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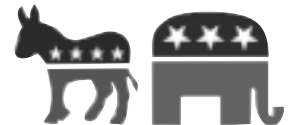
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Presidential Hubris

If we were going to spend \$700 billion, it seems it would be wiser having that \$700 billion going to folks who would spend that money right away.

In October Barack Obama said this in defense of his opposition to extending the 2001 and 2003 tax-rate reductions for people making more than \$200,000 a year. The government guesses that not extending them—that is, raising taxes—would bring in \$700 billion over a decade.

Let's break the statement down.

If we were going to spend \$700 billion . . . The "we" isn't you and I. It's him and his army of bureaucrats. There is no collective decision made by the *nation*. A group of identifiable individuals, backed by armed personnel, will decide how those resources will be used. How did they get those resources?

Imagine a mugger eyeing a potential victim, thinking, "I could spend that guy's money by leaving it in his pocket, or I could spend it myself right away. Now which would be the better way to spend it?"

Anyone can see what's wrong. But change the context to government, and all the rules are thought to change. Why? Because the government represents us? But it doesn't really. The people who run the government *say* it represents us, but they don't know what they're saying. True, they can be voted out of office by a majority. But no individuals can opt out. So while the politicians are in office, they represent only themselves and their patrons.

. . . it seems it would be wiser having that \$700 billion going to folks . . . Does it now? On what grounds are we to conclude that Barack Obama—or anyone else in political office—is qualified to say what a wiser use of such a sum of money would be? It's hard enough deciding what's a wise use of one's own meager resources. The future is uncertain and the choices are many. It is the height of hubris—a pretense of knowledge, to use Hayek's phrase—to invoke wisdom while asserting the power to dispose of that money.

. . . who would spend that money right away. There you go. He has a good reason after all. He says the money will go to people who will spend it in a hurry. Of course, he doesn't actually *know* that. The money would

just be distributed across the budget, funding the same old boondoggles or starting some new ones. Part of that \$700 billion would surely go to military contractors to make something irrelevant to Americans' welfare and inimical to the welfare of some non-Americans. We don't know how quickly those recipients would spend the money. The wealthy executives of the contracting companies may be the same people who would have held on to the money if the tax-rate reductions were extended. A lot of it will go to government employees, who have higher wages than people in the private sector. This is one of those talking points that sounds as though it makes sense until you . . . think about it.

But let's assume the people who get the money would spend it right away. Why is that better than simply letting the people who make the money keep it? The theory is that people making over \$200,000 a year don't spend enough of their incomes to stimulate the economy. So it's Keynesianism that Obama is espousing here. The economy's in a ditch. Consumer spending would get it out, but consumers are afraid to spend, so the government must spend for them.

But Keynesianism gets it wrong on so many counts. The fundamental economic problem is not that aggregate demand is too low. *Individuals* are doing things—and not doing things—for particular reasons in response to what's going on around them. Consumers are holding back because they've lost their jobs or fear they may do so. People are losing their jobs because a government-produced inflationary boom went bust and malinvestments need to be liquidated so resources can be realigned with consumer demand. But that's not happening (fast enough) because unpredictability over what the government may do next and other factors make entrepreneurs and investors cautious.

Once the reasons are understood, the remedy becomes clear. The burdens of government must be lifted quickly and people must be confident they will *stay* lifted.

★ ★ ★

Congress created the Privacy and Civil Liberties Oversight Board to assure the people their freedom is

safe. Was it just a device to lull people into believing their freedom is safe? James Bovard says that's closer to the truth.

Patents and copyrights can do some serious damage to genuine property rights and innovation. But they can also yield some funny stories. David Levine has a few.

New diseases are being invented (not discovered) all the time. They are the product of collusion among the medical profession, the pharmaceutical industry, and the government—not a combination to inspire confidence, writes Wendy McElroy.

Vested interests are powerful political forces, but not as powerful as ideas. Isaac Morehouse explains.

America's attempt to prohibit the manufacture and sale of alcoholic beverages was a failure on so many levels that it was called off after little more than a decade. Douglas Rogers examines those years via the latest scholarship on Prohibition.

Insider trading sounds like a terrible crime that strikes at the very foundation of the economy. Warren Gibson says it's more like much ado about nothing.

Wilhelm Röpke was at the first meeting of the Mont Pelerin Society with Ludwig von Mises, F. A. Hayek, Milton Friedman, and Leonard Read. For many years his book *A Humane Economy* was recommended reading for libertarians. Yet he had some differences with American free-market advocates—differences interesting enough to get the attention of Joseph Stromberg.

As our columnists were saying . . . Donald Boudreaux shows that tariffs did not create America's nineteenth-century economic growth. Burton Folsom tells the story of a boat-building entrepreneur. John Stossel points to early cracks in Obamacare. Walter Williams says people express preferences among human differences all the time. And Steven Horwitz, reading Paul Krugman's assertion that war can stimulate an economy, proclaims, "It Just Ain't So!"

This issue's book reviewers dissect tomes on the Constitution, revisionist history, socialism, and the New Deal.

—Sheldon Richman
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A note from the president

FEE Is Expanding to Atlanta

From its founding in 1946 until 2010, the Foundation for Economic Education had one office: its headquarters near the Hudson River in Irvington, New York, less than one hour from New York City. Now, I am proud to announce, it has a second home in the heart of the South.

In early May 2010, FEE opened a branch office in downtown Atlanta. Located in Atlanta's financial district, the office currently houses four staff members and is just three blocks from the site of five of FEE's summer 2010 student seminars, the Georgia-Pacific building.

While FEE's headquarters will remain in Irvington, there are many good reasons for a branch office in Atlanta. Local support is strong, and we are broadening our long-term geographical base. Operational costs are low, so we can be a better steward of donor dollars. Opportunities for FEE programs in the region are great, thanks to a major airport hub and the easy accessibility of the city.

FEE staff is already reaching out to the local community, working with local groups to spread the message of liberty and free enterprise into the schools and colleges in the region. One of many new lecture programs will be an occasional "Evening with FEE," fashioned after the successful "Evening at FEE" programs at the Irvington headquarters.

The opening of this branch office is a testimony to FEE's new growth and strong future. Our funding base is growing, our programs are reaching a record number of young people, our media exposure is soaring, and now we have a new office from which we can extend our reach. Supporters of FEE, such as yourself, are responding to our unique approach of combining free-market economics with the necessity of personal character, and we thank you. We hope you will continue your support as we enter this new phase of FEE's exciting future.

See you in New York and Georgia!



Lawrence W. Reed

War Would End the Recession? It Just Ain't So!

BY STEVEN HORWITZ

In his September 28 *New York Times* blog post (www.tinyurl.com/363mza3), Paul Krugman announced that “economics is not a morality play.” That turn of phrase is his way of defending the idea that in unusual times, such as the sort of deep recession we are in, we can get strange relationships between economic cause and effect. The result is that actions which we might find highly distasteful can have positive effects. Thus we cannot afford to be overly concerned with morality if the goal is to get out of the recession.

Specifically, Krugman defends the claim that World War II got us out of the Great Depression, because “this is a situation in which virtue becomes vice and prudence is folly; what we need above all is for someone to spend more, even if the spending isn’t particularly wise.” Even spending on something destructive like war, he argues, is what is needed to solve the problem, especially when the “political consensus for [domestic] spending on a sufficient scale” is not available. In Krugman’s version of Orwell’s *Newspeak*, destruction creates wealth, and war, though not ideal, is morally acceptable because it produces economic growth.

Thankfully, we can get behind his *Newspeak* to see the fallacy of his economics. To believe that spending—any kind of spending—is the cure for what ails us is to ignore the subjective nature of wealth and the micro-

economic basis of economic growth in favor of an absolute reification of economic aggregates such as GDP and unemployment. Spending trillions of dollars fighting a war can certainly bring idle capital and labor into employment, driving up GDP and lowering unemployment. *But this does not mean we are any wealthier than before.*

Wealth increases when people are able to engage in exchanges they believe will be mutually beneficial. The production of new goods that consumers wish to purchase

is the beginning of this process. When instead we borrow from future generations to spend on goods and services connected not to the desires of consumers, but rather to the desire of the politically powerful to rain death and destruction on other parts of the world, we are not allowing individuals the freedom to do the things they think will make themselves better off. And we are

certainly not extending that freedom to those killed in the name of our economy-enhancing war. At a very basic level, the idea that *any* kind of spending is desirable overlooks the fact that spending on war (and, I



Dresden, Germany, after step one of the WWII economic stimulus program that ended America’s Depression.

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would argue, public works as well) actively *prevents* people from enhancing their wealth through production and exchange linked to consumer demand.

Employing people to dig holes and fill them up again, or to build bombs that will blow up Iraqis, will certainly reduce unemployment and increase GDP, but it won't increase wealth. The problem of economics is the problem of coordinating producers and consumers. This coordination happens when we produce what consumers want using the least valuable resources possible. That is why it is wealth-enhancing to dig a canal using earth-movers with a few drivers rather than millions of people using spoons, even though the latter would generate more jobs.

Sending soldiers off to war is a waste of human and material resources, and is almost by definition wealth-destroying, no matter what it does to GDP or unemployment rates. The only way one can view economics amorally, as Krugman wishes to, is if one is only concerned with total GDP and not its composition. However, it is the composition of GDP, in the sense of how well what we've produced matches consumer wants, that ultimately matters for human well-being. It's easy to create jobs and generate spending, but those do not constitute economic

growth, and they are not necessarily indicators of human betterment.

So yes, Professor Krugman, it *does* matter how we try to get ourselves out of depressions. The world is not upside down and vices aren't virtues. War isn't peace and destruction isn't creation. The real solution to digging out of a recession is to remove the barriers to the free exchange and production that actually comprise wealth creation. Borrowing trillions more from our grandchildren to spend on building the equivalent of pyramids or on blowing up innocents abroad only digs the hole deeper. And when one is reduced, as Krugman is, to saying we "needed Hitler and Hirohito" to get us out of that hole in the 1930s, one has abandoned morality to worship at the altar of economic aggregates.

No critic of free-market economics can ever again accuse *us* of being irrational and immoral when it is Paul Krugman who says destruction creates wealth, and war is an acceptable second-best path to economic growth. Don't let Krugman's Newspeak fool you: War and destruction are exactly what they appear to be. To argue as Krugman does is to abandon both economics and morality. Big Brother would be proud. **FEE**

The real solution to digging out of a recession is to remove the barriers to the free exchange and production that actually comprise wealth creation.



How Washington Protects Your Privacy and Liberty

BY JAMES BOVARD

Preserving trust in government is the highest good—at least for politicians. To create that trust, government continually spawns façades to make people believe their rights are safe. Few things better illustrate this charade than the Privacy and Civil Liberties Oversight Board.

In 2004, three years after the Patriot Act was enacted, politicians started to worry about the rising number of Americans grumbling about government intrusions. The 9/11 Commission proposed creating “a board within the executive branch to oversee adherence to the guidelines we recommend and the commitment the government makes to defend our civil liberties.” Creating another office within the executive branch to report on executive branch activities was unlikely to produce anything more than extra jobs for Washington hangers-on. The White House edited the 9/11 commission’s report before it was publicly released, so the Bush team had no trouble with this toothless-tiger palliative.

In December 2004, acting on the commission’s recommendation, Congress mandated the creation of the Privacy and Civil Liberties Oversight Board. The same law that created the oversight board also made it easier for the FBI to get eavesdropping warrants on Americans, created a new standard to make it easier to prosecute citizens who donate to foreign charities of which the U.S. government disapproves, and provided a new layer of secrecy for federal agencies.

Some congressmen hailed the board as the start of a brave new era. Things would be different since

there was a new sheriff in Washington—or at least that was what people were supposed to think. The civil liberties developments in the years after the board was created offer profound lessons into how the government works.

It would have been difficult to design a better rubber stamp than the Privacy and Civil Liberties Oversight Board. It had no subpoena power, so it was effectively obliged to accept unsubstantiated assertions from the agencies violating privacy and liberty. The president had the right to appoint board members and could fire them any time. Bush did not appoint any experts on civil liberties; instead, the board was stacked with Republicans who formerly held government positions as enforcement zealots. And the first appointments did not occur until seven months after the

It would have been difficult to design a better rubber stamp than the Privacy and Civil Liberties Oversight Board.

law passed. The American Bar Association noted that Bush’s nominations were timed “as part of the administration’s push to encourage Congress to reauthorize provisions of the USA Patriot Act that expire within the next few months.” The oversight board supposedly guaranteed that Patriot Act powers would not be abused.

Six months after Bush stacked the board, the biggest civil liberties expose of recent decades exploded on the front page of the *New York Times*. The prior year, when he was running for reelection, Bush assured Americans

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that no wiretaps were occurring without federal court authorization. But the *Times* revealed that the National Security Agency (NSA) had conducted warrantless wiretaps on thousands of Americans based on flimsy pretexts. The *Times'* James Risen reported that Bush's "secret presidential order has given the NSA the freedom to peruse . . . the email of millions of Americans." The NSA's program was quickly christened the "J. Edgar Hoover Memorial Vacuum Cleaner."

In the Fourth Amendment of the Bill of Rights the Founding Fathers decreed that government searches must be based on probable cause and approved by a neutral magistrate. The Bush wiretapping program was based solely on the president's edict. Shift supervisors at the National Security Agency decided which Americans got wiretapped. But a GS-13 civil servant is not constitutionally on par with a federal judge.

An Ineffective Rage

Did the existence of the Privacy and Civil Liberties Oversight Board change how the wiretapping scandal played out? Not a whit. Bush seized on the *Times* exposé to portray himself as heroically rising above the statute book to protect the American people. A month later, Republican members of Congress gave Bush a standing ovation when he bragged about his "terrorist surveillance program" in his State of the Union address. There was more enthusiasm in Congress for prosecuting *New York Times* editors and reporters for treason than for prosecuting NSA officials for violating federal law.

Supporters of civil liberties rallied a few months later to try to slow the bandwagon to renew the Patriot Act. One major concern was the provision in the original Patriot Act that made it far easier for the FBI to use National Security Letters (NSLs) to compel private citizens, businesses, nonprofits, and other entities to surrender information on demand. NSLs empower the FBI to seize records that reveal "where a person makes and spends money, with whom he lives and lived before, how much he gambles, what he buys online, what he pawns and borrows, where he travels, how he

invests, what he searches for and reads on the Web, and who telephones or e-mails him at home and at work," the *Washington Post* noted. The FBI was issuing more than 50,000 NSLs per year.

While Bush pressured Congress to renew the Patriot Act in 2005, Attorney General Alberto Gonzales announced, "The track record established over the past three years has demonstrated the effectiveness of the safeguards of civil liberties put in place when the act was passed. There has not been one verified case of civil liberties abuse." In reality the feds had already discovered hundreds of criminal abuses of Patriot Act powers involving FBI agents and NSLs. But the abuses were kept under wraps until after Congress renewed the Patriot Act.

A bipartisan agreement to renew the Patriot Act was finally reached, giving the White House almost everything it wanted. As part of the deal Bush administration officials agreed to provide Congress far more details on how Patriot Act powers were being used. The Justice Department would be obliged to disclose to Congress how many Americans were having their privacy violated by NSLs.

However, Bush reneged in a "signing statement" quietly released after a heavily hyped White House bill-signing ceremony. He decreed that he was entitled to deny Congress any information that would "impair foreign relations, national security, the deliberative process of the executive, or the performance of the executive's constitutional duties." Bush announced that he would interpret the law "in a manner consistent with the president's constitutional authority to supervise the unitary executive branch and to withhold information."

In other words, any provision of the law that required disclosure would be presumptively null and void. The crux of the Bush administration's "unitary executive" doctrine was that all power rests in the president and that "checks and balances" are archaic.

The Privacy and Civil Liberties Oversight Board had no complaint about this charade. Instead, the members belatedly and heartily endorsed the NSA's warrantless wiretaps on Americans' phone calls and emails.

The Bush wiretapping program was based solely on the President's edict.

In 2007, before the Board could issue its first annual report, White House staffers massively rewrote and censored a draft version. Lanny Davis, the sole Democratic member of the board, resigned, later protesting that “the board was logically viewed . . . as the functional equivalent of White House staff.”

