THE FREEMAN
IDEAS ON LIBERTY

VOLUME 61, NO 2 MARCH 2011

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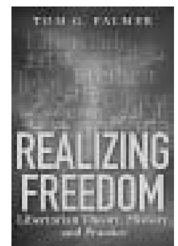

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THE FREEMAN

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

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

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

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

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A Boost for the Managed Economy

Nowhere is it easier to miss the forest for the trees than in discussions of government policy. Late last year the media were saturated with debates over the compromise tax package agreed to by Barack Obama and congressional Republicans. The package that passed the House and Senate included a two-year extension of the Bush-era tax-rate cuts for all income levels, a one-year two-point reduction in the employee's Social Security and Medicare payroll tax, and a 35 percent estate tax beginning at $5 million for an individual and $10 million for a couple (up from the current zero rate and heading off the scheduled 55 percent beginning at $1 million). The bill also contained an extension of unemployment benefits.

What prompted the compromise was the looming increase in everyone's income tax rates on January 1 and Obama's inability to maintain the middle-class rates while letting the rate on the top 2 percent of income earners rise, as he had promised to do during his campaign.

The first thing to note is that the media and other participants in the discussion have been sloppy (at best) in calling this a debate about tax *cuts*. Preventing a tax increase—even one set on automatic—is not a cut. Under the bill passed the tax rates in effect on December 31 were the same as those in effect on January 1. How is that a cut?

More important, all players in the game have revealed themselves to be interventionists. Regardless of party, they see the economy as something to fix by turning a knob here, pulling a lever there, and stepping on a pedal over yonder in order to get the desired performance: higher consumer spending, lower unemployment, and increased investment. It's as though the economy were a machine. But an economy is not a machine. It's a network of people engaged in myriad exchanges of goods and services—pursuing end-oriented activities informed by subjective values and expectations. Such information is largely unavailable to politicians, bureaucrats, and their economic advisers. That's why politically managed economies are chronically problem-ridden.

With unemployment at press time officially at 9.4 percent, the economy indeed remains in the doldrums. None of the palliatives that George W. Bush or Obama tried has worked, but instead of realizing that government and its corporate-state policies are the obstacles to a flourishing economy, the ruling elite remains committed to the managed economy. So it's decided not to raise taxes—for two years—and to reduce the employee payroll tax—for one year. These expiration dates are signs of political management. Understanding the necessity of a freed market would lead one to call for *permanent*—not temporary—government retrenchment.

Some questions were apparently overlooked. If tax rates may go up in two years, why make tax-sensitive long-term plans? If the payroll tax is to be two points lower in 2011, that implies it will most likely be two points higher in 2012. Will people spend the extra money next year or save it in anticipation of the tax increase to come? In any event, they will need to make an unpleasant adjustment in their household economies on January 1, 2012. People do think long-term, even if politicians don't.

Of course, there was scarcely an acknowledgment during the debate that money subject to taxation *belongs* to someone and not the State. You'd think it magically appears in a common pot and the government's job is to ladle it out effectively and fairly.

In objecting to politicians' taking money through taxation, I am not unmindful that in America much money is made through what sociologist Franz Oppenheimer called "the political means" (as opposed to the economic means: voluntary exchange). The plutocracy is real, thanks to the centralizing effect of much government intervention and the nature of politics. But the way to prevent accumulations of wealth via the political means is not taxation but *elimination of privilege*—that is, *all competition-stifling interventions*, including barriers to self-employment. The answer to government power can never be more government power. All that gets you is bigger government.

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In 1950 FEE founder Leonard E. Read faced a hostile congressional committee. Those were the days when advocates of individual liberty were subpoenaed by government investigators because of their views. David Beito tells the story.

Regardless of what selected statistics indicate, for many people the Great Recession goes on. Angel Martín Oro discusses the various theoretical explanations of what's happening.

Newsweek has declared the U.S. presidency an impossible job. Did it therefore recommend shrinking the size and scope of government? Richard Fulmer analyzes the mainstream news magazine's solution.

Though expelled from the monetary system long ago, gold refuses to go away. Why does it have such an allure, and will it make a comeback? Warren Gibson begins a two-part series on what some call real money and Keynes called the "barbarous relic."

When the United States was demoted from "totally free" to "mostly free" in a recent measure of economic freedom, Kevin Carson wondered when it was "totally free." That depends on whose freedom matters to the measurers, he explains.

Advocates of freedom constantly look for an effective strategy to roll back the power of government. What about establishing freedom outside government's reach on the high seas? Patri Friedman and Brad Taylor see promise in that approach.

Much of the impetus for government stimulus of the economy comes from the notion of "underutilized resources." Private spending is insufficient to put labor and capital to work fully, so government spending will have to do it. Tyler Watts exposes the bad economic theory within.

Our columnists have these enlightening offerings: Thomas Szasz explores how psychiatry thinks about coercion. Robert Higgs revisits Lyndon Johnson's Great Society. John Stossel asks why some people in the world are stuck in poverty. Charles Baird warns of union card check by nonlegislative means, while Art Carden and Steven Horwitz, having been bombarded with the message that the TSA keeps us safe, respond, "It Just Ain't So!"

Books on liberty, too-big-to-fail, economic self-interest, and intellectuals have occupied our reviewers.

—*Sheldon Richman*
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The TSA Makes Us Safer? It Just Ain't So!

BY ART CARDEN AND STEVEN HORWITZ

We both have contributed to the debate about the Transportation Security Administration (TSA) since the furor erupted over the new "enhanced pat-downs" and backscatter scanners, which some call "porno scanners." This debate has shown how few are the real defenders of liberty, since even the "liberal" media have lined up with the government. The debate has also demonstrated people's willingness to believe there is a tradeoff between liberty and security. In our view, no such tradeoff exists: More liberty and less government intervention would provide better security.

Jonathan Tobin

One example of media complicity is a Thanksgiving Day column in which Debra Saunders called the enhanced pat-downs "freedom fondles." *Reason* editor Matt Welch assembled two sets of links for the *Hit & Run* blog cataloguing favorable media statements about the new techniques. We have been advised by the *Los Angeles Times* to "shut up and be scanned." The *Santa Fe New Mexican* tells us we should "stand, or bend over, on principle and suffer attendant indignities," while the *Rochester Post-Bulletin* tells us to "grin and bear it." The *Louisville Courier-Journal* asks, "At what point did Americans turn into a nation of crybabies?"

What's particularly stunning is how often these defenses of TSA procedures came from the (so-called) *liberal* press, such as the *New York Times* or *The Nation*. Actress Whoopi Goldberg and her left-leaning colleagues on ABC's *The View* agreed that those protesting the invasive techniques by slowing down the process at airports are equivalent to terrorists. It is striking how quickly the left adopts "America: love it or leave it" and forgets that dissent is the highest form of patriotism when their guys are in power. Would these people be bending over backward to excuse the TSA if a Republican were in the White House? We don't think so.

