the World War II years championed patriotism in general and the U.S. war effort specifically but, leaving aside the body of work left by John Wayne, the common perception is that the entertainment industry at large, and Hollywood in particular, has been and is increasingly in the tank for left-statist causes and big-government remedies.

Of course the statist impulse was curtailed somewhat by the insanity of the House Committee on Un-American Activities (HUAC) hearings, which resulted in the 1947 blacklisting of The Hollywood Ten—including director Edward Dmytryk and screenwriters Ring Lardner Jr. and Dalton Trumbo—and ruined the careers of dozens more in perhaps the most unintentionally ironic defense of American freedom and constitutional rights.

Inserted in the middle of this imbroglio was director and screenwriter Elia Kazan, a Greek immigrant from Istanbul who had studied acting at Yale. Kazan had reached prominence first as a member of the famed Group Theater in the 1930s, and had gone bicoastal thereafter as a Broadway stage director responsible for the debuts of such theatrical classics as Arthur Miller's *Death of a Salesman* and *After the Fall*, and Tennessee Williams's *A Streetcar Named Desire*, as well as such Hollywood cinematic fare as *A Tree Grows in Brooklyn*, *Gentlemen's Agreement*, and *Pinky*. With Lee Strasberg, Kazan founded the Actors Studio in 1947, introducing the psychological realism of Method acting to both theater and film.

It was while cutting his theatrical teeth in the early 1930s that Kazan joined the Communist Party, as did many of the Big Apple's stage community. Disgusted with the CP's micromanaging of artistic content—such as its insistence on romanticizing the working class rather than depicting them warts and all, in realistic fashion—Kazan resigned from the Party in February 1935 after 18 months of membership.

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While no one can assert definitively why Kazan willingly cooperated with HUAC (despite convoluted explanations from Kazan himself, as well as those given by film historians of every political stripe), the fallout was immediate and his legacy will forever be haunted by it. For example, when the 89-year-old Kazan received his honorary Oscar in 1998, J. Hoberman, critic for the *Village Voice*, cattily remarked: "There's never been an industry acknowledgment of the careers that the blacklist cost." And his point is well taken if not a bit strained—what good would the destruction of one other Hollywood reputation—Kazan's—accomplish?

Further, the fact remains that Hollywood gave comfort and fat paychecks to a fair share of communists. In Richard Schickel's biography of Kazan, the film critic relates the reaction of the director's irrepressible first wife, Molly, to claims made by playwright Arthur Miller that the HUAC hearings were akin to witch hunts: "[Miller] was convinced that the parallels between the search for people possessed by the devil in seventeenth-century New England and the search for secret Communists in twentieth-century America was clear and powerful and would indeed write *The Crucible* to make that point. Molly observed to him that witches had not, in fact ever existed, whereas Communists really did.”

Kazan’s autobiography, *Elia Kazan: A Life*, recounts a conversation with the novelist John Steinbeck, with whom he collaborated on the film *Viva Zapata!*:

> I had a good friend at the Yale Drama School; his name was Albert Maltz. In the spirit of the time, we both became members of the Communist Party. I was in the Group Theatre and he was with a theatre closer to the Party line, the Theatre Union. Maltz was an honorable man with an honest heart; I liked him and I respected him. By the time I left the Party in February of 1935, I’d lost touch with him and even forgotten about him, until the year 1946, when he did something I considered heroic. He wrote an article in the *New Masses*, the Party’s magazine, the gist of which was that he’d come to believe that the accepted understanding of what “revolutionary art” is—a weapon in the class struggle—was not a useful guide for writers on the left but a—and I remember the phrase—a “straightjacket.” Maltz felt this about his own work and he’d felt it about the work of other “comrades.” Then he said something that was bold and, in the context of his continuing membership, even foolhardy. “It has become necessary for me to repudiate that idea and abandon it,” he declared. . . .
>
> Albert’s statement in the *Masses* gave hope to many artists in the left movement. . . . Even though I was out of the Party by then, I still considered myself of the left, and I thought what Albert had written was the truest thing I’d ever read about literature from any comrade and a kind of liberation for so many writers. I believed fine things would now come from Maltz and others, who’d been heartened by his challenge to the old laws of the Party. But what happened was not that at all. Party leaders arrived in California from New York to reeducate Maltz and straighten him out. There were many ideological meetings, kangaroo courts, as it were, to persuade him to recant, then to demand it. And he did. He took it all back. Later, I believe, he made a trip to Europe, one *they’d* suggested, to “clear his mind.”