Toothless Watchdog

But the mere existence of the board allowed members of Congress to pirouette as constitutional saviors. When the House passed legislation later in 2007 moving the board out of the White House and requiring Senate confirmation of its members, Rep. Carolyn Maloney proclaimed, “The American people must have trust in their government to support its tactics against terrorism, and a strong Civil Liberties Board is vital to upholding that public trust.” But the restructured board, like the original, was better designed to alleviate public fears than to restrain federal power. The “reformed” Board was given little or no power to acquire information that federal agencies chose not to give. And it is difficult to understand how requiring Senate confirmation of Board members was a silver bullet, since the Senate had given approval, retroactive or otherwise, to the Bush administration’s most controversial abuses.

The same season that Congress passed the civil liberties board reform proposal it also enacted a law requiring the Homeland Security Department’s chief privacy officer to “to report each year about Homeland Security activities that affect privacy,” the *New York Times* reported. The law required that “reports be submitted directly to Congress ‘without any prior comment or amendment’ by superiors at the department or the White House.” Congress passed this law because of an earlier controversy about White House censorship of the Homeland Security Department’s report on privacy violations.

Five months after the law passed, Bush covertly issued a legal opinion effectively declaring that provision null and void. Deputy assistant attorney general Steven Bradbury declared that “such interference [by

Congress] is impermissible.” Sen. Arlen Specter of Pennsylvania, the ranking Republican on the Senate Judiciary Committee, denounced Bush’s action as “unconstitutional” and “a dictatorial, after-the-fact pronouncement by him in line with a lot of other cherry-picking he’s done on the signing statements.” But Bush’s action was largely ignored by the media. And his Civil Liberties Board certainly did not even whimper.

When Bush lagged in appointing members to the restructured board, Sen. Joe Lieberman, chairman of the Senate Homeland Security Committee, urged him in 2008 to move quickly “to preserve the public’s faith in our promise to protect their privacy and civil liberties as we work to protect the country against terrorism.” Lieberman wanted to preserve “the public’s faith” at the same time he championed “enhanced interrogation” methods and retroactive immunity for any company or

person who violated Americans’ rights in the name of antiterrorism. (The Senate did not confirm any of Bush’s belated nominations.)

The mere existence of the board allowed members of Congress to pirouette as constitutional saviors.

Change You Can Forget About

During his presidential campaign Barack Obama vigorously criticized Bush’s civil liberties abuses. Many of his supporters expected that, if elected, Obama would radically change federal policies regarding American liberty.

As of this past October, Obama had made no appointments to the oversight board. Rep. Bennie Thompson, then chairman of the House Homeland Security Committee, and Rep. Jane Harman, then hairman of that panel’s subcommittee on intelligence, wrote Obama early last year urging him to speedily make appointments because “we believe that the Board will give an anxious public confidence that appropriate rights are respected.” Harman is best known as the sponsor of the Violent Radicalization and Homegrown Terrorism Prevention Act, which could have spurred massive crackdowns on libertarians, constitutionalists, and others with nonmainstream ideas.

Many newspaper editorials have also complained about Obama’s failure to stock the oversight board. But this is perhaps the most honest action the Obama

administration has taken regarding civil liberties. In area after area Obama has rubber-stamped Bush-era abuses and signaled that there would be no investigation or prosecution of official wrongdoers from the previous administration. Obama is also embracing Bush-style State-secrecy doctrines that prohibit disclosure of the rationale for U.S. government-planned assassinations of Americans.

The oversight board is far more likely to induce complacency than to protect liberty. Since 9/11, trampling the Constitution is a no-fault offense. In Washington nowadays, only “extremists” believe that federal officials should be jailed for violating citizens’ privacy.

For every member of Congress such as Rep. Ron Paul (R-Tex.), who vigorously and consistently opposes federal abuses, there are vanloads of congressmen cheering federal agents’ trampling the statute book in the name of public safety. The founders intended Congress to be a vigorous check on the abuses of the executive branch. However, few members of Congress have the gumption to pursue official lawbreakers or to fight to expose

agencies’ crime sprees. In the 1970s, senators like Sam Ervin (D-N.C.) and Frank Church (D-Id.) spearheaded probes into executive-branch abuses, revolutionizing how Americans thought about the president, the CIA, and the FBI. Ervin and Church succeeded in part because of sheer willpower. But there is little or no such courage in Washington nowadays.

Washington vastly prefers the appearance of checks and balances to the reality of government under law. At a time when federal officials who violate Americans’ rights have nothing to fear from Uncle Sam, the existence of the oversight board is a cruel taunt to private citizens.

Perhaps the best epithet for the feds’ civil liberties record is the saying of Lily Tomlin: “No matter how cynical you become, it’s never enough to keep up.” “I’m from the government, and I’m here to safeguard your privacy” is the post-9/11 version of the old joke. But American liberty cannot afford any more sham protections. Abolishing the oversight board would be the most honest step Washington has taken on civil liberties in this century.

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The Oversight Board is far more likely to induce complacency than to protect liberty.



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Intellectual Property: Silly or Sinister?

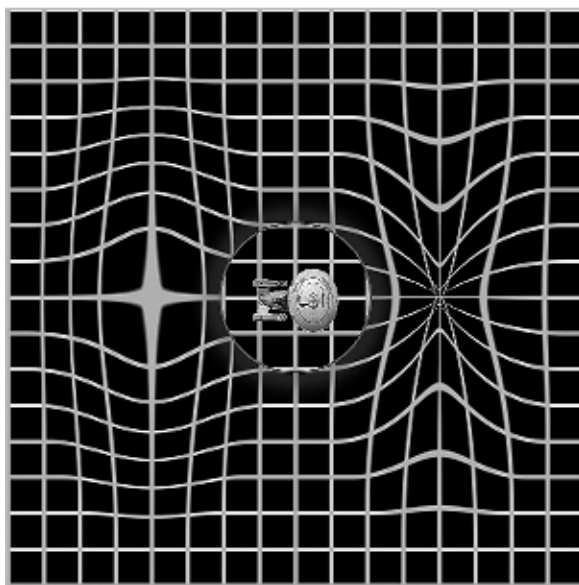
BY DAVID K. LEVINE

Imagine a land recently seized from a foreign power where there is little law and a lot of gold. Since nature abhors a vacuum, prospectors quickly adopt the conventions of private property: Whoever is first to put four stakes in the ground is the proud owner of the land and any gold beneath. This would pretty much describe California in 1848. It makes a lot of sense, too: We can't both mine for gold in the same spot, so only one of the two of us can claim the land. "First come first served" seems as fair a basis for adjudicating claims as any.

Now imagine that some lobbyists have staked out part of Antarctica and brought suit in federal court against tourists who trespassed on "their" land. Fine, you say: After all the lobbyists got there first. Replace "Antarctica" with "ideas" and you have the surreal world of "intellectual property." Unfortunately, while you and I cannot both mine for gold in the same spot, we can certainly make use of the same idea, and therein lies the heart of this story.

A good spot to start the tale is in 1998, when a panel of judges ruled that software was patentable, thereby starting the intellectual property equivalent of the California gold rush (*State Street Bank & Trust v. Signature Financial Group*). Every child knows how to answer the door: "Knock knock." "Who is there?" But what if I

taught a computer how to say, "Who is there," and patented the idea? Absurd, you say. Well, we all understand how to run an auction—but do not try doing it with a computer because the holder of U.S. Patent 7,702,540 (also known as e-Bay) will sue you. And that in a nutshell is what software patents are all about.



Warp drive is purely fictional at this point. It's also been patented.
wikimedia.org

The entire concept of being able to patent a commonly used idea because it is implemented on a computer is silly, but this article is too short to review all of the millions of software patents issued since 1998. A famous and not-so-famous example may serve to reinforce the point. Raise your hand if you have not heard about the Amazon "one-click" patent (U.S. Patent 5,960,411). No hands? Okay, if you can patent one click, why not two? Sorry, that you cannot do. Why not? Microsoft beat you to it (U.S. Patent 6,727,830).

Software patents, though, are only a modern incarnation of an ancient evil. How about patenting the peanut butter and jelly sandwich? Too late, already done—in 2005, no less (U.S. Patent 6,874,409). That one did not hold up in court. There are so many

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silly patents that there are two websites, totallyabsurd.com and patentlysilly.com, to publicize them. Many seem to tell a tale of inventors with little sense—and a government patent office with even less. How about a thong diaper (U.S. Patent D539422)?

Here is one that was approved by the eagle eyes at the U.S. Patent Office (U.S. Patent 6,637,349): “A motorized picnic table having a drive mechanism, wheels connected to and driven by the drive mechanism, a table mounted above the drive mechanism, and at least one seat adjacent the table. In the preferred embodiment, the seats are bench-type seats and flank the drive mechanism.”

That was “invented” by Gregory A. Lafferty, “approved” by patent examiners Robert Olszewski and James S. McClellan, and lawyered by Baker & Daniels.

And what was the patent examiner smoking when he approved this one?

A method of swinging on a swing is disclosed, in which a user positioned on a standard swing suspended by two chains from a substantially horizontal tree branch induces side to side motion by pulling alternately on one chain and then the other (U.S. Patent 6,368,227).

But if you think patenting the obvious is silly, then what about patenting the impossible? Do these inventors sit around and watch *Star Trek* all day, then rush off to the patent office? U.S. Patent 6,025,810 protects the warp drive: “[This] invention takes a transmission of energy, and instead of sending it through normal time and space, it pokes a small hole into another dimension, thus sending the energy through a place which allows transmission of energy to exceed the speed of light.” It comes complete with elaborate wiring diagrams.

Fun is fun. But there is a serious side to all this nonsense. In *The Social Network*, Facebook creator Mark Zuckerberg asks, “Why should a guy who makes a really good chair owe money to anyone who ever made a chair?” Yet in practice that is what patents are for. Take the matter of faster-than-light travel. The

patent is silly because it is science fiction rather than science. But should a real entrepreneur ever come up with a way of communicating faster than the speed of light, the only thing we can be certain of is that she will then have her pants sued off for patent violation by Mr. David L. Strom—owner of the “idea” of the warp drive.

Does that sound crazy? Consider the true story of Jerome Lemelson, who in 1954 and 1956 filed patents (or so he later claimed) on optical scanning. Optical scanning was no more practical in 1956 than the warp drive is today—and needless to say, Lemelson’s “invention” did not include a working device. Still, when optical scanning became widespread in 1998, Lemelson demanded and received millions of dollars in royalties from the companies that produced optical scanners. It is true in the end the courts invalidated his patents. But he did not give back the money.

“Why should a guy who makes a really good chair owe money to anyone who ever made a chair?”

The Rest of the Story

Patents are not the end of the story. They seem so serious: They’re essential, it’s said, to innovation, growth, economic welfare. Patents involve weighty and important things. By contrast, trademarks and copyright seem lightweight. What does a song really matter to our economic well-being? The logo of a company? If the

International House of Pancakes wants to sue the International House of Prayer for a trademark violation (www.tinyurl.com/2483ww0), well it’s silly, but so what? If a woman trademarks her name and threatens to sue anyone who uses it in written communication (www.tinyurl.com/2wauumw), well the world is filled with silly people. If one restaurant sues another over grazing goats on the roof, it’s an amusing article in the *Wall Street Journal* (<http://tinyurl.com/2dm3l8p>). Or suppose a company calls itself “Rosetta Stone,” trademarks the name, then sues Google for selling it as a keyword for searches (www.tinyurl.com/287kb8h). At least a big company like Google can afford the lawyers to defend itself. And if the media industry’s anti-piracy lawyers are suing one another for copying cease-and-desist letters (www.tinyurl.com/2wrbn6c), that’s not

only silly but ironic, right? It's true that these silly lawsuits clog up the courts, but that's the price we have to pay for . . . well I am not sure why we have to pay it, but you get the point.

Some copyright stuff is sleazy. For example, Stephens Media encourages people to share its news articles with their friends, then sues them for copyright violation when they try to do it (www.tinyurl.com/298olub). It's true the company intimidates a lot of people into paying up—but “no harm no foul”: Nobody has actually gone bankrupt on its account yet.

The truth is that trademarks—unlike patents and copyright—have a legitimate purpose. Why should someone be allowed to do business pretending to be me? That's how trademark law is written. Yet no law has been written that lawyers cannot distort. A company, Peabody Energy, recently tried to take down a website making fun of its clean-energy claims because—you've got it—the site used its trademarked name (www.tinyurl.com/yz8x425).

The Electronic Frontier Foundation has an entire catalog of these kinds of offenses. Are they just silly? Or are they sinister? Suppressing free discussion of the demerits of a person (who trademarked her name) or a company (that trademarked its name) certainly is not the purpose of trademark law. Or how about this: When the book *Alice's Adventures in Wonderland*—a book not under copyright and in the public domain—was reformatted for the Adobe e-book reader, readers were told that any effort to copy, print, lend, or give the book away—or indeed to read the book out loud—would be a violation of international copyright law. Leaving aside that these restrictions are as meaningless as they are legally unenforceable, and that this falls into the silly rather than sinister category, the idea that a copyright holder might want to prevent something from being read aloud should give pause.

After you pause, take a deep breath: There is worse to come. There are copyright holders who want to prevent things from being read at all. The Diebold Corporation sued a group of students. Their offense? They

made public internal company emails documenting that Diebold voting machines do not work especially well, and in particular are vulnerable to the casting of fraudulent votes. Pretty serious stuff. Why did Diebold sue these students? It sued them for copyright violation. It claimed the internal emails were copyrighted and that the students had reproduced them without permission. In this instance the courts behaved sanely: Judge Jeremy Fogel wrote in his decision that “no reasonable copyright holder could have believed that portions of the e-mail archive discussing possible technical problems with Diebold's voting machines were protected by copyright.” But while threatening and carrying out meritless lawsuits is not as bad as winning them, it imposes a real tax on free speech. And more to the point, the history of intellectual property is the history of absurd requests being repeatedly rebuffed by the

courts (think “software patents before 1998”) until a panel of judges finally caves in.

Let us be realistic: People sue each other for all sorts of silly reasons having nothing to do with intellectual property—and often win in court. People who spill coffee on their laps sue the maker of the coffee; burglars who fall through the roofs of

properties they are robbing sue the owners for unsafe roof conditions, and so forth.

Abusive by Nature

So why condemn intellectual property law over, say, tort law more broadly? Why focus on IP and not on the broader problem of excess litigation? The answer is that intellectual property is abusive by its very nature. Despite what the propagandists say, intellectual property is not about protecting land from trespassers. It is about controlling what belongs to other people. It is about the right of Disney Corporation to tell me what to do with things I have on my computer—even things I have created myself.

Is it a coincidence that the main accomplishment of the patent system is to encourage rent-seeking behavior? Well, consider that originally the *only* purpose of the patent system was to encourage rent-seeking

Originally the *only* purpose of the patent system was to encourage rent-seeking behavior.

behavior. There was no fiction that it was a reward for invention: The king simply granted favored rent-seeking courtiers monopolies over the production of salt, the land in Virginia, or whatever the favorite with the largest bribe happened to desire.

Is it a coincidence that the main use of copyright is to suppress free speech? Well consider that originally the entire purpose of copyright was to suppress free speech. When the printing press became widespread, a monarchy deathly afraid of popular dissent granted printing companies "copyright" monopolies over the printing of (government-authorized) books, along with the right (and obligation) to burn any books the monarchy disapproved of.

Where is this all headed? Intellectual property is not merely a threat to freedom of trade and speech. It is also a threat to freedom of thought. Sound far-fetched? A ridiculous straw man? A wild exaggeration?

Is it? How about this famous copyright lawsuit

that the plaintiff *won*? It concerned two songs: One consisted of four repetitions of a short musical phrase A followed by four repetitions of B. The other and subsequent song also consisted of four repetitions of A followed by three repetitions of B. And indeed, the tune was sufficiently "obvious" that the judge concluded that George Harrison did not knowingly copy the song

"You're So Fine" when he wrote "My Sweet Lord." He nevertheless ruled for the plaintiff: "His subconscious knew it already had worked in a song his conscious did not remember. . . . That is, under the law, infringement of copyright, and is no less so even though subconsciously accomplished" (www.tinyurl.com/24yrvnz).