Beyond the media treatments, the idea that we should trade off a little liberty to get more security presents a false choice. The TSA does not provide security. It provides what security experts like Bruce Schneier call "security theater." As one of us (Carden) wrote recently, the TSA agent with his hand in your pants is not there for your safety. He is there to give you the illusion of safety. The TSA dog-and-pony show is just the government's very expensive way of saying, "We're doing something about this."

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If we were serious about security, we would do three things. First, we would eliminate the TSA. It makes flying less convenient and gives people an incentive to drive. Per passenger mile, driving is far more dangerous than flying. The evidence suggests that more people will die on the roads than would have died in terrorist attacks on planes because they are discouraged from flying by the TSA and its new more invasive procedures.

Second, we should give the airlines responsibility for security. The discovery process of genuine market competition among airlines would determine the degree of security passengers are comfortable with, while also avoiding techniques they find invasive. What profit-seeking firm would want to alienate its customers by taking nearly nude photos or touching "their junk"? It's the airlines that stand to lose physical capital and reputation, so they have every reason to get it right. They will certainly be more responsive to fliers' needs than a monopoly would.

This second point is the response to the claim that we are corporate shills looking to advance a privatization agenda. While there might be some cost savings from privatization, this might also do more harm than good since a "privatized" TSA would do a lot of the same invasive things, only the State would be able to shift blame to the private sector. As a monopoly, a "privatized" TSA would still lack the ability to respond to customers' desired tradeoffs. What we need is not "privatization" but "de-monopolization."

Finally, we would get serious about using decision markets for terrorism detection. This idea met with fierce resistance when first introduced—politicians and pundits said no one should "profit from terrorism." These critics missed the point, though. As economist Robin Hanson has written, decision markets are a very high-efficiency way to obtain information, even when the payouts are small.

Hanson points out that a crucial failing of international intelligence gathering is that information is incomplete and/or flawed. Ironically (and tragically), the political outcry over the Policy Analysis Market (PAM; summarized on Hanson's website: www.tinyurl.com/6879e3) demonstrated precisely why such a market is necessary. In the face of incomplete and incorrect information and in the presence of important cognitive biases, sources of reliable and unbiased information are indispensable—especially when so many lives are on the line.

The PAM started as a Defense Advanced Research Projects Agency (DARPA) project to allow people to purchase very small contracts that would pay out in the event of a given combination of outcomes. The project drew fundamentally on the insights of F. A. Hayek and James Buchanan, who argued that the process of exchange itself reveals crucial information and generates order. In the early trials of the project, traders were asked to predict different combinations of events that might result from adopting a particular policy.

The Need for Information

As an aside, the furor over the Policy Analysis Market and the ratcheted-up procedures by the TSA are especially interesting in light of the controversy over WikiLeaks. Some have denounced WikiLeaks and its founder, Julian Assange, for endangering American lives, and we remain agnostic on this until the fury has settled. Even if WikiLeaks is morally culpable for endangering innocent people through its leaked documents, we would be willing to bet that those who were instrumental in canceling the PAM in 2003, thereby *thwarting* the open flow of information, are responsible for more casualties by several orders of magnitude. As a rule, more information is better than less.

Bruce Schneier and others argue that the best way to fight terrorism is to identify terrorists rather than scanning grandmothers or treating someone's urostomy bag as if it were a possible explosive device. One of the best ways to do this would be to develop a terrorism prediction market like the one proposed by Hanson.

The TSA should be abolished and serious, competitive alternatives should be explored. As Carden argued on Forbes.com, "Full Frontal Nudity Will Not Make Us Safer: *Abolish* the TSA" (emphasis added, www.tinyurl.com/2drrzz4). The problem with government-run airport security is that it eliminates the market's search process that would otherwise allow people to discover the most effective *and* customer-friendly security methods. FEE

The Day FEE Was Called before Congress

BY DAVID T. BEITO

In 1950 Leonard E. Read faced one of the most difficult challenges of his life as he prepared to appear before a hostile congressional committee. His friend W. C. Mullendore warned that the committee was out to destroy him: "You should be under no illusion whatever but that the intention is to smear and not look [for] information, enlightenment and the philosophy of freedom. You are going against a bunch of cutthroats who have very vicious motives."

Read was not the only target of this committee. Even more in the crosshairs was Edward Rumely, who had refused to divulge the names of those who had purchased controversial books he published.

When modern historians, most of whom write from a left-wing perspective, chronicle the "witch hunts" of the 1940s and 1950s, they rarely have in mind the likes of Read and Rumely. Neither fits their formal victim profile. Read, of course, was the founder and president of FEE and the future publisher of *The Freeman*. Mullendore was his close associate and a trustee of the organization. Rumely was the president of the Committee for Constitutional Government, a group that defended the free market and limited government.

Edward Rumely was hounded by Congress and columnists for his opposition to the New Deal and Fair Deal.

Read and Rumely were not alone. Ever since 1933, many prominent New Deal and later Fair Deal Democrats had relied on the same methods of guilt by association, character smears, and other forms of intimidation to attack conservative and libertarian critics of the growing federal bureaucracy.

Why have most historians ignored these witch hunts? Part of the reason is undeniably the political bias of historians. They tend to be sympathetic to the New Deal and Fair Deal and, in many cases, causes much further to the "left." This has encouraged a natural human tendency to overlook the dark side of those causes and an unwillingness to sympathize with conservatives and libertarians who may have been their victims. But some of it has to do with the methods used by the New Deal witch hunts, which were often informal and avoided head-on attacks. For example, in *New Deal or Raw Deal?* Burton Folsom describes how Franklin Roosevelt worked closely with his good friend and Treasury secretary Henry Morgenthau to use the Bureau of Internal Revenue against political opponents. Roosevelt arranged audits against such prominent opponents as the wealthy anti-New Dealer Moses Annenberg, publisher of the *Philadelphia Inquirer*; former Treasurer Secretary Andrew Mellon; and conservative U.S. Rep. Hamilton Fish, who represented Roosevelt's hometown in New York.

In addition to informal pressure, the New Deal witch hunt also included congressional investigations.

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The first of these was the Special Committee on Lobbying Investigations (better known as the Black Committee)—named after the committee chairman, Senator Hugo Black of Alabama. Black was a committed New Dealer. From 1933 on he targeted companies and organizations that opposed Roosevelt's policies. In 1936 he went after the American Liberty League, which united Democrats and Republicans who opposed the New Deal. In this effort Black pioneered the use of the so-called dragnet subpoena. He also teamed with the Federal Communications Commission to require Western Union, a private company, to turn over copies of thousands of telegrams sent by New Deal opponents. At the time the FCC required Western Union to keep a copy of each telegram sent.