For as much as they seem dated by today’s standards, his films dealing with prejudice in the 1940s were edgy and thematically groundbreaking for their time.

Perhaps even more important to Kazan was his perception of his own hypocrisy: “Did I really want to change the social system I was living under? Apparently that was what I’d stood for at the time. . . . Everything I had of value I’d gained under that system. After 17 years of watching the Soviet Union turn into an imperialist power, was that truly what I wanted here? Hadn’t I been clinging to once-held loyalties that were no longer valid?”

Kazan related in his autobiography what commentator Arthur Schlesinger wrote on the matter, best capturing the double standard of the left that would’ve enjoyed seeing the Greek’s head on a platter:

> After searching his conscience, he wrote, Kazan published an explanation in the form of a newspaper advertisement which to my depraved sensibilities seemed a reasonable and dignified document. But to *The Nation*, Kazan’s whole performance seemed beneath contempt. . . . But if Kazan had been an ex-Nazi or even an ex-Klansman, telling the same story, would not *The Nation*’s reaction been completely different?

This unfortunately is the prologue to what deserves to be a much longer appreciation of the films Kazan made both before and after the 1952 HUAC testimony. For as much as they seem dated by today’s standards, his films dealing with prejudice in the 1940s were edgy and thematically groundbreaking for their time. His movies during and after HUAC reveal his distrust of government solutions and politicians. In *Viva Zapata!*, for example, Kazan and Steinbeck take liberties with the biography of the Mexican revolutionary to depict a man too pure to accept the reins of political leadership. The regrettably often-overlooked *Man on a Tightrope*, made in 1953, features the true story of a circus troupe's escape from behind the Iron Curtain. Featuring Frederick March, Gloria Graham, Terry Moore, and Cameron Mitchell, the film captures life under communism in bleak black-and-white detail.

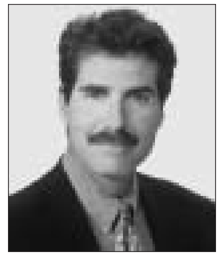
*On the Waterfront*, scripted by Budd Schulberg, is perhaps the closest Kazan came onscreen to defending his HUAC behavior. Brando's Terry Malloy is prompted by his girlfriend, a priest, and his own conscience to inform on racketeering and murderous union bosses. In *A Face in the Crowd*, Kazan and Schulberg once again teamed up to depict a cautionary tale of what happens when opportunistic media personalities—especially those like Larry "Lonesome" Rhodes, chillingly portrayed by Andy Griffith—have a too-easy path to political power.

In 1960's *Wild River*, Kazan both wrote and directed a tale of a Tennessee Valley Authority agent (Montgomery Clift) sent to uproot a backwoods clan led by Ella Garth (Jo Ann Fleet). Themes of racial inequality are prevalent, but secondary to the property rights theme as expressed poignantly by the stoic Ella. In fact, when lecturing on property rights and the exercise of eminent domain, I frequently show a clip of Fleet's Garth explaining why she refuses to leave or sell her family's land by government coercion or otherwise.

Next time you go to your online video queue and worry that all that's available is statist propaganda, keep in mind that you could do a lot worse than the films of Elia Kazan.

Kazan made other films that I have left off this list deliberately for space and topic considerations, but the final one I'd like to discuss is my personal favorite: *America, America* (1963). The film abjures the Communist Party approach of depicting the proletariat as strictly noble actors in a class war. Instead, Kazan uses the story of his uncle who struggled both valiantly and amorally to leave Turkish-controlled Anatolia for a better life in the United States. The character, Stavros, leaves his family to slowly wind his way onboard a steamer bound for America. Along the way, he is robbed, taken advantage of by an Armenian he eventually kills, manipulates himself into the family of a wealthy rug merchant, and serves as a gigolo to ensure his passage to America. The point isn't that Stavros is the typical high-minded, moral immigrant most often depicted in Hollywood films, but that the lure of the freedoms to be found in the United States is so great that, sometimes, bad actions are committed to fulfill the immigrant's dreams. Viewers may not love Stavros for all his faults and misdeeds, but they are moved certainly by his kissing American soil on leaving Ellis Island. Special consideration goes to the glorious black-and-white cinematography provided by leftist filmmaker Haskell Wexler, who despised Kazan over HUAC, and went on to win an Academy Award of his own for his work, ironically, on *Bound for Glory*, a biography of the socialist-leaning folksinger Woody Guthrie.