Subconscious copyright violation! Just wait until we all have video cameras implanted in our retinas! Then you will have to pay a fee to Walt Disney Corporation or some other big company each time you look down the street. Or perhaps you will have to pay me: I'm thinking of patenting the idea. **FEE**

Originally, the entire purpose of copyright was to suppress free speech.

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Tariffs and Freedom

BY DONALD J. BOUDREAUX

A historical episode that opponents of consumer sovereignty—that is, opponents of free trade—frequently cite to support their case for high tariffs is late nineteenth-century America. Pat Buchanan, for example, in his book *The Great Betrayal* asserts about the 1800s that “Behind a tariff wall . . . the United States had gone from an agrarian coastal republic to become the greatest industrial power the world has ever seen—in a single century. Such was the success of the policy called protectionism that is so disparaged today.”

It is true that the U.S. government imposed relatively heavy tariffs on American purchases of foreign-made goods throughout the nineteenth century. After steadily falling throughout the 1830s, 1840s, and 1850s, tariff rates began to rise again in the 1860s. A pinnacle of sorts was reached with the McKinley Tariff of 1890, which imposed what were then the steepest tariff rates in U.S. history.

It is also true that the nineteenth century was one of steady industrialization and great economic growth. According to Nobel laureate economic historian Douglass North, in 1820 America’s agricultural workforce was nearly seven times larger than her nonagricultural workforce. By the late 1890s, however, the number of nonagricultural workers surpassed the number of Americans working on farms.

And real per-capita income also rose steadily during this time. In 1900 it was about three times higher than it was in 1840.

Was this industrialization and significant improvement in Americans’ incomes the *consequence* of high tariffs? Or at least can we say that high tariffs did no harm to America’s economy during the 1800s?

No and no.

Facts on other fronts undermine protectionists’ claims that the nineteenth-century experience with high tariffs was positive.

Begin by noting that throughout the 1800s tariff revenues were a major source of operating funds for Uncle Sam. But tariffs that could significantly reduce imports would also reduce government revenues. After all, the very purpose of a “protective tariff”—as opposed to that of a “revenue tariff”—is to dramatically decrease the occurrence of the thing being taxed:

imports. (In the extreme case, even a very high tariff rate on imports yields no government revenue if that rate causes Americans to stop importing completely.)

Because sustained budget deficits were practically out of the question in the nineteenth century, genuine protective tariffs arguably kept government in general smaller than it would otherwise have been by keeping revenues lower than they would have been under revenue (rather than protective) tariffs.

Smaller government, in turn, meant less intrusion into the economy. The resulting freedom of entrepreneurs and consumers, and lower likelihood of government handouts (and bailouts!) to favored interest groups, promoted healthy economic growth.

More generally, except for high tariffs, the U.S. economy of the nineteenth century was relatively free. Labor unions enjoyed no special legislative protections; outright industrial and agricultural subsidies were rare;

The nineteenth century saw steady industrialization, great economic growth, and rising per-capita income *despite* the U.S. government’s heavy tariffs.

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nontariff taxes were either low or nonexistent; antitrust obstructionism wasn't even possible until 1890, with the passage of the Sherman Act (and even then, it was largely held in check by the courts for a few more years); and there was no SEC, FDA, FTC, EPA, or any of the other alphabet-soup bureaucracies that haunt the economy today. (The first such agency—the Interstate Commerce Commission—wasn't created until 1887.)

Real Growth Factors

Low taxes and minimal regulation paved the way for entrepreneurs to create, investors to invest, and consumers to reap the resulting benefits. America's economic growth in the nineteenth century owed a great deal to this freedom.

One particular unregulated feature of the economy was immigration. Substantial immigration, especially during the last few decades of the 1800s, infused the American economy with productive human power and creativity. This immigration also expanded the size of the market able to be served by domestic firms, permitting these firms to take advantage of economies of scale that would otherwise have been unavailable to them because of restrictions on trade with foreign markets.

Economists Cecil Bohanon and T. Norman Van Cott reported, in a 2005 paper published in *The Independent Review*, that America's policy of open immigration went a long way toward minimizing the harmful effects of high tariffs.

In addition to the immigrant-fed growth of the U.S. population in the nineteenth century, there was the growth of U.S. geography. By the end of the nineteenth century, the United States stretched from the Atlantic to the Pacific, and from Canada to Mexico and the Gulf. This enormous geographic area was a free-trade

zone. Consumers and producers in frigid New England could specialize and trade with producers and consumers in sunny Florida and even faraway California.

The different geographic features that are among the reasons why trade among different small countries is so beneficial were present within this one sprawling and geographically diverse country.

Home of the Free(-Trade Zone)

So America's impressive economic growth during the nineteenth century was in fact the result of free trade—trade unhampered within the expansive boundaries of a country that was huge, growing, and diverse in both its geography and its population.

If the protectionist logic was correct, then even greater wealth—or at least as much—would have been produced had each U.S. *state* adopted its own policy of protecting in-state producers from out-of-state competitors. But I know of no serious scholar who laments the fact that the United States, from its origins, has truly been a zone of free trade.

Of course, the fact that America's economy grew impressively during the 1800s despite Uncle Sam's restrictions on foreign trade does not mean that these restrictions weren't harmful. They no doubt were. The restrictions stopped specialization from going ever further; they diminished the intensity of competition from the levels that consumers would have enjoyed without high tariffs; and they hampered the ability of American producers and consumers to tap into the creativity of non-Americans who did not immigrate to America.

Fortunately, though—or is it unfortunately?—nineteenth-century America's other advantages were so great that the bounty they made possible blinds many people to the harm caused by that era's high tariffs. **FEE**

America's nineteenth-century growth owed a great deal to the era's low taxes, minimal regulation, open borders, and expanding territory.

Ask Not For Whom the Drug Tolls

BY WENDY MCELROY

“Fifty years ago, it made sense to assert that mental illnesses are not diseases, but it makes no sense to say so today. Debate about what counts as mental illness has been replaced by legislation about the medicalization and demedicalization of behavior. Old diseases such as homosexuality and hysteria disappear. New diseases such as gambling and smoking appear.” So writes the iconoclastic psychiatrist Thomas Szasz.

Almost 50 years ago Szasz published *The Myth of Mental Illness*. It changed the political framework in which mental illness was addressed by laying the foundation for a concept Szasz developed through a series of books, including *The Manufacture of Madness* (1970). That concept was “the Therapeutic State”—a collaboration between psychiatry and the State through which “undesirable” actions, thoughts, and behavior patterns were suppressed. Thus Szasz not only disputed the moral and scientific basis of psychiatry but also argued that modern medicine was an engine of social control, with pharmaceuticals as primary tools.

A new slate of drugs now addresses a wide range of so-called disorders, or dysfunctions, that former generations considered environmental problems or lifestyle choices: from obesity to attention deficit, from erectile dysfunction to social anxiety (shyness), from menopause to alcoholism. Indeed, laziness is now being discussed as “a neuro-developmental dysfunction” for which drugs are being developed. The current Therapeutic State may be best analyzed as a collaboration between modern medicine, the pharmaceutical industry, and the State.

The debate stirred by Szasz has muted. The medical establishment and mainstream media are now advocates of the Therapeutic State. Similar advocates dominate universities, studies, prestigious committees, FDA hearings, and governmental bodies. Since writing *The Myth*, Szasz himself has noted that “the formerly sharp distinctions between medical hospitals and mental hospitals, voluntary and involuntary mental patients, and private and public psychiatry have blurred into nonexistence. Virtually all medical and mental health care is now the responsibility of and is regulated by the federal govern-

ment, and its cost paid, in full or in part, by the federal government.” Problems of everyday life have been medicalized, and people are viewed as having little or no ability to “cure” conditions such as alcoholism or drug abuse through willpower or change of habit. The focus Szasz tried to foster on the individual’s responsibility for his or her own dysfunctions has eroded.

Happily, a backlash against the medicalization of everyday life is occurring. Alas, it is being fought on the wrong ground.

In this regard, a fascinating book has just been published. *Sex, Lies, and Pharmaceuticals: How Drug Companies Plan to Profit from Female Sexual Dysfunction* by Ray Moynihan and Barbara Mintzes is a work of investigative journalism that explores the close financial relationship between the medical experts who define and develop the “science” behind new dysfunctions and the

The medical establishment and mainstream media are now advocates of the Therapeutic State.

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\$500-plus billion pharmaceutical industry that profits from treating them. For example, Moynihan examines the makeup of experts on committees that define dysfunctions for the extremely influential *Diagnostic and Statistical Manual of Mental Disorders* (DSM); it is from the DSM that “social anxiety disorder” derives. (Revealingly, homosexuality was only delisted as a disorder in 1970.) Moynihan observes, “The DSM has been criticised for the closeness between the expert committees who write the definition of diseases and the pharmaceutical companies that sell the drugs prescribed to treat them. One study that looked closely at the affiliations of the men and women on those committees found that more than half of them had ties to drug companies. On the committees revising mood disorders, including depression, the figure was closer to 100 per cent.”

In short, he constructs a strong case for endemic bias within the medical establishment in favor of drug companies and the creation of disease.

Another sign of backlash is the emergence of grassroots rebellions against specific “diseases,” such as the currently emerging “female sexual dysfunction,” and against the use of drugs, such as Ritalin, to “cure” attention deficit disorder in children.

A reopening of debate on medicalizing everyday life is to be applauded. But, unlike Szasz, the new critics, such as Moynihan, do not take aim at the Therapeutic State; instead they focus on the therapeutic industry—that is, the flow of money between the medical establishment and the pharmaceutical companies. The culpability of the government in the creation of disease is either marginalized or denied.

Other pharmaceutical dissidents tend to view the State as the solution, not part of the problem. For example, feminist activist Leonore Tiefer works through the World Health Organization to impose new legislation that promotes such “rights” (or entitlements) as “the right to comprehensive sexuality education” and “the right to sexual health care, which should be available for prevention and treatment of all sexual concerns, problems, and disorders.”

It is possible that critics like Moynihan and Tiefer will accomplish some good. Perhaps they will be able to reduce the widespread prescription of the powerful Ritalin to grade-school children. But without understanding the essential role played by the State in the medicalization of everyday life, critics can never strike at the root of the problem. Indeed, they may well worsen matters by shifting blame and giving more authority to the very agency most responsible for the creation of disease.

The Need for a New Focus

The focus of the reemerging debate needs to shift onto Szaszian grounds, onto an analysis of the Therapeutic State, in at least four ways.

First, it must be clear that government defines the framework for all medical practices within North America. Second, the protection offered to pharmaceutical companies should be analyzed as legal privilege. Third, the relatively new and influential “private-public partnerships”—a marriage between the corporate sector and government institutions—should be examined and exposed. And, fourth, the role government plays in “marketing” drugs through institutions like the public school system and social services must be examined.

Government framework. There is no genuine competition allowed in the practice of medicine or the administration of drugs. Both of these vital functions of society are monopolies that the government assigns to those who meet State requirements and abide by State rules. Thus the American Medical Association (AMA) is able to exert monopoly control of medical care, such as hospitalization, and has a long history of persecuting competitors such as midwives.

But licensing is only the most obvious way in which the State and AMA define medical care. There are many other labyrinthine ways in which the medical establishment partners with authority. In reporting on the AMA’s support of Obamacare, for example, the *Wall Street Journal* explained last year, “The organization

The medical establishment is biased in favor of drug companies and the creation of disease.

wants to protect a monopoly that the federal government has created for it—a medical coding system administered by the AMA that every health-care professional and hospital must use if they wish to get paid for the services they provide. This monopoly generates income of \$70 million to \$100 million annually for the AMA. That makes the AMA less an association looking out for doctors and more a special-interest group beholden to Congress and the White House.”

FDA Approved

Legal privilege. All prescription drugs must be approved by the FDA; but, again, the monopoly privilege of being the sole legal drug dealers in society is only the most obvious one granted the pharmaceutical industry and hardly captures the extent of partnership. Moynihan chronicles a less obvious privilege in writing about “one of the biggest healthcare frauds in U.S. history. Pfizer was accused of illegally promoting an anti-arthritis drug for unapproved uses and, so, creating a health risk to users. Pfizer admitted to limited guilt and paid a criminal fine of \$1.2 Billion and civil penalties of \$1B.” Despite the hefty financial hit, not one executive was held personally responsible; no retribution was sought. The sentencing judge, federal District Court Judge Douglas Woodlock (Massachusetts) commented in his concluding remarks, “This is a case in which no human being, apparently, is going to be held responsible for substantial criminal activity by a corporation.” He notes that Pfizer absorbed the financial hit as a “cost of doing business” and still returned record profits.

Private-public partnerships (PPP). A PPP is a collaboration between government and the private sector in which a venture is funded (in part or in full) by tax dollars and operated through the private sector, or else the private sector raises capital under contract with the government to provide services. Although PPPs are most often associated with infrastructure projects, such as the repair of roads or building of bridges, this sort of ersatz capitalism is rampant within medical research and drug promotion. According to a 2001 study, “hundreds

of millions of dollars” have been invested in the United States to promote partnerships around health issues, creating “thousands of alliances, coalitions, consortia and other health partnerships.” That trend has only increased in the ensuing years. Tax-funded research is commonly funneled through nominally private organizations or researchers. Conferences, studies, reports, and such are conducted at taxpayer expense. Arguably, such funding constitutes the greatest barrier to alternative, independent research.

Uncle Sam the Pusherman

Government peddling of pharmaceuticals. It is not merely that private for-profit organizations have used tax dollars to climb aboard the public health bandwagon. The government uses its agencies to create a market base. Just one example is the role of the public schools as a “pusher” of Ritalin—a form of speed more potent than cocaine—to millions of school-age children. Overwhelmingly, it is prescribed to boys who are “unruly” in class. A 2001 report stated, “If Huckleberry Finn and Tom Sawyer were in a school in Massachusetts today, they’d be drugged with Ritalin, according to many psychiatrists and other experts.” As a recent September *Huffington Post* headline asked, “Do 2.5 Million Children Really Need Ritalin?” Dr. Sanford Newmark continued, “What is going on here? Have millions of our children become so hyperactive and unable to focus that they are incapable of succeeding at school or dealing with the demands of normal life? Or are we creating an illness where there is none, calling normal variations in temperament and personality a ‘disease’ that requires the intervention of long term, and extremely profitable, pharmaceutical medication?”

Monopoly, legal privileges, the rise of PPPs, the use of tax dollars to create disease and eliminate competition, the peddling of pharmaceuticals through government agencies—these issues must be prominent in any productive discussion of the medicalization of everyday life. If the discussion focuses on corporate greed, then the Therapeutic State will have merely entered a new phase. FBE

Ideas versus Interests

BY ISAAC M. MOREHOUSE

One of my favorite quotes about the power of ideas comes from Ludwig von Mises in *Human Action*: “What determines the course of a nation’s economic policies is always the economic ideas held by public opinion. No government whether democratic or dictatorial can free itself from the sway of the generally accepted ideology.”

This is a rather extreme statement. Are governments really so tightly bound by the beliefs of the public? Anyone versed in Public Choice theory is likely to find Mises’s statement a bit much.

After all, Public Choice demonstrates how incentive structures in the political system can lead to policies that are not in fact favored by the majority of citizens but are in the interest of a powerful few.

Public Choice analysis is incredibly useful to economists and laypeople alike. It has opened our eyes to the difficulty of government reaching its own stated ends because of incentive problems within the system of government itself. It has dispelled the myth that government ineptitude is simply the result of bad leaders. However, in all this emphasis on incentives and interests, Public Choice often overlooks or minimizes the role of ideas.

We cannot forget the power of ideas to *overcome* the bad incentives inherent in any system of government and to act as a roadblock to the seemingly inevitable expansion of State power.

Consider a rather silly example that illustrates the inability of Public Choice alone to explain the world of policies in which we live.

A billboard says, “Kicking chickens creates prosperity.”

This is part of a campaign sponsored by the Partnership for a Chicken-Free America. The group is made up of people who have an extreme dislike for chickens, and they are willing to put vast resources into reducing the well-being of such fowl. In fact, they advocate legislation to establish national Kick-A-Chick Day.

Most voters and members of the general public do not share this distaste for chickens. Then, again, most

people are relatively indifferent when it comes to chicken happiness. With a few exceptions, it is not in an individual’s interest to spend resources on a counter-campaign or to hire lobbyists to oppose the Kick-A-Chick bill; the costs of doing so simply outweigh the benefits.