The next phase in the New Deal witch hunt began in 1937, when Roosevelt tried to expand the U.S. Supreme Court after it had overturned key New Deal legislation. No one was more important in mobilizing public opposition to the "court-packing scheme" than Edward A. Rumely. Rumely was born in LaPorte, Indiana, in 1888 and became wealthy as a manufacturer of tractors. He got involved in politics as an enthusiastic supporter of Franklin's distant cousin, Theodore Roosevelt. Rumely depicted himself as a Theodore Roosevelt Progressive for the rest of his life. (Favoring TR *and* limited government was a curious combination that Rumely and others were able to rationalize somehow.)

FEE founder Leonard Read was called before Congress in 1950, after the Feds raided FEE's headquarters.

In 1915 Rumely purchased the *New York Evening Mail* with funds borrowed from an American citizen living in Germany. Rumely later claimed he did not know that all such loans had first to be funneled through the German government. Nevertheless, he was convicted under the Trading with the Enemy Act and served time. Although President Calvin Coolidge issued a full pardon, Rumely's enemies brought the case up repeatedly to discredit him over the next three decades.

During the 1930s he turned against the emerging New Deal, which he feared was undermining individual liberty by centralizing power in Washington. He found common cause with his friends publisher Frank Gannett and conservationist and civil-libertarian Gifford Pinchot. On the same day that Franklin D. Roosevelt announced his court-packing plan in 1937, the trio organized the Committee for Constitutional Government (CCG). Gannett wrote the checks, and Rumely ran day-to-day operations. In fighting the court plan, the CCG led perhaps the first successful offensive against the New Deal and pioneered the use of direct mail.

Despite an overwhelming three-fourths Democratic majority, the Senate rejected the court plan. It was the first major congressional defeat for the Roosevelt administration. Hugo Black, however, received the ultimate reward for his loyalty when Roosevelt nominated him to the Supreme Court the same year. Not even news that Black had once belonged to the Ku Klux Klan deterred Roosevelt from nominating him.

After the court plan lost, New Deal Democrats almost immediately launched a counterattack against the CCG. In 1938 Senator Sherman Minton of Indiana, another ardent New Dealer and Black's successor as head of the lobbying committee, announced a sweeping congressional investigation targeting forces opposed to "the objectives of the administration." Minton had actually been Roosevelt's first choice for the Supreme Court appointment that went to Black, but Minton had turned it down because he preferred to stay in the Senate. At the top of his Senate agenda was the investigation of the CCG. He issued yet another dragnet subpoena, this time for the CCG's records, and sent his staff down en masse to the CCG's office, where they began copying files. After watching this go on for several hours, Rumely ordered them out, charging them with an illegal "fishing expedition."

Minton's undoing was his proposed bill to ban newspapers from publishing articles known to be false. The public backlash over a perceived threat to free speech led to the collapse of the investigation. Like Black, however, Minton's loyalty to the New Deal was ultimately rewarded with an appointment to the

Supreme Court by his former Senate ally, President Harry S. Truman.

The CCG continued to be a stumbling block for the New Deal and later the Fair Deal. After 1937 the committee distributed over 82 million pieces of literature criticizing such policies as expanded government medical insurance, public housing, and labor legislation. In an article for *Colliers*, Interior Secretary Harold Ickes presented the administration's case against the CCG. He called it a "devilish petard" and said it had been "arousing mob spirit, that miasmic, bloodthirsty degrading emanation out of the dim past."

The New Deal witch hunt reached its apogee during World War II. Once the United States entered the war, Roosevelt put constant pressure on Attorney General Frances Biddle to crack down on critics of his foreign policy. Most notably he wanted Biddle to prosecute the publisher of the *Chicago Tribune*, Robert McCormick, a powerful critic of the New Deal and entry into the war, for sedition. To his credit, however, Biddle resisted this pressure. Finally, though, he began to relent by, for example, ordering wiretaps on key administration critics such as Joseph Patterson, publisher of the *New York Daily News*. In addition, the postmaster general barred dozens of anti-administration periodicals from the mails. Finally, and much more quietly, Roosevelt ordered Treasurer Secretary Morgenthau to launch a new round of tax audits on such prewar noninterventionists as Rep. Fish.

The New Deal witch hunt reached its apogee during World War II. Truman's Fair Deal supporters launched their own after the war.

In 1944 a U.S. House committee chaired by Clinton Anderson of New Mexico launched a second major lobbying investigation. Many New Dealers, notably Wright Patman, were upset about the CCG's campaign for a constitutional amendment to limit taxes to 25 percent of income. Patman characterized the CCG as the "most sordid and most sinister lobby ever organized." He charged that it represented the "Quisling reserves" of Hitler because it was trying to "sap the power and strength of this government at its tenderest spot, its purse strings, in time of war."

Like Minton, Anderson subpoenaed the names of the CCG's contributors. After Rumely refused to comply, the Committee cited him for contempt. A court acquitted him in 1945, finding that the subpoena was improper because the CCG was not a political organization. The most important result of this event was the Lobbying Act of 1946, which required lobbies (broadly defined) to disclose the names of all contributors of $500 or more. Although the CCG decided to register under protest, it found an inventive way around the reporting requirement, or so it thought. Instead of accepting cash contributions over $490, it took them in the form of book orders.

After Truman's 1948 upset victory, Fair Deal Democrats promised again to scrutinize lobbies such as the CCG. *The New Republic* declared triumphantly that the "New Deal is again empowered to carry forward the promise of American life" and that it was high time to investigate "the great lobbies and the millions they have spent . . . to defeat social legislation." The AFL and CIO agreed on this goal, as did two of the best-read columnists in the United States: Drew Pearson and Walter Winchell.

One of the early targets was FEE, which Pearson condemned on the grounds that it was "flooding the country with propaganda aimed at undermining the Marshall Plan, rent control, aid to education, and social security."

After a failed effort to set up a Senate-House joint committee, the House assigned the investigation to a committee led by Rep. Frank Buchanan of Pennsylvania. Buchanan was not only a stalwart Fair Dealer but had his own ax to grind because the CCG had successfully fought expanded public housing, a goal he had championed. He defined lobbying in the broadest possible terms to include groups that had an indirect influence on the formation of public opinion. The committee sent out a probing questionnaire to 166 businesses and organizations, most of them opponents of the Fair Deal. The Buchanan committee ignored lobbying by government agencies, but perhaps for the

sake of balance a questionnaire also went to the Civil Rights Congress, an organization with close ties to the Communist Party.

When Buchanan's staffers, armed with a dragnet subpoena, arrived in force at FEE's headquarters in early 1949, Read reluctantly cooperated. It became readily apparent to him, however, that the investigators were leaving no stone unturned in the hope of finding something—anything—to discredit the organization. It was also clear that the committee had formed a working alliance with key New Deal interest groups and journalists. Almost immediately after the committee rummaged through FEE's offices, someone leaked the information to Drew Pearson. Pearson's column publicized the best-known names on FEE's "secret" contributor list and quoted liberally from internal correspondence. Mullendore expressed his outrage about the leak in a letter to Buchanan: "Those who seek to extend the power of government try to close the mouths of citizens who dare to oppose them. . . . Your inquisitorial and extremely burdensome demand for information which you have no moral right to demand is a most alarming example of the use of this means of intimidation."

