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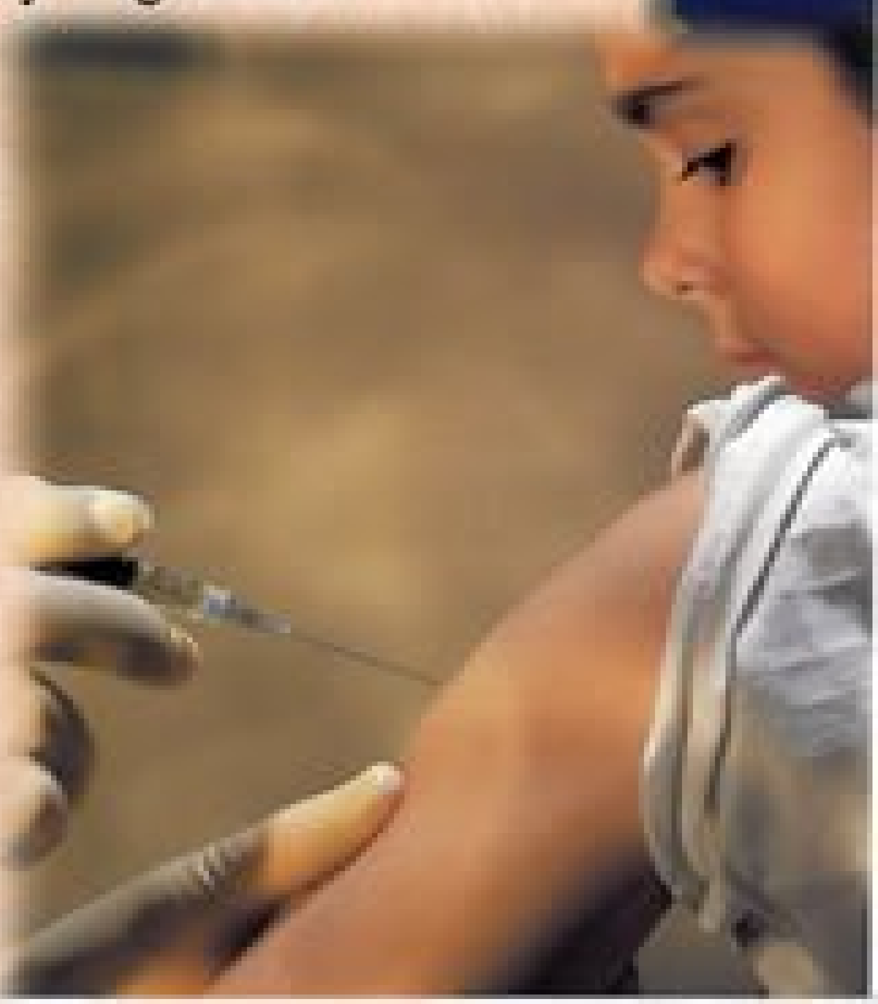

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One Man's Regulatory Nightmare

The U.S. Army Corps of Engineers Strikes Again

MARCH 01, 2003 by Stephen Lathrop

I am an independent homebuilder in Granite City, Illinois. If I told you that while building a housing development, I created a dangerous and mosquito-infested dump, ripped up a pristine pond, and created severe flooding for my neighbors, you would rightly be outraged—perhaps enough to call for government regulators to throw the book at me.

Hold that thought. . .

It is true that I did set out with a plan to build houses on some land in my hometown. But in the process of doing so, I removed a mosquito-infested dump from my neighborhood, created a peaceful pond my neighbors could enjoy, and drafted rock-solid plans that would alleviate many of my neighbors' chronic flooding problems that have plagued their property for decades.

In spite of all the side benefits of my work, I am still having the book thrown at me by government bureaucrats.

The red tape and regulatory intransigence have shut down my effort to build affordable homes. It has me, my wife, Ruth, and our two daughters teetering on the brink of financial ruin. And, with government officials seemingly blocking my every avenue, I wonder in this post-9/11 world what it really means to be an American.

My story started more than a decade ago. In 1990 I bought the dump at the end of my street. Since the 1950s the dump has been filled by a 500-foot-long pile of concrete road slabs, bricks, concrete from demolished buildings, old sewer manholes, and other refuse. In addition to all the rubble, the dump had been overtaken by weeds, mosquitoes, snakes, and rats. Most of my neighbors considered it a peril to their children, and little more than a hangout for thieves and vandals.

The dump also was a chief cause of a 40- year flooding problem in my neighborhood. In the process of developing home sites, I saw an opportunity to clean the dump and create a lake to serve as a storm reservoir.

My plan was to build new homes around the lake in this bedroom community just nine miles from St. Louis's Gateway Arch. Along with turning the neighborhood dump into a lake, my plans included the creation of wildlife habitat. Numerous trees were to be left in place, and inside the lake would be an island for endangered waterfowl.

I was sure I had stumbled across my American dream—until U.S. government officials turned it into my American nightmare.

I cleaned up most of the dump and was eagerly embarking on my plan to spruce up the neighborhood when the U.S. Army Corps of Engineers stepped in. Based on observations of cattails growing through the concrete and rubble at the dump, the Corps ordered me to halt activity or face fines of up to $25,000 per day. The unsightly mountain of concrete slabs, bricks, and refuse was a wetland.

But even the Environmental Protection Agency (EPA) labeled the dump a "nonfunctioning" wetland. This raised a question: How can it be a "wetland" if it is nonfunctioning? In my opinion, it was the bureaucrats who were "non-functioning."

The Army Corps knew all about the dump and how my plan would help alleviate the town's storm-water flooding problems. Because of the wetlands vegetation growing in the concrete slabs, however, Corps officials told me they had no choice. They not only ordered me to stop work, but they also ordered me to fill in the reservoir I created and restore the dump to its original state.

Knowing I risked going to prison for 21 months as a "wetland violator," I refused to comply with the Corps' directives. In return, the federal regulators wouldn't allow me to fill in a dangerous temporary construction ditch or smooth the dirt so I could cut the weeds on my property. During the hot, humid summers in the St. Louis area, the weeds grew out of control and several times caught fire, endangering my home and those of my neighbors.

Prison and Financial Ruin

Still with the threat of prison hanging over my head and the specter of financial ruin knocking on our door, for the next four years my family and I stood our ground. I decided to take a proactive path by submitting several freedom-of-information requests to the Army Corps to find out what was in the file regarding my project.

You'll never guess what I found. When the Army Corps stomped on my project in 1990, they were also taking a new look at three studies they conducted on my neighborhood during the 1980s. According to documents that I hold dear, these Army Corps studies reported average home damages in my neighborhood of more than $315,000 annually due to floods.

Digging a little deeper, I also found a $90,000 study from 1972 that recommended a storm reservoir or lake to alleviate the flooding problem. The government's solution—very similar to the one I already put into action—was projected to cost taxpayers millions of dollars. Flood-wise, the results would have been identical to my plan.

There were at least two government-studied solutions to the flooding problem, both costing more than $4 million. The topper—I would have built the flood-control structures for free. My family's most terrifying run-in with our government came in May 1994, when we were served with a "voluntary settlement agreement." That document proposed that I leave the reservoir, never mow within 35 feet of it, and excavate all or part of the adjacent nine lots into a swamp.

I immediately called the Army Corps' chief of enforcement. My question cut to the chase. If Corps officials knew something should have been done about the flooding, why did they not support my project? I also informed the Corps of my intention to build a home for my family on the flood-control lake I planned.

The reply I received will forever burn in my mind. The Corps official coldly told me: "You can think about building on your property and you can think about putting food on your family's table—but, you know, 'Daddy's in jail' makes for a bad show-and-tell [presentation for your little daughter]."

Ruth and I were terrified, but we stood our ground.

Corps Threat

One week later, I received a certified letter from an Army Corps colonel stating that if I refused to sign the "voluntary settlement agreement" within ten days, I would be referred to the EPA for the imposition of fines of up to $25,000 per day—without a court hearing or trial.

The Army Corps also communicated with one of my state's U.S. senators at the time, contending that the agency was "not debating the application of engineering principles" nor my "efforts to clean up the property." However, the Corps' letter did question my intent of building homes and making a profit even if my neighbors benefited. To this day, I wonder why the Corps was opposed to my development proposal, when it knew all about the longstanding flood problem I was resolving.

In summary, I was threatened with jail and fines for turning a dump into a lake and resolving a 40-year flooding problem. In the process of building houses, I was doing, at no cost to the taxpayer, what two expensive government studies had recommended—digging a lake or reservoir to control flooding.

After my tussle with the Army Corps and having been referred to the EPA for legal action, it turned out the EPA was too embarrassed to prosecute me. Its wetlands regulatory chief told me the lake I had already dug should have been sufficient mitigation, or tradeoff, for the brick, rubble, and concrete-filled dump I cleaned up. He also told me I would have to find a way for the Army Corps of Engineers to "save face."

So I came up with what I believed was a perfect new proposal to clear my name, let the Army Corps save face, and put the entire controversy to rest. I showed the EPA chief my plan for a second housing development that was designed around a second, 17-acre man-made reservoir on the farm adjacent to my original lake. My proposal was to connect both reservoirs by a large pipe to permanently resolve my neighborhood's flooding problem. The EPA chief agreed this plan would satisfy the Army Corps by creating a new lake that would, as he said, make up for my "original sin" of cleaning up the dump.

Thus I now had my course set, and I wasted little time in gathering capital. After a couple of years of hard work and saving, I had enough money to finance an offer for the farm adjacent to my property and to pay for the necessary preliminary work.

Things looked bright. Then, again, in stepped the Army Corps.

In October 1999, Corps regulators had told me my plan looked acceptable, but that I would need a wetlands permit since my new reservoir would “fill in” six acres of “actively farmed wetland.” I submitted my wetland permit application in February 2000 and was told it would be completed by April of that year.

At the same time, a new Army Corps study on my neighborhood’s flooding was submitted, and it suggested—believe it or not—a flood-control reservoir on the same farmland included in my proposals. It was eerily identical to my plan—same farm, same “farmed wetland,” same connecting pipe to my original lake. The main difference—the Army Corps’ plan would cost taxpayers more than $1.1 million in excavation costs alone. This figure did not include money for land purchase, engineering, landscaping, or other costs.

The Army Corps kept promising, but never issued my permit. I was slowly approaching financial ruin. I begged the regulators to let me do for free what their expensive studies recommended.

On July 25, 2000, I met with Army Corps regulators to discuss the permit and request a release of my property. That was when the Army Corps regulatory chief made an astonishing revelation. After ten years of stopping my work and threatening me with prison, fines, and financial ruin, the Corps complaint with my original dump-to-reservoir cleanup project was that I had not made my original lake big enough. Amazingly, the bureaucrats’ decision took so long that they forgot they were the ones who stopped me from making my original lake big enough in the first place.

After that revelation, the Army Corps assured me the permit for my new lake project would be completed by October 1, 2000. In reality, however, by that date my permit had not even seen bureaucratic ink. In November 2000, the full scope of the Army Corps’ misrepresentations came into focus. That was when I learned what I now believe the regulators knew all along: I did not need a wetlands permit to complete my proposal because the six acres of “farmed wetlands” included in my plan had been farmed for decades and were therefore exempt from wetland regulations and permits.

In fact, of the 80 acres I was trying to develop, the Army Corps had jurisdiction over only a one-acre stand of trees, which I was leaving next to my new lake, and the half-acre farm pond, which I left in two back yards. I found out that if I did not disturb the trees or the farm pond, no permit was needed.

By the time this information came to light, after years of bureaucratic harassment and misrepresentation, it was too late. Even though no permit was needed, my family was financially ruined, my credit destroyed by the delays. To date, more than 20 banks and financial institutions have refused to finance my project, even though I have hundreds of thousands of dollars in pre-sales contracts.

To make matters worse, last summer West Nile virus came to my neighborhood, and the Corps of Engineers still would not allow me to smooth out a number of bulldozer ruts and potholes that are now full of stagnant water, weeds, and mosquitoes.

My family and I have decided to hang tough and take the last possible step we can take. We are telling our story to the public to show how our own government has treated us.

I suspect vindictiveness was the reason the government regulators withheld vital information from me. I stood up to them and embarrassed them, and now my family and I are paying the price. I gave them an opportunity to back down, but they took my good will and shoved it back into my face.

For more than a decade the regulatory division of the Army Crops of Engineers has shackled me inside a financial prison. I wonder how many other people have faced this kind of bureaucratic arrogance and intimidation. How many Americans have simply rolled over and let the federal bureaucracy have its way with their lives, their life savings, and their livelihoods?

Where Did All Those Potatoes Come From?

Farming Productivity Has Increased Dramatically

MARCH 01, 2003 by David Hendersen

Are we running out of farmland? Worried about all those new houses being built on large lots, land that was previously farmed? Will there be enough food to go around?

You may want to relax, enjoy that second helping at the supper table, and let the marketplace do its thing. Why, you might ask, such a cavalier attitude toward this gravely serious subject? To answer that, let's look at one specific food source, the French fry.

U.S. production of frozen potato products such as French fries consumes a vast amount of potatoes each year, estimated at 18 billion pounds in 2000. A typical French-fry plant requires up to four million pounds of raw potatoes delivered to its door in good condition every day for 300 days each year. Imagine rounding up that many potatoes daily.

How can the processing plants be assured enough potatoes will be grown to supply their facilities? The processors contract with individual growers each year to assure an adequate supply. Only the best farms are awarded contracts. Processors can be selective because more farmland is available than necessary. Why is more farmland available? Largely because potato farmers become more efficient every year. Compare these figures regarding U.S. potato production:

Year Total Harvested

Acreage

Potatoes Harvested

Per Acre

Total Production 1890 2,557,000 3,990 lbs. 10 billion lbs. 1997 1,362,000 33,800 lbs. 46 billion lbs.

In the 107 years from 1890 to 1997, U.S. farmland acreage devoted to potatoes *decreased* by almost half. What happened to total production? It *increased* by four and a half times. Why? Because farmers continually improved the productive use of their land. The amount of harvested potatoes per acre increased from less than 4,000 pounds to nearly 34,000 pounds in that time. A steady increase in production per acre is evident throughout the span. Even if you picked other dates since 1890, the results would be similar.

Why does potato farmland today produce this abundance? There are too many reasons, both subtle and obvious, to list. Improved seed potatoes, better planting techniques, more consistent watering through irrigation, the use of fertilizers to replenish the soil, chemical treatments to stem losses from blight — these are a few of the easily recognizable reasons. Much progress results from the unique knowledge acquired by successful farmers as they search for even small improvements in yield.

Since potatoes are so plentiful in the United States, does that mean processors can be careless with their usage? Hardly. Competitive pressures drive the sloppy processors out of the market.

Twenty-five years ago, one pound of raw potatoes produced about seven ounces of finished frozen French fries. Today, one pound of potatoes produces nearly nine ounces of finished French fries, roughly 25 percent more.

To achieve this dramatic increase, processors have invested mightily in equipment, training, and people. They have reduced the losses due to peeling, installed equipment to automatically locate and remove bruised and discolored sections of each potato, reduced fry breakage throughout the plant, and looked at every part of the process to improve efficiency. They keep finding new ways to reduce waste.

So at lunch today, while you are munching on your super-sized meal, imagine one acre of potato farmland and picture the roughly 19,000 pounds of frozen French fries produced from this crop. How many pounds of French fries will be produced from a single acre ten, 20, and 50 years from now? In a relatively free and competitive marketplace, no one knows the answer, but it is a safe bet to say: more—probably many more.

At Least Ponzi Didn't Threaten Violence

Social Security Participation Is Compulsory

MARCH 01, 2003 by David Surdam

Suppose while perusing your annuity fund's quarterly statement you read: "By 2038, the funds will be exhausted and the contemporary contributions will be enough to pay only about 73 percent of bene?ts owed." Your emotions might run the gamut from outrage to fear.

In the wake of the Enron, WorldCom, and (insert the latest name) corporate scandals, legislators are decrying the lack of ethics in business and demanding more regulations.

Now consider Social Security. In the interest of accuracy, I quote the actual phrase from "Your Social Security Statement": "The excess funds are credited to Social Security's trust funds, which are expected to grow to over $4 trillion before we need to use them to pay bene?ts. In 2016, we'll begin paying more in bene?ts than we collect in taxes. By 2038, the trust funds will be exhausted and the payroll taxes collected will be enough to pay only about 73 percent of bene?ts owed." Let me faintly praise the Social Security Administration for at least calling your payments "taxes." For a long time, the of?cials preferred the term "contributions."

By concentrating their scrutiny on business ethics, the press and public are missing a bigger story. Indeed, some legislators are using the business scandals to promote Social Security and to bash privatization schemes. I ? nd such efforts deeply ironic. Corporate scandals that upset the media and politicians usually involve allegedly using "anti-competitive" tactics; endangering the "public welfare"; employing accounting tricks to mislead citizens; using willfully obfuscating terminology; exploiting consumers' "greed" and fear; and ?outing regulations. Yet Social Security displays many of the same outrageous practices.

From the first, Social Security was swathed in misleading statistics. In her 1982 book *The Crisis in Social Security*, economist Carolyn Weaver argues that advocates for social insurance relied on faulty data and erroneous interpretation of the ?nancial status of older Americans during the 1920s. The advocates claimed that older Americans were at greater risk for being impoverished, although older Americans typically have had greater wealth than younger Americans. The pre-Depression era was no exception. If older Americans experience a diminution of their incomes, they may draw down their wealth. Before the Depression, private companies were developing an array of ?nancial tools to help Americans save for old age, and Americans were taking advantage of them. Only the extreme depth and persistence of the Great Depression led enough Americans to embrace social insurance.

The champions of social insurance were not secure enough to let Social Security face real competition. Senator Bennett Champ Clark of Missouri offered an amendment to the legislation that would have allowed employers to opt out of the nascent program by offering comparable retirement plans. Clark argued that the private alternative would provide ?exibility and freedom of choice (which some modern politicians favor only in the context of abortion rights). Social insurance advocates rightly saw the amendment as a threat to the viability of a government-run retirement program, and they fought long and hard to preclude it.

Although President Franklin Roosevelt made some effort to put the Social Security program on an actuarially sound basis, the program quickly assumed a pay-as-you-go nature. Today the stakes involved in the combined business scandals pale before the stakes involved in Social Security. Instead of billions, Social Security involves trillions of dollars of unfunded liabilities.

The Social Security program has been dubbed a “Ponzi scheme,” even by some of its defenders. The allegation is unfair to Mr. Ponzi. Charles Ponzi set up a pyramid scheme right after World War I, when he noticed an arbitrage opportunity with international postal-reply coupons. He promised investors $15 within three months for every $10 they put in. The initial investors did get the 50 percent return, but of course the pyramid grew exponentially and ?nally collapsed. Notice that, fraudulent as his scheme was, Ponzi had to persuade people to invest. The federal government doesn’t use persuasion. As the commercial says, “It’s the law.”

Vice Is Virtue

Nobel Prize-winning economist Paul Samuelson recognized the pyramid aspect of the program. In his February 13, 1967, *Newsweek* column, he conceded that Social Security was actuarially unsound, but he lauded this as a virtue: The beauty of social insurance is that it is actuarially unsound. Everyone who reaches retirement age is given bene? t privileges that far exceed anything he has paid in. . . . How is this possible? It stems from the fact that the national product is growing at compound interest and can be expected to do so for as far ahead as the eye cannot see. Always there are more youths than old folks in a growing population. More important, with real incomes growing at some 3 percent per year, the taxable base upon which bene?ts rest in any period are much greater than the taxes paid historically by the generation now retired. . . . Social Security is squarely based on what has been called the eighth wonder of the world—compound interest. A growing nation is the greatest Ponzi game ever contrived. And that is a fact, not a paradox.