This is a classic case of concentrated benefits and dispersed costs. The anti-chicken people derive tremendous happiness from harming

chickens, making their campaign a worthwhile expenditure. Yet the general public gains little from preventing chicken kicking, and the cost of opposing it is very high.

On the other hand, the public loves prosperity. If they believed that punting hens created wealth, there is little reason to suspect they would not support the policy. A public-awareness campaign would be just the ticket.

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In all its emphasis on incentives and interests, Public Choice often overlooks or minimizes the role of ideas.

Armed with Public Choice theory we can see the sad but likely result. The chicken-free association will exert its influence and get its bill. The public will either support what they believe to be a prosperity-creating policy or ignore it altogether because the cost of fighting is too high. The interests align in such a way that we can expect the anti-bird forces to get their way.

Of course this story is absurd and such a law would never be introduced, let alone pass. What makes it so obviously impossible?

Ideas.

People know there is no causal connection between kicking a chicken and enjoying a higher standard of living. That knowledge makes the campaign laughable. Regardless of how the interests are aligned, if people are educated enough to know that chicken kicking does not equal prosperity, such an absurd policy will not be enacted.

Ideas and Public Opinion

This was an admittedly silly example. You could claim that the real reason such a stupid policy wouldn't fly is not public opinion, but the fact that no real interest group would advocate for kicking chickens. But it is not hard to imagine other instances where a real interest would benefit from marketing a false cause-and-effect relationship, but where they simply cannot because the public knows enough not to buy it. Hotdog producers would gain if the consumption of one frankfurter per day were required by government. Why don't they promote such a law? They could run ads saying, "If you eat a hotdog, a child will be cured of cancer." It is not hard to see that, real or imagined, interest groups cannot get away with everything, even in the face of bad incentives.

Yesterday I saw a sign on the side of a bus that I found no less absurd than the chicken-kickers campaign. It read, "Converting buses creates jobs. What are we waiting for?" The ad was sponsored by a "clean air" association, no doubt consisting of members of the natural-gas industry and people for whom a reduction in fossil fuel use would bring some great personal pleasure.

The power of ideas means things are not as hopeless as pure Public Choice theory might suggest.

Just like our chicken story, the incentives are aligned so that the benefits of bus-conversion mandates to the members of this small group exceed the cost of their advocacy efforts, while the benefits to individual citizens of stopping the mandates fall short of the cost of opposition. As far as incentives go, the situation seems pretty dire.

Unlike our chicken story, however, most people do not know there is no magical or "free" job creation when government mandates bus conversions. The resources used to convert the buses must be taken from somewhere, and it is as likely as not that there are many other jobs destroyed or never created in the first place when the resources are redirected. Furthermore, most people do not know that there is no causal connection between more jobs and more prosperity, or a higher standard of living. In fact, if a government mandate creates jobs, it is likely that it does so precisely because it is destroying wealth by moving it from more-productive to less-productive (and more labor intensive) uses.

This lack of knowledge is actually good news.

It means things are not as hopeless as pure Public Choice theory might suggest. Bad incentives can be overcome by good ideas. In our chicken story it was clear that interests alone were insufficient to enact policy. Knowledge of the policy's incoherence trumped the incentive structure. With a grasp of basic economics, people may find the sign on the bus just as laughable as the idea of Kick-A-Chick Day.

Special interests can only appeal to things within the realm of accepted public opinion, which is shaped by public knowledge. We can affect public knowledge.

Special interests can do much to destroy liberty given the incentive structure in our political system. Indeed, with an ignorant populace there is little they cannot do. But even the most powerful interests ultimately answer to the ideas held by a majority of citizens. Policy follows the path blazed by belief.

In emphasizing the role of ideas in limiting the expansion of the State or the power of special interests I do not mean to say Public Choice is incorrect. It is a valuable toolkit that brings a dose of realism to our

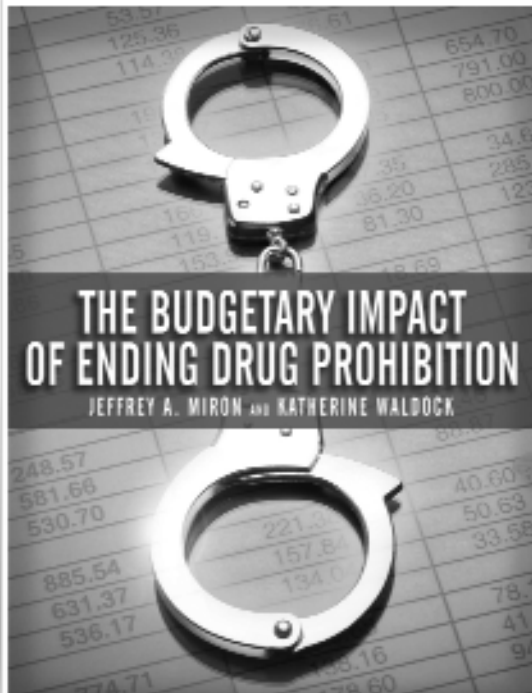
efforts at reforming the State. But it is most powerful when it recognizes and incorporates the power of ideas to change and shape interests, and to help people put aside their short-term interests and understand their long-term interests.

It was recognition of the power of ideas over interests that motivated Leonard Read to start the Foundation for Economic Education. It is because of the power of ideas that FEE has tirelessly educated individuals on economic principles for these many years. It is because of the power of ideas that we must continue our educational efforts, no matter how frustrating it may sometimes be.

When we succeed, all interventionist interest groups and their ploys will be shown to be just as ridiculous as the Partnership for a Chicken-Free America. No matter how powerful an interest, how strong its incentives, or how corrupt the system, government can ultimately only do what people permit it to; and people will only permit it to do what they believe it capable of doing. Through education we can demonstrate just how incapable government is. In the end, despite the very real power of interests, ideas win.

To paraphrase Victor Hugo, "More powerful than an army of special interest lobbyists, is an idea whose time has come." **FEE**

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The Budgetary Impact of Ending Drug Prohibition

BY JEFFREY A. MIRON AND KATHERINE WALDOCK

State and federal governments currently face massive fiscal deficits. But there is one policy change that can help significantly reduce these deficits: ending the drug war. This detailed new report illustrates how legalizing drugs would save state and local governments roughly \$41.3 billion a year in enforcement costs. It also estimates that drug legalization would yield tax revenues of \$46.7 billion annually.

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Andrew Higgins: Boat Builder of WWII

BY BURTON FOLSOM, JR.



Who was Andrew Higgins? Almost forgotten now, he was, according to Dwight Eisenhower, “the man who won [World War II] for us.”

As General William T. Sherman observed, “War is hell.” That hell includes oppressive taxes, loss of freedom, and crushing debt, as well as deaths in combat. But once in war, as the United States was after Pearl Harbor, losing is an even greater hell. Thus we had a need for war entrepreneurs, and some—like Higgins—were given enough freedom to innovate and help U.S. troops finish the war sooner than expected.

Andrew Higgins became indispensable because he was one of the very few men who could create and manufacture reliable landing craft to transport troops from ship to shore. Using landing craft in warfare was a key World War II innovation. Troop ships would bring thousands of soldiers within a mile or so of the coast. Then the soldiers would climb down the sides of the ships on cargo nets into Higgins boats (as his assortment of landing craft came to be called), each holding 36 men. The landing craft would then bring the soldiers into shore—a ramp would open at the end of the boat, and the men would disembark. Then the boats would return to the troop ship to load more men.

Higgins’s boats were so reliable, so flexible, and so fast that Americans could reach many different parts of a coastline, not just the major ports. Thus the Higgins boats gave Eisenhower many options for landing spots into North Africa, then into Italy, and finally into France. The Germans couldn’t cover the entire Euro-

pean coast, and the Allied forces used thousands of landing craft to hit Normandy beach at D-Day.

What’s especially remarkable about the Higgins story is that he almost didn’t get a chance to show the world what he could do. The biggest obstacle Higgins faced was overcoming the bureaucrats in the U.S. Navy. In particular the Bureau of Ships, which had authority to buy landing craft for the Navy, regularly refused to consider Higgins’s offers to supply various landing craft and PT boats. Why?

First, the Bureau of Ships wanted to use its own internally designed landing craft. What’s more, the naval leaders couldn’t imagine Higgins, a small boat builder from Nebraska, having the answers to the Navy’s needs. Therefore, they usually rejected his offers and nitpicked his designs, then purchased their own inferior vessels.

With the success of the war, and his company, at stake, Higgins fought back. “I don’t wait for opportunity to knock,” he said. “I send out a welcoming committee to drag the old harlot in.” He openly condemned the Bureau of Ships for “prejudice” against his boats. American lives were being lost, he contended, because Higgins boats

were on the sidelines. Jerry Strahan describes Higgins’s battle with the Navy bureaucracy in *Andrew Jackson Higgins and the Boats that Won World War II*.

Higgins called the tank lighter—the mechanized landing craft that carried tanks—built by the Bureau of Ships “godawful.” He added, “I want to say that there are no officers, whether present in this room or otherwise in the Navy who know a goddamn thing about



Andrew Higgins’s entrepreneurial skills helped end WWII.
Wikipedia.org

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small boat design, construction, or operation—but by God, I do.”

Of the Bureau of Ships, Higgins said, “If the ‘red tape’ and the outmoded and outlandish Civil War methods of doing business were eliminated, the work could be done in the Bureau of Ships very efficiently with about one-sixth the present personnel.” The bureaucrats at the Bureau of Ships loathed Higgins and rejected his superior boats, even when their own vessels malfunctioned and killed American soldiers in transport.

Fortunately for Higgins, the U.S. war effort was just decentralized enough to give him a chance to go outside the naval bureaucracy to prove himself. First, the Marines desperately needed amphibious boats, and after doing tests they discovered that the Navy’s landing craft often didn’t work but Higgins boats did. The Marines bought Higgins boats when possible and helped get a hearing for Higgins in higher tribunals. Second, Congress authorized the Truman Committee to investigate waste and corruption in the war effort. Higgins at last won a hearing from Senator Harry Truman and dramatic results followed: Truman demanded a “head-to-head operational test” of a Higgins boat and a Navy boat.

Head-to-Head

That was all Higgins ever asked for. In the dramatic contest that followed at Norfolk, Virginia, on May 25, 1942, both Higgins and the Navy had to have their landing craft carry a 30-ton tank through choppy waters. During the race, the highly touted boat built by the Bureau of Ships failed—and almost sank—while the Higgins boat dazzled the spectators. With the scrutiny of the Truman Committee, the Bureau of Ships had to convert to Higgins’s design and immediately he began receiving important contracts.

Shocked that the Navy had repeatedly rejected the best boat available, Truman launched a full investigation

into naval purchasing and concluded, “[T]he Bureau of Ships has, for reasons known only to itself, stubbornly persisted for over five years in clinging to an unseaworthy tank lighter design of its own. . . . Higgins Industries did actually design and build a superior lighter,” but was ignored because of a “flagrant disregard for the facts, if not the safety and success of American troops.”

With a green light from the Truman Committee and the Bureau of Ships, Higgins expanded his New Orleans plant and frantically churned out landing craft. He attracted good workers from across the country for his assembly lines by paying high wages, offering free

medical care, and providing great training and some community services. He hired black and white workers and, although he had to segregate them, he paid them similar wages. Getting good workers and training them was only part of his challenge. He also had to find loopholes in the new federal laws that limited wages and controlled prices and purchases. Higgins often had to buy steel on the black market, and once, when no bronze shafting was available for

making tank lighters, he stole the needed material from an oil company in nearby Texas. (He later paid for it.)

During March 1943, as Eisenhower began to prepare to invade Sicily and Italy, he had nightmares of shortages of landing craft. “When I die,” Eisenhower said, my “coffin should be in the shape of a landing craft, as they are practically killing [me] with worry.” The next year, when Ike planned the D-Day invasion, he said, “[L]et us thank God for Higgins Industries, management, and labor which has given us the landing boats with which to conduct our campaign.” A frustrated Adolf Hitler, who could not stop thousands of Higgins boats from landing soldiers at Normandy beach, called Higgins the “new Noah.” The old Noah helped save the animals; the new Noah helped save his country.

FEE

The Fiasco of Prohibition

BY DOUGLAS ROGERS

The national prohibition of alcohol, initiated by the Eighteenth Amendment to the Constitution and enforced via the Volstead Act, stands as an important illustration of the limits to social engineering. Prohibition failed to eliminate alcohol, and even exacerbated many of the social ills related to its consumption, because government is limited both by its knowledge of how people react to regulation and also by the incentives faced by the regulators themselves.

In *Last Call: The Rise and Fall of Prohibition*, a brilliant and exhaustively researched book, David Okrent examines the forces behind the enactment and repeal of Prohibition as well as its consequences, both intended and unintended. From 1920 until 1933 most Americans were forced to choose between abstinence and illegal consumption.

But Americans loved to drink: Per capita alcohol consumption in the nineteenth century was three times today's rate. It's no surprise that so many chose to continue their consumption illegally.

If the goal of Prohibition was to eliminate, or even reduce, many of the problems associated with alcohol consumption—such as criminal activity, binge drinking, drunk driving, and deaths and injuries via alcohol poisoning—it was an unambiguous failure. As Okrent

illustrates, after 13 years of speakeasies, corrupt enforcement, and criminal empires, the repeal movement had little difficulty in convincing a beleaguered public that Prohibition was a mistake.

However, this is not to say that Prohibition was entirely ineffective. If the goal was to reduce overall consumption of alcohol by increasing its price, Prohibition worked largely as intended. Initial consumption declined to 30 percent of its pre-Prohibition level, though this number rose to 70 percent within three years and stayed roughly at that level by the time of repeal. However, even for its advocates this is an odd

measure of success for *prohibition*. Also worth noting is that repeal did not bring about a significant increase in drinking. Per capita consumption rates did not reach their pre-Prohibition levels until 1973.

E n f o r c e r

Colonel Ira L. Reeves bitterly stated at the end of his term that the only thing he had accomplished was that he “had raised the price of alcoholic beverages and reduced the quality.” This was a declaration of frustration and defeat, an admission he had been unable to remove alcohol from the American way of life. In line



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with this assessment, one of the main lessons Okrent derives from Prohibition is that government cannot effectively legislate against people's tastes.

Okrent primarily focuses on the battle between the "wet" and "dry" political movements dating from the mid-nineteenth century until the 21st Amendment and the repeal of Prohibition in 1933. Both sides had their share of notable and influential characters, perhaps none more so than the dry Wayne Wheeler, leader of the Anti-Saloon League (ASL). In the history of American politics, no interest group has been as influential as the ASL and few individuals have had as much direct impact on public policy as Wheeler. H. L. Mencken, a dedicated wet, wrote of Wheeler: "In fifty years, the United States has seen no more adept political manipulator."

Wheeler and the ASL, supported primarily by rural Protestant voters, had a stranglehold over Congress and most state legislatures during most of Prohibition. Okrent writes that the Wheeler-led ASL "effectively seized control of both the House and the Senate in the 1916 elections" and did not loosen its grip until the early 1930s.

Perhaps the most enlightening, and disturbing, revelation in the book is how the ASL became the most powerful pressure group the nation had ever known and how the dry movement was able to enforce its will on a population that loved to drink. Most people are familiar with Prohibition-era stories involving corrupt police and politicians taking bribes from bootleggers like Al Capone. What most people are unaware of, however, is just how openly most members of Congress manipulated the political process to push Prohibition on a largely unwilling public.

A primary reason Prohibition happened was that the dry rural voters in favor of it were vastly overrepresented in state legislatures and in Congress. To get an idea of just how overwhelming this discrepancy was, consider that by 1929 a staunchly wet congressional district in Detroit had a population of 1.3 million, while ten separate dry districts in the Missouri had fewer than 180,000 people total. This disparity

was the work of dry legislators, who blocked reapportionment and thus denied accurate representation to wet districts that were experiencing unprecedented immigration. Okrent summarizes the significance of the situation aptly: "Never in American history, not even during the tumult of Civil War, had Congress disregarded the constitutional mandate, enunciated in Article 1, Section 2, to reapportion itself following completion of the decennial census. . . . Between 1921 and 1928, forty-two separate reapportionment bills were introduced in the House. Not one became law."