Immediately after the Feds ransacked FEE, information they seized was leaked to a popular national columnist.

For its part, the CCG ramped up its anti-Fair Deal efforts by promoting purchases of John T. Flynn's book *The Road Ahead*. Flynn warned that pro-New Deal pressure groups were pushing the United States, like Britain, into socialism. Harper & Brothers sold the book for $2.50, but the CCG cut the price to a dollar, thus encouraging bulk purchases. From 1949 to 1950 the CCG distributed an amazing ten million copies.

Despite Mullendore's warnings, Read agreed to testify before the committee. Ever the optimist, he used that venue to educate the members, and he had some success. He found a sympathetic audience among the leading Republican members, and even Carl Albert, a member of the majority, admitted Read was "far more effective than the average buttonhole artist, so-called, around the capital."

While most of Read's testimony explained FEE's mission to inform and educate Americans about free markets, he also challenged the legitimacy of the committee's investigation. To Read, under the committee's all-inclusive definition, lobbying "becomes synonymous with communication of thought—all thought. The Bible communicates ideas that may affect legislation. . . . The list is endless."

Rumely agreed to answer all the Buchanan committee's questions except the one asking the names of those who had purchased *The Road Ahead*. Pointing to the First Amendment, he asserted that the committee had "no power to go into a newspaper publisher and say, 'Give me your subscription list.' And you have no power to come to us." If the House wanted to cite him for "contempt and bring me to trial," it would "get an education on the Bill of Rights."

By this point the press had turned against the Buchanan committee and its methods. *Editor and Publisher* found it guilty of "an invasion of the guaranteed right of the American people to own, hire or use a printing press without interference." Similarly, the *Cleveland Plain Dealer* called the investigation "Fair Deal Intimidation." Even Buchanan's hometown paper, the *Pittsburgh Post-Gazette,* condemned the probe. Frank Chodorov, a leading libertarian and future editor of *The Freeman*, asked during the period: "Why did the Committee want these names? Simply to discourage support of the anti-collectivist organizations by harassment and intimidation. . . . Buchananism, then, is a step in the direction of thought control."

The Buchanan committee presented three separate contempt resolutions for a House floor vote in August 1950. Each had the support of most Democrats. The first and most-publicized centered on Rumely. The second resolution focused on Joseph Kamp, head of a much smaller group, the Constitutional Education League. Unlike Rumely, Kamp had stated he was willing to cooperate but was unsure exactly what the Buchanan committee wanted from him. The last of the contempt resolutions dealt with William Patterson,

head of the Civil Rights Congress. Like Rumely, he had refused to reveal the names of contributors.

In the floor debate Rep. John W. McCormick, the Democratic majority leader, went to bat for the committee. In language as extreme as just about any smear uttered by Sen. Joseph McCarthy, he condemned Rumely as "a spy in World War I, and a man who is nothing but a Fascist, who is an opponent of American institutions and American Government." Virtually all those opposed to the resolution were conservatives, with the notable exception of Rep. Vito Marcantonio. As the lone American-Labor Party member in the House, he was easily the most left-wing person in Congress. Marcantonio portrayed himself as absolutist champion of free speech even for a "fascist" like Rumely. If Rumely's conservative defenders truly valued free speech, he challenged, they would also vote against the contempt resolution for Patterson. Despite his claims, Marcantonio's record on free speech was at best mixed. During World War II, for example, he had urged tough action against critics of the war.

The final vote on the Rumely resolution was close but went against him. Nearly all Republicans, joined by Marcantonio and 42 Democrats, almost all from the South, opposed it.

The Supreme Court eventually overturned Rumely's contempt resolution as a violation of free speech and privacy rights.

The Patterson contempt resolution also passed but by a much more lopsided majority. Although the debate took place at the height of the McCarthy era, Republicans cast virtually all their 109 votes against it. By contrast, those southern Democrats who had opposed the Rumely resolution were not about to vote against the Patterson resolution even though the charges were essentially the same. For the southerners, race and anticommunism apparently trumped all other considerations.

In April 1951 a federal judge gave Rumely a six-month suspended sentence for contempt and a $1,000 fine, saying he would have sent him to jail save for his advanced age. Rumely's old nemesis, Walter Winchell, exulted that he "got real satisfaction out of the conviction last week of Edw. A. Rumely. . . [a] convicted pro-German agent." Few newspapers or columnists agreed with Winchell. Even *The New Republic* and Drew Pearson, who had egged on Buchanan at the beginning, steered clear of the controversy.

The Last Laugh

It was Rumely who had the last laugh, however, when in 1953 the Supreme Court overturned his conviction 7-0. Two justices recused themselves because of possible conflicts of interest. In a separate opinion the Court's most "liberal" members, William O. Douglas and Hugo Black, endorsed Rumely's free speech and privacy rights in no uncertain terms. When it turned to the Buchanan committee's demands it declared: "If the present inquiry were sanctioned a publisher would be compelled to register as a lobbyist with the federal government, would be subjected to harassing inquiries. A requirement that a publisher disclose the identity of those who buy his books, pamphlets or papers is indeed the beginning of surveillance of the press."

By this time some prominent New Dealers were losing their appetite for investigative crusades against the conservatives and libertarians. For one thing, they were too busy beating back McCarthyism. By championing Rumely's free speech, they could better fend off charges of hypocrisy. Even before the House cited Rumely for contempt, for example, the pro-New Deal columnist Marquis Childs pointed to him as an example of how the First Amendment protected "rightists" just as much as communists. In addition, lawyers for two victims of McCarthyism, Owen Lattimore and Corliss Lamont, cited the Supreme Court ruling in defense of their clients. Rumely had become a case study in the need to protect free speech. It was quite a turnabout for a man whom the left only a few years earlier had roundly condemned as a fascist, a federal convict, and a German spy. FEE

"F" as in Fed

BY SHELDON RICHMAN

The Federal Reserve, America's fatally conceited monetary central planner, is not terribly popular these days—which is cause for hope—and now we have a report card on the entire Fed era that strongly supports the view that we'd be better off without it. At the very least, as the authors suggest, the burden of proof is squarely on those who would retain the central bank.

The report card comes in the form of a working paper from the Cato Institute: "Has the Fed Been a Failure?" by George A. Selgin, William D. Lastrapes, and Lawrence H. White.