Next time you go to your online video queue and worry that all that's available is statist propaganda, keep in mind that you could do a lot worse than the films of Elia Kazan. He wasn't a free-market proponent by any stretch of the imagination, but at least he recognized that the comparative economic and political freedoms available to artists in the United States were far preferable to those residing elsewhere during the twentieth century. And the result is a pretty staggering body of work—impressive by any measure—that hasn't been equaled since. FEE



# The Economy Needs No Conductor

BY JOHN STOSSEL

We spend too much time waiting for orders—and money—from Washington.

The collapse of the housing bubble gave politicians a license to do what they wanted to do all along: spend. The usual checks on extravagance, weak as they are, were washed away. Budgets? We'll worry about that later. Inflation? We'll worry about that later.

As I point out in my brand new book, *No, They Can't: Why Government Fails—But Individuals Succeed*, a true free market doesn't require much. It's not like an orchestra in need of a conductor. What it needs is property rights so no one can take your stuff. Then people trade property to their mutual advantage. Resources move around without the need for a central, coercive government telling people which resources should go where—or telling them that they must get permission to do what they think is advantageous.

Given time, an economy, unless crippled by further government intervention, will regenerate itself. But during the recession, Keynesians in the administration said government had to "jump-start" the economy because businesses weren't hiring. An economy, however, is not a machine that needs jump-starting. It is people who have objectives they want to achieve.

Despite politicians' talk of "giving" money to this or that (remember those tax rebate checks with President George W. Bush's name emblazoned on them?), government has no money of its own. It has to take it from the private sector. Grabbing those scarce resources stifles the real economy.

One of the most important questions in politics *should* be: "Would the private sector have done better things with that money?"

Even as smart a person as economist John Maynard Keynes seemed to forget about that when he wrote in his *General Theory* back in 1936, "Pyramid-building, earthquakes, even wars may serve to increase wealth."

By that logic government could create full employment tomorrow by outlawing machines. Think of all the work there'd be to do then!

Think about the two other methods to "increase wealth" that Keynes lumped in with pyramid-building: earthquakes and war. Now, sure, after a war or earthquake, there's plenty of construction to be done. After the Haitian earthquake, House Democratic Leader Nancy Pelosi actually said, "I think that this can be an opportunity for a real boom economy in Haiti." *New York Times* columnist Paul Krugman made a similar error. On CNN he said if "space aliens were planning to attack and we needed a massive buildup to counter the space alien threat . . . this slump would be over in 18 months." Before that, he said the 9/11 attacks would be good for the economy.

This is Keynesian cluelessness at its worst.

Isn't it obvious that without a catastrophe those same workers and resources could have done productive work—with the overall standard of living higher as a result? There is something wrong with mainstream politics and economics when some of their most respected practitioners overlook this point. FEE

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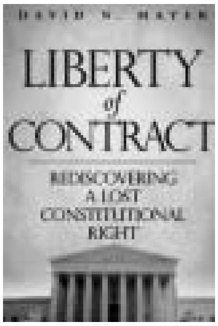
# Book Reviews

**Liberty of Contract: Rediscovering a Lost Constitutional Right**

*by David N. Mayer*

Cato Institute • 2011 • 189 pages • $21.95 hardcover; $9.95 paperback; $7.99 e-book

Reviewed by Jacob H. Huebert




The U.S. Supreme Court has no coherent ideas about—or real respect for—individual rights. It generally allows governments to do whatever they want, with limited exceptions for a handful of rights it has deemed "fundamental," such as the right to free speech (in some areas) and the right to sexual privacy (in some respects). Other rights, such as the right to economic liberty, receive almost no protection at all.

Why so much protection for some rights and so little for others? Because the Court has arbitrarily said so.

Libertarians, of course, think differently about rights. Libertarians think that our rights exist independently of government, and that if government has any legitimate purpose at all, it is to protect those pre-existing rights.