Although political manipulation was vital to the dry movement, Prohibition would not have passed if not for the support of one of the broadest coalitions in American history. The diverse movement behind the Eighteenth Amendment and the Volstead Act included such groups as the Ku Klux Klan, the American Medical Association, the women's suffrage movement, and the Industrial Workers of the World, to name a few. Although these groups were diametrically opposed on most issues, each saw potential advantages from Prohibition.

The American Medical Association and Coca-Cola were among those who stood to gain from Prohibition.

Baptists and Bootleggers and Doctors and Coke

Prohibition provides a clear illustration of one of the basic lessons of Public Choice economics: Interest groups use the political process to concentrate benefits on themselves while dispersing costs on others. The AMA, for example, foresaw the potential for a lucrative business providing prescriptions for alcohol under the Volstead Act for roughly \$3 (or about \$33 in 2010 dollars). Although in 1917 the AMA ruled that the use of alcohol in therapeutics "has no scientific value," after two years of Prohibition the organization declared alcoholic beverages to be useful in the treatment of 27 separate conditions including diabetes, asthma, and old age. The AMA's sudden change in medical advocacy was in line with its self-interest.

The AMA was not alone in this regard. Asa Chandler, the founder of the Coca-Cola Company, was an

ardent supporter of Prohibition because he saw the potential to eliminate the competition provided by brewers and distillers. Chandler was rewarded for his vision: Coca-Cola saw sales triple. Charles Walgreen expanded his drug store chain from 20 to 525 stores during the 1920s. Although family historians have credited this expansion to the invention of the milkshake, the profitable trade in medicinal alcohol provides a more likely explanation.

Making Matters Worse

As important as it is to understand how Prohibition passed, it is even more important to understand why it made many alcohol-related problems worse. Prohibition failed in this sense because the policymakers behind it failed to predict how consumers, suppliers, and regulators would respond. Many people continued to drink, and a multitude of bootleggers, violent mobsters, and corrupt politicians were willing to provide a continuous supply.

As with most cases of failed social engineering, the people who advocated Prohibition suffered from a conceit that it would work exactly as intended. The economist Irving Fisher, known for his groundbreaking work on interest rates, claimed in 1919 that Prohibition would increase national output 10–20 percent every year. Although alcohol consumption remained high, Fisher continued to attribute the growth of the 1920s to Prohibition.

Per capita alcohol consumption returned to around 70 percent of its pre-Prohibition levels by 1923 because a multitude of entrepreneurs were willing to operate outside of the law to quench the public's thirst. The infamous Purple Gang controlled the vast alcohol traffic flowing from Canada through Detroit, while New York mobsters like Charles "Lucky" Luciano launched their long criminal careers in the illicit alcohol trade. The notorious Chicago bootlegger and gangster Alphonse Capone said of his profession, "I give the public what the public wants. I never had to send out

high pressure salesmen. Why, I could never meet the demand."

This is not to say that Capone or his contemporaries were unfamiliar with the use of force. Since Prohibition drove the market for alcohol into the illegal sector, men like Capone had to rely on extralegal measures to enforce contracts and resolve disputes. Sometimes these measures included violence. To get an idea of just how much, consider the homicide rate. In the United States it went from less than 12 per hundred thousand people in 1920 to 16 by the end of Prohibition, then subsided to less than 10 by 1940.

Nonviolent Means

Not all bootleggers were violent, however. Men like Samuel Bronfman and William "Bill" McCoy specialized in the importation of alcohol through ports and border towns all over the country. Once these specialists had evaded or bribed Prohibition agents and local politicians to bring their products into the country, they would sell them to gangsters like Luciano who handled the massive distribution to local speakeasies. New York, for example, had roughly 32,000 speakeasies during the height of Prohibition.

Although some Prohibition agents could not be bought, the prevalence of corruption throughout the era was staggering. Okrent illustrates countless examples of rampant opportunism by Prohibition enforcers. Chicago Mayor Bill Thompson, for example, received more than a quarter of a million dollars directly from Capone's organization for his 1927 campaign. Ranking police captains amassed bank accounts approaching hundreds of thousands of dollars on salaries ranging from \$2,500 to \$4,000 a year.

The bootleggers controlling the black market in alcohol were actually more likely to support dry politicians in favor of Prohibition than wet politicians favoring repeal. The logic behind this strategy is simple: Bootleggers and gangsters needed Prohibition to stay in business. If alcohol were legal they would quickly be

As with most cases of failed social engineering, the people who advocated Prohibition suffered from a conceit that it would work exactly as intended.

replaced by legitimate companies. The ideal combination from the criminal perspective was dry policy and corrupt enforcement, and they spent whatever was necessary to make this happen.

To understand why criminals were willing to spend so much to ensure political cooperation and endure work-related hazards like gang warfare, it is necessary to know just how much was at stake. Annual sales of bootleg liquor were estimated at \$3.6 billion in 1926, which is roughly \$43.4 billion in 2010 dollars. This astounding sum was about the same as the federal budget that year.

Why Not More Violence?

Given the stakes, the real puzzle is why *more* violence did not occur. Events such as the St. Valentine's Day Massacre, where Capone's South Side Gang killed seven rival gangsters, garnered a lot of attention in the national press. The extended periods of peace, stability, and even cooperation that occurred both between and within different criminal enterprises, however, have generally gone unnoticed.

Seattle bootleggers convened in 1922 to set prices and, more important, to establish rules to minimize conflict. Similar meetings occurred in Philadelphia, New York, and other major cities throughout the 1920s. Despite the enormous amount of money at stake, most areas of the country where alcohol remained avoided outright gang warfare.

The fact that economic activity of the same magnitude as the U.S. government could be organized outside of the law is surprising for a number of reasons. Those who choose a life of crime tend to be violent, impatient, and untrustworthy by nature. Despite these obstacles, criminals often discover ways to cooperate on a large scale to capture illicit profits.

Besides the use of violence, how did a bunch of violent, impatient criminals manage such organizational stability? They employed reputation, costly signaling, and constitutions as means to enforce agreements and resolve disputes. Criminals worked hard to avoid con-

flikt where possible because conflict is costly. Gangsters like Capone and Luciano were driven to cooperate with other criminals by the same economic forces underlying cooperation between their law-abiding counterparts.

It is important to understand the robustness of criminal organization for a number of reasons. For one, it explains to a large extent why Prohibition was doomed to failure. If there is a strong enough demand, legal prohibitions on certain goods and services will simply shift markets into the waiting arms of the illegal sector of the economy.

That criminals could engage in complex economic interactions outside of the law also illustrates some important lessons for the robustness of self-enforcing exchange in general. If criminals are capable of overcoming major obstacles to organization and exchange, then conventional arguments that the State is necessary for cooperation and exchange to occur must be reconsidered. Even in an environment of mistrust and violence, firms were formed, contracts were honored, and disputes were mostly settled peacefully. A better understanding of these processes can shed considerable light on the ability of individuals to cooperate and trade in the absence of a formal legal framework.

This is not to say that criminal organization is the pinnacle of achievement in a market economy. On the contrary, the experience of black markets brought about by Prohibition illustrates how inefficient they are relative to markets with well-defined and legally enforceable property rights. Overall quality diminished, while fraud, theft, and violence increased. Criminal cooperation also periodically broke down into outright gang warfare, though as noted, this was generally the exception to the rule. The important lesson, however, is that under Prohibition, criminal suppliers found a way to meet the public's demand despite all the obstacles they faced.

Although Okrent avoids making any explicit comparison between the prohibition of alcohol and the



Prohibition launched the careers of gangsters like Al Capone.

ongoing prohibition of certain recreational drugs, there are a number of obvious similarities. Criminal organizations continue to provide a seemingly limitless supply of illegal drugs; quality is low, potency is high, and corruption and violence are endemic.

Some 28,000 people have died in the border war between drug cartels and United States and Mexican government agents since 2006. Street gangs continue to battle over territorial distribution rights. As Nobel Prize-winning economist Milton Friedman aptly said, "Al Capone epitomizes our earlier attempts at Prohibition; the Crips and Bloods epitomize this one."

Examples of Legalization

As was the case with the prohibition of alcohol, advocates of the "war on drugs" often claim that decriminalization would result in a massive spike in drug use. Although it is impossible to know in advance exactly how much consumption would increase, the experience of Portugal could provide some clues. Since the decriminalization of all drugs there in 2001, user rates have not increased and remain near the

lowest in Europe. Sexually transmitted diseases and deaths due to drug usage have decreased significantly (see Glenn Greenwald, "Drug Decriminalization in Portugal: Lessons for Creating Fair and Successful Drug Policies," Cato Institute, April 2, 2009, www.tinyurl.com/dhkzm4).

Just as Coca-Cola and the AMA lobbied for alcohol prohibition because it was in their economic interest to do so, a number of groups have a vested interest in the war on drugs. One illustrative example is the California Beer and Beverage Distributors, which donated money to oppose last year's unsuccessful ballot proposition to legalize marijuana in California. History rhymes in interesting but predictable ways. This behavior is consistent with the lessons of Public Choice. The distributors, like Asa Chandler of Coca-Cola 90 years earlier, see prohibition as a means to eliminate competition.

The unfortunate reality is that despite the diagnosis of failure for prohibitions past and present, policy-makers often prescribe a further dose of the same failed policies. In 1926 Wayne Wheeler said the "very fact that the law is difficult to enforce is the clearest proof of the need of its existence." **FEE**



Today, the drug war does the same for people like Pablo Escobar.

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Inside Insider Trading

BY WARREN C. GIBSON

Insider trading is something we hear a lot about these days. To most people, the practice smells of foul play, and federal law restricts it. But the inside story of insider trading is something very different, as we shall see. The alleged ill effects on shareholders in particular and on the economy in general are mostly illusory, and in fact insider trading produces benefits that are little understood.

If I may first indulge in a little personal history: I was once a corporate insider. Two friends and I started an engineering services firm in 1982, and we set it up as a corporation. The paperwork required to register the corporation was minimal, but the law allowed us to offer shares only to specially qualified individuals, in addition to ourselves and our employees. Actually this rule wasn't binding on us. We didn't want to be answerable to strangers so the only "outsiders" we sold to were a couple of relatives, whom we later bought out.

Most Silicon Valley firms like ours aim to "go public" at some point—that is, sell shares to the general public to raise additional capital and reward early investors. We had no such ambition. We did not want to jump through all the hoops required in an initial public offering, nor did we want the continuing hassle of running a public corporation. (Since that time hassles have been multiplied by Sarbanes–Oxley.) However, we might have benefited from something short of a full public offering, where we would have offered shares to a wider but still limited set of shareholders.

Yet SEC rules allow only a very restricted offering or a full public offering, and nothing in between.

What if we had gone public? The law would have restricted our ability to trade our own shares for reasons roughly as follows: Insider trading would violate our fiduciary responsibility to our shareholders. As managers of a public corporation we would have placed ourselves under a board of directors answerable to shareholders. Our job would be to watch out for shareholder interests, not subordinate them to our own private gain.

There is some truth in these arguments. Shareholders can never be totally sure that management is looking out for their interests. Corporate regulations and employment contracts can do a lot to minimize these "agency problems," as they are called, but perfection is not possible. Purchasers of shares should be aware of the risks they take and act accordingly. But none of this justifies insider-trading restrictions.

Before we delve into insider trading, a little about prices generally and stock prices in particular. Unhampered prices play a vital but little-understood role in transmitting information. Short-term fluctuations aside, stock prices convey investors' aggregate judgment about the earning potential of corporations. If some significant event occurs that would impact that potential, price changes rapidly spread the news that something is up. But "rapidly"



The courts occasionally convict famous people like Martha Stewart for a crime Congress has refused to define.
David Shankbone

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does not mean “instantly,” even in the Internet era. Someone is necessarily first to hear and understand the news, and that person or group can reap gains unavailable to those not in the know. The second wave of traders to find out would gain a little less, and so forth. Is there something unfair about gains and losses due to unequal information? Not if we want the price system to do its job. As gravity keeps water moving downhill, information disparities provide profit opportunities that motivate the trades, which keep information flowing. Indeed, anyone who buys or sells shares (except perhaps someone who sells in order to use the proceeds for consumption) does so because he believes he has information that is not widely known and therefore not adequately reflected in the current price.

Consequences of Restriction

What happens when insiders are not allowed to trade on an important piece of news? That news will get out eventually, and the first people to find out about it will be outsiders just beyond the gates. These will very likely be securities analysts, whose full-time job is to keep abreast of developments in public companies. So they, the firms they work for, and their clients would be the first to benefit from the news. The news will eventually reach most shareholders, but later than it would otherwise. Instead of early profits accruing to insiders, they will accrue to professionals, and this makes no difference to most shareholders, especially long-term shareholders.

During a time when the dissemination of significant news about a company is blocked by insider-trading restrictions, that company’s shares are mispriced relative to where the price would be if the news were out. If the news is bad investors will buy at prices they would not have paid had they heard the news. Movement of capital toward more productive uses is inhibited. If it is good some sellers will let go of their shares at prices they would not have accepted had they heard. Movement of capital toward such firms is inhibited. In either case there is a net loss to the economy.

As gravity keeps water moving downhill, information disparities provide profit opportunities that motivate the trades, which keep information flowing.

Insider trading might have averted the Enron debacle. Enron’s managers were using a complex web of partnerships to keep losses off the books. Several insiders must have had at least partial knowledge of these shenanigans. They would have had substantial incentive to dump their shares or even sell short had the rules permitted it. They might have blown the cover on Enron a lot sooner.

In summary, insider-trading regulations benefit securities professionals, harm insiders, misallocate capital, and have no substantial effect on small long-term shareholders. They may occasionally block the revelation of corporate misdeeds. They do increase the power and budget of the Securities and Exchange Commission bureaucracy, which enforces the rules.

Qui Est In, Qui Est Out

Insider trading is restricted but not entirely forbidden. Just what constitutes the “bad” kind of insider trading? This is generally understood to be trading on information originating within a company that could have a material effect on the share price had it been publicly known. The law applies not only to insiders—employees and directors—but also to any outsiders to whom inside information is disclosed.

As precise as this definition may sound, it rests on some very shaky concepts. First, the source of a particular piece of information isn’t always clear. Second, how is materiality established? Suppose a firm is expected to win a particular contract and an insider learns that it has been lost. If the contract amounts to 1 percent of a firm’s annual revenue, is that material? Ten percent? And how is a defendant supposed to establish that a particular fact was “widely known” at some particular time?

We see that insider-trading regulations are subjective and arbitrary, rivaling antitrust laws in this respect. It is no wonder that Congress never defined insider trading and that the SEC resisted defining it for many years; the courts have had to make up the rules as cases arose. Every so often someone like Martha Stewart is thrown

to the lions, drawing cheers from the jealous and spreading fear to successful and therefore high-profile managers.

Vagueness and subjectivity make insider trading well-nigh impossible to police. Difficult as it is to decide whether a particular transaction violated the rules, it is impossible to police nontrading. What if an insider had planned to sell but, having heard inside good news, decides to hold instead? Insider gains from such inaction could be very real but impossible to detect or punish.

Alternatives to Government Regulation

Shareholders who object to insider trading are usually thought to have no alternative but government regulation. That's just not so. Insider trading could be prohibited or restricted by corporate bylaw provisions. Outside auditors would monitor management behavior, and suspected violations would be referred to arbitrators. It might seem inefficient for small shareholders to expend the time and energy necessary to get together and pursue possible corporate violations. But following David Friedman's innovative ideas on law and economics, we can imagine shareholders selling in advance their rights to recover damages from possible future violations. Specialists could acquire these rights and pursue violations efficiently. Corporate management would be well aware of the watchful eyes of these specialists.

There are several classes of restrictions that might be added to bylaws. A blanket prohibition of insider trading would be unlikely to be adopted because, as we have seen, it could hamper the dissemination of important information. More important, blanket prohibition would likely be frowned on by most market participants, making it more difficult for the corporation to raise new equity or debt capital and thereby suppressing

share prices to the detriment of shareholders big and small. In addition, by depriving insiders of profit opportunities from trading, blanket prohibition would make it more difficult to recruit the best managers.