The authors state in their abstract:

> As the one-hundredth anniversary of the 1913 Federal Reserve Act approaches, we assess whether the nation's experiment with the Federal Reserve has been a success or a failure. Drawing on a wide range of recent empirical research, we find the following: (1) The Fed's full history (1914 to present) has been characterized by more rather than fewer symptoms of monetary and macroeconomic instability than the decades leading to the Fed's establishment. (2) While the Fed's performance has undoubtedly improved since World War II, even its postwar performance has not clearly surpassed that of its undoubtedly flawed predecessor, the National Banking system, before World War I. (3) Some proposed alternative arrangements might plausibly do better than the Fed as presently constituted. We conclude that the need for a systematic exploration of alternatives to the established monetary system is as pressing today as it was a century ago.

The burden of proof is on those who would retain the central bank.

In light of the Fed's defined mission—monetary support for economic growth, stable prices, maximum employment—the authors use the following criteria to assess its record: "the relative extent of pre- and post-Federal Reserve Act price level changes, pre- and post-Federal Reserve Act output fluctuations and business recessions, and pre- and post-Federal Reserve Act financial crises." The Fed has done poorly on every count. No one familiar with the Mises-Hayek critique of central planning will be surprised. Central banking is not equivalent to comprehensive planning of the economy, but money is the most pervasive good and monetary engineers suffer the same insurmountable ignorance as any central planner.

I can only hit the paper's highlights here.

Inflation

Selgin et al. pronounce the Fed a dismal failure in controlling inflation. "[F]ar from achieving long-run price stability, it has allowed the purchasing power of the U.S. dollar, which was hardly different on the eve of the Fed's creation from what it had been at the time of the dollar's establishment as the official U.S. monetary unit, to fall dramatically."

The value of the dollar was essentially stable from the late eighteenth century to the second decade of the twentieth century! "A consumer basket selling for $100 in 1790," they write, "cost only slightly more, at $108, than its (admittedly very rough) equivalent in 1913."

And since that time? "[T]hereafter the price soared, reaching $2,422 in 2008. . . . [M]ost of the decline in the dollar's purchasing power has taken place since 1970, when the gold standard no longer placed any limits on the Fed's powers of monetary control."

The dollar has lost 95 percent of its value since the Fed came into existence.

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Deflation

The authors say that since the Great Depression the Fed has rid the economy of deflation (defined as falling prices), which was a feature of the late nineteenth-century economic landscape. Economists, including Fed chairman Ben Bernanke, generally deem deflation as something to be avoided at almost all costs, so they would give the Fed kudos in this respect. But Selgin et al. point out (as have others, such as Steven Horwitz, in the January/February 2010 *Freeman*, www.tinyurl.com/ycqzyyv) that what matters is not deflation per se but the *kind* of deflation:

> Harmful deflation—the sort that goes hand-in-hand with depression—results from a contraction in overall spending or aggregate demand for goods in a world of sticky prices. As people try to rebuild their money balances they spend less of their income on goods. Slack demand gives rise to unsold inventories, discouraging production as it depresses equilibrium prices. Benign deflation, by contrast, is driven by improvements in aggregate supply—that is, by general reductions in unit production costs—which allow more goods to be produced from any given quantity of factor and which are therefore much more likely to be quickly and fully reflected in corresponding adjustments to actual (and not just equilibrium) prices.
>
> Historically, benign deflation has been the far more common type.

During roughly the last quarter of the nineteenth century, prices in the United States *declined* 37 percent—1.2 percent a year on average. *That's* what the Fed has saved us from, thank you very much.

Frequency and Duration of Recessions

Again, the pre-Fed record is better than the Fed's performance. Drawing on the latest research, the authors conclude:

> [A]lthough contractions were indeed somewhat more frequent before the Fed's establishment than after World War II (though not, it bears noting, more frequent than in the full Federal Reserve sample period), they were also almost three months *shorter* on average, and no more severe. Recoveries were also faster, with an average time from trough to previous peak of 7.7 months, as compared to 10.6 months. Allowing for the recent, 18-month-long contraction further strengthens these conclusions.

Moreover, the Fed has violated traditional standards by bailing out insolvent banks. Selgin et al. reject the "too big to fail" doctrine, arguing that the fear-mongering about "systemic risk" is unsubstantiated. Bailing out the creditors of insolvent institutions, as the Fed did during the current financial crisis, has increased the future exposure of the public by reinforcing moral hazard—encouraging excessively risky behavior by creating the expectation of government rescue. In the process the Fed has gone from lender of last resort to allocator of capital—an ominous move toward central planning.

> The dollar has lost 95 percent of its value since the Fed came into existence.

The authors do not endorse the pre-Fed system, which was heavily regulated by the national and state governments. Indeed, for most of American history interstate and intrastate branch banking was illegal, producing an industry of uncompetitive and undiversified banks.

Nor do they explore the free-banking alternative, though Selgin and White are well-known advocates of it. Instead they confine their analysis to various rules that would take away the Fed's discretionary power over the money supply. These would be improvements but a far distant second to free banking.

The authors leave no doubt that "the Fed's poor record calls for seriously contemplating a genuine change of regime." FEE

And the Slump Goes On

BY ANGEL MARTÍN ORO

Official economic statistics and the underlying economic reality sometimes differ starkly. Such discrepancies may be almost inevitable when a small group of macroeconomic experts sets the official dates for peaks and troughs of aggregate economic activity. The Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) recently "determined that a trough in business activity occurred in the U.S. economy in June 2009." According to the official announcement, this date "marks the end of the recession that began in December 2007 and the beginning of an expansion."

Yet some data and sound theory, which take into account more than simple macroeconomic aggregates—higher GDP good, lower GDP bad—indicate that the U.S. economy has not fully recovered. The official unemployment rate is still over 9 percent, private long-term investment remains at low levels, and even GDP growth has been weak, in spite of the great increase in government spending for final goods and services (which adds directly to GDP, defined as consumption plus investment plus government spending plus net exports).

> The official unemployment rate is still over 9 percent, private long-term investment remains at low levels, and even GDP growth has been weak.

The weak recovery is clearly recognized by policymakers, who have advocated and implemented additional fiscal and monetary stimulus by the Obama administration and perhaps the Federal Reserve. They seem to take for granted that an unexpectedly slow recovery requires even more expansionary government policies to keep the economy on track.

The slow recovery from the recession presents an analytical challenge, provoking debate among macroeconomists and pundits. As usual, there are many diverse explanations, some complementary, some contradictory. To an important extent these divergences reflect different conceptions of the business cycle. I will describe and briefly analyze four of the most common explanations.

The Keynesian Story

Let us start with the Keynesian story, filtered through the writings of Paul Krugman. (There are much more nuanced versions of Keynesianism than Krugman's.) In his weekly column and popular blog at the *New York Times*, Krugman declares that the slow recovery and the persistence of high unemployment arise from a "lack of aggregate demand," which is the main cause of the poor sales by private businesses and hence of the high unemployment rate.

In his characteristic self-confident argumentative style, Krugman asserts, "Businesses aren't hiring because of poor sales, period, end of story." This sentence is followed by a graph showing a substantial increase since late 2008 in the percentage of small businesses that named "poor sales" as their "single most important

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The author thanks Robert Higgs for his assistance.

problem." The remedy for this malaise is, of course, more public spending: "[T]he best thing government could do to help business would be to spend more, increasing demand."