Libertarians also think that all our rights are really property rights. We each own ourselves, and from that follows a right to own private property that we acquire through voluntary exchanges with others. Other rights, such as the right to free speech, derive from our right to use our own property as we see fit. And the right to economic liberty—that is, to trade your property and your labor freely with others—is just as "fundamental" as any other right.

In *Liberty of Contract: Rediscovering a Lost Constitutional Right*, law professor and historian David N. Mayer shows how Americans went from embracing the libertarian conception of rights reflected (imperfectly) in the Declaration of Independence to the statist conception of rights reflected in modern Supreme Court decisions.

At the center of Mayer's discussion is *Lochner v. New York*, a 1905 case in which the Supreme Court struck down a New York law that limited the number of hours that bakers could work. In that decision the Court held that the Fourteenth Amendment's "due process" clause protects the liberty of contract. Because the New York law violated that right by denying bakers the right to contract to work more hours than the law allowed, it was unconstitutional.

In a famous dissenting opinion, Oliver Wendell Holmes accused his fellow justices of reading their own free-market "economic theory" into the Constitution and of attempting to "enact Mr. Herbert Spencer's *Social Statics*," referring to a book by the great classical-liberal writer.

Today most law professors embrace Holmes's view and consider *Lochner* to be one of the worst court decisions ever. Many accuse the justices of basing their decision not on an honest interpretation of the Constitution but on their own devotion to extreme libertarian ideology, the interests of big business, or both.

Mayer's book demolishes these myths and many others surrounding *Lochner* and liberty of contract.

For example, Mayer makes a compelling argument that *Lochner* did not depart from existing law. He shows that "due process" clauses and similar provisions in state constitutions and the U.S. Constitution were used throughout U.S. history up to that time to protect private property rights and the liberty of contract.

He also shows that the *Lochner* Court did not reach its decision simply because it was beholden to big business. In fact the Court applied the same principles to uphold property rights and freedom of contract in many cases where big business had nothing to gain. For example, in 1917 the Court infuriated Progressives when it struck down a Louisville, Kentucky, ordinance that mandated racially segregated housing, as a violation of private property rights.

At the same time, Mayer shows that the justices were not really the devotees of laissez-faire ideology that critics say they were. The Court was always willing to allow "reasonable" restrictions on people's rights, and following the rise of Progressivism, the exceptions predictably swallowed the rule.

I appreciated that Mayer doesn't suggest that the Court might return to *Lochner* or adopt consistent libertarian principles anytime soon. Why would it? We won't have liberty unless a substantial portion of the people appreciates and demands it. We can't expect government-employed judges to lead the way.

There is much more to the story, of course, and it is all worth reading. For anyone interested in the history of the liberty of contract in the courts—and, more importantly, in the minds of the American people—David Mayer has provided a great guide. FEE

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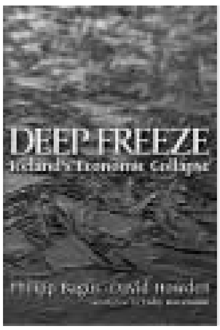
## Deep Freeze: Iceland's Economic Collapse

*by Philipp Bagus and David Howden*

Ludwig von Mises Institute • 2011 • 125 pages • $12.00

Reviewed by George Leef




In this short but highly illuminating book, economics professors Philipp Bagus and David Howden (both of whom are schooled in Austrian theory, both fellows at Britain's Cobden Centre, and both currently teaching in Spain) explain the collapse of Iceland's economy in 2008. Why bother with the difficulties of that little nation (population of only 313,000) in the remote North Atlantic? The Icelandic debacle stemmed from exactly the same governmental blunders that have caused so many other boom-and-bust cycles around the globe. Iceland's horrible recent experience has important lessons for Americans—indeed for people everywhere.

The key insight of Ludwig von Mises was that artificial credit expansion will initially lead to a boom in certain sectors of the economy, but the boom cannot be sustained indefinitely. Once the artificial stimulus of cheap credit ends, as it eventually must, the overexpanded sectors must contract. The misallocation of resources becomes apparent. Workers must be released, and overextended firms must cut back or go bankrupt. Government policies set this train of economic mistakes in motion, and once it's going, they often propel it faster and faster. Bagus and Howden demonstrate that Iceland's collapse—the first such implosion in a *developed nation* since the Great Depression—fits the Austrian theory of the business cycle perfectly.