Unfortunately for Samuelson's reputation as a prognosticator, the Baby-Boom generation opted for fewer children and productivity may have slowed down after 1973. The pyramid began to wobble badly. At least Samuelson was candid about the program's nature; many Social Security of?cials are either deluded, or they are less than forthright.

Although changing demographics account for some of Social Security's actuarial imbalance, much of the imbalance is due to overly generous bene? ts for some workers and expansion of coverage to people who did not pay into the program. Consumer advocates warn us about the "too good to be true" offers we all receive. Politicians all too often engage in similar shenanigans. Social Security proved an admirable vehicle for creating obvious winners while camou?aging the losers, a process that I believe to be the essence of politics.

A private insurance company that awarded bene?ts to uninsured parties or that maintained inadequately funded liabilities would violate many existing regulations, and the of?cers would be subject to civil and possibly criminal penalties. Not only is Social Security actuarially unsound, but the government places its own IOUs into a "trust fund." Readers may recall that one of the current business scandals involves corporate of?cers who "borrowed" from the company coffers. When Social Security runs a surplus, the rest of the government borrows from it, and the Treasury issues an interest-bearing instrument to the Social Security Administration. Eventually, Treasury will have to redeem its debt by running its own surplus, borrowing money from the public, or printing money, exactly the alternatives if there were no trust fund. As economist Martin Feldstein wrote in the *Wall Street Journal* (February 1, 1999): “Extending Social Security solvency to 2055 is based on a complex accounting sham so duplicitous that it is hard to believe.” Why abuse the word “trust”? Why not call it an obfuscatory fund?

The government has powers beyond those of mortal men and corporations. Its ability to borrow (backed by its ability to coerce) far exceeds that of any corporation. Indeed, the government can run an inadequately funded retirement program for an extended time (if not into perpetuity), but why not be candid about the process? Why the counting and double-counting, the elaborate illusions? Why co-opt terminology from insurance: reserves and surpluses? F.A. Hayek suggested in *The Constitution of Liberty* that the use of insurance terminology was a “stroke of promotional genius” that allowed Social Security’s sponsors to “capitalize on the goodwill of private insurance” and to gain public acceptance. It is interesting that the government envied the trust that private insurers had gained after years of probity and honesty.

Misleading Language

Roosevelt was shrewd enough to make sure that proponents of Social Security ran the program and controlled the ?ow of information. The misleading language and the unwillingness to identify the true nature of the program created confusion among the public. The cynicism of administrators was evident in one of?cial’s anonymous quote in the April 26, 1965, issue of Barron’s: “The continued general support for the Social Security system hinges on continued public ignorance of how the system works. I believe that we have nothing to worry about because it is so enormously complex that nobody is going to ?gure it out.”

Even Congress was concerned enough about the misconceptions that in the 1950s it held hearings. In some ways nothing has changed. For instance, many people are genuinely surprised to discover that there is no account holding their taxes (both employee and employer shares) and accumulated interest. Indeed, people assume that, similar to a 401(k) or other retirement fund, there is a contractual agreement between the U.S. government and its citizens. As reported in the December 7, 1964, *U.S. News & World Report*, then-Social Security commissioner Robert Ball admitted before Congress: “No, there is no such contract. This is one of the major distinctions between a private insurance arrangement and a government social insurance arrangement. But, under a government program, people have statutory rights.”

Advocates argued that statutory rights were suf?cient because of the compulsory nature of the tax. Don’t you feel much better with your statutory rights? Don’t you wish that your 401(k) rested on statutory rights instead of contractual rights? In any case, the Baby Boomers and the subsequent generations will get Social Security payments at the sufferance of the government. Although I fully expect Social Security to be around for a long time, the uncertainty surrounding its future diminishes its value as a retirement tool. How much in bene?ts will you receive? How will such bene?ts be taxed in the future? Retirement planning just became much more uncertain.

“Employer contributions” are another misleading aspect of the program. The notion of employer contributions via the payroll tax is an egregious use of the term. Currently, workers pay 7.65 percent of their wages or salaries into Social Security and Medicare, although there is a cap on the amount going into the former. The employer pays another 7.65 percent of wages and salaries. Initially, you might think, as the politicians hope you will, “Great, my money is being doubled automatically.” The system creates the illusion of employees getting something for nothing (this is similar to the Clintons’ push for employers to “pay” health insurance premiums for their workers).

Of course, the real issue is whether the employer would have paid the workers the 7.65 percent in wages or whether the employer passed the extra cost on to consumers in higher prices. Many economists believe that the worker essentially pays the entire 15.3 percent. Therefore, designating “employee” and “employer” contributions is spurious. Anyway, as Carolyn

Weaver showed, Franklin Roosevelt understood the chicanery involved in the ?nancing of Social Security: “I guess you are right on the economics, but those [taxes] were never a problem of economics. They are political all the way through. . . . With those taxes there, no damn politician can ever scrap my social security program.”

Of course, when your employer “matches” your retirement-plan contribution, the story is similar. The contribution is in lieu of higher cash wages. But both of you prefer the arrangement due to the favorable tax treatment, and, of course, the arrangement may have been negotiated between your employer and you. Coercion is no part of it.

The politicians who created and the bureaucrats who have administered Social Security have been less than candid about the nature of the program and its long-term viability. That we’re coerced into participating makes it all the more offensive.

Water Markets Are the Answer

Property Rights for Water Would Simplify Conservation

MARCH 01, 2003 by Charles Oliver

The rains spun off by Hurricane Lili and Tropical Storm Isidore brought welcome relief from drought for much of the Southeast. But the respite may be temporary. While the drought may end, the southeast's water problems have just begun.

The population of the United States as a whole grew 13.1 percent in the 1990s. But that of the southeast—Florida, Georgia, Tennessee, North Carolina, and South Carolina—jumped an average of 20.6 percent. Water use in the region has more than doubled since 1970. Population and water use will continue to climb over the foreseeable future, straining resources.

Politicians keep looking for a plan that will satisfy all water users. But instead of a top-down solution, policymakers should be looking for one that works from the bottom up. Instead of one grand plan, we should seek a way for each home, business, and farm to make the best use of its water. That will involve a more market-oriented approach to the region's problems.

For now, authorities are trying to cut water use through regulation. Georgia, for instance, now allows people with even-numbered addresses to use water outdoors only on even-numbered days and those with odd-numbered addresses to do so only on odd-numbered days.

Governments threaten to pass even more regulations to hold use down. And some experts say these rules will have to last beyond the drought for the region to deal with the strain a growing population will put on water supplies.

But why do we need government to tell us to conserve water? Bureaucrats don't have to tell us to conserve gasoline or natural gas or other goods when they become more scarce. When the supply of these goods shrinks, the price goes up, and users have a reason to conserve.

But water is different. In Atlanta, authorities haven't raised prices paid by city users to reflect the scarcity of water. Indeed, in much of the region, prices have barely moved, if at all. That's not exactly a system that will encourage conservation.

The failure to raise prices is a big mistake. Studies from around the world show a 10 percent increase in the price of water can slash urban use 12 percent and farm use 20 percent. Higher prices will be painful. But the alternative is an ever-increasing amount of red tape regarding water use. And since those rules will be useless unless enforced, that alternative will also bring a large amount of snooping into our personal lives by neighbors and government agencies.

Better yet, municipal water systems should be privatized. Many cities have contracted out the operation of their water systems to private firms. But prices are still set by city governments. Full privatization would remove pricing decisions from government hands and allow competitive firms to adjust prices to market conditions.

Privatizing municipal water systems alone won't solve the region's water woes. There's a more fundamental problem. In much of the southeast, no one really owns much of the water. By tradition, anyone who has access to water can take as much as he wants as long as the amount is "reasonable." That worked well when there was more than enough water to go around. But a growing population has made that rule unworkable. As each user tries to get the most for himself, water is depleted. No one has a reason to conserve because whatever he saves is used by someone else. Lawmakers have restricted that rule a little. In Georgia, for instance, users must get a state permit to withdraw more than 100,000 gallons of water a day from common sources. But the basic problem remains.

There's a better way to allocate scarce water. Several western states—as well as nations such as Mexico, Australia, and Chile—have created property rights in water. This water can be used or bought or sold, just like other goods. And that has allowed water markets to thrive in those areas.

Market Allocation

A report by World Bank economist Mateen Thobani found that markets shift water in response to changing demand more cheaply than political processes and with less rancor. These markets also give users an incentive to conserve since any excess water they have can be sold to others. ("Formal Water Markets: Why, When and How to Introduce Tradable Water Rights in Developing Countries," *The World Bank Research Observer*, August 1997.)

Property rights and water markets can also serve the objectives of environmentalists. In the west, environmental groups have bought water from farmers and other owners and left it in streams, rivers, and lakes. That helped protect those waterways and support the fish and wildlife that depend on the water.

Privatization, property rights, and water markets could help the southeast make the best use of its now scarce water.

The Theory of the Corporation

Corporate Capitalism Is a Great Achievement

MARCH 01, 2003 by Norman Barry

Ever a topic of dispute for observers of capitalism, the corporation has been undergoing increased scrutiny in the light of current business scandals. While other forms of capitalist enterprise, such as partnerships and single proprietorships, have avoided some of the wrath of socialist agitators, the limited-liability corporation, public or private, has had to endure the criticism of some market advocates as well as socialists. Of course, now that most sensible collectivists know that real socialism doesn't work, they have had to use a different intellectual methodology to buttress their anticapitalist predilections. They have chosen *morality*. This has turned out to be quite effective. Moral arguments are pretty much irrefutable, whereas economic ones can be subjected to some kinds of theoretical and empirical tests. Hence the craze for the "social responsibility" of business.

As a matter of fact, the invention of the corporation is the great achievement of Anglo-American capitalism, contributing both to its prosperity and to the freedom it promotes. But it has to be constantly defended. The most obvious advantages of the corporate form are its ability to raise capital for investment and the liquidity that share ownership provides. Free transfer of shares, the main feature of corporate capitalism, produces that flexibility which is the envy of other free enterprise forms.

The major problem is its apparent "privileges"; that is, it is claimed that the corporation can do things that private individuals or business partnerships cannot do, and critics argue that these advantages have to be paid back to society. In other words, the corporation operates under some kind of politically granted license, which has to be earned. Business ethics starts from this assumption. Thus Thomas M. Jones wrote: "the corporation which acts in a socially responsible manner may simply be paying back society for the social costs of doing business, costs for which firms rarely receive an invoice."[1] When he was secretary of labor in the first Clinton administration, Robert Reich repeatedly threatened to withdraw "privileges" from uncooperative firms and promised to reward socially responsible ones with tax and regulatory advantages.

What are these privileges, these gifts of society that grateful corporations must pay for with the sacrifice of shareholder value for the benefit of "society"? First there is entity status; that is, the corporation is allegedly an artificial person, separate from its owners, which can sue and be sued. Then there is limited liability for debt and for torts—stockholders are liable only up to the value of their investments; their private assets are protected. A third "privilege" is permanent life.

Limited liability (especially for torts) has angered even some libertarians, for it seems, superficially, to disadvantage creditors and allows individuals to repudiate debts and evade personal responsibility for (civil) wrongs. It is also argued that separation of ownership from control, a product of the division of labor, makes it efficient for owners to delegate management to specialists, leaving only loose authority for owners through the board of directors. Thus irresponsible managers have become the new dictators even though they are not normally owners.[2]

Privileges or Rights?

But are these privileges? The most thorough analysis of the corporation, by Robert Hessen, maintains persuasively that they are not. If, as he maintains, the corporation "throughout its growth . . . is a voluntary association based exclusively on contract," then a major argument for its heavy regulation falls to the ground and the demands of business ethicists become no more than the meretricious moral pleas of archbishops, professors of ethics, and other anti-capitalist zealots.[3] Would the corporation and its defining features have emerged spontaneously with no help from the state or statutory law? If this is so, then it really is no different logically from any other free-market institution.

Hessen's major achievement is to show that the critics confuse two types of corporation. The first are those created in medieval England, when bodies such as churches and boroughs were given certain corporate privileges in return for fealty to the Crown. In the early years of the American Republic, some states granted similar advantages to organizations that acted for the public; for example, they built canals and bridges.

The other type, the modern business corporation, which is solely responsible to its owners, the shareholders, was treated similarly. But Hessen argues that the business corporation is nonetheless very different. It emerges through contract and does not depend at all on the state (apart from having the convenience of registering with it). Although in modern Western democracies corporations are now governed under various companies acts, that need not have been the case. We have to use the state's money, but we all know that private money is perfectly feasible. Corporate governance is the same.

There is nothing special about entity status. Individuals get together and pool their resources. They decide by contract to accept a new legal status. They can sue and be sued as a collective body, unlike a partnership, in which several or joint responsibility applies. Indeed, a corporation is better viewed as a "nexus of contracts," rather than in strict ownership terms. The various participants operate under different types of agreement. That is why the shareholders of a large company cannot enter the company's premises without permission though they are its owners. A contract will specify who has the right to do what. What Hessen rightly wants to dismiss is the notion that entity status is conferred by the state, since this notion implicitly gives government the authority to regulate the firm beyond the requirements of regular civil and criminal law. The attribute of permanent life is meaningless. Corporations are not immortal; they regularly go bankrupt.

Of course, there is also an economic rationale for the creation of firms as corporations. If everybody dealt with one another through pure market transactions, transaction costs would make efficient business impossible.[4] It is rational, therefore, for firms to develop via bilateral contracts, which give managements control over workers. The latter are of course free to leave. Corporations are firms, though not all firms are corporations.

Limited Liability

Limited liability is perfectly explicable in contracting terms. No creditor is compelled to accept it, and sometimes it is circumvented when one or more of the shareholders guarantee debts beyond their investment in the company. Indeed, it is merely convenient that a company should claim limited liability as a whole rather than for the creditor to negotiate with each shareholder individually. There is an implicit contract of limited liability unless it is explicitly stated to the contrary. It is quite wrong to assume, then, that the formation of the corporation is a device by which unscrupulous individuals can escape debts. Indeed, there are procedures by which creditors can recover money from shareholders if companies were to distribute high dividends in advance of a debt.

Although limited liability was a feature of the various companies acts that were passed in nineteenth-century Britain and America, it had already emerged through free contracting. If creditors had felt especially victimized by limited liability it would not have developed spontaneously. And, of course, it has great utilitarian value in the raising of capital. Furthermore, it is not a feature exclusive to corporations. Limited partnerships have it also. Limited liability for torts, however, is another matter, for one can't imagine potential tort victims freely contracting to limit their claims for damages for the (unintentional) wrongful actions of a corporation. Hessen argues that limited liability for torts should not have occurred and only did so because of the difficulty of extending the notion of vicarious liability (whereby the master is liable for the wrongful actions of his servant) to the corporation.[5] He thinks that this idea was an unfortunate consequence of the entity concept, as if the corporation were something separate from its owners. Hessen is critical of the deliberate creation of one-man corporations, which have the sole purpose of avoiding tort liability, ("I didn't do it; the company did.")

Contrary to some opinion, it is quite conceivable that capitalism could function adequately without limited liability for torts. Large companies could pay the costs of actions (even under American tort law), and smaller companies would be advised to take out insurance. Still there are some interesting points here. If companies lost limited liability for torts, they would have an incentive to supervise their staff more carefully. However, if they took out insurance, that might well produce a moral-hazard problem: the protection that insurance offers itself might produce laxness on the part of companies and severe problems for the insurance market. We have already seen this in the current travails of the Lloyds insurance market in London. It had historically been a curious unlimited-liability company, and its members ("Names") were badly hit by the tort claims it has had to pay in the last ten years. In the future all new Names will have to offer limited liability.

If corporations were to lose limited liability for torts, it would produce some change in corporate behavior, but it is not the sort of change that capitalism could not cope with. After all, moral hazard has been a problem ever since insurance began, and methods have been found to mitigate its worst effects. What is interesting, however, is how limited liability for torts first came about. Of course, it is now in statute, but it began, presumably, in common-law processes. It must be the only example in American law that reduces the claims of tort victims. That should make libertarians think a little more carefully about the supposed sanctity of the common law. I can't imagine a libertarian law code being designed to let obvious tortfeasors evade their responsibilities.

Corporate Crime

A serious danger in the entity theory of the corporation has turned out to be the attribution of criminal liability. If the corporation exists as an artificial person separate from the individuals who compose it, then it is not surprising that it should be said to have some kind of surrogate "mind" enabling it to act with a mens rea, that is, from a guilty motive. It is true that the original prosecution of the Ford Motor Company for reckless homicide in the famous Pinto case failed, but since then there have been a number of successful prosecutions of companies for actions that one would have thought only real, live humans could commit.[6] The Boeing Corporation was found guilty of corporate theft, and the prosecution and persecution of Exxon in the Alaskan oil spill proceeded over a (fairly minor) criminal offense.[7] There have been more serious examples.

The United Kingdom has been vexed by this issue. Following the Zeebrugge ferry disaster, in which over 200 people were drowned, there have been endless demands that corporations be charged with manslaughter.[8] In that case, there was such a prosecution, but the judge threw it out on the ground that the whole range of individual wrongs that occurred could not be aggregated into a corporate wrong. The company charged, P&O, was not actually involved in the tragedy. It had simply later taken over the firm thought to be responsible. But it is noteworthy that the prosecution did not try the individuals directly responsible for the tragedy. We seem to have come a long way from the traditional idea of personal culpability for action.

Oddly enough, the only prosecution for corporate manslaughter that has succeeded in the United Kingdom involved a one-man corporation. Here, of course, a clear line of responsibility could be established. It might be difficult to do so in a large corporation, but that is not a reason to use the entity idea of the corporation as a substitute for individual wrongdoing. When we examine the idea of the corporation legally and morally, it is not such a remarkable institution, since some of its features appear in business organizations that do not take the corporate form, such as partnerships and trusts. What is distinctive about it is the easy transfer of shares, which arose out of the original joint-stock companies. Indeed, Hessen suggests a continuum in which a business starts out in single proprietor form, develops into a partnership, and finally emerges as a corporation.[9]

Business Ethics

An explanation of the genesis of the corporation suggests that its responsibilities are not to that nebulous entity "society," but to those who create it and invest their money in it. Any obligations that they owe to anyone else must be a function of their decisions as private persons. And the managers of the enterprises that they create owe duties only to the owners, or to anyone else in a contractual relationship with the firm. In a famous essay written 30 years ago, Milton Friedman said that the social obligations of business agents were to increase the profits of the companies for whom they worked, subject only to the basic rules of society, "both those embodied in the law and those embodied in ethical custom."[10]

But there is a problem with "ethical custom." It has ceased to be limited to the do's and don'ts of any civilized order, and has now been expanded widely. It includes what philosophers call *supererogatory* duties, that is, worthy but not compelling. Those virtuous actions, such as employing ethnic minorities irrespective of marginal productivity considerations, taking special care of the environment, not trading with certain unfashionable nations, and building swimming pools for deprived children, have now become as compulsory as the basic moral and legal rules. But these new duties can hardly be described as ethical, since corporate executives normally perform them with shareholders' money and often without their permission.

Company annual reports are replete with mission statements that boast the firms' moral profile. Is this what Friedman meant by customary morality? I hardly think so, but in these morally ambiguous times it is difficult to know what that is. Some shareholders themselves may not object to such morality, and the new activists seem more anxious to tilt the firm in the right moral direction than to chivvy managements to produce better results. The moral argument has been helped by the separation-of-ownership- and-control thesis: if the dispersed shareholders can no longer hold the management to account, then why should not society set the agendas of companies?