However, as many economists have written in recent years, Krugman's focus on aggregate demand is simplistic, to say the least. First, one needs to ask, why is the growth of aggregate demand so weak? It may very well be that spending less and saving more is a *healthy* reaction to the previous unsustainable boom. Thus weak demand might be an inevitable consequence, not the deep cause, of the current bust.

Furthermore, what particular parts of the economy—which markets or industries—suffer most from low sales? As Austrian economists argue, we need to disaggregate the macroeconomic picture to understand what is going on. Nevertheless, such disaggregated analysis does not seem to be important for some Keynesians, such as Krugman and Brad DeLong. In November 2009, DeLong wrote, "At this point, anything that boosts the government's deficit over the next two years passes the benefit-cost test—anything at all."

The Monetarist Story

The monetarist story of Milton Friedman's followers is usually presented as the free-market alternative to the Keynesian interpretation. However, these explanations have important though subtle points in common.

In simple terms the monetarist thesis focuses mainly on sudden bank credit contraction. Monetarists argue that the accumulation of vast amounts of excess reserves by banks—which basically means that instead of lending money to the private sector, they are keeping it to themselves—has negative effects for the whole economy. Given that credit is usually considered the economic equivalent to the human body's blood circulation, a credit contraction is seen as invariably dangerous. If a person suffers a sudden loss of blood, the cure would be to inject blood into him. The same cure applies to credit, the monetarists claim.

Economists from this perspective usually refer to how the velocity of money—the average frequency with which a unit of money is spent in a specific period—collapsed in the second half of 2008. To compensate for this reduction, monetarists recommend an expansionary monetary policy by the central bank.

Although one might think that Fed Chairman Ben Bernanke's strategy has been to respond precisely in this way, some economists, such as Scott Sumner, argue otherwise. Sumner claims the Fed's monetary policy since the end of 2008 has actually been contractionary *relative to what the economy needed at that time*. Bernanke should have been more aggressive, Sumner argues, to avoid the contraction of nominal GDP that finally occurred.

> The monetarist story, usually presented as the free-market alternative to the Keynesian one, shares its excessive aggregation of key concepts.

This explanation suffers from several problems, similar to the shortcomings of the Keynesian story: (1) excessive aggregation of key concepts—making extensive use of GDP as the key indicator of the cycle does not allow the monetarists to explain the crux of the matter, which is the real microeconomic distortions in the productive structure of the economy that had been created during the boom; (2) the analysis of the crisis and the sharp credit contraction as exogenous shocks, rather than consequences of the previous unsustainable credit expansion. From Sumner's point of view, it seems that the fall in nominal GDP was something to be avoided.

The Austrian Story: The Adjustment Problem

For economists drawing on the Austrian story, GDP contraction was a symptom of the bust, the inevitable hangover after a credit spree that led to bad decisions—malinvestments and excessive leverage. As the Austrian business cycle theory emphasizes, the economy has to go through a process of adjustment that cleanses the massive errors resulting from economic decisions taken in the past. This restructuring involves not only reallocating factors of production (capital and labor), but also reducing debt a sig-

nificant amount (deleveraging), which has contractionary effects on demand and aggregate economic activity.

This consideration leads to the first element of the best explanation for the prolongation of the recession: the fact that the necessary adjustment process has not been completed. As a recent report by the Bank for International Settlements (BIS) concludes, the debt reduction of private economic agents still has a long way to go. But as the Spanish economist J. R. Rallo argues, keeping interest rates extremely low for a prolonged period, as the Federal Reserve has, creates incentives for people not to reduce debt and adjust to the new circumstances. Moreover, government "stimulus" policies may have made things worse by massively increasing federal government debt.

Furthermore, the necessary reallocation of the factors of production—both intersectoral (from sectors overexpanded during the bubble to sectors that will yield higher profits in the future) and intrasectoral (among different products and services in the same sector) may take a long time, especially in the labor markets. Apart from the fact that the adjustment in relative prices and wages may take longer than desirable because of rigidities, there are additional issues worth considering.

Physical capital and human capital have to go through an adjustment process. All this takes time.

Research on markets with search frictions—which won Peter Diamond, Dale Mortensen, and Christopher Pissarides the 2010 Nobel prize in economics—may fit in this context. For several decades mainstream neoclassical economists have depicted the market as a mechanism that perfectly and instantaneously coordinates supply and demand. The Nobel laureates, however, have emphasized that economic agents often have to spend time and resources in making that adjustment (search frictions). Moreover, finding satisfactory employment for people who have just lost jobs may require the acquisition of substantially different skills and capabilities. The features of this process depend on the degree of specificity and complexity of the economy's capital structure. Thus not only physical capital but also human capital has to go through an adjustment process. All this takes time.

Regime Uncertainty

The second main piece of the puzzle of the recession's duration is the "regime uncertainty" argument formulated by Robert Higgs. He first elaborated this concept to explain why the Great Depression lasted so long, finding that the Roosevelt administration, with its constant attacks (in rhetoric and in policies) on the free-enterprise system and its threats to private property, was largely responsible for the failure of long-term private investment to recover fully until World War II ended.

Not surprisingly, in a series of commentaries since 2008, Higgs has found parallels in the Obama administration's actions and in the stagnant private investment that help to explain why sustained economic recovery has not yet taken place.

Higgs points to several particular causes: the surge in the federal deficit and debt; the likely introduction of new taxes to finance the recent massive public spending, or changes in existing tax rules; the potential burdens on businesses brought about by environmental and energy regulations; and the still uncertain real effects of Obamacare and the new financial regulatory framework.

Problems related to the adjustment process, along with the existence of regime uncertainty, might form a relatively complete explanation of why the U.S. economy is still suffering from the Great Recession, complementing the analysis expressed in the Mises/Hayek business cycle theory.

The importance of this debate, and how current economic events are interpreted, can hardly be exaggerated. As economist Mario Rizzo has noted, the resolution of this puzzle "will affect economics and public perceptions for a long time to come," just as the debate between Hayek and Keynes in the 1930s had profound (and unfortunate) consequences for the future of the economics discipline. Let us hope that the outcome will be different this time. FEE

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Congratulations to Kevin A. Carson

Winner

Beth A. Hoffman Memorial Prize for Economic Writing

The first annual Beth A. Hoffman Memorial Prize for Economic Writing has been awarded to Kevin A. Carson, the Foundation for Economic Education announced. Through the generosity of a FEE donor, the prize has been established to honor the memory of Beth A. Hoffman by recognizing the best article on economics or economic history published in *The Freeman* the previous year.

Carson's article, "The Distorting Effects of Transportation Subsidies," appeared in the November 2010 issue of *The Freeman*. It was selected from a list of five nominees by an outside panel of judges who knew and worked with Beth Hoffman for many years.