Iceland's boom was rooted in a 2001 decision by the country's central bank (the CBI) to act as lender of last resort for all Icelandic banks. That let loose the problem of moral hazard. Knowing that they could depend on the CBI to come to their rescue, commercial banks began to operate without much concern for the level of risk. To make matters worse, the CBI also lowered reserve requirements for commercial banks, enabling them to make more loans from the same deposit base, and it drove down interest rates. Icelandic banks found that to compete among themselves, they had to undertake increasingly risky loans, often denominated in foreign currencies where interest rates were even lower than in Iceland. The authors explain, "Artificially low interest rates in Europe, the U.S. and Japan deceived entrepreneurs about the availability of real savings not only in their own currency areas, but in Iceland." Icelandic banks engaged in massive short-term borrowing around the world to finance long-term investments.

Much of that investment went into housing, just as in America, aided by the government's Housing Finance Fund (HFF). The HFF was even worse than our atrocious mortgage twins, Fannie Mae and Freddie Mac. Bagus and Howden observe that while Fannie and Freddie had low mortgage standards, HFF had none at all. Everyone could get a low-cost mortgage. Another huge long-term investment was the construction of two aluminum smelting plants. Icelanders also splurged on lots of high-end automobiles during the boom.

The prosperity bubble had other effects too, particularly in the financial sector and the labor force. During the boom, many young people were drawn into banking and finance, which were "hot" fields, and away from Iceland's traditional productive industries, especially fishing and related commerce. Bagus and Howden do an excellent job of driving home the vital point: Cheap credit distorts a nation in many ways.

The air went out of the bubble in 2008 when foreigners realized that Iceland's currency was terribly overvalued. The inflow of cheap funds that the banks were hooked on stopped. The CBI tried to keep the party going, but that was (and should have been known to be) hopeless. The economic crash swept over the country like a tidal wave: defaults, foreclosures, abandoned projects, unemployment. At one point hunger was even a real prospect until several Scandinavian governments made an emergency loan to Iceland so that food importers could pay for shipments.

By now Iceland's severe turmoil has subsided, and it is slowly adjusting to normalcy, putting labor and capital back to profitable use. Many housing projects stand uncompleted; many of those luxury cars have been shipped off to bargain hunters elsewhere. The situation is akin to a once hard-working individual who wagered his wealth on a big gamble, lived it up for a while on early winnings, but has now been wiped out and has to start over.

The authors end by explaining how nations can avoid the boom-and-bust cycle that did so much damage to Iceland: sound money and banking. Money needs to be based on gold. Banks must never be led to think that their losses will be covered by the government. Moreover, the State must refrain from actions that manipulate interest rates and steer capital into politically favored uses. Boom-and-bust is not a feature of laissez faire; it's a bug of government planning.

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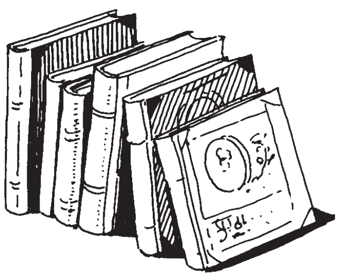

## Adapt: Why Success Always Starts with Failure

*by Tim Harford*

Farrar, Straus and Giroux/Picador • 2011/2012 • 320 pages • $27.00 hardcover; $17.00 paperback; $9.99 e-book

Reviewed by Richard W. Fulmer


Tim Harford's thought-provoking book argues that complex systems cannot be created—they must evolve—and that evolution is necessarily a messy, trial-and-error process. In nature, error often results in death. Failure in the marketplace, while harsh, is rarely fatal and often yields lessons from which success springs.

If so, failure should be expected and planned for. Lessons learned should be identified and incorporated into future efforts. Attempts to eliminate failure will themselves fail because of the myriad interconnections that exist in complex systems and because independent actors respond to such attempts in unpredictable ways.

Rather than trying to construct failsafe systems, Harford suggests constructing resilient structures and institutions that can fail yet continue to work. To do this, Harford recommends "decoupling" a system's components so that failures do not snowball. Using the example of falling domino exhibitions in which thousands of dominoes are artfully toppled, Harford relates how experience led exhibitors to place "safety gates" between dominoes at key points during setup so that, in the event of a mishap, only a few would fall.