Law and practice are confused about this. On the one hand, company executives have a fiduciary duty to the stockholders and may only pursue noncommercial activity if it has some positive effect on shareholder value.[11] But on the other, corporations are recognized as part of society with a concomitant duty to advance its well-being even if that might entail some loss to shareholders.[12]

An equally dangerous idea is that property owners should not be decisive in the management of a company, but that other "stakeholders" should be influential in such things as plant relocation, remuneration, and takeovers. Of course, it is easy to show that with a number of stakeholder groups holding divergent goals, no rational decision could ever be reached. There would be only endless conflict.[13] At least stockholders can be assumed to have one overriding goal, to maximize the value of their stock. But most of the corporate moral activists are Kantians, believing that certain absolutely binding moral duties should always trump utility. Whatever contracts these stakeholders have, they are unlikely to be contracts of ownership.

The striking thing about business's current problems is that they illustrate an old issue in corporate governance. For all the advantages of financing by freely transferable stock, it does generate an agency problem. How do we ensure that the agents, the employees, act on behalf of the principals, the owners? Won't they shirk on the job and divert to themselves income that should go to the stockholders? Adam Smith's objections to the joint-stock company were on these efficiency grounds rather than derived from moral reasons. He thought that only a single proprietor would have the incentive to act efficiently. Of course, he was not prescient and did not anticipate the devices, including the takeover, that capitalism would develop to ensure that managers would pursue owner value.

It is interesting to note that none of the proponents of the separation-of-ownership-and-control thesis, from Adolph Berle and Gardiner Means through to J.K. Galbraith and modern business ethicists, ever inquired into these new developments. They were simply against the corporation, unless it could be compelled to do good.

Notes

1. Quoted in John Hood, "Do Corporations Have Social Responsibilities?," *Ideas on Liberty*, November, 1998, p. 680.

2. See Adolph A. Berle, Jr., and Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932).

3. Robert Hessen, *In Defense of the Corporation* (Stanford, Cal.: Hoover Institution, 1979), p. 43.

4. See Ronald Coase, "The Nature of the Firm," *Economica*, vol. IV, 1937, pp. 386–405.

5. Hessen, pp. 18–21.

6. See Norman Barry, *Business Ethics* (London: Macmillan, 1998), pp. 57–58.

7. Ibid., p. 62.

8. Ibid., pp. 65–66.

9. Hessen, chapter 4.

10. Milton Friedman, "The Social Responsibility of Business Is to Increase Its Profits," reprinted in Thomas E. Beauchamp and Norman E. Bowie, *Ethical Theory and Business*, sixth ed. (Englewood Cliffs, N.J.: Prentice

Hall, 2001), p. 51.
11. *Dodge v. Ford* (1919).
12. *A. P. Smith Manufacturing Co. v. Barlow* (1953).
13. See Norman Barry, "The Stakeholder Theory of Corporate Control Is Illogical and Impractical, *"The Independent Review"*, Spring 2002, pp. 541–54.

Some Seven Men Form an Association

MARCH 01, 2003 by W.S. Gilbert

[Editor's Note: The penultimate comic opera produced by W.S. Gilbert and Arthur Sullivan was titled Utopia Limited, or the Flowers of Progress, which debuted in 1893. It's the story of a South Paci?c island, Utopia, which its sovereign, King Paramount, wishes to model on Great Britain. To that end, he hosts several British advisers, one of whom, a Mr. Goldbury, proposes that the state be organized as a "company limited" according to England's Joint Stock Companies Act of 1862. King Paramount is unfamiliar with the term, and so Mr. Goldbury proceeds to enlighten him and his people.]

SONG—Mr. Goldbury

Some seven men form an Association
(If possible, all Peers and Baronets),
They start off with a public declaration
To what extent they mean to pay their debts.
That's called their Capital; if they are wary
They will not quote it at a sum immense.
The ?gure's immaterial—it may vary
From eighteen million down to eighteenpence.
I should put it rather low;
The good sense of doing so
Will be evident at once to any debtor.
When it's left to you to say
What amount you mean to pay,
Why, the lower you can put it at, the better.

Chorus: When it's left to you to say, etc.

They then proceed to trade with all who'll trust 'em
Quite irrespective of their capital
(It's shady, but it's sancti?ed by custom);
Bank, Railway, Loan, or Panama Canal.
You can't embark on trading too tremendous—
It's strictly fair, and based on common sense—
If you succeed, your pro?ts are stupendous—
And if you fail, pop goes your eighteenpence.
Make the money-spinner spin!
For you only stand to win,
And you'll never with dishonesty be twitted.
For nobody can know,
To a million or so,
To what extent your capital's committed!
Chorus: No, nobody can know, etc.
If you come to grief, and creditors are craving
(For nothing that is planned by mortal head
Is certain in this Vale of Sorrow—saving
That one's Liability is Limited),—
Do you suppose that signi?es perdition?
If so, you're but a monetary dunce—
You merely ?le a Winding-Up Petition,
And start another Company at once!
Though a Rothschild you may be
In your own capacity,
As a Company you've come to utter sorrow—
But the Liquidators say,
"Never mind—you needn't pay,"
So you start another company tomorrow!
Chorus: But the Liquidators say, etc.

Is the Corporation a Free-Market Institution?

The Success of the Corporate Form Comes with Some Drawbacks

MARCH 01, 2003 by Frank Van Dun

Is the modern large publicly traded business corporation compatible with a truly free market?

The question itself may seem strange, even silly. Corporations are primary actors in what the media refer to as “the market economy.” Also, when the media refer to “the market,” they as often as not mean the stock exchange, which is the place where the shares of large corporations are traded. Moreover, during the age of socialist ascendancy, many defenders of the free market have felt themselves moved to defend the corporation against socialist or “liberal” attacks.

Many genuine advocates of the free market even appear willing to make the stronger claim that a defense of the free market requires a defense of the corporation. In their view, defending the corporate form of business organization is an essential part of the argument for the free market. Prima facie, there seems to be a strong case for saying that the large publicly traded corporation is compatible with the requirements of the free market.

Nevertheless, I believe classical liberals and libertarians have good reasons to question that view. First, what the media say is not always accurate even on the count of reporting facts, which supposedly is their core business. Conceptual analysis is not their forte. They do not have much consideration for the theoretical contexts from which terms such as “free market” derive their significance or for the requirements of consistency in their use of such “theory laden” terms. The stock exchange is a market of sorts, but it is not “the market.” In any case, the stock exchanges with which the media are familiar are not really free but rather heavily regulated markets.

Second, socialist critiques of the corporation often were presented as critiques of free-market capitalism and merited a vigorous response from the latter's defenders. Sometimes, however, that response merely consisted in conceding that there were problems with the form of the corporation *in its present environment*. The gist of that response was to draw attention to legal and regulatory requirements imposed on the corporation. The argument was that such regulations set up "perverse incentives" that lead corporations to engage in behavior that the socialist critics adduce as evidence for the evils of capitalism. However, defending the corporate form of business organization against socialist attacks is not the same as proving its consistency with the principles of the free market.

Obviously, with merely impressionistic evidence and without a workable definition of its central terms, we cannot hope fruitfully to address the question that concerns us here. Let us therefore try to frame the question within a meaningful theoretical context. As a philosopher of law, I am particularly interested in the study of markets and corporations from the perspective of law. That perspective delimits the scope of the following observations. For reasons of space, I must leave other—historical, sociological, or economic—perspectives for another occasion.

Order of Natural Persons

Let us begin with a clarification of the idea of the free market. From the point of view of classical-liberal, or libertarian, political philosophy, the free market is the economic aspect of a particular order of human affairs. To be more specific, it is the result of adherence to the principle of individual sovereignty in the production and exchange of tradable goods and services. That principle is that a person's natural rights are respectable per se. One's natural rights are one's:

- life (in the biological sense);
- freedom (one's life in the sense of one's activity as a thinking, speaking, acting, and working person);
- natural property (one's body, which is the physical seat of one's life and freedom).

All other rights are respectable if and only if they are established in a manner that does not violate anyone's already established respectable rights (be they natural or established). This is the case specifically for a person's works, that is, those things that he produces by his own actions. As John Locke conveniently summed it up: his life, his freedom, and his property (his body and his works) are a person's rights under the law of nature, which reason declares to be respectable.

The law of nature, properly speaking, is the order of natural persons.[1] It is a condition without disorder or confusion in human affairs, without a trace of war among natural persons. Human affairs are in order when there is no confusion about who said, did, or produced something. Then people can base their actions, words, and works on a correct ascription of authorship. Nobody gets away with blaming, praising, or holding responsible one person for what another said, did, or produced. Nobody gets away with treating the respectable property of another as his own.

Respect for person, property, and personal responsibility, and liability for one's words, actions, and works, are the basic rules of law of the natural order—the basic rules of the natural law. Disorder emerges when people do not heed those rules in every particular instance of human interaction. Then people start treating a person as if he were somebody else, or as if he were not a person at all, which is the epitome of injustice.

Deviations from the basic rules are possible but only with the free consent of those whose respectable rights otherwise would be violated. Thus consensual undertakings, giving rise to contractually established rights, can be compatible with the natural law. In short, they can be lawful—unless, of course, they involve infringements or violations of already established respectable rights.

Those propositions apply to all human affairs. They apply in particular to the production and exchange of tradable goods and services. Thus whether or not there is a free market depends on the degree to which people respect the rule of natural law in their economic activities.

Natural Persons and Corporations

It is beyond dispute that people can agree to form corporations within the boundaries of what is lawful on a free market. A corporation, indeed, need be no more than a consensual undertaking. However, our question concerns the large publicly traded corporation, not just any conceivable corporate formation.

We can rephrase our question by asking whether such a corporation could lawfully arise on a free market. An affirmative answer to that question invariably stresses the consensual or contractual nature of the corporation. For example, we often read that a corporation is a "network" or "nexus" of contractual relationships.[2] However, that is far from sufficient to prove the lawfulness of such corporations. Not all contracts are lawful; not all contracts are such that their execution does not involve infringement or violation of the respectable rights of others. A and B may contract to murder C. That is a contract but not a lawful one. Moreover, even if a corporation is to some extent a network or nexus of contractual relations, it still may derive some of its characteristics from other sources, for example, legal or royal privilege. In the natural order of human affairs, there are no such privileges.

The large publicly traded corporation enjoys at least one legal privilege: its "legal personality," which it shares with the granter of the privilege, the state. Let me stress at the outset that the partners in a lawful consensual undertaking may well decide to endow their organization with an "artificial personality." There is nothing intrinsically unlawful about that. It is merely a convenience for ordering their relations and interactions within the organization. It does not bind or obligate any third parties.

However, being binding on third parties is the primary function of that other type of artificial personality, "legal personality." As John Marshall opined, a "corporation is an artificial being, invisible, intangible, and existing only in contemplation of the law." The crucial phrase is "in contemplation of the law." The "law" in question obviously is neither the natural law nor the law established by the contract that founds the corporation. The phrase here means "in the contemplation of the officials and agents of the existing legal order."

Artificial Systems Derive from Rulers' Commands

Now a legal order just may happen to conform to the requirements and rules of the natural order of human affairs, but usually it does not. Specifically, when artificial persons such as the state or other corporations are given equal standing with natural persons in an order, it is not a natural but an artificial order. That is even clearer when their status is superior to that of natural persons. The patterns of order ("laws") of an artificial system does not derive from the law of natural persons but from the general commands of its rulers. What is most distinctive about it is that it also reduces the standing of natural persons to that of "legal persons." All the fallacies of the positivistic legal ideology follow from that premise. For example, the individual person—and only natural persons are individual or indivisible—is said to be a "creature of the legal system," whose "rights and duties" are defined by the rules of the proper legal authorities.

A corporation that is compatible with natural law is no more than an association of natural persons, who agree to recognize the association as an artificial person "in its own right." However, as far as other persons are concerned, the existence of the association and its recognition by the partners as an independent artificial person in no way diminish the responsibility or the liability of the partners. How the partners assign responsibilities and liabilities among themselves is their business, but they lawfully cannot agree to deflect them to the artificial corporate person that they created. The partners own the corporation, and, as owners, they are fully responsible and liable for what "it" does. I cannot give lawful personality to my dog or my car and tell others that, when an accident happens, they should sue the dog or the car and leave me alone. In natural law, a corporation is just as much a means of human action as a dog, a car, or any other tool might be.

The privilege of "legal personality," however, consists precisely in the dilution of the responsibilities and liabilities of ownership. For those who receive the privilege, it is both an immunity and an empowerment. For others, the privilege is a dilution of their respectable rights. That is obvious in the case of the corporate form of political dominion. That construction, a.k.a. the state, implies incorporation of natural persons into a corporate body. The rulers stipulate that their subjects (a.k.a. "citizens") are legally liable for the debts incurred by the rulers. At the same time, they deny that the subjects are owners of shares of the corporation. To say that the state legally owns the subjects is more accurate than to say that the subjects own the state.

However, the corporate veil of the state also obfuscates the fact that the rulers make the decisions. It forbids saying that the rulers own the state. Historically, that is even a defining characteristic of the state. When the kings of yore failed to establish proprietary title over their political realm, they created the corporate entity now known as the state. Unable to make the realm the property of the king, they made kingship a property of the realm. Kingship became a function within an artificial, invisible, intangible person, the corporate legal system that exists only "in the contemplation of the legal system itself."

The English philosopher Thomas Hobbes put the seal of his redoubtable intellect on the new invention. He declared that the political sovereign (the king) is but the representative actor whose subjects own his every word and action. What he does to them, they do to themselves. Hence, as Hobbes shrewdly pointed out, the sovereign cannot do his subjects an injustice. Their legally presumed prior consent absolves the ruler of every responsibility and liability. The state, an entity owned by no one, exists outside the law.

Liability of Shareholders

In the world of business, the shareholders own the private or closed corporation. They are fully liable for its debts, whatever the nature or the cause of those debts. They may agree to a regime of limited liability. However, that merely means that they instruct the officers and managers of the corporation to restrict the obligations of the corporation to the sum invested in it. When the obligations of the corporation exceed that sum, it has to be determined who has to bear the excess liability. Will it be the managers for having failed to fulfill their assignment, or the shareholders for having failed to supervise their corporate property? The corporate veil cannot serve as a pretext to dupe outsiders. In particular, the shareholders face the risk of full liability just as much as would any owners of another type of property. (Obviously, the attitude of the courts and the legal rules they apply vary widely from one country to the next.)

However, the large publicly traded corporation is different from the private corporation. In its pure form, its shareholders merely supply capital to the corporation. It is pointless to say that they have “limited liability,” when in fact they have no liability at all. It is true that the value of their investment may fall to zero, but that is a risk all investors run. The shareholders are not liable for the debts of the corporation. They own the shares, which entitle them to dividends (if the corporation decides to pay out dividends) and perhaps also to attend, speak at, and even vote at certain meetings of the corporation’s members. However, they are not the owners of the corporation. They do not have any of the responsibilities and liabilities of an owner. Nor is it the case that they have contracted away the burdens of ownership to willing parties. The only persons that would fit that role are the managers, but they too are not owners. Their liability is limited by their status as employees of the corporation.

From the perspective of natural law, the original or first owner of the corporation is the entrepreneur who founds it, but the legal form of the corporation obfuscates that fact. The founder sells shares, invests the proceeds in the corporation, and hires managers to run it. Typically, he becomes a shareholder or a manager. According to the legal definitions of those positions, he no longer is an owner in the full sense of the natural law. Like the state, the large publicly traded corporation is an entity owned by no one.

Of course, the business corporation is in many respects unlike the state. It cannot shift liability for its debts to the shareholders in the way a state can shift liability to its subjects. It cannot prevent its shareholders from selling their shares in the way that states can prevent their subjects from selling their legal liabilities or benefits.

The corporation, in the Anglo-Saxon world and to some extent elsewhere, operates on a number of competitive markets—factor markets, product markets, and markets for corporate control. Moreover, official courts, which are organs of the state, tend to have less scruple in lifting the corporate veil when business corporations are in the dock than they have when the state is involved. They are likely to go after the natural persons (shareholders, but more likely managers) who actually made the wrong business decisions. They are not so likely to go after voters, legislators, or ministers who made the wrong political decisions. Because of that competitive environment and the attitude of the courts, there are more or less efficient ways for disciplining the actions of a business corporation. State actions may be notoriously inefficient and still elicit no more than an annoying question in parliament or an occasional repudiation at the polls.

However, our question was not whether large publicly traded corporations are more or less efficient than the state. It was whether such corporations are compatible with the free market. The argument presented here appears to lead to the conclusion that they are not. Without the grant of the privilege of "legal personality," the partners who make up the corporation would remain fully liable for the actions of their corporate tool. Every diminution of respect for lawful property weakens the free market and the natural law of human affairs. Diluting the burdens of ownership for a particular type of property is but one way to undermine the regime of property that defines the free market.

Risks of the Corporate System

Business corporations are significant players in the modern economy, but that is an economy in which they are policy-makers almost as often as policy-takers. Perhaps there are moments when the advocates of freedom can rejoice in the existence of Big Business as an effective counterweight to Big Government (or vice versa). But there are also times when the two of them weigh heavily on the freedom of non-artificial persons. Both are social organizations, very much interested in eliminating "the human factor," in "socializing" human beings into corporate creatures, docile citizens, and ditto workers. Both are enticing us to trade in our natural rights —and the burdens of responsibility and liability that go with those rights— for a limitless right to the satisfaction of our needs and desires. Both rest their claim for legitimacy on the purported fact that they can satisfy our needs better than we can ourselves.

Leave aside the catastrophic losses of wealth and life that the failings of the corporate system of business organization and politics have inflicted on several occasions during the past century. Let us admit that the corporate form of business organization has proven itself an immensely successful tool for mobilizing capital and labor. Let us also admit that it often has led to great achievements. In that respect, too, business corporations are like their political counterparts, the states, which have a similarly impressive record of mobilizing men and means and achieving great things. However, let us not forget the downside of those successes. It shows in the loss of freedom, our natural right to be the master of our own lives, albeit at the price of taking full responsibility for them.

Notes

1. For details about this nonmetaphysical conception of the law of nature and about the fact that reason cannot but find the natural law a respectable order—one that rational beings ought to respect—see my book (in Dutch) *The Fundamental Principle of Law* (Antwerp: Kluwer-Rechtswetenschappen, 1983).

2. See for example, Robert Hessen, *In Defense of the Corporation* (Stanford, Cal.: Hoover Institution, 1979) and Norman Barry, Business Ethics (London: Macmillan, 1998). Is the Corporation a Free-Market Institution?

A Ton of Prevention: How the FDA Threatens Vaccine Supplies

FDA Regulations Make Vaccines Scarce

MARCH 01, 2003 by Arthur Foulkes

After two troubled years, the supply of flu vaccine was plentiful in 2002. But toward the end of November, after nearly all flu shots had been given, one of the three companies making injectable vaccine said it was dropping out of the business, raising immediate concerns of greater scarcity in the future.

The news was especially disturbing for older Americans and others for whom the flu can lead to serious complications, including death. The Centers for Disease Control and Prevention (CDC) estimates some 20,000 Americans, mostly over 65, die annually from flu-related illness.

When I first heard about the vaccine scarcities of 2000 and 2001, I wondered why this was happening. After all, I never hear about short supplies of McDonald's hamburgers or Coca-Cola. Even more complex goods, such as computers or televisions, are always in stock. Why, of all things, flu vaccine?

Media accounts of the problem in 2000 named two causes. First, they said, several vaccine makers were having problems growing one of the three virus strains mandated by the Food and Drug Administration (FDA) to be included in that year's vaccine. The vaccine is different each year because the flu bug circulating changes. Each dose of vaccine contains three virus strains that are designed to best combat the year's expected virus.

Second, they reported, "manufacturing difficulties" occurred at two of the four vaccine companies. Apparently, these two companies stopped production in mid-season to comply (or attempt to comply) with FDA regulations.