But there are times when secrecy does serve the shareholders, such as during a takeover bid. Managers of a corporation accruing shares of a takeover target would not want that news to get out prematurely, because if it did, outsiders could bid up the target shares. Just as employees are bound to protect corporate trade secrets, they could be contractually obligated to keep sensitive matters like takeover information secret.

Another possible bylaw provision would merely

require disclosure of insider trading. While this would help get information out faster, it might also discourage insiders and hamper recruitment. Short sales (sales of borrowed stock in anticipation of a price decline) might also be forbidden, likely with mixed results.

Only a free-market trial could show what works and what doesn't.

Any vagueness or inconsistencies in the rules that are tried would become evident and would be discarded or cleaned up. While we can't be sure what would evolve, it does seem likely that some limited restrictions would emerge. Independent agencies could confer ratings on the restrictive practices of particular corporations, and management would be keen on earning a four-star rating.

In summary, insider trading is not the problem it is made out to be. Freely adopted bylaw provisions that impose selective restraints would be superior to arbitrary one-size-fits-all regulations imposed by a politicized bureaucracy. This idea is just one example of a wider argument in favor of contract law over government law. The free market allows for discovery of the best ways to inhibit and punish undesirable behavior—ways politicians and bureaucrats never could discover. **FEE**

Vagueness and subjectivity make insider trading well-nigh impossible to police.



The Charade

BY SHELDON RICHMAN

Writing in *Forbes* recently, Dinesh D’Souza presents the bizarre idea that Barack Obama’s presidency can be best understood by realizing that “Incredibly, the U.S. is being ruled according to the dreams of a Luo tribesman of the 1950s [that is, Obama’s late estranged Kenyan father]. This philandering, inebriated African socialist, who raged against the world for denying him the realization of his anticolonial ambitions, is now setting the nation’s agenda through the reincarnation of his dreams in his son.”

D’Souza needs to get out more. Specifically he should have a talk with Timothy Carney and Charlie Gasparino, whose books demonstrate beyond question that the best phrase to sum up Obama’s presidency is not “African anti-colonial socialist” but “American Progressive corporatist.” Carney’s 2009 book is titled *Obamanomics: How Barack Obama Is Bankrupting You and Enriching His Wall Street Friends, Corporate Lobbyists, and Union Bosses* (it was reviewed in the June 2010 *Freeman*: www.tinyurl.com/36uneaz). Gasparino’s recently published book is called *Bought and Paid For: The Unholy Alliance Between Barack Obama and Wall Street*. Neither writer could be mistaken for a left-winger.

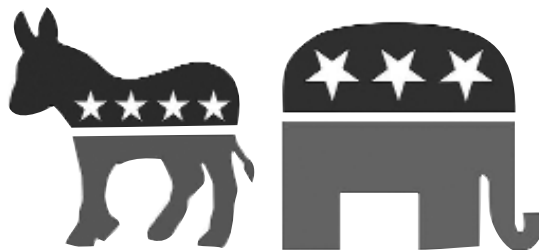
The political establishment, helped by the mass media and intelligentsia, has long played a game in this country. It consists in depicting the competition for power as between two blocs: one hostile to business in the name of social justice, the other friendly to business in the name of “the free market.” Each bloc’s talking points and pet projects are calculated in superficial ways to reinforce its signature theme. Whenever the blocs

need to rally their respective bases, they accentuate their surface differences. The “antibusiness” bloc accuses its opponents of being, say, Wall Street lackeys, while the “pro-free-enterprise” bloc accuses its opponents of being, say, socialists.

It’s all a sham that serves each side’s interests. The rivals actually want two variations of the same thing: the corporate state, a system of economic privilege that transfers wealth via government from market entrepreneurs, workers, and consumers to well-connected business interests.

What we have are two factions of a single establishment. Differences in rhetoric notwithstanding, both are friends of and beholden to big entrenched manufacturers (military contractors lead the way) and big financial institutions. Neither faction wishes to do anything to undermine the interests of these businesses. And for their part, the business people have no desire to antagonize either side. They need one another: The politicians need the

campaign funds and economic cooperation; the businesses need the subsidies, guarantees, low interest rates, and impediments to competition. The banks in particular need friendly relations with politicians (federal, state, and local) who float debt that brings big fees for bond underwriters. It’s one close and lucrative alliance (which is not to say the various parties agree on every detail). Thus it has been throughout American history. (Doubters should consult Arthur A. Ekirch, Jr.’s classic, *The Decline of American Liberalism*.)



Both parties want the corporate state; they only differ on which well-connected business interests should receive the benefits.

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Obama to the Rescue

Enter Barack Obama. “For the most part, Obama had been good to the banks—really good. They’d gotten everything they wanted in terms of bailouts and handouts and reaped enormous profits because of it,” Gasparino writes. “. . . The fact of the matter is, when you strip away the name-calling and class warfare coming from the Obama administration, and when you ignore Wall Street’s gripes about the new financial reform legislation that will put a crimp in some of its profits, these two entities are far more aligned than meets the casual eye. They coexist to help each other—in an unholy alliance against the American taxpayer.”

Gasparino points out that Obama signaled his eagerness to be Wall Street’s friend at a meeting with the big players during his presidential campaign, and they came through with the money. Wall Street had no reason for remorse when they saw his economic appointments and advisers: Timothy Geithner (formerly of the New York Fed), Lawrence Summers (Treasury secretary under Bill Clinton and former World Bank president), Paul Volcker (former Fed chairman), Robert Rubin (formerly of Goldman Sachs, later of Citigroup), Ben Bernanke (reappointed as Fed chairman), Rahm Emanuel (formerly of Goldman Sachs), and Greg Craig (a political insider who has gone on to represent Goldman Sachs from one of the nation’s top law firms). Many other Wall Street insiders, whose names are not so well known, have the President’s ear.

Gasparino’s thesis is confirmed by the essential continuity between the Bush and Obama administrations. Wall Street got first consideration beginning when the rotten fruit of bipartisan housing and monetary policies became apparent. If anything, the Obama team has substantively treated Wall Street better than the Bush team did. The Fed has gone into the business of allocating

capital selectively, buying up mortgage-based and other “assets” of dubious value from institutions deemed too big to fail. One must guard against being deceived by political rituals. The Dodd-Frank financial “reform” is portrayed as the long-overdue taming of Wall Street, but no one who pays close attention believes that. The usual players will help write the myriad rules the new law calls for, and they are not likely to harm the insiders’ interests.

Sure, Obama bashed Wall Street last fall. No surprise: There was a campaign on and his party was in deep trouble; unemployment was stuck above 9.5 percent; and the disillusioned base needed rallying or it might

The American political system is an intramural competition between two rival factions that favor government management of the economy on behalf of special interests.

not have shown up at the polls. The bigwigs at Goldman and the other firms may not be happy about the rhetorical roughing-up. They may even be concerned that a desperate Obama will do something in the short run that could reduce the growth of profits and executive pay. Such uncertainty is surely one reason for the reluctance to invest and slow recovery. But it’s unlikely that any big player fears that the future holds a radical anti-capitalist revolution.

The daily talk-radio and cable-news alarms about this being the most radical left-wing administration in U.S. history should be chalked up

to base-rallying on the other side. As I suggested at the outset, the American political system capitalizes on the division in public opinion over the role of government by propagating the myth that there is a grand war raging between the advocates of Big Government and the advocates of Free Markets. In fact, it’s an *intramural* competition between two rival factions that favor government management of the economy—with a few differences in detail—on behalf of special interests.

Why the charade? All the better to exploit the productive classes, those that would be prospering in a freed market. FEE

Some Constructive Heresies of Wilhelm Röpke

BY JOSEPH R. STROMBERG

Wilhelm Röpke was a pro-market liberal who helped found the Mont Pelerin Society in 1947 along with F.A. Hayek, Ludwig von Mises, and Leonard Read. But he has some significant differences with Anglo-American classical liberals that are worth exploring.

Born in Schwarmstedt in northern Germany in 1899, Röpke came from a family of Lutheran ministers and medical doctors. After his time in World War I he studied law and economics and embarked on a career as an academic economist. A firm opponent of National Socialism, Röpke was forced to “retire” in late 1933 and left Germany. He taught briefly in Turkey before settling permanently in Switzerland, whose tough and sturdy bourgeoisie he came to admire.

The intellectual historian Razeen Sally notes that Röpke produced around 900 publications. His books include *Economics of the Free Society* (1937, 1963), *International Economic Disintegration* (1942), *The Solution of the German Problem* (1946), *Civitas Humana* (1948), *The Social Crisis of Our Time* (1950), *International Order and Economic Integration* (1959), and *A Humane Economy* (1960; see *The Freeman’s* review at www.tinyurl.com/mh8d69). In Germany, the Röpke *Stiftung* (Institute) keeps alive his work and memory.

Röpke was closely identified with Germany’s “Neo-Liberals” (or “*Ordo* liberals”), who included Walter Eucken, Alexander Rüstow, Alfred Müller-Armack, and Ludwig Erhard. Writing in the aftermath of Weimar and National Socialism, these men wanted competition

and free price movement ensured by a strong State (more on this shortly). Favoring a social-market economy, they served as architects of the West German economic “miracle.” While Anglo-American liberals claimed to be aggregating and balancing interests, German Neo-Liberals wanted an honest (and rather rational Hegelian) civil service to establish and preserve free competition. Seeing “planless” State intervention in aid of organized interests as the key problem, Neo-Liberals wished to block the influence of private “social power” over State policy and foster the common good.

Röpke believed strongly in the market mechanism and free price movement, but saw a role for a strong State.

For conservative economist William Campbell, Röpke was a Protestant thinker in the line of Erasmus and Grotius, despite his adoption of the Catholic principle of subsidiarity. His work displayed distributist and radical Jeffersonian themes along with a dislike of entrenched aristocracies, and he distrusted what Campbell called “scientific approaches to the production process,” such as Taylorism.

Röpke’s work in technical economics bore considerable resemblance to that of the Austrian school. Believing strongly in the market mechanism and free price movement, Röpke was nevertheless quite critical of modern business practices, corporations, advertising, and more. As he wrote in 1958, “[A]ctually existing forms of market economy . . . are a far cry from the assumptions of theory.” Social conditions shape outcomes “beyond supply and

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demand.” In 1929-30 Röpke argued that once a depression is under way, modest “reflation” to stimulate new demand may be called for. This argument for compensatory credit expansion can hardly be rejected out of hand—despite a partial agreement with Keynes—and a number of Austrian economists have taken a similar position. (Certainly he later rejected Keynesian methods as a *normal* part of State fiscal policy.)

One of Röpke’s central concerns was restoration of the world market crippled by World War I. Economically the world before 1914 had been “*virtually* a unit.” Customs duties were “merely data,” and there were no “raw materials” problems. The “gold standard was a working fiction of a real ‘world money’” with London at its center. In its heyday this order had promoted social and international peace. Pre-war protectionism had, however, fostered domestic monopoly, but Röpke lost little sleep over the modest tariffs of a bygone age. Instead, it was heavy State involvement in national economies (national corporatism) during World War I and between the world wars that concerned him.

The old trading system had not been a self-sustaining natural order but had had an “extra-economic . . . framework of moral, political, legal and institutional conditions.” Röpke’s views on international trade—“liberalism from below” by agreement of independent nations—appear to conflict with the current American top-down globalization model, even if Röpke showed some affection for the Pax Britannica. Under reasonably free trade there would be no special problems of “raw materials” and “living space,” and business as such was not the source of imperialism. Instead, States were the key promoters of monopoly, and if monopoly led to empire, State policy remained the most important cause.

While opposed to national corporatism, Röpke was perhaps insufficiently critical of the post-1945 (and U.S.-led) multilateral corporatism (“embedded liberalism”) of GATT and the ITO. On the other hand, he criticized exported U.S. inflation from the late 1950s onward and generally frowned on the top-down eco-

nomic management of the Common Market, ancestor of the European Union.

Reflecting in 1946 on the disastrous course of German history in his *Solution of the German Problem*, Röpke applied his historical and economic ideas to the renewal of German political and economic life. As he saw it, a proper federal equilibrium had never existed in Germany. In late-medieval and early modern times, communal (town-based) decentralization succumbed to powerful feudal magnates making the transition to absolutism and bureaucratic management (“state feudalism”). On the land in western Germany free peasants emerged; to the east in Prussia “feudal” magnates successfully suppressed the peasantry. This dualism of agrarian structure persisted into recent times. Prussia’s

underdeveloped cities posed no counterweight to the East-Elbian landed aristocracy (Junkers), and the factory-like Prussian state made society rational, mechanical, and clock-bound—whence inhuman Kantian “ethics” and the Prussian “cult of the colossal.”

German unification had been less organic than that of Italy. The new central state (from 1871) dominated by Prussia adopted elements of economic liberalism and abandoned them as needed. Here was a top-down social revolution involving proletarianization, population increase, mass conscription, State education, and the rise of atomized mass society. Subsidized, cartelized, hierarchical, and centralized as it was, German capitalism was “*the prototype of monopoly-and-proletariat capitalism . . . of rigidly organized industry*” looking toward “*organized socialism*” (italics in original).

The ideal political revolution would have constrained Prussian domination, while the ideal “*economic and social* revolution” would have required “agrarian reform breaking up the great estates and putting peasant farms in their place,” and tariff abolition to undermine industrial cartels. Interestingly, important Social Democrats opposed agrarian reform as necessarily backward and unprogressive.

Now—in 1946—something positive could be done about German agrarian and industrial “feudalism” and

One of Röpke’s central concerns was restoration of the world market crippled by World War I.

their attendant evils. Ideally, a new German revolution—sponsored by the Allies—would dissolve Bismarck’s imperial edifice in favor of the *Länder* (states). Local administration had survived the collapse of the National Socialist state, and the Allies could *revive* the constituent German states by negotiating a separate peace with each one, effectively dissolving the Reich. The Allies, Röpke thought, should also enforce “complete free trade, external and internal, for all these German states” to assure German economic viability in spite of political decentralization, thereby preventing the persistent poverty envisioned in the punitive Morgenthau Plan. Allied-enforced free trade would undermine the old order of cartels. As to Germany’s new political structure, a working compromise between a *Staatenbund* (confederacy) and a *Bundesstaat* (federal state—in the unfortunate American sense) would be required.

Röpke’s treatment of the German case reflected a broad historical vision. He spied a “plutocratic taint” in early capitalism and wrote that historical (and actually existing) capitalism featured “monopolies, mammoth industries, stock corporations, holding companies, mass production, proletariat,” and was thus “very misshapen” indeed. (This line of analysis parallels that of Franz Oppenheimer, who was a direct influence on Albert Jay Nock, Rüstow, and Röpke.)

The “feudal-absolutist heritage” resulted in “immense accretions of capital and economic positions of power which endow capitalism with that plutocratic taint which clings to it”—giving it “a false start from the very beginning.” But “violent contrasts between rich and poor, between power and impotence, are rather due to extra-economic (‘sociological’) positions of power” such as “feudal land holding . . . profits from the slave trade . . . war and speculative profits . . . pirates’ and soldiers’ booty, monopoly, concessions granted in the age of absolutism, plantation dividends, and railroad subsidies.” Such things were the *basis* of later “development.” Some were now gone; some, like “feudal mining properties,” lingered as “strongholds of robber barons. . . .” Thence came the *odium* unjustly

extended to all market activity. As for that emblematic nineteenth-century investment—railroads—they had been premature and inflationary.

Consistent with this approach, Röpke found mass society and proletarianization central to the twentieth-century crisis. And where had proletarians come from? His answer: *Political* power made them, even if their numbers (population) increased later. In both eastern Germany and England (especially in the seventeenth and eighteenth centuries) dispossession of peasants created a reservoir of cheap industrial labor. In Röpke’s opinion, *Capitalism and the Historians* (1954), a book on the Industrial Revolution edited by Hayek, swung “too far the other way,” but could not dispose of proletarians—whatever their caloric intake may have been—and the social “catastrophe” that came with them.

Such phenomena had feudal-absolutist causes in Europe—but why then did we see *much the same results* in the United States? Here Röpke refers to Oppenheimer’s “political means” to wealth. The State, whether feudal-absolutist or not, made possible interest-group politics, and American democracy had long allowed “vested interests to flourish unchecked.”