Harford takes the concept of decoupling and applies it to, among other things, financial systems. Surprisingly, the author, an economist generally favorable to free markets, offers few market-oriented solutions even when they fairly leap off the page. For example, he notes that the legal structure of Lehman Brothers, which failed when the housing bubble burst, had been made intentionally complex to avoid taxes. Its "Byzantine" structure made bankruptcy chaotic and resulted in assets being frozen far longer than would otherwise have been necessary. Despite this, Harford does not suggest simplifying the nation's tax structure to reduce incentives to create such tangled webs.

He does mention the moral hazard of guaranteeing bank debts, which reduces bankers' incentives to invest wisely and all but eliminates depositors' incentives to ensure that the banks to which they entrust their money are well managed. However, he doesn't propose that government end such guarantees even though relying on a single insurer is an extreme form of coupling.

*Adapt* also fails to note that regulations requiring institutions to do the same things, in the same ways, at the same times are another way to couple complex financial systems and thus risk falling dominoes. For example, the Securities and Exchange Commission's mark-to-market accounting rules required financial instruments to be valued at current market prices. Those rules amplified the effects of both the boom and the bust. Mortgage-based securities, overvalued when housing prices soared, became undervalued as the panic grew, and financial institutions saw their assets become worthless. Banks, required by law to maintain specified levels of AAA-rated securities, were forced to sell devalued assets at fire-sale prices.

Another critical safety gate that Harford neglects is a diversified investment portfolio. Americans learned the value of diversification during the Depression. Branch banking laws tied the solvency of thousands of the country's banks to insular economies—sometimes to single commodities such as a locally grown crop. When, after the stock market crash of 1929, the Federal Reserve failed to increase the money supply, a deflationary spiral caused thousands of small, isolated banks to go under. By contrast, Canada, unencumbered by branch-banking laws, suffered no failures.

Another form of regulatory coupling has been introduced by security-rating agencies, members of a cartel created by the Securities and Exchange Commission. During the boom the agencies uniformly gave unrealistically high ratings to packaged debt containing subprime loans. Basel II, an international banking accord, encouraged banks to hold highly rated mortgage-backed securities by allowing them to keep smaller cash reserves to back them than it required for traditional loans. Were financial institutions allowed to assess and manage asset risks themselves, it's unlikely they all would have made the same mistakes at the same time. When governments act as guarantors of last resort, however, they not unreasonably attempt to limit their risks through regulation. Problems arise when one-size-fits-all rules cause institutions to act as a herd, making booms and their subsequent busts bigger and far more damaging.

*Adapt* is delightful, well written, and packed with fascinating examples drawn from everything from offshore oil rigs to Iraqi battlefields. Harford's diagnoses are right on target, but his prescriptions could use a bigger dose of deregulation and free markets.

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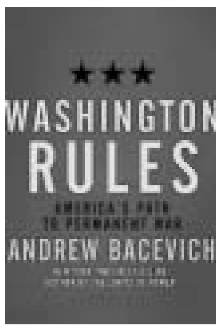
## Washington Rules: America's Path to Permanent War

*by Andrew J. Bacevich*

Metropolitan Books • 2010/2011 • 304 pages • $25.00 hardcover; $15.00 paperback; $9.99 e-book

Reviewed by Ivan Eland




In this excellent book Andrew Bacevich provides an easy-to-read history of the evolution of post-World War II American intervention overseas. Bacevich, a retired Army officer and professor of international relations at Boston University, argues that "prior to World War II, Americans by and large viewed military power and institutions with skepticism, if not outright hostility. In the wake of World War II, that changed. An affinity for military might emerged as central to the American identity." The book is a history of that monumental shift from a public desire to avoid war to a tolerance for permanent war.

Bacevich first takes the reader through the 1950s, when the postwar U.S. national security apparatus was built and when the "trinity" of Washington rules—American global military presence, armed forces configured for power projection rather than defense, and a willingness to use such forces to intervene worldwide—was adopted as U.S. policy. He could have added that the first U.S. permanent alliances were formed just when the advent of nuclear weapons made them unneeded for American security. Also, during this period, peacetime foreign military and economic aid first became a major tool of U.S. foreign policy.