I quickly noticed both causes had one thing in common: the FDA. This made me suspicious. Could it be that the agency notorious in economic literature for preventing, obstructing, and delaying drug development, was having a similar effect on vaccines?[1] I believe the answer is yes. (The vaccine scarcities in 2001 owed much to the anthrax scare when politicians and others urged people to get shots to prevent anthrax false alarms.)

The FDA has the legal authority to determine which three flu virus strains are to be included in each year's vaccine. Until the FDA decides on the "proper" mix of strains, vaccine makers have their hands tied. If the FDA is slow reaching its decision, vaccine producers are immediately on a tight schedule—it normally takes six to eight months to manufacture flu vaccine. As it happens, the FDA was slower reaching its decision in 2000 than usual. It did not determine the three acceptable strains until April. This, even though the World Health Organization had recommended complementary strains in February and European health officials had made their recommendations in March.

More important, the FDA also contributed to the 2000 scarcity through a set of regulatory guidelines known as Current Good Manufacturing Practice (CGMP) regulations. These rules allow the FDA to dictate even minor details of vaccine making (such as record keeping, lighting, and labeling) and force manufacturers to constantly invest in the "latest, greatest technology" to keep up with FDA-determined industry standards.[2] Worse, the FDA can change CGMP standards without warning. This seems to have happened in 2000.

"The FDA didn't communicate very clearly that they were changing the rules of the game," said economist and industry observer David Webster. Two vaccine makers were "caught unaware" he said—namely Parkedale Pharmaceuticals and Wyeth Pharmaceuticals. "The FDA presented a decision to them, which was to completely upgrade or leave the business."[3]

Out of Business

Parkedale took the latter option and left the business on the eve of flu-shot season, 2000. In doing so, the company wrote off some $51 million in losses and took 15 percent of the expected flu-vaccine supply with it.[4] Wyeth, on the other hand, halted production only temporarily then resumed (after paying a $30 million fine to the federal government and agreeing to stepped-up FDA inspections). But by then it was several weeks behind schedule. (Wyeth had both biological problems and FDA problems, making it the last major vaccine producer to ship all its vaccine—several weeks later than usual.)

Two years later, Wyeth joined Parkedale in leaving the injectable flu-vaccine business. The company manufactured 20 million doses of the vaccine in 2002, but near the end of the season it still had not sold over 25 percent of its product.[5] A company spokesman said Wyeth was quitting partly to focus (with partner MedImmune) on its revolutionary nasal spray flu vaccine, known as FluMist, which has still not received FDA approval, despite several years of development and testing. (The FDA rejected FluMist for sale in the United States in 2001 and again in 2002, saying it could not be sure the medicine was safe for children in combination with other vaccines.[6])

The FDA has not merely disrupted influenza vaccine supplies, but those of many other vaccines as well. An "already serious shortage" of tetanus vaccine was made worse after Wyeth left that market two months after the FDA found quality-control problems at two of its plants in October 2000.[7] In 2001, FDA inspectors brought about a one-month shutdown at a Merck and Co. plant resulting in a temporary shortage of vaccine for measles, mumps, chicken pox, and hepatitis.[8] In a classic example of the FDA's making questionable risk/benefit analyses on behalf of Americans, the agency shut down a plant making a life-saving hemophilia vaccine. This move led to a temporary aggravated scarcity that put hemophilia patients at risk even though the FDA acknowledged that the vaccine produced at the plant was safe.[9] And finally, in March 2002, *Infectious Disease News* listed the FDA's CGMPs as the specific cause of five vaccine shortages, including MMR (measles, mumps, rubella), hib, varicella, and hepatitis B.[10]

The FDA plays a major role in hampering vaccine production and innovation. Len Lavenda of Aventis Pasteur, the largest U.S. flu-vaccine company, said in an August 14, 2002, telephone interview with me that the FDA is in the forefront of any innovation decisions his company makes. Because the innovations require FDA approval, which is costly and time consuming, his company makes only those changes deemed "absolutely necessary."

Despite that role (or because of it), vaccine and drug company officials are reluctant to speak out publicly about their federal overlords. Three of the four flu-vaccine makers I contacted for this article would not return phone calls. Another company, Merck, simply rules out any comment on its relations with the FDA.[11]

With its decision to drop out of the injectable flu-vaccine business, Wyeth may have decided to take the offense against the FDA by increasing pressure on the agency to approve FluMist. This may work. As political scientist Daniel Carpenter has shown, the FDA is not above being swayed by public opinion or political considerations. "The case of AIDS offers a lucid example. When ACT-UP protesters, dismayed that the FDA might delay approval of lifesaving therapies, demonstrated at agency headquarters in 1988, they embarrassed the agency and prompted a sharp change in policy on AIDS drugs."[12]

This strategy, if that's indeed what it is, may also backfire. As one industry observer told TheStreet.com, Wyeth's decision "is going to raise some eyebrows."[13]

FDA Damage

The economic literature showing the damage done to Americans' health by the FDA is impressive.[14] While this work focuses primarily on prescription and other drugs, vaccines are clearly not immune. The best solution for Americans' health and freedom is to do away with the FDA altogether. Drug and vaccine companies would find it to their interest to have their products privately certified and inspected—without a bureaucratic agency holding the authority to make life-and-death decisions for the entire population.

As economist David R. Henderson points out in *The Joy of Freedom*: "The FDA may have some expertise when it comes to drug safety and efficacy, but on the only issue that matters—your tradeoffs between various risks—you are the expert, and the FDA's scientists are rank amateurs."[15]

But would private drug and vaccine inspectors face an insurmountable conflict of interest? After all, they would be seeking business contracts from the very companies they would be certifying. It is of course possible that some certification companies would be fraudulent. But the market would soon distinguish between poor certifiers and top certifiers. The best certification companies would have a strong incentive to perform honestly and maintain a clean reputation—their very existence would depend on it.

Indeed the free market offers many examples of for-profit certification companies that guard their reputations closely. For instance, motorcycle helmets are required to meet a certain level of quality by the U.S. Department of Transportation. These helmets are fine for some people, but those seeking the really top-quality helmets look for a certification from a private company, Snell, which only certifies helmets that meet tougher quality standards. The threat of bankruptcy provides a strong incentive for Snell to maintain its reputation for strict standards and impartiality.

In 2000, critics said the free market was unable to guarantee flu vaccine to the most needy people and led to "price gouging." (The American Medical Association led the charge against "price gouging" and called on Congress to investigate flu-vaccine distribution problems. It also asked Congress to develop a "mechanism" to guarantee better vaccine distribution in the event of another shortage.[16]) Some flu-vaccine prices clearly did rise dramatically. Vaccine ordered in June sold for under $3 per dose. By November the average price had risen to $7, but some vaccine sold to last-minute purchasers was going for $12 or more.[17]

But these problems were symptoms of bad public policy, not "market failure." Naturally the price of a commodity will rise when, other things remaining unchanged, supply drops dramatically. This is an important signal for new entrepreneurs to enter the market. Yet if FDA regulations continue to drive more and more companies out of the vaccine business, scarcities will remain a threat. If the agency can further impose unexpected and never-ending costs, entrepreneur-producers will naturally look to other investment possibilities. As even one FDA official recently noted, costs imposed by the agency have helped lead to "a decreased interest in making vaccines."[18]

Not surprisingly, most proposed solutions to the flu and other vaccine-supply problems have called for a larger government role. One idea, proposed by U.S. Representative Peter DeFazio, would give the federal government the power to declare a public-health emergency (according to its own judgment) and seize vaccine supplies.[19] While manufacturers would be reimbursed, distributors (who must shoulder large investments in specially designed shipping and storage equipment) would be left without the ability to cover their capital costs. In other words, even in years of high demand (such as a bad flu season or more FDA-caused shortages) distributors would suffer losses after the government took over vaccine distribution. On the other hand, in years when supplies were high, demand low, or both, distributors would again face losses or tiny profits because of natural market forces. The prospect for above "normal" profits would disappear. Soon entrepreneur-producers would take productive resources out of the flu-vaccine distribution business altogether.

It's not hard to see how this would lead to more supply and distribution problems—opening the door for *even more* government intervention and possibly the eventual nationalization of the flu-vaccine distribution business. It would be far better to free vaccine companies to determine their own virus-strain combinations (if the FDA gets it wrong, everyone suffers), eliminate CGMP regulations, and allow uninhibited innovation. Perhaps then vaccine shortages would be as unheard of as shortages for hamburgers and Coca-Cola.

Notes

1. For an excellent summary see Daniel B. Klein, "Economists Against the FDA," *Ideas on Liberty*, September 2000. For a good look at the political culture of the FDA, which contributes to these problems considerably, see Paul J. Quirk, "Food and Drug Administration," in *The Politics of Regulation* ed. James Q. Wilson (New York: Basic Books, 1980), pp. 217–18. Also see Henry I. Miller, "First Do No Harm," *Hoover Digest*, 2000, no. 4.

2. Jess Kilby, "Nobody is Immune," *Portland Phoenix*, March 2002.

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13. Adam Feuerstein, “Flu Vaccine Shift Smells Sweet to Wyeth,” TheStreet.com. Nov. 19, 2002, www.thestreet.com/_tsclsii/tech/adamfeuerstein/10055071.html
14. See Klein, and Quirk, pp. 217–18. Also, Miller, and Henderson, pp. 276–80.
15. Henderson, p. 277.
16. See Stephanie Stapleton, “Flu Vaccine: Enough to Go Around?” *American Medical News*, January 1–8, 2001.
17. Government Accounting Office (GAO) report, *Flu Vaccine: Supply Problems Heighten Need to Ensure Access for High-Risk People*, May 2001, GAO-01-624.
18. Kathryn Zoon, director of the Center for Biologics Evaluation and Research at the FDA, quoted in “Government, Industry Discuss Strategies for Preventing Vaccine Shortages,” *Reuters Medical News*, February 11, 2002.
19. See H.R. 910, introduced March 7, 2001.

A Capitalist Party in China?

The CCP Is Seeing the Need for Capitalism

MARCH 01, 2003 by John Welborn

The Chinese Communist Party (CCP) is struggling to reinvent itself. At the 16th National Congress in Beijing last November, the party approved policies intended to make it appear more connected with China's rapidly liberalizing society and economy. After a week of introspection and political reorganization, party members seemed serious about reclaiming their position at the top of Chinese society. It appears they may do just that.

One key policy shift could yield important gains for Chinese citizens. In a speech at the opening of the party congress, President Jiang Zemin gave a sweeping endorsement of private property. He said, "We need to respect and protect all work that is good for the people and society and improve the legal system for protecting private property." Though the notion of private property has existed in China for some time, this is the first time that it has received official attention at such high levels. As one party secretary stated, "From now on, public and private property will be viewed on an equal footing."[1]

This process is already underway. In August the Standing Committee adopted the Rural Land Contracting Law (RLCL), which strengthens 1998 legislation giving 30-year land-use rights to farmers, and explicitly outlaws "administrative readjustments" by local cadres.[2] For the 210 million farm families in China, this legislation ensures incentives for long-term investment, and should result in increased productivity and efficiency.

Similar reforms are taking place in urban areas. In Shanghai, almost 90 percent of homes are now privately owned, which has led to the creation of profitable mortgage markets and allowed homeowners to use property as collateral for consumer loans.[3] Party delegates also formally endorsed Jiang's invitation for entrepreneurs to join the CCP, a handful of whom were voted into the powerful Central Committee. Though it may seem remarkable that the Communist Party would open its doors to the "running dogs of Western imperialism," in reality this move merely formalizes the status quo. A quarter of China's 100 richest multimillionaires listed in this year's *Forbes* magazine survey claimed to be CCP members.[4] Most CEOs of private companies or public corporations also have party connections. A prominent example is Jiang's eldest son, who heads the country's largest telecom firm, China Netcom, now privately held.

Jiang and party loyalists devised clever political rhetoric to justify the induction of "red capitalists." At the party congress, the Constitution was amended to include Jiang's signature political philosophy, the "Three Represents," alongside "Mao Zedong Thought" and "Deng Xiaoping Theory." Jiang's theory calls for the party to represent the "advanced productive forces, the advanced culture and the interests of the broad masses." While the "Three Represents" may help recast the party as vibrant and progressive, in truth it is an intentionally vague political device designed to reconcile the party's increasingly pro-market views with Chinese socialism.

The Communist Party has every incentive to reform. The private sector in China has grown at an annual rate of 20 percent since the start of the reform era in 1978, far above the economy's 8 percent average growth for the same period.[5] More than 30 million private businesses have been established, contributing a significant share of tax revenue to the government and employing millions of people laid-off from failed state-owned enterprises.[6] According to the World Bank, the nonstate sector in China now accounts for two-thirds of the country's productivity and GDP, even though the state still controls two-thirds of China's industrial assets.[7]

Personal Connections Count

But to successfully rekindle its popularity, the party must do more than simply show that it too is open for business. To many in China, there is little difference between the communist leadership and its new business comrades; they are all part of the same entrenched ruling class that thrives in an unjust and corrupt system. Given that legal institutions in China are weak and individual success is often a function of personal connections, it is hard to disagree.

If the Chinese Communist Party wishes to regain the trust of the masses, party leaders must prove they are genuinely interested in extending the benefits of this new "capitalism with Chinese characteristics" to all citizens. That will require the establishment of the rule of law, not just property rights.

What an irony: the communist party may only be able to survive by letting capitalism bloom.

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Utopia Versus Eutopia

The Formula for Building Eutopias Is Based on Freedom

MARCH 01, 2003 by Daniel Hager

Utopianism has a long-running history that includes turning the 1900s into the bloodiest century in human experience. Typically utopian schemes are founded on the premise that individual self-interest must be subjugated for the purported greater public good. As such, utopianism is fit for only a utopia: the term derives from the Greek words *ou* ("not") and *topos* ("place") and means simply "not a place."

Real-world social experiments that seek to achieve a communitarian ideal generally lead either to disintegration or repressive rule. Utopia turns into *cacotopia*, a "bad place." The utopian Soviet Union, according to ample documentation, was a *kakistotopia*, a "worst place."

By contrast, a *eutopia*, or "good place," is eminently attainable in the real world. The organizational structure that fosters it consists of a limited government that permits human creativity and achievement. Individual self-interest—far from being a bane—expresses itself in relationships of mutual benefit that result in productivity and the generation of wealth. Prosperity does not have to be forced. It just happens.

In his 1516 work *Utopia*, Thomas More claimed that his imaginary island of that name was a *eutopia*, translated as "happy land" in the Yale edition of his works.[1] You may not agree.

In More's *Utopia*, wrote coeditor J. H. Hexter, "men live all the time under everyone's eyes."[2] Citizens shunned individuality. All dressed in bland, simple garments and disdained ostentations like jewelry and other finery. Gold had so little appeal that it was used for making chamberpots. All persons ate their meals in large groups in common halls. Communistic Utopia had no money or private property.

Each household had access to as many goods from the common storehouses as desired. Abundance was so great, and no one secured in excess of need. This standard of living was attributable to the production only of necessities, not self-glorifying superfluities. Since so few goods had to be made, the diligent and productive labor force worked a maximum of six hours a day. The eradication of greed, achieved through the abolition of private property, eliminated wars.

The level of regulation of the citizenry extended even to travel permits—as Hexter noted, "there is no place to hide" in this Utopia[3]—but all the people were content to live out their lives and seek their homey pleasures under rule by benevolent magistrates and scholars, by cosmopolitan intellectuals, in effect by humanists like [More] himself."[4] Hexter further observed that "part of the charm which his brainchild had for More derived from the eminent place in Utopia occupied by the intellectual élite."[5]

Intellectual elites are responsible for most utopian concoctions, such as the French Revolution, which like More's Utopia produced unstylish uniforms for the citizenry. The revolution was aimed at more than merely creating a new form of government. The astute French critic Frédéric Bastiat (1801–50) clarified the revolution's goals through quotations from prominent leaders, including educational theorist Michel Le Pelletier: "Considering the extent of human degradation, I am convinced that it is necessary to effect a total regeneration and, if I may so express myself, of creating a new people."

Jean-Nicolas Billaud-Varennes claimed that "a people who are to be returned to liberty must be formed anew" and favored the ancient Sparta model of a restrictive, tightly controlled state. Louis Antoine de Saint-Just staked out a broad mission for the new leadership: "The legislator commands the future. It is for him to *will* the good of mankind. It is for him to make men what *he wills* them to be." Maximilien Robespierre had a plan for remodeling the human race: "The principle of the republican government is virtue, and the means required to establish virtue is terror."[6] Saint-Just advocated a dictatorship under Robespierre—the populace must be coerced into its utopia. Both the dictator Robespierre and his ally Saint-Just perished under the guillotine as the projected utopia collapsed in kakistotopic carnage.

The sloganeering of the French Revolution—*liberté, égalité, fraternité*—persisted into the nineteenth century and undergirded various types of socialism and communism as they took shape. The ultimate failure of these movements could already be predicted in their formative phases. For all the homage paid to *égalité* and *fraternité*, they were marked by the maneuverings of numerous individuals who sought dominance. The motto of the Federation of the Just as it evolved into the Communist League was "all men are brothers," but the federation's original brother-in-chief, Wilhelm Weitling, found the heights of leadership perilous. Friedrich Engels recalled that Weitling became "one who was ever suspecting his rivals, his secret enemies, of laying traps to snare him . . . a seer who had a recipe ready to hand for the realisation of heaven upon earth, and fancied that every one he encountered was trying to steal it from him. . . .

Weitling could not get on with any one." (Some brotherhood.) Engels and Karl Marx disdained another would-be leader, Hermann Kriege, and "the slobbering spinelessness" of his doctrines, and blunted his influence so effectively that "as far as the Federation was concerned, Kriege was heard of no more." As Marx and Engels jointly jockeyed in the competition for supremacy in the movement, Engels used hyperbole worthy of a Madison Avenue flack. Marxist theory, he claimed, was built on "a firm scientific foundation" and contained "scientific conclusions."[7]

Pie in the Sky

Engels fancied his and Marx's brand of communism as feasible in contrast with "the fantastical elaboration of a social ideal as nearly achieving perfection as possible" that competing communists had cooked up.[8] Yet Marxism is real pie-in-the-sky stuff. After the proletariat seizes all means of production, the state is supposed to wither away because the economic machine will produce such egalitarian harmony and prosperity that men will govern themselves without the need of external governmental structures.

But to get to that utopia a dictator is required to provide the initial shove. Marxism sputtered until Lenin seized the reins of Russia in the 1917 Bolshevik Revolution. The new Soviet Union became the darling of worldwide admirers of centralized state control, of would-be oligarchs who fantasized that with the right power granted to the right people the right results could be achieved for the masses.