Indeed, the interpenetration of interests and bureaucracies “has probably reached its highest degree in the United States”! For Röpke the underlying cause of the evil was “the division of labor, pushed to extremes, and interlocking everything in the most complicated manner”—an unnecessary result since division of labor *could* in fact be “more humane and natural, and less mechanical and proletarian.”

Röpke announced his “Third Way” revisionist liberalism as early as 1941 in the *Swiss Journal of Economics and Statistics*, calling for the *restoration* of competitive markets and distinguishing good economic intervention from bad. He contrasted the industrial division of labor—*within* a firm or factory—with the *social* division of labor in which markets coordinate “activities of independent units.” Real, functional independence was what distinguished market economies from socialism, while excessive division of labor led “increasingly to mechanization [and] monotonous uniformity.” The

American democracy
had long allowed
“vested interests to
flourish unchecked.”

obvious antidote for Röpke was widespread ownership of productive assets: deproletarianization through small property. Where possible, the realm of self-provision outside the market should be expanded and competition *enforced*.

On Röpke's rather institutionalist view, State and economy are not and cannot be entirely separated except for purposes of analysis. As noted, he—like other German Neo-Liberals—saw interest-group liberalism as false pluralism: “Unhealthy pluralism . . . is not defensive but offensive. It does not limit the power of the state but tries to use it for its own purposes and make it subservient to these purposes.” Here then is a kind of socially conscious liberal cameralism as opposed to corporate syndicalism.

The false or unhealthy market economy rested on “legal forms and institutions”—“stock companies, the corporation, patent law, bankruptcy,” trusts, and so on, supported by legislation. Indeed, “the growth of the corporation with its much discussed but unfortunately too seldom remedied abuses has led more and more to the assumption of risk by the community.” The State's job was to defend competition and *refrain* from favoring monopoly.

Röpke favored free movement of prices rather than a command economy, but insisted on a suitable legal-social framework, in stark contrast to the kind of liberal who imagines that private property and free price movement themselves constitute a social order. To achieve such fit legal foundations, Röpke suggested the need to overhaul laws dealing with bankruptcy, corporations, patents, money and banking, and antitrust. He saw economic concentration as being in particular the product of company law and tax policy. The low birthrate of new firms (as of 1960) surely reflected “something fundamentally wrong with the capital market and the tax system.”

For Röpke the best counterweight to the State was “the minimum economic independence for the individual which in turn is based on a minimum amount of property, economic freedom and security of existence.” Only a market economy could produce favorable out-

comes—but what kind of market economy? Real independence was “jeopardized by proletarianisation, by concentration of private economic power, by increasing organization and monopoly, by cartels and associations, by agglomerations of financial interests, by corporatism, by the private planning of vested interests, in short by ‘business collectivism’”—which resembled (at best) a kind of feudal-authoritarian decentralization. The market required mutual trust, long-run legal stability, an ethic, as well as “certain psychological-moral reserves.” The economy was not “an autonomous sphere of rational behavior,” and philosopher Max Scheler (an important influence on Pope John Paul II) had shown that “contractual cooperation of men . . . cannot work without genuine communities.”

Röpke insisted that free markets require a moral framework outside themselves in order to work optimally. The market is only defensible “as part of a wider general order encompassing ethics, law, the natural conditions of life and happiness, the state, politics, and power.”

Röpke could perhaps be seen as wanting precisely the combination of “free market and strong State” some writers associate with Margaret Thatcher and Ronald Reagan. But in that model (also called “neo-liberal”) the strong State pursues a two-pronged strategy of “starving” the welfare beast while feeding the military-industrial one—the latter being (beyond controversy) a great den of special interests. Empirically, then, it appears that the Thatcher-Reagan regimes involved the triumph of new political coalitions working—free-market rhetoric notwithstanding—wholly within the logic of interest-group liberalism. (Financial magicians might also be mentioned.)

In Röpke's Neo-Liberalism the State is “strong” in an *ethical* and not just a structural sense and is therefore able to resist special-interest pressures, whatever their ideological coloration. It is of course nearly impossible for Americans to believe that a neutral and ethical civil service can exist (or ever has existed) anywhere. But as John Taylor of Caroline, Hans-Hermann Hoppe, and Röpke have suggested, republican forms of government

On Röpke's rather institutionalist view, State and economy cannot be entirely separated.

are the special prey of well-organized, rent-seeking interests.

Liberal and Libertarian Constructs

But, alas, Röpke frequently mentioned “regulation” and even “planning.” Here acquired reflexes will inevitably kick in, with sundry classical liberals shouting “statism” in a crowded tea party. But does Röpke’s model really differ *so much* from certain liberal-to-libertarian constructs? Let us consider some of those. In the educational model associated with F. A. Hayek, dedicated scholars put in decades of work, eventually turning the tide of public opinion, whereupon the State relents and *gives* us free markets. This plan is as old as the Physiocrats’ idea of persuading an absolute monarch to impose their vision of free internal markets on all of France. A good idea, no doubt, but it was *the State* that would do the imposing.

Next comes the model in which a libertarian legal code solves all our problems. All we need do is have a *revolution* of some sort. In one variant a kind of Patriot King will rally the masses behind a right-wing populist agenda. This “libertarian” man on horseback will then dismantle the State and give up his own (State-like?) power when his State-smashing frenzy is over. The law code being in place, we are asked to believe that thenceforward individual contracts undertaken in a complete ethical vacuum will constitute society. (This version does not have probable success written all over it.)

So here we arrive at some common paradoxes of libertarian *policy-making*. Everyone concerned wants a government of laws and not of men, but this unlikely outcome demands some automatic *mechanism* to replace the fallible men. Have we ever seen such a

mechanism? In practice it seems, everyone wants the State, or some suitably stateless-looking substitute for the State, to impose his or her program. On balance, Röpke’s ideal of a genuinely neutral and ethical civil service with a limited agenda subordinated to the common good does not seem *more* utopian than the proposals just sketched.

Institutions and Culture

Röpke’s Third Way, with its revision of liberalism and its slight tilt toward distributism and agrarianism, has the virtue of foregrounding issues of economic sociology, institutions, and culture, which everyday classical liberalism and libertarianism contrive to ignore.

His specific insights and themes—however radical-reactionary and Romantic they may seem—ought to be of interest to all who see a need to combine the insight that markets are very useful with “thicker” social theory able to take account of community, shared values, and nonmaterial interests. Front Porch communitarians, “civic republicans,” left libertarians, conservatives, and many others might do well to revisit Röpke from time to time.

Perhaps Röpke was mistaken in thinking that, absent his ideal ethical and neutral State, people surrounded by “thin” markets could not generate essential “thick” (intermediate) social-cultural relationships. If he was wrong, then arguably it is naturally generated thick libertarianism that would in fact be the true Third Way. Röpke’s own experience, however, convinced him that non-neutral States and capitalism (in a negative sense here), working in tandem, had done so much damage (as in Germany)—and for so long—that it would be idle to rely on society to reconstitute itself in the short run.

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Röpke’s Third Way has the virtue of foregrounding issues of sociology, institutions, and culture that everyday libertarianism ignores.



Congress Can't Repeal Economics

BY JOHN STOSSEL

It's raining! I don't like it! Why hasn't Congress passed the Good Weather Act and the Everybody Happy Act?

Sound dumb?

Why is it any dumber than a law called the Patient Protection and Affordable Care Act, which promises to cover more for less money?

When Obamacare was debated, we free-market advocates insisted that no matter what the President promised, he and Congress couldn't repeal the laws of economics. Our opponents in effect answered, "Yes, they can."

Well, Obamacare has barely started taking effect, and the evidence is already rolling in. I hate to say we told them so, but . . . we told them so. The laws of economics have struck back.

Health insurers Wellpoint, Cigna, Aetna, Humana, and CoventryOne will stop writing policies for all children. Why? Because Obamacare requires that they insure already sick children for the same price as well children.

Sick Children

That sounds compassionate, but—in case Obamacare fanatics haven't noticed—sick children need more medical care. Insurance is about risk, and already sick children are 100 percent certain to be sick when their coverage begins. So if the government mandates that insurance companies cover sick children at the lower well-children price, insurers will quit the market rather than sandbag their shareholders. This is not callousness—it's fiduciary responsibility. Insurance companies are not charities. So, thanks to the compassionate Congress and President, parents of sick children will be saved from expensive insurance—by being

unable to obtain any insurance! That's how government compassion works.

In 2014, the same rule will kick in for adults. You now know what to expect.

This is just the beginning of reality's backlash. President Obama promised that under his scheme no one will have to change medical plans, but some 840,000 Americans are already left without coverage because their insurer, the Principal Financial Group, decided to leave the market.

"[T]he company's decision reflected its assessment of its ability to compete in the environment created by the new law," the *New York Times* reports. "Principal's decision closely tracks moves by other insurers that have indicated in recent weeks that they plan to drop out of certain segments of the market. . . ."

A recent bombshell was that McDonald's may drop coverage for its 30,000 workers unless the Obama administration waives some rules. The central planners of the Obama administration decided in their infinite wisdom that all insurers should spend at least 80 to 85 percent of their revenues on patient care, a mandate aimed at minimizing administrative costs. It's natural to assume that higher patient-care ratios are better for consumers, but there's no proof of that. Health economist James C. Robinson explained years ago that "medical loss ratios" are just an accounting tool and were "never intended to measure quality or efficiency. . . . More direct measures of quality are available."

Obamacare has barely started taking effect, and the evidence is already rolling in. I hate to say we told them so, but . . .

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

The *Wall Street Journal* reports: "Insurers say dozens of other employers could find themselves in the same situation as McDonald's. Aetna Inc. . . . provides [similar] plans to Home Depot Inc., Disney Worldwide Services, CVS Caremark Corp., Staples Inc. and Blockbuster Inc., among others, according to an Aetna client list."

McDonald's may get a waiver, but I like the Cato Institute's Michael Cannon's take on that: "Sorry, but I don't find it comforting that Obamacare gives HHS the power to waive these regulations on a case-by-case basis. Power corrupts. We've already seen HHS Secretary Kathleen Sebelius use other powers granted her by Obamacare to threaten insurers who contradict the party line."

HHS has used its power to grant special exemptions to McDonald's and threaten insurers who speak out against the party line.

In a letter to the trade group America's Health Insurance Plans, Sebelius wrote there would be "zero tolerance" for companies that attribute "unjustified rate increases" to Obamacare. "Simply stated," she wrote, "we will not stand idly by as insurers blame their premium hikes and increased profits on the requirement that they provide consumers with basic protections."

In other words: "We have repealed the basic laws of economics. Insurance companies must now give people more but not charge them for it. If you do charge more, you must not tell your customers why. Shut up, obey, and don't complain. We are your rulers." **FEE**

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Book Reviews

Plain, Honest Men: The Making of the American Constitution

by Richard Beeman

Random House • 2009/2010 • 544 pages • \$30.00
hardcover; \$18.00 paperback

Reviewed by Joseph R. Stromberg



This book is a well-executed account of the Constitutional Convention, clearly the fruit of many years of scholarly work. It will doubtlessly and quite deservedly come to be seen as one of the best nationalist accounts of the origins of the Constitution. (And since nationalist accounts hold American historical writing under military occupation, the book's status is assured.) Interesting character sketches enliven the narrative, and appropriate attention is paid to events inside and outside the Convention. Naturally the focus is on crucial debates “in doors” and the key turning points and compromises that produced the final constitutional text. Beeman's discussion of the 11-day head start enjoyed by a cadre of early-arriving Virginian and Pennsylvanian centralizers is quite arresting.

So here is a very good book of its kind. Some problems lie, however, in the teleology, optimism, and undemonstrable assumptions that mark the genre to which it belongs—that is, the literary form that John Rao irreverently calls “founderology.” Forewarned, we know how things must unfold: zealous, gifted statesmen with a superior Continental Vision struggled against “provincial” stupidity, “power,” and “interest.” Anti-constitutional skeptics acted out of “fear” or “old republicanism,” while nationalists acted (mostly) out of reasonable concerns and timely ideas, and with an eye to economic growth.

Much like his “plain, honest” founders, Beeman (professor of history at the University of Pennsylvania) frequently invokes “THE people” and the sovereignty residing in them. Without further analysis the second notion seems of no more use than Cuba's “ultimate

sovereignty” over Guantánamo Bay. As for “THE people,” one thinks of historian Edmund Morgan's claim that founder-in-chief James Madison “invented” the (singular) American people. This is true enough in a way but raises the question whether Madison had any business doing so. Nationalists apparently conceived the People—not yet fully existing as one—as prime matter needing the *form* the framers wished to supply. The whole business confuses words, relations, and things, reverses itself as needed, and ends with nationalist ideology taking the board.

Elsewhere, Beeman is realistic about the clauses counting three-fifths of slaves in figuring representation in the House and forbidding Congress to end imports of slaves before 1808. The latter provision was cold-bloodedly traded for allowing Congress to pass navigation acts by ordinary majorities. Despite later complaints in New England (whose intellectuals—different ones—invented both abolitionism and the pro-slavery ideology), there was no chance that the Convention would address slavery in ways that would please modern people.

Beeman stresses turning points in the Convention but also misses some. One he misses is Hamilton's defense on June 19, 1787, of the Convention's right to *violate* the representatives' instructions in such a great emergency (see Charles C. Tansill, ed., *Documents Illustrative of the Formation of the Union of the American States*, 1927, 776ff., which, if nothing else, foretells his later construction of such constitutional mysteries as the Necessary and Proper clause.) Beeman also overlooks the creative writing of Gouverneur Morris (the biggest wheel on the Committee of Style), who later admitted working his own ideas into Article III on the judiciary (see Wythe Holt, “The First Federal Question Case,” *Law and History Review*, 1985, 187–189). If committee men could *amend* the draft, why debate and vote on the details?

Throughout, Beeman slides past conceptual traps like divided sovereignty, only to concede their problematic character in the last several chapters. See, for example, his discussion of the preamble—as improved by Morris—where dropping the names of the states (just after “We the People”) “seemed to suggest that the people of the *nation* possessed that sovereign power”

claimed by the states. Yet Beeman clearly sees that changes in already ambiguous language may not entirely resolve things.

Beeman skirts some telling remarks made in the Convention. The “intemperateness” of Martin, Lansing, Paterson, Bedford, Gerry, and Mason seems insufficient ground for dismissing as mere provincial error the serious questions those critics raised. “Mason railed against the separate existence of a ‘federal territory’ predicting that it would become a ‘sanctuary of the blackest crimes.’” Surely not!

I will now add my two cents. On June 9, 1787, William Paterson of New Jersey observed, “We are met here as the representatives of 13 independent, sovereign states, for federal purposes. Can we consolidate their sovereignty and form one nation, and annihilate the sovereignties of our States who have sent us here for other purposes?” Well, *could* they? Hamilton’s integral nationalism, Madison’s incoherent divided sovereignty, and John Taylor of Caroline’s anti-Federalist (that is, anti-nationalist) republicanism have given answers. We are overrun with “original intentions” and interpretations of them. Still, it may be that continued (and peaceful) relations among 13 concrete political societies did not require nearly as much structure as certain framers hoped to supply. If so, Taylor may yet have the last laugh. **FEE**

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Why American History Is Not What They Say: An Introduction to Revisionism

by Jeff Riggenbach

Ludwig von Mises Institute • 2009 • 212 pages • \$15.00

Reviewed by George Leef



In one of his most iconoclastic essays, “The Anatomy of the State,” Murray Rothbard observed that it is crucial to ruling groups to manipulate the thinking of the ruled. They must get the populace to accept that the rulers are truly good people working tirelessly to advance the common good. Toward that end, the rulers

employ a bag of tricks, among them the writing of history to cast the State in a positive light.

Such accounts do not have to be and usually aren’t downright false. The writers need only select the “right” facts to create the desired impression.

The task of historians who understand that the pro-State accounts are misleading is difficult, requiring not just that they write differing, corrective narratives, but also that they fend off the inevitable reaction that they are doing something “unpatriotic” in undermining belief in the saintliness of our government.

In this book Jeff Riggenbach introduces his readers to revisionist historians who have sought to change the way Americans understand their history. If you have never heard of Charles Beard, Harry Elmer Barnes, James Martin, William Appleman Williams, or other revisionists, the book will inform you how they came to reject the conventional view of our history and the impact of their work.