Initially, according to Bacevich, President Eisenhower, both enamored with and frightened by the dawning of the atomic age, relied on a massive buildup of such destructive armaments to deter the Soviet Union. At the same time, however, he tried to avoid conventional conflict that could escalate into a nuclear conflagration by developing covert operations to do "dirty tricks" in foreign countries. By the end of Eisenhower's tenure he began to believe that the now-permanent "military-industrial complex" (MIC)—the vested interests in the military services and the industrial interests profiting from the permanent state of Cold War—was a threat to the country's institutions. Unlike most other authors, who merely deride the MIC's waste and profiteering, Bacevich is concerned about what MIC-driven foreign interventions are doing to freedom at home.

During the Kennedy-Johnson tenure the long neglected Army was able to use its doctrine of "flexible response" to get back into the national security game by fighting conventional wars that filled the gap between CIA covert action and nuclear war. Vietnam was a failure of that strategy and almost took down the trinity with it. But the "Vietnam Syndrome" didn't last long, as Ronald Reagan began the march back toward military adventurism. George H.W. Bush and Bill Clinton stepped up the interventionism further.

When George W. Bush took office he established the doctrine of preventive war, which pledged to use military force to take out threats to U.S. security before they have even formed (for example, invading the already weakened post-Gulf War Iraq) and established a permanent war footing. His successor has not repudiated either policy.

Bacevich argues that too many vested interests in the security bureaucracies, the defense industry, Congress, and the media benefit from the Washington consensus on interventionism to cause its demise. Only education of the public and civic involvement can turn back these forces that are ruining the republic.

Although Bacevich is correct that only the public can override the vested interests to effect change, that outcome is hard to accomplish because Public Choice theory shows that concentrated benefits of a government policy usually trump costs dispersed across the entire population. The public is rational about how much effort to expend to alter policies that cost each taxpayer only a small amount. Educating the public is important, but it is slow and other solutions may be needed. Bacevich provides little help in this realm. The only other solution Bacevich hints at is a return to compulsory military service, but enslaving people to promote freedom is contradictory. Perhaps, instead, cutting regular forces and putting the bulk of U.S. forces into the National Guard and reserves would better serve Bacevich's goal of reconnecting the military with society.

Sometimes a crisis provides impetus for public support for reform, but policies aiming at reform can just as well do the wrong thing as the right thing. The record U.S. budget deficits and gaping national debt provide a danger that may allow shrinkage of the grossly excessive U.S. security posture. Across-the-board cuts in every program the government runs—with no exceptions for the military, intelligence, entitlements or any other government effort—might allow the following justification: "In a time of fiscal crisis, everyone has to sacrifice."

Although Bacevich correctly recommends cutting the Pentagon budget, reducing U.S. overseas military presence drastically, and using the U.S. military only to defend the nation, he could have spilled more ink telling us how we can overcome vested interests to achieve these worthy goals. Despite that deficiency, the book is convincing in its analysis and policy recommendations, and well worth the read as an antidote to the usual "national security" pabulum. FEE

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# Politicians' Dreams

BY WALTER E. WILLIAMS

Several aspects of human behavior, besides a misunderstanding of reality, are critical to the survival of political scoundrels. Let's look at a few.

Tariffs and import quotas raise sugar prices. Michael Wohlgenant and Vincent H. Smith, in their article "Bitter Sweet: How Big Sugar Robs You" (*The American*, February 2012), say sugar restrictions cost the economy an average of over $3 billion a year in higher food prices. That's the cost side. Roughly 40,000 Americans in the sugar industry benefit from import restrictions because they raise sugar prices and deliver higher profits and wages. One might reasonably ask, "How is it possible for the few to impose huge costs on the 312 million of the rest of us?"

One might reasonably ask, "How is it possible for the few to impose huge costs on the 312 million of the rest of us?"

It is easily explained by a phenomenon economists refer to as concentrated large benefits versus dispersed small costs. It pays those in the sugar industry to raise millions to lobby Congress with campaign contributions in order to get them to vote for restrictions on foreign sugar. They receive billions of dollars in higher profits and wages. That's the benefit side. The cost is the doubled price that 312 million American consumers pay for sugar, increasing annual food costs by about $9 per person. Members of Congress are at ease in imposing this cost because they know that few Americans are willing to bear the burden of trying to unseat a legislator whose actions cost their families $40 or $50 more a year in sugar costs. It's cheaper just to pay the higher price.