One of the chief American encomiasts for the Soviets was George S. Counts, a Columbia University education professor who believed that public education was a vital tool for quashing capitalism and replacing it with a command economy. He toured the Soviet Union in 1927 by rail and in 1929 in a rugged American automobile. He admired "the socialist state which is maturing in Soviet Russia."[9] In contrast, he wrote, "the American people lack the machinery necessary for controlling the vast economic structure which they have fashioned. . . . Since they are unable to direct the course of events, they must content themselves simply wondering and guessing what is going to happen. Needless to say, unlimited indulgence in this game of chance is full of hazards."[10] But the Soviet communists, he explained, proceeded under the assumption that "social phenomena are capable of being controlled and that the development of society can be made subject to the human will."[11] (*Saint-Just vive*.) Success had not been uniformly achieved during the 13-year regime of the communists, Counts admitted, but "the evidence indicates that they make fewer mistakes than formerly and are slowly and painfully learning how to operate the machinery of control."[12]

Counts was aware of the existence of the GPU, the state political police, as an adjunct to a government that "sought to promote the rational and orderly development of the entire social economy,"[13] but offered an apologetic: "While no doubt [the GPU] has made mistakes in individual cases, it has on the whole served well the purpose for which it was created —it has given solid support to the revolutionary cause during the critical years of infancy. Without it the dictatorship would most certainly have collapsed long ago."[14] Counts remained blindly committed to planned perfectibility. In 1937 he stated, "A map of the world that does not contain the land of Utopia is not worthy of mankind."[15]

Equally agreeable to dictatorship in the name of emancipation was the American journalist Lincoln Steffens, who had chronicled corruption by the volumes in the United States and perceived the Soviet Union as a new system that would expunge "such evils as poverty and riches, graft, privilege, tyranny, and war" by "remov[ing] the causes of them." Steffens viewed Lenin as a fellow liberal who reluctantly employed terror for the larger end of preserving the revolution against reactionaries who would destroy it. Lenin told Steffens in 1919 he preferred to scare opponents into leaving rather than having to execute them. But, Lenin added, only a "few thousands" had been killed in comparison with the recent "slaughter of seventeen millions of men in a purposeless war." According to Steffens, the dictatorship, supported by a small, trained minority," was but an evolutionary step to "make and maintain for a few generations a scientific rearrangement of economic forces which would result in economic democracy first and political democracy last." When he returned to the United States, Steffens told friends, "I have been over into the future, and it works."[16]

Private Gain

The utopistic oligarchy described by Steffens was seen by Counts as far superior to the American model in which "the evolution of institutions proceeds for the most part without plan or design, as a sort of byproduct of the selfish competition of individuals, groups, and enterprises for private gain."[17]

Yet that "selfish competition," that pursuit of self-interest that Counts denigrated, unleashes magnificent material abundance when it is allowed to operate under a legal and social system that promotes it. Trade has existed among members of the human race since early tribal times. Each trading partner benefits by securing a good not previously possessed. Persons, individually or in groups, have incentives to expand production and trade to meet the needs of others if they are allowed profit from those endeavors. Thus government should protect property rights and prevent confiscation of legally attained assets. Abundance is certain to result.

As FEE's founder, Leonard Read, wrote in his essay "I, Pencil," *"Leave all creative energies uninhibited*. Merely organize society to act in harmony with this lesson. Let society's legal apparatus remove all obstacles the best it can. Permit these creative knowhows freely to flow."[18]

The formula for building eutopias is based on freedom. It is so simple that the perplexing question is why the formula has not been adopted worldwide. It opens the way for ordinary people to realize extraordinary accomplishments that serve both their own interests and the interests of others.

But the formula excludes utopians and their arrogant urge to mastermind social organization into conformity with their chimeras. Utopians have to use coercion to attain cooperation. Eutopians attain cooperation through voluntary actions that yield mutual advantage.

Except in fiction, the former approach founders in destitution. The latter produces abundance.

Why is the choice so hard to make?

Notes

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3. Ibid.
4. Ibid., p. civ.
5. Ibid., p. cvii.
6. Frédéric Bastiat, *The Law*, trans. Dean Russell (Irvingtonon-Hudson, N.Y.: Foundation for Economic Education, 1998), pp. 52–54.
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The Return of the Keynesians

Governments Cannot Fine Tune Economies

MARCH 01, 2003 by Christopher Lingle

The Keynesians are back. After laying low in recent years, they are promoting their interventionist plans once again. Take Joseph Stiglitz, for example. He apparently waited until he gained the credibility of sharing the Nobel Prize in Economics in 2001 to become an unabashed cheerleader for Keynesian economics. Such a universally recognized accolade allowed him openly to support a body of economic thought that had recently been thoroughly discredited by its notable failures. His new book, *Globalization and Its Discontents*, is his most recent exercise in expressing contempt for free markets.

True to form, promoters of Keynesian economic theories are encouraging governments to engage in active policies to manage demand and consumption. Their selective memory contains a gap that overlooks the stagflation of the 1970s, soaring public-sector deficits of the 1980s and 1990s, and relentless growth in government control over private lives during most of the post-World War II period.

It would be wise for the rest of us to resist their belief that governments can fine-tune an economy by making adjustments in taxes or government spending or manipulating interest rates. This caution is offered since there is a dearth of evidence to support their views. As it is, Keynesian policies are based on a widely accepted fallacy that economic growth is driven by demand, especially consumption spending. Perhaps unwittingly, those who support this view see savings as a nonessential and even counterproductive activity that undermines the health of the economy.

Nothing could be further from the truth, since economic growth requires the fuel provided by savings. When households decide to boost their savings, the pool of investment capital is increased. In turn, interest rates are pushed down naturally and a larger number of investment projects can be undertaken.

The negative view of savings is painfully familiar in Japan. However, attempts at demand management by Japan's government over the past decade have failed. Now that interest rates are virtually at zero and fiscal spending has become constrained by high debt levels, Tokyo has exhausted conventional policy tools to offset its economic malaise. The truth is that these traditional tools do not work.

Instead of the Keynesian presumption that demand drives economic growth, the reverse is true. Demand is the result of economic growth. Paraphrasing an economic law named after the nineteenth-century French economist J. B. Say, market economies work on the basis of the supply of one good creating the demand for one or more other goods. In other words, you must first produce to be able to consume.

Reviving the neglected verities of Say's Law requires debunking a belief system that is subconscious and seldom subjected to introspection. One problem in exorcising Keynesian policy influences is that the demystification requires understanding some basic economic theory that is hard to grasp. Further, many implicit assumptions behind much of Keynesian analysis will seem obscure in their effect or validity to lay persons.

Understanding Say's Law begins with the commonsense observations that purchasing power as the basis for consumption necessarily arises out of the act of production. Moreover, just as goods cannot be purchased unless people earn income from producing, so goods cannot be consumed if they are not produced. Hence, the driving force of a market economy is supply and not demand.

This logic shows that economic growth depends on how much is saved (and how well it is invested) instead of how much is consumed. Savings and investment can lead to increases in the per capita quota of invested capital so that increases in productivity lead to higher real wages and increased prosperity. Spending on consumption leaves fewer resources for production.

Policies to force interest rates artificially lower to boost consumption are actually counterproductive since they discourage savings. Such policies also have the undesirable effect of encouraging long-term investment although consumers have not changed their preference for future goods over present goods.

The Grasshopper and the Ant

If all goods were consumed and none were set aside to invest in time-consuming production, we would be in the situation faced in the fable of the grasshopper and the ant. While the ant toiled away, the grasshopper derided him for not playing in the sun. When winter came, the grasshopper faced starvation for not laboring in the present to prepare for the future. Keynes, being childless, perhaps saw no merit in the wisdom of nursery tales.

Attempting to increase aggregate demand by increasing government spending also will not restore growth. There is little evidence to suggest that fiscal or monetary policies have a systematic effect on real economic variables.

In fact, government's printing money and spending more cannot induce stable long-term growth because those activities do not generate new wealth, capital, or savings.

Sustainable economic growth requires an expansion of the capital base, and that requires savings. When central banks push down interest rates to put more money into the economy or when governments run deficits, funds are diverted from wealth generators to wealth consumers. A better move would be to cut government spending so that resources are released for productive use.

It is astonishing that the failed principles of central planning are readily applied in government attempts to manipulate market economies. Nevertheless, policymakers are as incapable of acquiring the knowledge needed to control markets as planners are. Even though macroeconomic meddling to "correct" market conditions involves the same presumptions that (mis)guided central planners, supporters of Keynesian policy willfully ignore evidence from the failures of communism and socialism.

Although market economies experience fluctuations, extreme booms and busts are caused by the sort of meddling that is supported by Keynesian prescriptions. These interventions also interfere with the innate selfadjustment mechanisms that would generate stability in capitalist economies.

Alas, Keynes's teachings remain very much alive and just as wrong now as they always have been. Apparently the discovery that centralized economic decision-making through political mechanisms is inferior to decentralized market mechanisms has already been lost on some.

Unsustainable Development

Centralized State Control of Economic Resources Won't Help Future Generations

MARCH 01, 2003 by James Peron

Sound economic thinking lies in accounting for the secondary results of private and government actions.[1]

This observation is not limited to economics. It can be applied to all areas of human study, including political philosophy. Once learned, that lesson can prevent a great deal of human hardship. Take, for instance, a concept promoted by left-wing environmentalists, "sustainable development." The term itself actually sounds rather pleasant. Most of us—oddly, excepting those who use this term most often—support development, and we want it to last.

But to understand this concept we have to look beyond the short term. We have to ask ourselves what are the ramifications and logical conclusions of this theory. First, we have to be clear about what is usually meant by the term. It most often means the preservation of resources for future generations. The concept originated with the United Nation's World Commission on Environment and Development, the Brundtland Commission, named after its socialist chairwoman, Gro Harlem Brundtland. The commission members said sustainable development "meets the needs of the present without compromising the ability of future generations to meet their own needs."[2] The more vocal proponents refer to the consumption of resources today as "stealing" from future generations.

The advocate of individual rights immediately has problems with this theory. It not only postulates that rights belong to a collective but to a collective that doesn't even exist. By definition, a future generation is a group of people not yet born. As the saying goes, "Tomorrow never comes." The reason is simple: when tomorrow does arrive it ceases being tomorrow and becomes today. So it is with future generations. Once an individual is actually born he ceases to be a potential member of a future generation and becomes the actual member of the current generation.

If we accept the theory that resources must be preserved for future generations, then we assume that groups of unborn individuals have a right to those resources. But, strangely, this right vanishes the moment those individuals are born, because each future generation, once born, is saddled with the same obligation to yet-still-unborn generations. Moreover, while advocates of sustainable development argue that the unborn have a right to a resource, they also argue that many members of the same future generations should be prevented from coming into existence—that is, they tend to support government intervention meant to reduce the size of future populations. Apparently, unborn generations have property rights but no right to life.

Another problem for the sustainable development theory is that we don't know what resources will be needed in the future. A hundred years from now people might still be using petroleum to heat their homes or power their cars. But they might not.

As a boy I often visited my grandmother in Chicago. She had a large old house not far from Lake Michigan. On one side was a trap door with a metal slide leading to the basement. Periodically, a truck would pull up and drop a large load of coal down the slide to the basement. There was always a massive pile of dirty, smelly coal down there. The basement was covered in fine coal dust. A large furnace, which required constant maintenance, generated steam for the radiators and for hot water. Every so often my grandmother would have to shovel coal into the furnace—otherwise there would be no heat.

A policy in my grandmother's day to save coal for future generations would have required her to use much less. She would have been colder—but no one would have been better off. If that old house still exists, I doubt it is heated with coal. Her children don't use coal today. Coal conservation would have been a lose-lose situation.

Similarly, if we had made policies 20 years ago based on consumption patterns then, we would have worked hard to preserve copper supplies for telephone use. Yet today few phones use copper wires for transmission. They use fiber-optic cables. A huge percentage use no transmission wires at all.

Why sacrifice the well-being of living people for the sake of nonexistent possibilities? Why make sacrifices when we know for certain that much of what is used today will be unwanted tomorrow? Certainly there are resources used today that will still be required in the future, but demand may be significantly less relative to supply. In fact this is precisely what has been happening with virtually every natural resource.

Impossible Projections

In just a short time the resource needs of our generation have changed dramatically. It is unlikely that any of us would have correctly projected today's resource requirements. Yet sustainable-development advocates project future consumption over generations, centuries, perhaps millenniums.

To complicate matters even more, whether something is or is not a resource depends entirely on human ingenuity. Once, oil on one's property devalued the land. It killed the cattle, made agriculture difficult, smelled bad, and had no useful purpose. The negative value turned positive when someone figured out how to use it. A bane became a resource. As human knowledge increases, more and more substances become resources.

The basic premise of sustainable development theory is that the supply of all resources is limited across time. While this has been challenged, let's accept the premise for the sake of argument.

The goal of sustainable development is to preserve "enough" of a resource for future generations. But how much is enough? And for how many generations? While a meteor, or some other catastrophe, may wipe out the human race, we must assume infinite future generations.

But this assumption leads to problems. If we figure that resources are finite and consumption is not, then we have to recognize that any level of consumption will eventually mean that some future generation will have to do without. Logic would seem to demand that we consume nothing at all. And this would apply not only to our generation but to every one that follows. Thus the very people for whom we would be preserving the resource are themselves required not to use it. But if they have no right to use the resource, then our consumption of it today could not possibly be considered "stealing" from them. (The advocates of sustainable development, coming from the apocalyptic Green movement, never consider the role of prices and market incentives, which prevent any needed resource from being depleted.)

Would we actually improve the life of future generations? As illustrated by my grandmother's use of coal, this may not be true. In fact, we could diminish the well-being of future generations by limiting consumption today. Coercive limiting of petroleum consumption would no doubt make us poorer than we would have been. It would also reduce the well-being of our children and their children. Yet technological changes will no doubt reduce our need for petroleum, as it has been doing for decades. In other words, forced conservation would lower our living standards, and that of following generations, in order to preserve a resource that we'll need less and less of in the future—and maybe not at all.

Moreover, forced reduction in consumption today may well stifle the very technological innovations that would eradicate the need for petroleum. Innovation requires investment, and investment requires wealth. If we reduce wealth we reduce investment and, in all likelihood, innovation. We may actually increase the consumption of a resource over the long term by reducing its usage in the short term.

The "right" set of environmental regulations just a couple of decades ago could have prevented development of fiber-optic, cellular-telephone, and Internet technology. As a result, vast quantities of copper, paper—and trees—would still be required today for communication.

Of course, no one misses a technology that never was. It is only by looking backwards that we can see what effect such policies would have had on us had they been foolishly implemented by our parents or grandparents.

Other Stifling Effects

Sustainable development would stifle innovation in other ways as well. It is supposed to guarantee "equal" access to resources today, tomorrow, and a hundred years from now. The idea is to prevent resource crises. Yet crises often bring new technologies into existence. Price controls in the United States artificially stimulated demand for oil during the 1970s and caused shortages. When deregulation later increased prices (temporarily), consumers demanded new technologies to reduce consumption. Cars built before the crisis consumed more fuel per mile than those built since. (Higher prices also summoned new supplies.)

Thus, in a free market, crises contain the seeds for their own solutions. Often the solution dramatically reduces demand for the resource in question and sometimes eliminates demand entirely.

But the ebb and flow of markets cannot be allowed to operate under sustainable development, which requires state control. This inevitably means that price and profit signals will become distorted, causing both consumers and producers to miscalculate the availability of resources and forcing them into patterns contrary to their actual well-being.

Sustainable development is one of the most perilous theories around. It can’t even answer the basic questions it raises. It can’t tell us what resources to sustain. It can’t tell us for whom they should be sustained. It can’t tell us how long such sustainability should be maintained. It merely makes unsupported assertions and calls for centralized state control of economic resources, preferably on a global scale.

Apparently, small is beautiful to the Greens, except when it comes to government. Then “the bigger the better” is the rule. While “sustainable development” sounds good, it actually is a hollow phrase with little or no meaning but with some dubious, if not dangerous, implications.

Notes

1. This, of course, is the “one lesson” immortalized by Henry Hazlitt: “the art of economics is looking not merely at the immediate but at the longer effects of any act or policy: it consists in tracing the consequences of that policy not merely for one group but for all groups.” Economics in One Lesson (San Francisco: Laissez Faire Books, 1996 [1946]), p. 5.

2. World Commission on Environment and Development, Our Common Future (Oxford: Oxford University Press, 1987), p. 8.

From Crystal Palace to White Elephant in 150 Years

Britain's Great Exhibition of 1851 Celebrated Innovation, Free Trade, and Free Enterprise

MARCH 01, 2003 by Lawrence W. Reed

Mention the ill-fated Millennium Dome to almost any citizen of Great Britain and you'll get an earful about one of the greatest government sponsored, scandal-ridden fiascoes of all time. Costing more than a billion dollars, it was a white elephant that bled red ink from its public opening on New Year's Day 2000 until it closed a year later. It was intended in part to rival a famous project of a century and a half earlier but, by any important measure, it never came close.

The Millennium Dome's colossal flop prompted Prime Minister Tony Blair to remark, "If I had my time again, I would have listened to those who said governments shouldn't try to run big visitor attractions." Two years before, Blair and his whiz kids in the London bureaucracy thought there was nothing about the Great Exhibition of 1851 that couldn't be improved with a generous dose of modern central planning and loot from the taxpayer. How wrong they were. If the Dome sparks renewed interest in that earlier show, it will serve perhaps its most useful purpose. What happened in 1851 was a spectacular tribute to the enterprising spirit of that day.

By the middle of the nineteenth century, Britain was the industrial "workshop of the world," producing more than half of all coal, iron, and cotton cloth. Powered by a relatively free economy that was becoming freer by the decade, Britain's railroads, factories, and machine technology were well ahead of any other nation's. It was time to celebrate not only Britain's remarkable achievements, but also those of free trade and free enterprise the world over. Around the mid-1840s, these thoughts came to animate Queen Victoria's husband, Albert, the Prince Consort.

Albert and his advisers felt that Britain should host a fair to showcase the industrial might of all nations. Like so many people of the time, they were ecstatic about the potential of capitalist invention and the peaceful, international trade it fostered. In January 1850, Victoria named Albert to head a 24-man Royal Commission to make the "Great Exhibition of the Industries of All Nations" a reality.

Prince Albert declared at the start of the commission's deliberations that the Exhibition should not and would not be funded by government. This was to be a celebration of private enterprise, and it seemed only logical for private, enterprising citizens to foot the bill. Everything from the building that would house it to the exhibits themselves would be paid for by voluntary contributions, fundraising campaigns, and admission fees. The Millennium Dome of 2000, by contrast, was a giant public works scheme from its inception—filled with uninspiring, politically correct, and just plain boring displays and financed by taxes and the government's national lottery.

As soon as London's Hyde Park was chosen for the 1851 site, the Royal Commission solicited proposals for a building to house the Exhibition during the expected six months it would be open to the public. The project was in danger of foundering amid designs deemed too costly, when entrepreneur Joseph Paxton came forth with plans for a monster edifice made entirely of glass panes (nearly a quarter million of them) and the supporting iron framework. Thanks to the repeal in 1845 of Britain's longstanding and onerous "window tax," the price of glass had fallen by 80 percent, making Paxton's design affordable.

When the "Crystal Palace" opened its doors on May 1, 1851, the sheer immensity of it made for a grand show all by itself: 1,851 feet long (a dimension intended to fit the year), 408 feet wide, and 108 feet high at the entrance. It was built to accommodate as many as 60,000 people at one time, in addition to nearly 14,000 exhibits. There was nothing like it in all the world. Michael Leapman, author of *The World for a Shilling: How the Great Exhibition of 1851 Shaped a Nation*, calls it "the first mass spectacle that appealed to almost every social class."

For a visitor to give every exhibit the attention it deserved would have required 200 hours in the building, according to London's most famous newspaper of the day, *The Times*. There were the huge and fabulous Koh-i-

Noor diamond from India; a 40-foot scale model of the Liverpool docks, complete with 1,600 meticulously accurate miniature ships; sophisticated threshing machines and other labor-saving farm equipment; a knife with 1,851 blades; exotic fabrics and furnishings, looms, sewing machines, and even a prototype submarine; gas cookery, electric clocks, and one of the earliest versions of a washing machine.

The Latest from America

The wide array of displays representing the very latest of industry from America included a set of unpickable locks, a model of Niagara Falls, a 16,400-pound lump of zinc, a McCormick reaper, a Colt revolver, and, in Leapman's words, "a piano that could be played by four people at once and a violin and piano joined in such a way that a single musician could play them both at the same time on a single keyboard."

The Exhibition itself gave birth to new inventions. One of many examples was provided by George Jennings, a sanitary engineer. His ingenious flush toilets and decorative, space-saving urinals prevented a potential health hazard. They sparked so much public interest and fascination that his designs were subsequently copied in cities around the world.