Consider first the Constitution. Most Americans believe that the nation was facing a crisis under the Articles of Confederation, so a group of wise and public-spirited men assembled to draft a much better and indeed nearly ideal plan of government. Revisionists have punctured both of those notions. There was no crisis under the Articles, and as for the Constitution, its somewhat vague language did not—and perhaps was not meant to—prevent the reemergence of a government that could assist favored commercial interests. History professor Arthur Ekirch wrote that the Constitution provided “a skeleton for the further development of a strong paternalistic state.”

What about the Civil War? The standard view is that the states of the Confederacy acted illegally in seceding from the Union and did so to preserve slavery. If you accept that, the war looks justified. Beard and Williams, however, saw things differently. Williams argued that “the cause of the Civil War was the refusal of Lincoln and other northerners to honor the revolutionary right of self-determination—the touchstone of the American Revolution.” Regarding slavery, Beard observed that abolition had never appeared in the platform of any major political party and few northern citizens cared about it, much less wanted war over it.

American involvement in World War I has also come in for a great deal of criticism from revisionists. The pro-State line is that President Woodrow Wilson had to bring the United States into the war to keep the vicious Germans and Austrians from crushing the peaceful, democratic Allies, and that mission was brilliantly accomplished. Harry Elmer Barnes, among others, thought the prowar, pro-Wilson adulation was absurd. Moreover, it took Americans' attention away from the fact that the war had caused a shocking deterioration of liberties we had always taken for granted.

Okay, but World War II ("the good war") is certainly above question—right? No. A number of revisionists maintain that the Roosevelt administration contrived to put the Pacific Fleet in Hawaii as bait for the Japanese (a top-ranking admiral was sacked when he complained about moving it from San Diego to Pearl Harbor), made diplomatic moves in November 1941 intended to provoke the Japanese, and gave the commanders in Hawaii no warning of the likelihood of an attack.

Revisionists have similarly taken a skeptical view of the Cold War, Vietnam, and Iraq. Nor have their efforts been limited to challenging pro-State justifications for war. Some have worked to correct conventional beliefs about our economic history, especially the Depression and the New Deal.

A remarkable fact about the revisionists is that although they come from different political philosophies (Riggenbach groups them as "Progressive," "New Left," and "Libertarian"), they have come to conclusions that are quite consistent. *State power is predatory and harmful, except to some special interests.* No, the Progressives, new leftists, and libertarians don't agree on everything, but there's more commonality than you might expect, particularly when it comes to war.

Riggenbach argues that the terms "left," "right," "liberal," and "conservative" themselves need revision. Those terms arose from the French national assembly following the overthrow of Louis XVI, where deputies who wanted to conserve the old order of strong governmental control mostly sat on the right side, while those who advocated more individual liberty sat on the left. Therefore, he argues, we currently have two "con-

servative" parties since both Democrats and Republicans mostly want to maintain the statist, corporatist status quo.

An enlightening and provocative book.

FFB

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Why Not Socialism?

by G. A. Cohen

Princeton University Press • 2009 • 92 pages • \$14.95

Reviewed by Art Carden



In the late 1980s and early 1990s, the Soviet Union collapsed, the Berlin Wall came down, millions were lifted out of oppression, and the Mises/Hayek critique of socialism was (supposedly) vindicated. As the world slogs through the continuing recession, however, dissenting voices grow louder. The late G. A. Cohen, an iconic political philosopher of the left who taught at Oxford University, offers one of those dissenting voices in *Why Not Socialism?* In this short book Cohen offers a defense of socialism that some will find superficially appealing, but he utterly fails to persuade. The case for socialism remains thoroughly refuted. Practically speaking Cohen and other socialists offer not an enlightened and superior moral system but a recipe for the destruction of civilization.

Cohen provides what he terms "a compelling preliminary case for socialism." He proceeds to identify two desirable features of a camping trip—equality and community—and then asks readers to consider whether those principles don't also make socialism desirable for whole societies. Later he discusses the feasibility of socialism but never responds to the criticisms made by Mises and Hayek. Cohen thus builds his case on a foundation that was blasted to rubble decades ago.

He argues (rightly, in my view) that few would like a camping trip in which every act of cooperation took place within formal markets and explains persuasively why personal relationships are not mediated through

markets. I do not charge my children for attending to meals and bath time, nor do I expect to be paid for accepting dinner invitations. There certainly are degrees to which our daily affairs are organized along “socialist” principles, but that’s irrelevant to the economic critique of socialism, which concerns economic calculation in a complex society when the means of production are not privately owned. As Mises and Hayek have shown, such calculation is impossible.

Arguments for socialism, Cohen’s included, crumble when they fail to recognize the problems inherent in socialist production. In constructing his example of the camping trip, Cohen begins by assuming “facilities with which to carry out our enterprise: we have, for example, pots and pans, oil, coffee, fishing rods, canoes, a soccer ball, decks of cards, and so forth.” The questions of what should be produced and how have just been assumed away. Cohen’s hypothesized camping trip is also (I assume) voluntary, which is at odds with the coercive nature of socialism.

For Cohen socialism’s problem is that designing production processes is difficult, but he thinks the problem can be solved by wise technicians and bookkeepers. Further, he seems not to understand the problems of competing claims to productive resources and competing ideas about what should be produced. Cohen doesn’t say what he would do with people who don’t wish to be reacquainted with their “species-essence,” as Marx put it, by abandoning the market in favor of allegedly “natural” socialism. Most telling of all, he never mentions the mountains of corpses produced by those who tried to implement his vision in the twentieth century. How do we avoid “the worst getting on top,” as Hayek put it?

Cohen calls the free market “a casino from which it is difficult to escape” and denounces the inequalities it produces. Markets, he contends, are based on greed and fear, but even if that charge were true, it isn’t clear that centralized control of the means of production would be an improvement. The organization of production, as he sees it, is a question of overcoming greed and harnessing generosity. Only someone who knows nothing about the twentieth century could think that putting government officials in charge of the economy overcomes greed and harnesses generosity.

Cohen’s misunderstanding of the market is also evident in his discussion of people like doctors, nurses, and teachers, who he thinks are motivated by higher ideals than narrow self-interest (though doctors and teachers are represented by powerful lobbying groups aiming to increase their incomes). He writes, “. . . market signals are not necessary to decide what diseases to cure or what subjects to teach, nor are they efficient means of deciding that.” That simply isn’t true. Market signals are of utmost importance; without them, we cannot know whether to devote our next dollar or hour to AIDS eradication or cancer research.

The book leaves the impression that Cohen’s vision of social organization is one with an army of smiling New Socialist Men and Women accepting orders from a small coterie of philosopher-kings who are blessed with knowledge of The Very Best. In the final analysis Cohen’s attempted “compelling *preliminary* case for socialism” is neither compelling nor convincing. The book will make excellent grist for the mills of freshman seminars, but it collapses under the slightest scrutiny. **FEE**

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The Politically Incorrect Guide to the Great Depression and the New Deal

by Robert P. Murphy

Regnery • 2009 • 272 pages • \$13.57

Reviewed by Raymond J. Keating



The Great Depression ranks as one of the most misunderstood periods of history. For that, we can thank biased historians who for generations have favored activist government, along with Keynesian economists who never understood how the economy works.

Since the last few months of 2008, the Great Depression has been thrust back into the national debate about economic policy. The deepest recession in more than six decades, including a credit meltdown and steep decline in production, has generated serious spec-

ulation about “another Great Depression.” If so, what is needed to avoid it? And who or what was to blame for this mess?

Let’s begin with questions about the causes of the Great Depression and how it eventually ended. The conventional idea is that unbridled capitalism in the 1920s crashed to earth, laissez-faire advocate Herbert Hoover failed to take needed action, and then Franklin Roosevelt and his New Deal rescued the nation. For many years that has been the accepted story.

Robert P. Murphy’s *The Politically Incorrect Guide to the Great Depression and the New Deal* joins a growing list of books based on sound economics and history that, in recent years, have questioned the accepted narrative. Murphy’s book—a quick, easy read—provides a valuable counter to wrongheaded conventional wisdom, while offering some points for debate among free-market economists.

As for the causes of the Great Depression, Murphy makes clear that it was not capitalism run amok but rather bad public policy. The debate within free-market circles is which policies were most responsible. Murphy favors the idea that it was monetary policy being far too easy in the 1920s, thus creating a bubble that inevitably had to burst. That puts him in the seemingly awkward spot of arguing that the 1920s were about both real prosperity (helped along by substantial tax relief during the Coolidge administration) and false prosperity. It also leads Murphy to declare that given “the unsustainable boom when Herbert Hoover took office, . . . a bust and the ensuing small ‘d’ depression were unavoidable, no matter what Hoover did in office.” That’s a debatable point within the free-market community.

Murphy notes that many free-market advocates have other ideas on the Great Depression’s causes. Unfortunately, he fails to give a full hearing to those who point to other poor policy choices, namely, the Smoot-Hawley Tariff, which acted as the trigger, followed by grossly misguided tax, regulatory, and spending policies.

Once beyond the debate over what sparked the Depression, Murphy does excellent work debunking many myths about the era. For example, he makes clear that Hoover was not a free-market stalwart but instead

a big-government Republican. He criticizes Hoover’s labor and wage, trade, immigration, spending, and tax policies, which all worked to deepen the Depression. Murphy highlights Hoover’s farm-support programs, public-works spending, and Reconstruction Finance Corporation as examples of “Hoover’s New Deal Lite.”

Murphy also does yeoman’s work in explaining the many ills of Franklin Roosevelt’s policies, showing how they made things far worse, particularly highlighting two important points that often have gone unnoticed.

First, Murphy observes the dearth of private-sector investment during the Depression, and ties that to the uncertainty created and costs imposed by FDR. Second, he notes that most previous recessions or depressions in “U.S. history were over within two years, and all of them within five.” So the question is, “Why did the Depression last so long?” If one honestly looks at the history and the economic and policy facts, the clear answer is that Hoover-nomics and FDR’s New Deal created the longest and deepest economic downturn in U.S. history.

That brings us to the present. Murphy argues in his closing chapter that President Bush was Hoover-like in his big-spending ways and his complete abandonment of free-market principles when confronted by the credit mess at the end of his administration. And like FDR, President Obama has offered an unprecedented agenda of government expansion.

Murphy wonders if Obama’s New Deal “will finally sink the American economy.” At best the Obamanomics agenda of higher taxes, increased regulation, and a vast expansion in government spending seems destined to result in lackluster economic performance.

As Murphy notes about the New Deal and the wartime economy, “True prosperity did not return until demobilization, when the federal government relinquished its stranglehold on the American economy and once again allowed private investors and entrepreneurs to direct resources.” Currently, there is no sign that anyone in the White House understands the economics of FDR’s or Obama’s New Deal. So the stranglehold tightens. FEE

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Government and Conflict

BY WALTER E. WILLIAMS

Human differences such as race, ethnicity, religion, and language have always been sources of conflict. Despite arguments to minimize the importance of these differences, people still exhibit preferences in these areas when choosing a spouse, friend, business partner, employee, neighborhood, and other associations. People do not associate randomly. Efforts to deny such assortative behavior in the name of political correctness are foolhardy.

Far more worthy of our efforts is to acknowledge, not necessarily sanction, assortative behavior as natural. We should ask: How can we minimize the probability that such preferences will produce conflict?

The Marriage Market

Examination of marriage can provide concrete insights for our discussion. Like many other transactions, marriage is a contractual relationship where goods and services are exchanged under mutually agreeable terms. Most people tend to seek marriage partners similar to themselves in race, ethnicity, religion, language, and socioeconomic status. It may be tempting to dismiss marriage choices as trivial but, given their impact on society, that is utterly erroneous.

Highly educated people tend to marry other highly educated people. High-income people (or those with prospects for high income) tend to marry other high-income people. Just these two aspects of choice create an income distribution more skewed than would be the case if high-income and highly educated people chose opposites as partners. Thus marriage decisions have an important impact on society.

Despite the widespread use of race, ethnicity, religion, and other characteristics as criteria in mate selection, there is very little social conflict or controversy in the matter. It is such a nonissue that people hardly ever

think of the marriage contract as an activity rooted in discriminatory choice. Moreover, if the discriminatory features of marriage were brought to people's attention, they would probably respond, "So what!"

One suspects that marriage decisions pose few social problems because they are voluntary. Other than sanctioning the contract once it has been made, government plays only a trivial part unless there is a dispute. Interestingly enough, we only observe conflict in the marriage market when people use government or quasigovernment institutions, like the church, to impose restrictions according to race, ethnicity, socioeconomic status, or religion.

We should ask: How can we minimize conflict from preferences based on human differences?

Different Preferences, No Conflict

Freedom of choice can be found elsewhere. Just as people have strong preferences in race, ethnicity, and religion, they have strong preferences in goods and services. Some people strongly prefer Cadillacs while others prefer Volvos. Despite those

differences, we seldom hear of conflict between the two groups. People simply purchase the cars they prefer.

In fact free markets are a great leveler of men; personal attributes have less importance. When a person buys a Cadillac or Volvo, his least concern is the race, ethnicity, or religion of the workers who produced the car. The person's greatest concern is likely to be whether he has gotten the highest quality car for the lowest possible price.

Whenever government allocates resources, there is increased potential that preferences will give rise to conflict. Education is a good typically financed and produced by government, and as such it has been the focal point of considerable conflict. Some parents prefer

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that their children have a morning prayer in school. Other parents have the opposite preference. Both preferences appear to be legitimate exercises of parental prerogatives.

The problem arises because when schools are publicly produced, they will either have prayers or no prayers. Parents who prefer morning prayers must enter into political conflict with those who do not. There is a lot at stake. Parents who lose will have their kids in a public school not to their liking. Then the alternative is for parents to bear the financial burden of tuition at a nonpublic school, plus be forced through property taxes to pay for public school services for which they have little use.

A conflict-reducing method, if education is publicly financed, is to have it privately produced. Each parent could be given a voucher equivalent to the per capita expenditure on education. Parents who wished for their children to have a morning prayer would simply enroll them in such a school, and parents who preferred otherwise would enroll their children in an appropriate school. There would be little scope for education conflict between the two groups of parents. Instead of adversaries, they could be friends.

The primary reason government allocation of resources enhances the potential for conflict is that most government activity is a zero-sum game whereby one person's gain can only be achieved through another person's sacrifice. Parents who win the political struggle for prayers in school would benefit at the expense of those who were against prayers in school, and vice versa. By contrast, with market provision of goods and services we have a positive-sum game where everybody wins. This applies to any good or service. If the choice between Cadillac and Volvo were decided collectively, we would witness the same kind of conflict that arises over school prayer. Instead of people with differing tastes in automobiles getting their way and living in harmony with one another, those with strong preferences for Volvos would have to organize with like-

minded people against those who had strong preferences for Cadillacs.


Race and Ethnicity: Government versus Markets

People have racial or ethnic preferences and will seek to indulge them. They will do so whether there is market or government allocation of resources. However, there is a key distinction. With government allocation part of the costs of preference indulgence tends to be borne by people other than the decision maker. With preference indulgence under market allocation, the decision maker tends to bear a greater proportion of the cost.

Suppose for purposes of simplicity that a black worker has the same productivity as a white worker, but the black worker offers his services for \$5 while the white worker demands \$8. If the decision maker is a government bureaucrat, the indulgence of his discriminatory preferences for the white worker is virtually free. It is taxpayers who bear the burden of paying \$8 rather than \$5; the bureaucrat takes home the same pay whether he discriminates or not; his cost of indulging his racial preferences is zero.

By contrast, in the private sector, the owner paying \$8 for the work that could have been done for \$5 an hour means a lower residual claim of \$3. The cost of racial preferences is directly borne by the decision maker.

Basic economic theory postulates that the higher the cost of doing something, the less it will be done. Therefore, it follows that we expect to see less racial discrimination in the private sector than the public sector. Similarly, when the political atmosphere changes to favor discrimination in favor of blacks, we expect to see more of it in the public sector.

The fact that it costs something to discriminate explains why those who wish to engage in it typically seek some form of government intervention. Intervention makes discrimination less costly to the discriminator than otherwise. The essential ingredient of intervention that makes discrimination less costly is restriction of peaceable, voluntary exchange. 

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