Sugar tariffs and quotas produce effects beyond simply higher food prices. Chicago used to be America's candy manufacturing capital. In 1970 Chicago's candy manufacturers employed 15,000 workers. Now the number is 8,000 and falling. Brach's employed about 2,300 people; now most of its jobs are in Mexico. Ferrara Pan Candy also moved much of its production to Mexico. Yes, wages are lower in Mexico, but wages aren't the only factor in candy manufacturer flight from America. Sugar is a major cost, and in Mexico, the sugar cost is one-third to one-half what it is in the United States. After 90 years, Life Savers has moved to Canada. Canadian wages are comparable to ours, but Life Savers' yearly sugar cost is $10 million lower.

Most Americans are decent and truly care about the welfare of their fellow man. Few things create as many opportunities for self-interested manipulators and political hustlers to exploit this sense of decency as wages earned by the poor. Gabe Zaldivar, in an article titled "Dallas Cowboys Reportedly Involved in Sweatshop Exploitation" (*Bleacher Report*, January 10, 2012), warns, "Before you put on your Dallas Cowboys hoodie and throw over a scarf emblazoned with the insignia 'America's Team,' consider where it all came from. You may want to walk out the door cold." The Dallas Cowboys purchase some of their sportswear from apparel factories in Phnom Penh, Cambodia, where women, such as Kol Malay, featured in the story, earn just $100 a month. With those earnings she can only afford to live in an apartment about the size of our typical bathroom. Zaldivar says that Nike and other clothing giants have come under fire in the past for manufacturing clothes under sweatshop conditions and "working environments that continue to egregiously violate human rights."

I think that it almost goes without saying that Kol Malay would not work for $100 a month if she had a

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higher paying alternative. Would Kol Malay be better off if the Dallas Cowboys were forced to have their sportswear made in the United States rather than in Phnom Penh? I think she would be worse off. You ask, "Who would be better off if that were the case?" American workers. That might explain why American unions are the major supporters of mandated "living wages" paid by U.S. companies in Third World countries. It's sheer lunacy to think that American unions are concerned about the welfare of people such as Kol Malay.

## Income Inequality

The recent Occupy Wall Street movement demonstrates that Americans can be easily swayed by claims of inequality in income distribution. This helps explain the popularity of income redistribution and calls for the rich to give something back. Under some visions of how the world works this would make sense.

Suppose there was a gigantic pile of money meant to be shared equally among Americans. The reason some people have more money than others is that they got to the pile first and greedily took an unfair share. That being the case, justice requires that those who took their unfair share give something back, and if they won't do so voluntarily, Congress should confiscate their ill-gotten gains and return them to their rightful owners.

Or perhaps income is distributed by a dealer of dollars. The reason some people have more dollars than others is that the dollar dealer is a racist, a sexist, a multinationalist, or a conservative. The only right thing to do for those dealt unfairly is to re-deal the dollars. If this isn't done voluntarily, then Congress should send the IRS to confiscate the ill-gotten gains.

The sane among us recognize that in a free society, income is neither taken nor distributed; for the most part, it is earned by pleasing one's fellow man. The greater one's ability to do this, the greater one's claim on what one's fellow man produces. Those claims are represented by the number of dollars received from him.

The sane among us recognize that in a free society, income is neither taken nor distributed; for the most part, it is earned by pleasing one's fellow man.

## Certificates of Achievement

Say I mow your lawn. For doing so, you pay me $20. I go to my grocer and demand, "Give me two pounds of steak and a six-pack of beer that my fellow man produced." In effect, the grocer asks, "Williams, you're asking your fellow man to serve you. Did you serve him?" I reply, "Yes." The grocer says, "Prove it." That's when I pull out the $20 I earned from mowing my fellow man's lawn. We can think of that $20 as "certificates of performance." They stand as proof that I served my fellow man. It would be no different if I were an orthopedist with a large clientele, earning $500,000 a year by serving my fellow man. By the way, having mowed my fellow man's lawn or set his fractured fibula, what else do I owe him or anyone else? What's the case for being forced to give anything back? If one wishes to be charitable, that's an entirely different matter.

Contrast the morality of the requirement of having to serve one's fellow man in order to have a claim on what he produces with government, where in effect Congress says, "You don't have to serve your fellow man in order to have a claim on what he produces. We'll take what he produces and give it to you. Just vote for me."

How we fall prey to charlatans and quacks is not complicated, but it still has to be explained.