Some of Britain's best known businesses can trace their origins to the Great Exhibition. Thomas Cook, the firm that today boasts more than 4,000 affiliated travel agencies around the world, got its start when its namesake began offering low-price excursion packages to get people from all corners of Britain to the Palace in Hyde Park. The big profits Charles Harrod earned serving visitors in his modest grocery store proved to be the capital he needed to create one of the most famous department stores in the world.

When the Exhibition closed its doors on October 18 after five and a half months, more than six million people had come through it—almost the same number who visited the Millennium Dome over a 12-month period 150 years later. Factor in the time-consuming difficulties of transportation in 1851 compared to the ease and speed of the space age and the contrast is all the more stunning. And unlike the Dome of 2000, the unsubsidized Crystal Palace of 1851 produced a financial surplus.

Tony Blair is right. He should have listened to those who warned that government has enough trouble doing what it's supposed to do, that it doesn’t need to do what it shouldn’t.

Terrorism: The Price of Bad Energy Economics?

Middle Eastern Oil Is Less Important Than We Think

MARCH 01, 2003 by Doug Bandow

Fear of losing access to Saudi oil prompted the U.S. government to intervene in the Persian Gulf a decade ago, to maintain troops in Saudi Arabia ever since, to ignore Riyadh's role in underwriting terrorism even after September 11, and to confront Iraq again. In short, America has been paying a high price for its government's relationship with the rulers of Saudi Arabia.

Why that royal family, which has been spending ten times as much as Iraq on its military, wasn't expected to defend itself was never explained. The problem, presumably, was the lack of internal support for a monarchy both rapacious and useless. Thus enter Washington.

Yet contrary to popular wisdom, the Saudis' trump hand is surprisingly weak. True, with 262 billion barrels in proven reserves, Saudi Arabia has about one-quarter of the world's oil resources and 8.7 times America's supplies. Riyadh is not only the world's leading supplier, but as a low-cost producer can easily augment its daily exports, eight million barrels a day last year.

However, the reserves figure vastly overstates the importance of Middle Eastern oil to the U.S. (and Western) economy. Saudi Arabia accounted for about 10 percent of production last year; it plus Kuwait and the various sheikdoms came to one-quarter; OPEC produced 40 percent of the world's supplies. Were Saudi Arabia to fall, prices would rise substantially only if the conqueror, whether internal or external, held the oil off the market, especially if the other Gulf states also collapsed. The result then would be severe economic pain in the short term, though the Strategic Petroleum Reserve would help moderate prices.

Such a policy would, however, defeat the very purpose of conquest, even for a fundamentalist regime. After all, the Iranian revolution did not cause that nation to stop exporting oil; in fact, Iranian production increased steadily throughout the 1990s. If a new regime did halt sales, the primary beneficiaries would be other oil producers, who would likely increase exports in response to the higher prices. A targeted boycott against only the United States would be ineffective, since oil is fungible and available around the world. In fact, the embargo of 1973-74 had little impact on production; the global recession of 1975 caused a far more noticeable drop.

A new regime might decide to pump less oil in order to raise prices. Such a strategy would require international cooperation, yet the oil producers have long found it difficult to coordinate price hikes and to limit cheating on agreed-on quotas. Even if effective, restricting sales would have only a limited impact.

A decade ago, when oil was selling for about $20 a barrel, energy economist David R. Henderson, a professor at the Naval Postgraduate School, figured that the worst case of an Iraqi seizure of the Saudi oil fields would be about a 50 percent price increase, costing the U.S. economy about one half of one percent of GDP. Prices are today running close to $30 a barrel, but that includes an uncertainty premium over war with Iraq. Thus, the real price hike today of a Saudi collapse probably would be similar to that of a decade ago. Moreover, it would fall on an economy more than one-quarter larger.

In any case, the economic impact would diminish over time. Countries like Kuwait, Iran, Nigeria, Russia, the United Arab Emirates, and others have the ability to pump significantly more oil. A resolution of Iraq's status would bring substantial new supplies on line; Baghdad pumped 2.2 million barrels a day in 1990, before becoming subject to sanctions after the Gulf War. As economist Susan Lee puts it, should Riyadh turn off the pumps, "the U.S. would find itself plenty of new best friends."

Sharply higher prices would bring forth new energy supplies elsewhere. Total proven world oil reserves were 660 billion barrels in 1980, 1,009 billion in 1990, and 1,046 billion at the end of 2000. Yet in the last decade alone, the world consumed 250 billion barrels of oil. How could this be? A combination of new discoveries and technological advances increased the amount of economically recoverable oil.

Reserves rose even as oil prices dropped. Between 1980 and 1990, proven oil reserves jumped by 62 percent while prices for Middle Eastern petroleum were falling 43 percent. Prices eventually hit a dramatic low in 1998, down another 41 percent, before rising over the next two years.

Plugged Wells

America is dotted with high-cost wells that could be unplugged. The nation's outer continental shelf (OCS) alone is thought to contain more than 30 billion barrels of oil, greater than our current proven reserves; since barely 6 percent of the OCS has been leased, those resources have not been proved. Barely 15,000 acres of the 19.6 million-acre Arctic National Wildlife Reserve could contain a similar amount of oil. Even the modest estimate of five billion barrels of recoverable reserves at current prices would be a significant addition to current supplies. However, we won't know how much is there without drilling, which could be conducted in an environmentally sensitive manner.

Further, some 300 billion barrels of unrecovered oil, ten times our proven reserves and more than known Saudi resources, lie in beds of shale under the United States. They are not counted, however, because they are not currently worth developing. But as prices rise and new techniques are developed, they may become economically recoverable. Moreover, energy companies are looking for new oil deposits around the world, including in the Caspian Basin, Russia, South China Sea, and West Africa. Estimates of as-yet undiscovered potential recoverable oil range from one trillion to six trillion barrels.

At current consumption rates the Energy Information Administration estimates that we have enough oil for another 230 years and "unconventional" sources, such as shale, that could last 580 years. And even these figures are based on existing prices and technologies. Higher prices would stimulate exploration, as well as production of alternative fuels and conservation, reducing oil consumption.

In short, while an unfriendly Saudi Arabia might hurt America's pocketbook, it would not threaten America's survival. Thus there is no need to go out of our way to protect the Saudi dictatorship, let alone keep the royal family happy. Moreover, the withdrawal of U.S. forces would remove a prime source of potential instability.

Anyway, Riyadh isn't likely to turn hostile. It needs the money from selling oil as much as we need the oil.

Parity or Prevarication?

Mental Illnesses Are Not the Same as Physical Illnesses

MARCH 01, 2003 by Thomas S. Szasz

In my March 2002 column I showed that the advocates of parity for mental illness are engaged in a campaign of calculated falsehoods. Their claim that mental diseases are brain diseases is a lie. The last thing the mental-health zealots want is parity in the legal treatment of mental patients and medical patients. Despite being characterized by a scorched-earth policy toward the truth, this campaign enjoys the unanimous support of both psychiatrists and journalists. The parity warriors seem very near to "victory," as the following developments show.

Thanks to momentous advances in the science of psychiatry, the problems of diagnosing and treating these dreaded maladies have, according to the experts, been solved. Thus the battle lines have shifted from health and illness to money and where it should come from. Who should pay for mental-health treatment?

Formerly, the person who had a bodily disease, say diabetes, either paid for the treatment he needed, or his family paid for it, or he received care as a charity patient in a public institution, often the "teaching hospital" of a medical center. Today, private insurance, Medicare, and Medicaid are additional sources of payment for the treatment of such diseases.

The economics of treating mental diseases was never like this. Prior to the 1960s, the person who had a serious mental disease, say, schizophrenia, typically maintained that he was not ill, did not seek treatment, and was confined in a state mental hospital; the taxpayers of his state paid for the "treatment." The person who had a nonserious mental disease, say anxiety neurosis, paid for the treatment himself or employed nonmedical means of coping with it or managed to live without what we call "medication."

During the past several decades, psychiatrists, politicians, and the media convinced themselves and the public that “mental illnesses are like other diseases.” One result was that private health insurance, Medicare, and Medicaid have “recognized” some mental illnesses as diseases and have reimbursed patients for some psychiatric treatments. However, for reasons most people are familiar with, third-party payers have limited coverage for mental-health treatment to certain “conditions” and to defined periods of time. As a result, the war against mental illness has become a war against the enemies of “mental health,” waged with the slogan, “parity for mental illness.” Leading the war most recently were Marge Roukema and Patrick Kennedy in the House and Pete V. Domenici and the late Paul Wellstone in the Senate; they sponsored the new sets of mental-health parity bills.

As I shall now show, when our politicians talk about mental-health parity, they really mean parity between crazies and criminals, not between mental illness and bodily illness.

Our Lady of Peace Act of 2002

In the spring of 2002, Rep. Carolyn McCarthy of New York announced new legislation to “require states to notify the federal government when anyone who has been committed to a mental institution attempts to purchase a gun.” McCarthy was joined by Senator Chuck Schumer of New York, Father Bill Singleton from Our Lady of Peace in Lynbrook, New York, and Lynbrook Mayor Eugene Scarpato.

What prompted the introduction of still another law demonstrating parity between the mental hospital and prison, and hence, derivatively, between the “patient” in the “hospital” and the criminal in the prison? The shooting of two people in a church in Lynbrook allegedly by a “a disturbed gunman with a history of mental health problems.”

Actually, since 1968, federal law has required state and local government agencies to report the names of persons “adjudicated as mentally defective” to the FBI, which is responsible for conducting the National Instant Criminal Background Check System for people seeking to purchase firearms.

Not surprisingly, this law has not protected Americans from crazies with guns. But that has not persuaded the supporters of mental-health parity that the provision treating mental patients as felons ought to be abolished. On the contrary, it has inspired our policymakers to strengthen the law by defining mental illness more carefully.

How does the bill define mental illness? By criminal, not medical, criteria: “The term ‘adjudication as a mentally defective’ as defined in S. 2826, encompasses a variety of categories, including all individuals who have ever been involuntarily committed to a psychiatric facility, without regard to the seriousness of their disability, when the commitment occurred or the reason for the commitment. Additionally, any determination (formal or otherwise) by a governmental agency that a person is a danger to themselves as a result of a mental disorder or illness would serve as a basis for reporting their name to the FBI.”

The cost of implementing this bill? A total of $375 million for fiscal years 2004, 2005, 2006.

Hypocrisy Anyone?

None of this fazes the mental-health-parity fanatics. In May 2002 an editorial in the *New York Times* lauded President Bush for saying “some encouraging words this week about the need for a health care system that will treat mental illness with the same urgency as physical illness,” and urged him “to lean on recalcitrant House Republicans . . . to pass a bill elevating mental health coverage to a par with medical and surgical coverage.”

An editorial in the *Los Angeles Times* echoed the same view: ” . . . President Bush decried how the mental health system lets ‘too many Americans fall through the cracks,’ leaving people whose brains have somehow betrayed them stuck on the street or in prison before help is given.” This editorial also encouraged the President to embrace the so-called mental-health parity bill sponsored by Senators Domenici and Wellstone, compelling “health plans to offer equal payment for the treatment of certain mental illnesses and other physical ailments.”

In my March 2002 column I called attention to the fact that, by definition, diseases are afflictions of the body; hence, afflictions of the mind, called "mental illnesses," are not real diseases; and if, as many people now claim and seemingly believe, mental illnesses are brain diseases then they ought to be treated by neurologists.

Here I add that if we are serious when we say that "mental illnesses are like other diseases," then hospitalization for mental illness should, for purposes of qualification for gun ownership, be treated as hospitalization for trigeminal neuralgia, not as imprisonment for crime.

In the meantime, I stick to my view that there are no mental illnesses, and lament that we attribute the violence of so many people to these fictitious diseases and, in the process, undermine personal responsibility, individual liberty, and public safety.

The History of Deflation

Deflation Is Not Such a Bad Thing

MARCH 01, 2003 by Stephen Davies

Lately a new word has made an appearance in economic commentary and journalism. Or, rather, it is now being used in its original, correct meaning. That word is "deflation." Used correctly, it means a general decline in prices, or a steady increase in the value, or purchasing power, of a given unit of money.

For most of the last 50 years the term "deflation" has been misused to mean nothing more than a decline in the rate of price increase ("inflation"), rather than an actual decline in prices. This reflected the reality that since the end of the Great Depression, most economies were in a condition of secular, that is general, long-term, inflation. The rate of price increases might accelerate or diminish, but it never stopped, much less went into reverse. With time, inflation came to be seen as the normal state of affairs. Some critics argued that this was the product of mistaken policy, but even they only looked forward to price stability. They did not expect, much less advocate, price decline.

This has now changed. The economic columns are now full of alarmed comment about our entering a period of secular deflation, something most of them see as a dark prospect. The reason for this shift in perception can be summed up in one word: Japan. Since the bursting of its real-estate and share bubble in the early 1990s, Japan has had years of stable and, more recently, declining prices. The Japanese Consumer Price Index has shown a decline for each of the last three years. Last September Reuters reported that this deflation was, if anything, accelerating. The fear now gripping U.S. and European commentators and policymakers is that this phenomenon may spread from Japan to the rest of the world. Last June the Federal Reserve published a paper titled "Preventing Deflation: Lessons from Japan's

Experience in the 1990s." Its title reflects the two shared assumptions of most current argument: that secular deflation is something to avoid and that this can be achieved through the correct policy.

However this commentary reveals a lack of historical perspective. Using evidence such as price records for grain, real estate, and building materials, historians have been able to construct a historical account spanning hundreds of years. It puts our current alarms into a much bigger picture.

The central lesson of all this information is that secular deflation is not unusual. Periods of general price stability tending to deflation are as common and long lasting as periods of inflation. Typically, in periods of deflation the decline of prices is less dramatic than the rise in prices found in periods of inflation, although the prices of some particular products may decline sharply. A period of general inflation may be marked by episodes of deflation and vice versa, but these are short-lived and often local.

The work of economic historians such as James Thorold Rogers (1823-1890) and Wilhelm Abel (1904-1985) is ably summarized by David Hackett Fisher in his 1996 work, *The Great Wave: Price Revolutions and the Rhythm of History*. We can identify several major periods of generally rising prices ("price revolutions," in Fisher's terminology) and also long periods of secular deflation. There are relatively short episodes of price stability between the longer periods of secular inflation and deflation, but on closer examination these turn out to be times of sharp fluctuations in key prices.

Starting in the high Middle Ages we can trace periods of secular inflation in roughly 1180 to 1330, 1490 to about 1670, 1770 to about 1850, and 1895 to 1995. The corresponding periods of secular deflation were 1330 to 1490, 1670 to 1770, and 1850 to 1900. There were also episodes of deflation during the early years of the seventeenth and twentieth centuries.

The question is whether we are now entering a period of secular deflation. The evidence increasingly suggests so, with Japan leading the way. The data also imply that ultimately public policy has little or no influence over this.

Why do these long-term movements in prices happen? Here the evidence is suggestive but no more, and we have to say that ultimately this phenomenon is mysterious, given the present state of historical knowledge. A frequent explanation is demographic, relating periods of rising prices to population growth, and periods of stable or declining prices to population decline. This works for some periods but not others. In particular, the period of deflation after 1850 coincided with a sharp growth in population. Another popular argument is that these phenomena are the consequence of monetary fluctuations caused by both government policy and (before 1900) changes in the supply of money due to increases or stagnation in the available quantity of precious metals. However this works even less well, as Fisher convincingly argues (pp. 241-51).

One suggestive fact is that episodes of deflation occur when the quantity of resources at people's disposal tends to increase. This can be due to a fall in population, but also to a sharp rise in productivity, coupled with an increase in trade. The effect of this is to reduce costs generally and to limit the return to investors and producers as competition for consumers works to keep prices down. One thing we can say is that many features of earlier periods of deflation are now clearly present.

Not a Bad Thing

The other main lesson that the history of prices holds for us today is that deflation is not such a bad thing. As Fisher and other historians have pointed out, there are both winners and losers from deflation, and such periods correlate with other trends, many of which are generally thought to be desirable. In general terms, deflation is good for creditors but bad for debtors. It makes forward planning easier and encourages longer term thinking. Periods of deflation typically see a decline in the returns to capital (including land) and an increase in real incomes for wage earners. They are also characterized by a number of other major social trends, above all, declining rates of criminality and such other indicators of social stress as illegitimacy, family breakdown, and political upheaval. These are all trends that have become apparent in most countries during the last decade.

Almost everyone alive today has lived most of their life in an age of secular inflation. The apparently dull work of historians such as Abel suggests that we may now have to look forward to a long period of gently declining prices, or secular deflation. It also implies that we can do little about it and should, on balance, welcome it.

Self-Interest, Part 2

Flourishing Economies Aren't Based on Altruism

MARCH 01, 2003 by Donald Boudreaux

When he tried to do anything for the good of everybody,
for humanity, for Russia, for the whole village, he had noticed
that the thoughts of it were agreeable, but the activity itself
was always unsatisfactory; there was no full assurance that the
work was really necessary. . . . But now since his marriage,
when he began to confine himself more and more to living
for himself, though he no longer felt any joy at the thought of
his activity, he felt confident that his work was necessary,
that it progressed far better than formerly, and that it was
always growing more and more.
—Leo Tolstoy, Anna Karenina

Self-interest is vital to our prosperity. As Adam Smith famously explained, "It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages. Nobody but a beggar chuses to depend chiefly upon the benevolence of his fellow-citizens."

So very true. Private property and free markets harness self-interest, enlighten it, and inspire each of us to better our own condition by bettering the conditions of others.

This justification of self-interest is consistent with the belief that, while self-interest might be channeled into productive avenues, the world would be an even better place, and the economy would be even more productive, if people weren't self-interested.

I dissent from this oft-expressed belief. It isn't so much that a flourishing, highly productive economy such as ours is possible *despite* self-interest; rather, such an economy *requires* self-interest. This is so because there are two aspects of reality that every economy must deal with, but that altruism does nothing to alter: scarcity and ignorance.

Because resources are scarce, prosperity requires that what relatively few resources we have be used as wisely as possible. In a world without scarcity, for example, it would be sensible for me to keep my fireplace lit by tossing dining-room chairs into the blaze. Why shouldn't I do so? Chairs are superabundant and, hence, valueless.

Of course, in reality, while the wood that my dining-room chairs are made of would produce an excellent fire to warm my living room on a cold winter's evening, I clearly would reduce my family's prosperity if I used our furniture so foolishly.

But how do I know this fact? I know it because chairs—like all goods, services, and resources—have market prices. These market prices tell me the relative values of goods, services, and resources. It's because I must pay a few hundred dollars for a dining room chair, compared to a few cents for a chopped log, that I burn chopped logs rather than furniture in my fireplace. Self-interest directs me to use relatively abundant materials (logs) in place of scarcer materials (furniture) as fuel for my household fires. As a result, my family is wealthier than we would be if I didn't know to make fires from logs rather than furniture.

Likewise for the economy writ large. Motor fuel is today made from petroleum. Why? Nature doesn't dictate this fact. Motor fuel could be made from corn. But because the resources required to make fuel from corn are much scarcer than the resources required to make fuel from petroleum, we make fuel from petroleum. But without market prices to tell producers the least-costly means of making fuel, they would not know how best to do so. Vast quantities of resources (including human effort) would be wasted making fuel from things that could be better used for other purposes. Our economy would be far less prosperous in the teeth of such massive waste.

The only way anyone can know the value of any resource compared to the value of other resources (and compared to the values that consumers attach to the things that can be made from resources) is through market prices. These prices tell consumers how scarce different goods and services are. Prices also direct producers not only to make those things most valued by consumers, but also to do so in ways that are least costly. And importantly, market prices are determined by voluntary and self-interested offers to buy and sell.