The prize consists of $2,000 and a plaque. A perpetual plaque will also be displayed at FEE's headquarters.

The upshot of Carson's winning article is that "subsidies to transportation have probably done more than any other factor (with the possible exception of intellectual property law) to determine the present shape of the American corporate economy. Currently predominating firm sizes and market areas are the result of government subsidies to transportation."

Beth Hoffman (1950-2008) was the long-time managing editor of *The Freeman*, having joined the foundation staff in the 1970s. She also edited books, pamphlets and other materials. Over the years FEE supporters and seminar students came to know her as the friendly face or voice on the telephone ever ready to assist anyone seeking to learn the freedom philosophy.

Carson is an independent scholar and a public intellectual, whose books include *Studies in Mutualist Political Economy*; *Organization Theory: A Libertarian Perspective*; and *The Homebrew Industrial Revolution: A Low-Overhead Manifesto*. He is also a research associate with the Center for a Stateless Society and a prolific op-ed writer. He blogs at Mutualist Blog: Free Market Anti-Capitalism.

Three honorable mentions were also named: James C. W. Ahiakpor, "Paying the Unemployed Does Not Stimulate an Economy" (December); Warren C. Gibson, "GDP: Who Needs It?" (May); and Chidem Kurdas, "Financial Regulation Snake Oil" (September).

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An Impossible Job

BY RICHARD W. FULMER

Conventional wisdom has it that the more complex a nation's economy, the more government oversight and regulation are needed to keep it from spinning out of control. It follows that government must grow in size and complexity along with the economy. Apparently, however, our government has become so vast and complex that it may have spun out of control itself.

Daniel Stone, in the November 13, 2010, issue of *Newsweek*, addresses the dilemma in his article, *Hail to the Chiefs*. The essay's subhead summarizes the problem: "The presidency has grown, and grown and grown, into the most powerful, most impossible job in the world." Stone's solution, as suggested by his article's title, is to devolve presidential power either to cabinet members (oligarchy?) or to "outside agencies" (technocracy?).

Stone dismisses the notion that government or the president could simply do less. "It's hard to imagine," he writes, "how the office could sizably shrink, allowing the president to return to a more aloof, strategic role."

The job's impossibility stems from the sheer scope of government power and therefore the incredible array of issues with which any president must grapple: unemployment, Middle East peace, energy, homeland security, drug abuse, Iraq, offshore drilling and oil spills, foreign trade, terrorism, scandals, greenhouse-gas emissions, Afghanistan, North Korea, health care, the financial industry, pollution, education, transportation, nuclear proliferation, the national economy, the global economy—the list is endless. How can any one person competently deal with all that, no matter how many advisers he or she might have?

In Stone's words, "Days in the West Wing are a constant, head-spinning oscillation between dozens of domestic, foreign-policy, and political eruptions and concerns."

Imagine the mass of information flooding into the White House each day. Who could digest it? Some half-dozen aides are needed just to deal with incoming mail. Stone relates former chief of staff Rahm Emanuel's instructions to senior staff members trying to deal with the daily deluge: "We need to make his memos shorter. Last night we sent the president a phone book."

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Yet a library of "phone books" would be needed to adequately cover all the issues a president attempts to handle. A country, not to mention the world, is too complex for anyone (or any group) to manage; they simply cannot gather, analyze, and act on the necessary mass of information in a timely fashion. In fact, this understates the problem: The most critical knowledge on which a society depends for its smooth operation—"knowing how" rather than "knowing that"—is widely dispersed and cannot be fully articulated. This is the "knowledge problem" emphasized by F. A. Hayek. Delegating power to cabinet members or agencies cannot solve that problem.

Consider the process by which a government policy is instituted. First, the goal must be clearly defined or the problem to be solved properly diagnosed. Next, a policy is formulated to achieve the goal or address the problem. Then a bill must make its way through Congress relatively intact. Once enacted, it has to be properly implemented and enforced. Finally, the policy's impact must be monitored so that adjustments can be made in a timely manner. Performing any one of these steps successfully is difficult; performing all successfully is virtually impossible. And this only begins to identify the obstacles.

> A country, not to mention the world, is too complex for anyone to manage. The most critical knowledge is widely dispersed and cannot be articulated.

The chances of success decline rapidly as the complexity of the system to be controlled increases. Not only does predicting the impact of a given change become more difficult, but assessing the results also becomes harder. Did the policy really cause an observed behavior or was it the result of something else entirely? Further reducing the ability to determine cause and effect are the filters that ideology places on incoming information.

Ideological Filters

People use simplified models of the world to deal with its complexities. These models (aka paradigms, worldviews, or ideologies) provide logical frameworks for understanding cause and effect. Models also help filter out apparently unnecessary information from the flood of data we face every day, allowing us to concentrate on what we believe to be important. To the extent that our models are incorrect or only approximate reality, though, we can overlook important information that does not fit our worldview. This is known as "conformation bias."

Consider the CIA's acceptance of the face the Soviet Union presented to the world during the 1970s, including its claim that its economy was enjoying an impressive 3 percent annual growth rate. President Ronald Reagan, familiar with free-market critiques of central planning, did not believe a command economy could work as well as the CIA thought. William Casey, Reagan's CIA director, tasked agency analysts with exploring the possibility that the Soviet financial system was in fact crumbling. Specifically, Casey asked them what might be expected from a Soviet Union whose economy was shrinking.

The analysts speculated that popular discontent would rise. In response, Moscow would shift military spending to the civilian sector, perhaps by using steel to build locomotives instead of tanks. The Soviets might also purchase foreign technology to boost consumer-goods production, obtaining the necessary hard currency by increasing oil and gas sales to Europe.

Casey then asked analysts to determine whether any of these predicted signs of economic distress were in evidence. Within days, reports flowed in confirming the predictions. This data had long been available but was ignored as irrelevant given the assumption of a solid Soviet economy. (See articles by former intelligence official Herbert Meyer at www.tinyurl.com/24e7deh and www.tinyurl.com/2dyllqj.)

The lesson is not that models are inherently bad but that they must be periodically and critically examined to ensure they accurately mirror reality.

The Great Recession offers a more recent example of entrenched paradigms at work. There are many competing explanations for the current financial crunch: (1) an investment bubble produced by the

Federal Reserve's inflationary actions; (2) a housing bubble created by federal pressure on mortgage companies to lend to bad credit risks; (3) the federal government's implicit backing of Freddie Mac, Fannie Mae, and other financial institutions, leading them to take excessive risks; (4) deregulation, notably the repeal of the Glass–Steagall Act; (5) unregulated derivatives trading; (6) housing speculators; (7) predatory lending; (8) Wall Street greed; and (9) tax cuts that allowed imprudent investments by wealthy individuals leading to a financial bubble.