Profits Refused

Suppose that owners of oil and other energy sources become intensely altruistic, refusing to make profit. They start giving their products away. The immediate consequence is lower energy prices. But the fun won't last. Consumers now have no idea just how much energy to use—how careful they should be in conserving it. Nor can any consumer tell if, say, electricity, natural gas solar-heating cells, or fuel oil is the best option to heat his home. Many consumers will inadvertently do the equivalent of using dining-room furniture as kindling by using very scarce energy in low-valued uses.

Even more disastrously, producers will have no idea where to focus their scarce efforts and resources in finding and developing new sources of energy. Should more oil wells be drilled? If so, how many more? And what equipment to drill those wells? (Might an intensely altruistic oil-company executive be led by his humanitarian concern to purchase outmoded drilling equipment from a supplier verging on bankruptcy?) Should more R&D be pumped into making ethanol a practical substitute for gasoline? Altruism does nothing to answer these inescapable and important questions.

The only way to answer them (and millions of similar ones) is to have a set of prices that tell just how scarce each resource is relative to other resources. And one vital role of self-interest is to inspire owners to price their resources in ways that reflect these relative scarcities.

I don't mean to argue that altruism is undesirable. Far from it. But for altruism to promote good outcomes it must be confined to those situations in which the altruistic giver has good reason to know the circumstances and preferences of those whom he seeks to help. General, indiscriminate altruism might reflect wholesome motives, but its consequences will be unwholesome and, quite possibly, ruinous.

Disorder on the Court

How Fans Circumvent NCAA Rules

MARCH 01, 2003 by Russell Roberts

What does Adam Smith have to do with basketball? You will not find the word in either *The Theory of Moral Sentiments* or *The Wealth of Nations*. Yet Smith has much to say about the game played with the round ball on a hardwood court. Consider the following quote from *The Theory of Moral Sentiments*: The man of system, on the contrary, is apt to be very wise in his own conceit. . . . He seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chess-board. He does not consider that the pieces upon the chess-board have no other principle of motion besides that which the hand impresses upon them; but that, in the great chess-board of human society, every single piece has a principle of motion of its own, altogether different from that which the legislature might choose to impress upon it. If those two principles coincide and act in the same direction, the game of human society will go on easily and harmoniously. . . . If they are opposite or different, the game will go on miserably, and the society must be at all times in the highest degree of disorder.

Chess is not basketball, you mutter, and you are correct. And yet, and yet. Consider the National Collegiate Athletic Association, the NCAA, the governing body of college sports. The NCAA rule book governs how universities treat their athletes and how athletes must behave if they wish to retain their eligibility. The main function of the NCAA is to prevent people from doing what comes naturally. But of course Adam Smith understood that those chess pieces want to move in the ways that they want to move. Trying to place them where they do not want to go is ultimately going to lead to disorder.

Having a successful college basketball team is very lucrative. It leads to attendance at the NCAA Championship tournament held every March. That in turn leads to money. And glory. And publicity. So an 18-year-old high-school graduate who excels at basketball is a highly valuable and highly scarce commodity. Scarce valuable resources usually get paid for the employment of their services. In a normal competitive environment, talented basketball players would receive a salary in return for their work at the university. And universities would be happy to pay to get those students just as they pay to attract high-quality coaches and high-quality chemistry professors. Competition among universities would determine the market price for such students.

But universities are even happier getting those resources for free. That way, the university can capture the profits from athletic success rather than having to share them with so-called student/athletes. So the NCAA bans all payments to students other than tuition and room and board, books, fees, and a very modest stipend often referred to as laundry money.

That might seem generous enough, but alas, you have not reckoned with those chess pieces. Evidently, it is not generous enough. We know that tuition and room and board are less than the market-clearing price because every once in a while a scandal emerges that highlights the competition going on underneath the placid waters of universities complying with NCAA rules.

Such a scandal is unfolding at the University of Michigan. A fan of Michigan basketball was caught "lending" some of the players some money. A large sum of money. A very large sum of money. Eddie Martin has pleaded guilty to giving four Michigan players $616,000.

The scandal was uncovered after a car accident—a basketball player crashed his new $35,000 Ford Explorer after a party for a new recruit.

Cars, cash, and "loans" are ways that wealthy fans and sometimes coaches compete to get the best players. The NCAA may try to stop such behavior, but it's hard to keep those chess players from moving in the directions that come naturally. And of course even "clean" athletic programs compete in nonmonetary ways. They build luxurious training facilities for their students. They hire talented coaches and trainers.

Self-Punishment Imposed

Michigan has announced a self-punishment in hopes of averting more serious sanctions from the NCAA. Five years of victories have been wiped off the books. Championship banners have been removed. The basketball team will refrain from postseason competition for two years. And they have returned $450,000 in tournament money from previous NCAA Tournament experiences.

That's a lot of disorder, to use Adam Smith's phrase.

After scandals like the one at Michigan, there are always calls from the sports pages for colleges to clean up their act and play the rules.

Yet the rules imposed by the NCAA are not natural. They are designed to inhibit the movement of the chess players. And the real source of the problem isn't the players who take the money. The real source of the problem is you and me, the fans: the people who care about how our schools perform; the people who fill the stadiums and crowd front of the TV set on those March nights, is that enthusiasm which creates the pot money at the end of the NCAA Tournament driven by TV and advertising revenue. And driven by fan interest.

As long as fans care intensely about how their teams do in March in the NCAA Tournament, there are going to be scandals.

But the real scandal is the exploitation of players who would normally receive some of the largess that such fan interest generate. The NCAA keeps that largess largely in the hands of its member institutions rather than in the hands of the players.

There's an interesting footnote to the Michigan story that also relates to Adam Smith and those chess pieces. The story broke after a grand-jury indictment of Eddie Martin. He is a former worker at a Ford automotive plant. What was a grand jury doing investigating NCAA violations? How did a Ford worker have $616,000 dollars to spend on players?

Martin ran an illegal gambling operations out of the Ford plant—a lottery, a number game. The money he gave those players came out of those illegal winnings. He was indicted for gambling and money laundering. He probably has a few tax problems too.

So all of this really began with illegal gambling—an attempt on the part of the state to keep people from engaging in behavior that is harmless to the gamblers . . . behavior the state bans because it competes with the government's take in its lottery monopoly. Oh those chess pieces. So hard to keep then from moving the ways they want to move or their own.

Hijacking a Principle

States' Rights Have to Do with Much More Than Slavery

MARCH 01, 2003 by Sheldon Richman

This publication would not normally take notice of a Republican politician's embarrassing moment. But former Senate Majority Leader Trent Lott's apparent retroactive endorsement of Strom Thurmond's 1948 segregationist presidential campaign is relevant to *Ideas on Liberty*. It is relevant for this reason: the cause of liberty has been gravely harmed by the association of certain important ideas with slavery and state-enforced segregation. Those ideas come under the unfortunate term "states' rights." (Thurmond's party was the States' Rights Democratic Party.)

States have no rights. Individuals do. But that doesn't mean the term is worthless. It denotes the decentralization of power and competing legal jurisdictions, which are approximated in the Constitution and the Tenth Amendment. The principle comes out of the view that political power is not to be trusted and therefore must be diluted and fragmented. This is why as august a figure as Lord Acton endorsed "states' rights."

The essence of government is legal violence (or the threat of it) that is available for use not only against aggressors but also against people who have not broken the peace. Thus government should be limited and its power divided among branches and across jurisdictions. The alternative is tyranny waiting to happen. Advocates of the freedom philosophy understand that the Miracle of the West is largely attributable to decentralization. It is what permitted the emergence of vital zones of individual freedom and, eventually, the formal ideology of liberty, property, commerce, and peace known originally as liberalism.

Unfortunately, in the United States the "states' rights" principle was hijacked by illiberals who hitched it to slavery and then Jim Crow. This odious association helped to discredit the liberal cause.

That should make advocates of freedom angry. A lovely liberty-serving principle was disfigured and virtually destroyed by being twisted into a defense of slavery and statist racism. Every apologist for slavery and Jim Crow who defended his irrational anti-capitalist ideas in the language of "states' rights" did a grave disservice to the cause of freedom. (Similarly, the southern slaveocracy stained the principle of property by claiming property rights in human beings.) We live with the poisonous consequences every day.

The Dixiecrats objected not only to Washington's power grab per se, but also to the ostensible purpose of the grab: the abolition of forced segregation. In 1948 Thurmond never proclaimed that he favored repeal of Jim Crow and that his only beef was with Washington's violation of the Tenth Amendment. On the contrary, his party's platform stated, "We stand for the segregation of the races. . . . "

That's collectivism. Races cannot be segregated. Only individuals can be. As Ayn Rand wrote, "Racism is the lowest, most crudely primitive form of collectivism. It is the notion of ascribing moral, social or political significance to a man's genetic lineage."

Libertarians are justified in despising those who, in the name of "civil rights," would abolish private property and its institutional safeguards. Likewise, they should have contempt for those who have jeopardized those things by invoking them in the service of racial collectivism.

* * *

The theoretical objections to government land-use control have been rehearsed many times. But we need to be reminded that regulation can make hell of real people's lives. Stephen Lathrop knows firsthand.

It's a good thing farmers can get more crop out of an acre of land, or else there wouldn't be enough farmland to support us all. David A. Hendersen illustrates the principle with the humble potato.

If the creators and administrators of Social Security were running a private business, they'd be in jail. David Surdam's got the goods.

The water problems of the southeast are nothing that private enterprise couldn't solve—if given a chance. Charles Oliver wades in.

Is the limited-liability corporation a legitimate spontaneous product of the free market and common law? Or a privileged creature of the state? Norman Barry takes the former position, Frank van Dun the latter. In between, W. S. Gilbert gives his perspective in operatic fashion.

In recent years flu vaccine has been in short supply, and now one of the makers is stopping production. Arthur Foulkes says you'll never guess who's responsible.

The communist Chinese authorities have given a ringing endorsement to . . . private property. Good move. Now what? John Welborn has some ideas.

The record of utopia-building is something less than inspiring. Yet a certain type of intellectual persists in believing that with the right leader, socially planned bliss can be achieved. Daniel Hager says beware.

For a while, it seemed as though Keynesianism was as extinct as the dodo. Alas, it's not so, writes Christopher Lingle. If there's ever been a more incoherent concept than "sustainable development," Jim Peron has yet to hear about it.

Our columnists have been scouring the landscape for provocative subjects, and here's what they've come up with: Lawrence Reed looks back on England's privately funded celebration of progress, the Great Exhibition of 1851. Doug Bandow says U.S. policy toward Saudi Arabia makes no good sense. Thomas Szasz has another go at mental-health parity. Stephen Davies says don't fear deflation. Donald Boudreaux continues his discussion of self-interest. Russell Roberts recommends that the NCAA officials read *The Wealth of Nations*. And David R. Henderson, hearing the claim that Americans have never been more free, remonstrates, "It Just Ain't So!"

Book reviewers this month evaluate volumes on the "dismal science," Ayn Rand's philosophy, the Supreme Court and "substantive due process," the secret of economic growth, Japan, and global capitalism.

More Free Than Ever?

We May Be Wealthier, But Our Civil Liberties Have Diminished

MARCH 01, 2003 by David R. Henderson

In a November 2002 *Washington Times* column titled "Americans Enjoy More Freedom Today Than Ever," Jonah Goldberg stated, "Today, we worry desperately about our personal and political freedom even though we are more free today than at any time in our history." Attempts to measure freedom are inherently difficult because we must weight our freedoms to come up with an overall measure. How important is it, for example, that every American has lost his freedom not to use a seat belt while riding in a car? If I would virtually always use my seat belt anyway, have I lost a great deal of freedom? I'm not sure.

But Goldberg doesn't get into issues of weighting freedoms. Instead, he finesses the problem in four ways. First, Goldberg carves out a subgroup of people and considers whether they are freer. Second, he simply ignores the myriad of ways in which we are less free. Third, he confuses freedom with wealth. And fourth, he finds dark periods in our history in which we were less free than today and then implicitly assumes that those comprise the total of our history.

The subgroup he carves out for consideration includes women and black people, who, he points out, "are no longer the subject of legal discrimination." But even here he gets it wrong. Blacks and women *are* the subject of legal discrimination. Affirmative action gives legal privileges to women and blacks, whether in college sports (women) or in hiring and promotion (women and blacks). These legal privileges don't diminish their freedom, but they certainly do make them "the subject of legal discrimination." And they certainly do diminish the freedom of association of those who are required by law to hire them.

Because Goldberg doesn't detail for us the ways black people and women are freer, let me do so. Black people today are far less likely to be lynched than was true 100 years ago and cannot legally be prevented from doing jobs that government-backed white racist unions prevented them from doing from the early 1900s to the 1960s. Women, who were not free to own property for most of this country's history, can now do so. But notice something interesting about these freedoms: women and blacks have had them for at least the last 35 years. So it's hard to use that evidence to support Goldberg's case, which is not just that we're freer than we were 35 years ago but that we're freer than we've ever been.

But in many other ways even women and black people, like the rest of us, are less free than they were 35 years ago. Let me count just some of the ways.

No one is free to advertise cigarettes on television or radio. We cannot get on an airplane without a government-mandated search of our bodies and our possessions, and airlines are not free to hire security with guns to protect us on flights. Since the misnamed Bank Secrecy Act of 1970, Americans have not been able to have a bank account free from government snooping.

Since the Occupational Safety and Health Act of 1970, employers and employees have not been free to negotiate their own safety rules and standards. Since 1965, the federal government has taken substantial funds from almost every working American for Medicare, its socialized health plan for the elderly. Doctors who try to bill certain patients over the amount that Medicare pays can, in some cases, be fined or even sent to prison for doing so.

For virtually every drug crime, you can go to prison for a much longer term today than was true 35 years ago. This, incidentally, has caused a major decrease in freedom for hundreds of thousands of black men. Moreover, before 1914, when the Harrison Act was passed, there was almost complete freedom in the United States for people to consume drugs, including marijuana, cocaine, and heroin. And before 1913, there was no income tax in the United States either.

This is the tip of the iceberg of the bad news on freedom.

Of course, there are some substantial ways in which we are more free. Here are a few, although they are a greater percentage of the iceberg: Since 1974, Americans have been free to own gold. Since 1973, young American males have not been drafted into the military. Liquor sales in some states are more liberally allowed than they were 30 years ago.

Although I bet I could find a long list of other increased freedoms, the list is still much shorter than the list of lost freedoms. How, then, does Goldberg maintain that we are freer? He does so by confusing wealth, or options, with freedom, or the absence of coercion. Here are the key items that, according to Goldberg, make us freer: birth control pills, the Internet, cell phones, laptops, and cars. It's true that we have more of all these things than we had, say, 30 years ago, when the Internet, cell phones, and laptops didn't even exist. It's also true that all these things have made our lives easier in innumerable ways. Finally, it's true that they all resulted from a free economy. In "The Joy of Capitalism," one of the chapters of my recent book, *The Joy of Freedom: An Economist's Odyssey*, I celebrate the bounties of capitalism that have allowed even Americans below the poverty line to live what was, as recently as 1970, a middle-class lifestyle.

You can even make the case, as economist David Friedman does, that the Internet will make it harder for government to regulate us and will create more freedom. But that's not the case Goldberg makes. His basic case is that those innovations give us more opportunities, which is absolutely correct but is irrelevant for the issue of freedom.

Finally, remember that Goldberg is trying to assuage those of us who are concerned about the federal government's new assault on our civil liberties. Many of us get nervous when we see Americans thrown in prison indefinitely without being charged with a crime, as Jose Padilla recently was. Many of us get even more nervous when we learn that the federal government now has the power to compel our Internet service providers to disclose records of our Internet activity.

How does Goldberg handle this concern? He changes the subject by pointing out, correctly, that the situation is not nearly so bad as that in World War II, when over 100,000 Japanese-Americans were placed in U.S. concentration camps. He's right. The situation today is much better than that. But what does that have to do with his initial claim? Goldberg didn't start by saying we are freer today than we were in our least free periods. He claimed that we're freer than ever. But here it's very clear: given the government's willingness to suspend habeas corpus and its new powers to intrude in our private lives, we are far less free in this country than we were just two years ago.

Book Review: How the Dismal Science Got Its Name: Classical Economics and the Ur-Text of Racial Politics, by David Levy

MARCH 16, 2003 by Karen I. Vaughn

How the Dismal Science Got Its Name: Classical Economics and the Ur-Text of Racial Politics

by David Levy

University of Michigan Press • 2001 • 320 pages

$52.50 hardcover; $21.95 paperback

Reviewed by Karen I. Vaughn

For about a century and a half, economics has been known as the "dismal science." While perhaps few remember that it was Victorian writer Thomas Carlyle who coined the term, the phrase invokes sympathy from those who find economic theory difficult and mundane. What most people do not appreciate, however, is the reactionary, even abhorrent context within which Carlyle made his famous pronouncement.

In this important book, David Levy provides an exhaustive and authoritative account of that context. Levy exposes a shocking truth: the Victorian literary opposition to political economy had less to do with the dreariness of economic theory than it had with the consequences of the free market economy. That is, these Victorians (including in addition to Carlyle, John Ruskin and, to some degree, Charles Dickens) despised the flourishing of a market economy because it provided more goods to the lower classes and fostered equality of persons regardless of class or race.

Levy's thesis is as surprising as it is provocative. Generations of students have been taught that the Victorian critics of capitalism were the good guys, the defenders of the working class against the cruelties of early capitalist exploitation. By calling attention to the miserable condition of the working classes in Britain through essays, letters, and novels, they were demonstrating a humanitarian concern absent among economists of their day. Levy shows that the underlying view of humanity and society that motivated these Victorian critics was not so appealing as we were led to believe. Often pointing to the Middle Ages as a paragon, they believed that society was composed of a natural hierarchy wherein the lower orders are to be cared for by their betters to whom allegiance and deference is owed. At the bottom of the social hierarchy were the Irish and blacks, whom they considered subhuman and incapable of self-governance.

The unapologetic proslavery views of Carlyle and Ruskin come as a shock to the modern reader. While not completely unknown to literary scholars, such ideas tend to be wrapped in a blanket of silence. Levy removes the blanket and exposes such writings as Carlyle's, "Occasional Discourses on the Negro Question" (1849). In this odious essay about Jamaican former slaves, Carlyle claims that blacks are incapable of managing freedom. They live only for pleasure and are content to eat pumpkins rather than to work to grow the West Indian spices that the "gods ordained" should be their lot. Emancipation of Jamaican slaves, he argues, has left them bewildered and unwilling to work. The only solution is to re-enslave them while reforming the laws to encourage more benevolent masters.

While the call for re-enslavement was extreme, Carlyle's view of blacks was central to the critics of capitalism. They argued that rather than worry about the conditions of far distant subhumans such as Jamaican blacks, it is more important to be concerned about the plight of the fully human, if lowstatus, British working class. Capitalism, they argued, renders British laborers worse off than black slaves (a claim that Levy proves false), and so their improvement takes precedence.

Such reactionary ideas did not go unchallenged. Levy shows that at this time, slavery was opposed by a coalition between utilitarians (including the classical economists) and Evangelical Christians. Despite their differences, both groups believed that there was a single human nature, implying a universal equality among men. They also held that the utilitarian greatest-happiness principle was 55 equivalent to Christianity's golden rule. Slavery violated both precepts because, on the one hand, slaves were suffering unhappiness and redressing their ills would increase utility, and, on the other, no one would choose to be enslaved himself, so no one has a right to enslave others. Thus the hardhearted economists and enthusiastic Evangelicals turn out to be the true humanitarians of the Victorian age.

This review can barely scratch the surface of Levy's scholarship. For instance, there is no room to do justice to his claim that Dickens's novel Hard Times must be read in conjunction with Harriet Beecher Stowe's Uncle Tom's Cabin to fully understand the nuances of the text. The same is true for the essay in which Levy explores the implications of Adam Smith's contention that humans are the only species that trades, and that trade is a function of speech and reason. Hence, Levy argues, Smith's system of economics shows trade to be the logical starting point of economic theory and not rational choice, an insight almost lost to twentieth-century economists.

While the arguments of this fascinating book can be difficult and the reasoning sometimes elusive, the importance of the message and the light it sheds on the relationship between the foundational assumptions of economic theory and a benevolent view of human association make it wellworth the reader's effort.

Ayn Rand and Business

A Very Elementary Introduction to Rand and Her Thought

MARCH 16, 2003 by Ayn Rand, Donna Greiner, Douglas Rasmussen, Theodore Kinni

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What sort of book is this? Perhaps the best answer is to say that an alternate title could be: *Ayn Rand for Dummies*. Indeed, that might be a better title, for the book is a very elementary introduction to Rand and her thought. It is well written and organized, providing an accurate account of the basic tenets of Rand's philosophy. Moreover, the book offers the right combination of personal vignettes, scandal, and inspiration to satisfy the beginner who wants to be entertained as well as informed. It thus serves well as a book that one might give someone who has finished one of Rand's novels and now wants to know a *little* more.

The book is divided into three parts. Part one, "Ayn Rand and Objectivism," provides an account of Rand's life, her affair and breakup with Nathaniel Branden, and the rudiments of her philosophy. Part two, "Randian Work," describes in eight brief chapters the central virtues of Rand's ethical egoism. These chapters home in on "Rand's ideas regarding the personal characteristics of effective people." Part three, "Randian Management," explores the implications of Rand's thought for managing and leading organizations—in effect, for managerial ethics.

The presentation of Rand's philosophy, as well as the central virtues of ethical egoism, never strays far from Rand's language, and there is no attempt, beyond the usual contrasting of egoism with altruism, to place Rand's thought in an intellectual context. The reader never learns of works that are sympathetic and supportive of the rejection of altruism — for example, such works as Henry Veatch's *Rational Man* (1962) or David Norton's *Personal Destinies* (1976). Rand is thus made to appear as entirely original, as if no one else ever shared her commitment to the ethical centrality and sanctity of individual human life.

Though integrated nicely with examples from Rand's fiction, the discussion of the virtues does not consider their place in the lives of "effective people." Are the virtues—independence, integrity, honesty, justice, productiveness, and pride—practiced only because they are means to individual well-being, or are they also practiced for their own sake because they are constituents or expressions of such living? Also, do effective people ever have a place for treating others as more than merely means to their well-being? What is the place of friendship in Rand's ethics? Finally, Rand seems to portray rationality in theoretical terms only with little discussion of what practical reason, much less practical wisdom, might be. Can this view of rationality be reconciled with ethical individualism?

Perhaps these questions are unfair, because laymen might not be expected to ask such questions. Yet, after nearly 30 years of teaching ethics, I have always found the beginner capable of probing questions, and it is here that the authors fall down. They do not sufficiently discuss problems and ambiguities in Rand's ethics so as to allow the reader to understand or appreciate her positions. In effect, they treat their audience like dummies.

However, the book purports to do more than educate laymen. It seeks to tell the world something new and substantial about Rand's thought, particularly as it pertains to managerial ethics. We are told the following: that employees are not chattel; that voluntary cooperation is more effective than coercion; that employees ought to be judged by objective criteria; and that the principle of trade applies to both sides of the employer-employee relationship. Further, we are told that the human mind is the ultimate source of knowledge and wealth and that all progress, spiritual as well as material, stems from the innovators—those who use their minds.

All of those statements are true, and Rand certainly made or implied them. But none of this is new. There have been many works in business ethics using Rand-inspired insights. Robert McGee's *Business Ethics and Common Sense* and Tibor Machan's *Commerce and Morality* come to mind. Further, the relationship between these statements and the moral vision that is the United States can be found in Douglas Den Uyl's *The Fountainhead: An American Novel* (1999). *Ayn Rand and Business* is certainly not in this league.

The penultimate chapter, “Leading With Purpose,” does offer something new, namely that insights from Rand’s ethics can be used to manage people in business. We are told that purpose and focus are crucial to a successful business organization, for they unify effort and bring about productiveness. But there is nothing terribly profound here. It can be found in almost any organizational behavior text or management course.

The Lochner Court, Myth and Reality: Substantive Due Process from the 1890s to the 1930s

An Excellent Analysis of Constitutional Jurisprudence

MARCH 16, 2003 by George C. Leef, Michael Phillips

Lochner v. New York is an often-mentioned but misunderstood 1905 Supreme Court decision that lends its name to this excellent analysis of constitutional jurisprudence by Michael J. Phillips. Phillips, professor emeritus of business administration at Indiana University, has written probably the best book by a nonlawyer on any aspect of constitutional law, and the best survey of the *Lochner* line of cases by anyone. This book is a penetrating revisionist history of a key period in our legal history.

Briefly, in *Lochner* the Supreme Court struck down a New York statute that limited the number of hours bakers could work. The majority held that the freedom to contract for as much work as a man chose was within the "liberty" protected by the Fourteenth Amendment and that paternalistic health and safety rationales advanced by the government did not save the statute. The decision elicited a furious dissent from Justice Oliver Wendell Holmes, who argued that the Court was usurping state prerogatives. "The 14th Amendment does not enact Mr. Herbert Spencer's *Social Statics*," Holmes grumbled.

Lochner wasn't the first time the Court had declared unconstitutional statutes that interfered with liberty and property, but that name has been applied to a line of cases in which the Court, employing an approach later dubbed "substantive due process," defended individual rights against government encroachment. That philosophy came to an end during the New Deal, when the Court, with an augmented number of "liberals," upheld coercive New Deal programs. Ever since, law students have heard that

Lochnerism was a terrible mistake. Justices like Holmes and Louis Brandeis have been elevated to constitutional deities, while the defenders of individual rights have been pilloried.

Phillips correctly notes that there is a lot of myth in the standard account of the *Lochner* period. His study of the Court's decisions leads him to conclude that there was nothing like the uniform obstruction of "progressive" legislation that most people believe occurred during that era. Interventionist legislation sometimes lost, but some times it was upheld. Thus the Court doesn't deserve as much blame—or credit—as it is customarily given, depending on your point of view.

More important, Phillips's analysis of the particular decisions leads him to conclude that "some of the cases in which [the Court] did strike down governmental action were more justified than is generally believed." He demonstrates that the statutes in question were largely the sort of counterproductive special-interest legislation that we have come to expect from legislatures. In striking down such measures, the Court was not acting against the common good, but for it.

One of the most valuable parts of the book is the author's demolition of the canard that in the "substantive due process" cases, the Court was simply acting as an agent for business interests. Phillips refutes that bit of anti-capitalist posturing by noting that in most, if not all, of the cases where legislation was struck down, the Court was certainly not siding with business. For example, in *Louis K. Liggett Co. v. Baldridge* (as in the *Lochner* case), the Court invalidated an obviously anticompetitive statute. Phillips writes, "Pennsylvania's ostensible effort to protect the public health looked suspiciously like an effort by in-state pharmacists to block competition from chain stores."

In the course of his analysis, Phillips produces a delightful byproduct—a reassessment of the supposed brilliance and consistency of the Court's famed dissenters Holmes and Brandeis. Brandeis especially has been revered by leftists for his dissents in cases like *New State Ice v. Liebmann*. Read the chapter "What Motivated the Old Court?" and watch the lustrous Brandeis halo turn to junk before your eyes.

Also worthy of close attention is Phillips's chapter "The Question of Unequal Bargaining Power." The standard defense given by interventionists for minimum wage and other supposedly pro-labor statutes is that the government must intervene to "equalize bargaining power" where one party is said to have an “unfair” advantage. Phillips takes a fairly sharp sword to that idea. He points out that while an individual, whether a manual laborer or a Harvard Law School graduate, doesn’t have much “bargaining power” regarding employment offers, competition among prospective employers ensures that workers are paid according to their productivity. That the *Lochner* Court didn’t bite on the “unequal bargaining power” sucker bait, while the New Deal Court did, is a mark in favor of the former and against the latter.

Phillips concludes that the decisions of the *Lochner* era are best explained by a commitment, if imperfect, to the idea that freedom ought to be preserved unless there is a compelling reason to interfere with it. I’d love to see many law students confound their professors in constitutional law with the points raised by this book when they arrive at the “substantive due process” cases.

The Elusive Quest for Growth: Economists' Adventures and Misadventures in the Tropics

Aid to Foreign Governments Will Never Work

MARCH 16, 2003 by John T. Wenders, William Easterly

As this is being written, the television talking heads are imploring us "not to walk away" from Afghanistan and to "invest" billions there instead. Before buying into that idea, everyone should read this book by a former World Bank economist whose forthrightness has evidently cost him his job.

Early on, Easterly makes the following observation about foreign investment in Zambia: "I start with a comparison of what Zambians' actual average income would have been, $2 billion of aid later, if [all aid had gone into investment, and investment had gone into growth] as predicted. Zambia today would be an industrialized country with a per capita income of $20,000, instead of its actual condition as one of the poorest countries of the world with a per capita income of $600 (which is one third lower than at independence)."

No single statement more cogently exemplifies the tragic and ironic history of Western attempts to lift the lesser developed countries from their poverty by top-down, government-directed financial aid. No matter where it has been tried, or what methods have been used, it has been a dismal failure. Easterly's book tells us some of the reasons why.

In the past, attempts to alleviate Third World poverty "ranged from foreign aid to investment in machines, from fostering education to controlling population growth, from giving loans conditional on reforms to giving debt relief conditional on reforms. None of these has delivered as promised." To illustrate, Easterly points to the failure to recognize that incentives are what drives successful economic activity. Throwing capital and machines at an economy failed for a simple reason: the capital did not come as a result of someone's perception of a market for its output. The cart was before a nonexistent horse. Incentives create capital; capital without a market is useless.

When throwing physical capital at lesser-developed countries failed miserably, attention turned to increasing human capital—education—with similar results. From 1960 to 1990 the median rate of secondary-school enrollment more than quadrupled, and the median college-enrollment rate has increased more than seven times. "What has been the response of economic growth to the educational explosion? Alas, little or none."

Easterly's explanation is threefold. In economies with extensive government intervention, those with the most education either go into government or turn to lobbying the government for favors, both largely redistributive rather than productive. Further, much of the increased investment in education came from government-mandated schooling, which was just as useless as throwing capital at an economy. In many instances, mandatory schooling actually took children away from productive work. Finally, much of the investment in education is simply worthless. In Pakistan, for example, teaching positions are often dispensed as patronage, cheating is rampant, and teachers cannot pass the exams they administer.

Next, trying to create better incentives for growth, international institutions began making loans conditional on policy reforms. Instead of aid for investment, it was bribery for reform. The failure of incentive lending is confirmed by the admission that the debts cannot be repaid because the loans were unproductive to begin with. "Debt forgiveness grants aid to those recipients that have best proven their ability to misuse that aid, [and] governments will have too strong an incentive to keep borrowing in the expectation that their debt will be forgiven," Easterly writes.

He argues that government might, theoretically, aid the development process. His discussion of the externalities of knowledge and technological change is correct. But it is an unproven stretch to jump from what an all-powerful, well-meaning, benevolent government *could* do to what a real-life government *will* do, especially in light of the government corruption and meddling that Easterly himself describes in detail. He discusses how bureaucracies are corrupt, subvert markets, and create incentives that kill growth, especially in lesser-developed countries where decades of top-down foreign aid have solidified government's hold on the economy. The incentive of many in those governments is to promote policies flatly inconsistent with economic development.

Our author, nevertheless, remains hopeful, even though he often feels “like the clueless advising the helpless.” This reviewer is less hopeful. As Mancur Olson has shown, in the absence of revolution, or defeat in war, government sclerosis seldom reforms itself.

Easterly’s conclusion that government should stay out of the marketplace is certainly correct. However, many of the problems he cites, like high inflation, black-market premiums, high budget deficits, and negative real interest rates, are merely signs of governments obsessed with redistribution, not production. He naïvely presumes that corruption just happens. The idea that it emanates from unconstrained government power doesn’t seem to occur to him.

Like many economists who study economic development, Easterly has been mugged by reality. Now that he has left the World Bank, I hope his next book will go beyond illustrating how aid to foreign governments has failed and focus on why it always will fail.

Dogs and Demons: Tales from the Dark Side of Japan

What Explains Japan's Economic Malaise?

MARCH 17, 2003 by Alex Kerr, Victor A. Matheson

Dogs and Demons, by expatriate writer Alex Kerr, is another attempt to explain the malaise into which Japan has fallen over the past decade. Japan's real-estate and stock-market bubbles have burst with prices falling to one-quarter their previous highs; the Japanese government's budget deficits dwarf even those run by the United States during the '80s and early '90s; and a banking crisis looms over any possible economic recovery. Why?

Kerr places blame for Japan's troubles on the pervasive and powerful government bureaucracy that creeps into every facet of Japanese life. This unelected administration has had devastating effects on the environment, the culture, and the economy, and threatens to mire the country in a future of unpayable debt.

Japan's oversized construction industry is at the center of the country's problems. The sheer scale of this sector is astounding. As a percentage of the GDP, construction investment constitutes 18.2 percent of the Japanese economy compared to less than half that in the United States. By 2000 Japan was spending 9 percent of its GDP and nearly 40 percent of its government budget on public works, levels roughly ten times that of the United States. It has run out of beneficial projects to undertake and proceeds with projects of questionable value. The public-works sector of the economy has "succeeded" in encasing 55 percent of Japan's coastline in concrete and damming up 97 percent of its rivers. Japan is literally building "the road to nowhere."

Bureaucratic momentum has kept these massive expenditures in place. While nearly all politicians realize the cost these public works place on the nation as a whole, no local official is willing to give up his slice of pork. Indeed the economies of many rural communities depend almost entirely on government largess.

The book works best as a tale about what government does well and what it does not. The title derives from a quote by the court painter of the emperor of China. When asked what was the hardest thing to paint, he replied "dogs" and when asked the easiest he responded "demons." In other words, it is harder to manage the commonplace than the exotic. In Kerr's words, "Basic solutions to modern problems are hard, but pouring money into expensive showpieces is easy." Japan is a country full of modern concert halls without performers, futuristic sports stadiums without teams, and fantastic art museums without collections. Most important, these monuments are without paying visitors. Public subsidies allow for the creation of these edifices even when the costs far outweigh any potential benefits.

Japan's difficulties have parallels in the American economy. The U.S. government spent millions creating large-scale low-income housing projects in the '60s. The Department of Housing and Urban Development was notoriously unsuccessful, however, at creating workable neighborhoods. Similarly, the massive transformation of the American professional sports infrastructure over the past decade has often resulted in beautiful new facilities surrounded by acres of barren parking lots. It is easier to build the shining stadium than that comfortable sports bar on the corner.

The failure of Japan's economy to revive despite massive capital spending also casts doubt on the ability of Keynesian fiscal policy to revive a stagnant economy. Market-oriented economists have long argued that fiscal stimulus is doomed to failure over any extended period. Since expansionary fiscal policy must be financed by sale of government bonds, this borrowing naturally drains money from private capital markets. Thus government borrowing crowds out private investment. Indeed, while outsiders may gasp at the absurdly low nominal interest rates in Japan (the official interest rate is a minuscule one-tenth of 1 percent), when combined with widespread deflation, real interest rates in Japan are actually quite high.

Sadly, the book itself doesn't draw such lessons. For a work claiming to discuss the economic collapse of Japan over the past decade, the author displays an extraordinary lack of knowledge about even the most basic economic principles. For example, Kerr confuses nominal and real interest rates, leading him to conclude that the relatively low American savings rate is actually better for accumulating retirement assets than the high savings rates in Japan. Even low nominal interest rates provide a high level of future purchasing power when prices are falling. Furthermore, Kerr generally tries to prove his hypothesis by anecdote and story rather than by hard evidence. While this strategy makes for interesting reading, it does little to persuade a skeptical reader of the validity of his ideas.

For those with a dedicated interest in the rise and fall of modern Japan, this book poses many interesting questions and has numerous fascinating stories to tell. Those looking for convincing answers to those questions, however, will be disappointed.

About Stephen Lathrop

About David Hendersen

About David Surdam

About Charles Oliver

About Norman Barry

About W.S. Gilbert

About Frank Van Dun

About Arthur Foulkes

About John Welborn

About Daniel Hager

About Christopher Lingle

About James Peron

About Lawrence W. Reed

Lawrence W. ("Larry") Reed became president of FEE in 2008 after serving as chairman of its board of trustees in the 1990s and both writing and speaking for FEE since the late 1970s. Prior to becoming FEE's president, he served for 20 years as president of the Mackinac Center for Public Policy in Midland, Michigan. He also taught economics full-time from 1977 to 1984 at Northwood University in Michigan and chaired its department of economics from 1982 to 1984.

He holds a B.A. in economics from Grove City College (1975) and an M.A. degree in history from Slippery Rock State University (1978), both in Pennsylvania. He holds two honorary doctorates, one from Central Michigan University (public administration, 1993) and Northwood University (laws, 2008).

A champion for liberty, Reed has authored over 1,000 newspaper columns and articles and dozens of articles in magazines and journals in the United States and abroad. His writings have appeared in *The Wall Street Journal, Christian Science Monitor, USA Today, Baltimore Sun, Detroit News* and *Detroit Free Press*, among many others. He has authored or coauthored five books, the most recent ones being *A Republic—If We Can Keep It* and *Striking the Root: Essays on Liberty*. He is frequently interviewed on radio talk shows and has appeared as a guest on numerous television programs, including those anchored by Judge Andrew Napolitano and John Stossel on FOX Business News.

Reed has delivered at least 75 speeches annually in the past 30 years in virtually every state and in dozens of countries from Bulgaria to China to Bolivia. His best-known lectures include "Seven Principles of Sound

Policy" and "Great Myths of the Great Depression," both of which have been translated into more than a dozen languages and distributed worldwide.

His interests in political and economic affairs have taken him as a freelance journalist to 81 countries on six continents. He is a member of the prestigious Mont Pelerin Society and an advisor to numerous organizations around the world. He served for 15 years as a member of the board (and for one term as president) of the State Policy Network. His numerous recognitions include the Champion of Freedom award from the Mackinac Center for Public Policy and the Distinguished Alumni award from Grove City College.

He is a native of Pennsylvania and a 30-year resident of Michigan, and now resides in Newnan, Georgia.

About Doug Bandow

Doug Bandow is a senior fellow at the Cato Institute and the author of a number of books on economics and politics. He writes regularly on military non-interventionism.

About Thomas S. Szasz

About Stephen Davies

Stephen Davies is a program officer at the Institute for Humane Studies and the education director at the Institute for Economics Affairs in London.

About Donald Boudreaux

About Russell Roberts

About Sheldon Richman

Sheldon Richman is the former editor of *The Freeman* and TheFreemanOnline.org, and a contributor to *The Concise Encyclopedia of Economics*. He is the author of *Separating School and State: How to Liberate America's Families*.

About David R. Henderson

About Karen I. Vaughn

About Ayn Rand

Ayn Rand (1905–1982) was a Russian-American novelist, philosopher, playwright, and screenwriter. She is known for her two best-selling novels, *The Fountainhead* and *Atlas Shrugged*, and for developing a philosophical system she called Objectivism. She corresponded with FEE's founder Leonard Read and provided a meaningful intellectual influence over free-market thought in the second half of the twentieth century. Her influence continues to expand through her fiction and nonfiction works and the educational work being done on Objectivism.

About Donna Greiner

About Douglas Rasmussen

About Theodore Kinni

FEE

About George C. Leef

George Leef is the former book review editor of *The Freeman*. He is director of research at the John W. Pope Center for Higher Education Policy.

About Michael Phillips

About John T. Wenders

FEE

About William Easterly

About Alex Kerr

About Victor A. Matheson