Any of these views can be supported by citing isolated nuggets of carefully selected data. Predictably, libertarians and conservatives prefer explanations predicated on government failure. Proponents of government control favor theories rooted in market failure, while class warriors promote those blaming the rich in general and Wall Street in particular.

Theoretically, corrective policies based on each explanation could be implemented one after another. A policy's success or failure might indicate whether the explanation on which it was based is correct. But a nation is not a laboratory, and uncertainty caused by such experimentation would bring the economy to a grinding halt. Furthermore, success or failure would not be conclusive. Opponents of a successful policy might argue that conditions improved despite, not because of, the action taken. Similarly, supporters of a failed policy could claim that things would have been far worse without it.

Rather than experimenting, policymakers might consult history to determine the results of similar past policies. Yet history is also seen through a filter. After 70 years of hindsight, economists and historians still argue whether market or governmental failure caused the Great Depression and whether the New Deal helped or hurt.

Politicians generally surround themselves with people who share their fundamental beliefs. The president's staff controls the information he sees, and that information is likely to comport with their shared worldview. This alignment of "paradigm filters" exaggerates the importance of those bits of information that are consonant with the White House consensus and discounts those that are not. Failed programs are therefore more likely to be expanded than ended. The president and his advisers will want to believe that any problems were caused by insufficient funding or enforcement rather than an unsound worldview. Reinforcing this tendency is self-interest—admitting mistakes can shorten a politician's career.

Increasing Efficiency, Dispersing Information

The notion that a president can oversee an economy is a fantasy. Unfortunately, although central planning has been discredited, Keynesian-style policies for maintaining employment or aggregate demand are still thought feasible—despite overwhelming contrary experience grounded in proper theory. But anything more complex than the most primitive economy simply is not amenable to such "assistance" from a central authority.

The notion that a president can oversee an economy is a fantasy.

In *Capital and Interest*, Eugen von Böhm-Bawerk explained that economies become more efficient by employing increasingly "roundabout methods of production." For example, a caveman could catch small animals for food with his bare hands, or he could increase his efficiency by using tools, perhaps using rocks or sticks as clubs. Hunting becomes marginally more complex, but the result is a bigger "harvest." The caveman could raise his productivity further by crafting better tools—clubs, spears, snares, bows and arrows. It costs the caveman time and effort to construct tools and become proficient with them, but his investment is likely to be well rewarded.

The process of constructing hunting implements could itself be improved by fabricating tools such as knives and scrapers. The use of these tools is a further step removed from the process of hunting, constituting a yet more roundabout method of "producing" small game. This progression can be continued indefinitely as still other tools are created to facilitate the production of each new tool set.

Further efficiencies can be realized, as Adam Smith explained, through the division of labor. For example, while some cavemen hunt, others can concentrate on

crafting snares or spears. With each improvement, either by creating new tools or further subdividing tasks, efficiency is increased, though at the cost of additional time and complexity. This process is repeated endlessly as economies advance.

In undeveloped countries, manufacturers must be relatively self-sufficient because suppliers and transportation are expensive and unreliable. This was true in the Soviet Union and in early twentieth-century America. The first U.S. automakers built their cars from the ground up. Nearly everything—nuts, bolts, springs, and engines—was made in a single factory. A company's employees did everything from fabricating parts, to assembling them, to sweeping up afterwards. As the nation's economy and infrastructure developed, however, auto companies discovered they could make better cars at lower prices by purchasing components and services from specialized firms.

With inexpensive transportation, tools and subcomponents can now be fabricated far from final assembly points. Parts once built in one area of a plant then moved to another to be bolted onto a chassis are now transported from remote factories by ships, trains, and trucks over vast distances, often from other countries. Where once hundreds of companies helped to produce American cars, now tens of thousands from all over the globe help to produce far more vehicles of higher quality and with features unimaginable just a few decades ago.

With this explosion of companies comes an explosion of complexity. Those contributing to an end product's manufacture may have no idea what that product is, where it will be built, or who will use it. Logistics is now key—ensuring that molded plastic parts, tires, paint, fasteners, adhesives, and countless other components from all over the world arrive at assembly lines in just the right number and at just the right time. All this complexity is managed by millions of people with local knowledge who quickly adapt to changes in everything from costs to the weather. None of this could be centrally directed by boards of bureaucrats incapable of even cataloging all the people, tasks, parts, and services involved before the list became outdated.

Managing the Unmanageable

As Hayek pointed out in his essay "The Use of Knowledge in Society," the term "planned economy" is misleading. All economic activity is planned. The question is whether the planning is done by people on the scene with local knowledge and a stake in the outcome, or by remote bureaucrats with insufficient, outdated information and nothing to lose—bureaucrats ignorant enough to believe that people can be ordered like pieces on a chessboard and arrogant enough to try. Will planning be done by businesspeople who either replace faulty paradigms or fail, or by politicians holding fast to broken ideologies for fear of losing office?

All economic activity is planned. The question is whether the planning is done by people on the scene with a stake in the outcome or by remote bureaucrats.

Complex systems—from rainforests to economies—are less predictable than simpler ones. They are also harder to control because everything within them is interconnected. A tweak here or a prod there can have unintended and undesirable consequences. No one can anticipate how creative, entrepreneurial individuals will adjust their behavior to regulatory obstacles or stimulative measures. While a bad decision made at the local level can cause a manageable problem, that same decision made at the national level can create a nationwide or worldwide disaster.

The presidency has indeed grown beyond the capacity of any single individual. That is because government has ventured into areas where it has no business intruding. The answer is not to redistribute the government's vast power but to radically reduce its power so that private individuals are free to control their own lives and property. FEE

The Therapeutic State

The Shame of Medicine: Celebrating Coercion

BY THOMAS SZASZ

"Coercion is a subjective response to a particular intervention and has been considered an unfortunate but necessary part of the care of people with psychiatric illness." That definition of the State-sanctioned forcible control of innocent persons labeled mentally ill by persons labeled psychiatrists was offered by Giles Newton-Howes—honorary senior lecturer in the department of psychological medicine, Imperial College London, and consultant psychiatrist at Hawkes Bay District Health Board, Napier, New Zealand—in the editorial in the June 2010 issue of *The Psychiatrist,* a journal of the Royal College of Psychiatrists (United Kingdom).

In contemporary English the meaning of the noun "coercion" is clear and uncontroversial. The Merriam-Webster online dictionary defines it as "the act, process, or power of coercing; . . . <a promise obtained by coercion is never binding> . . . synonyms: arm-twisting, force, compulsion, constraint, duress, pressure . . .; near antonyms: agreement, approval, consent, permission." Coercion is emphatically *not* the private "subjective response" of the oppressed person; it is the objective, publicly observable action of the oppressor. According to the authoritative *Black's Law Dictionary* (Fourth Revised Edition), the relationship between hospital psychiatrist and patient clearly constitutes coercion: "COERCION. Compulsion; constraint; compelling by force or arms."

> Contemporary practitioners of psychiatry brag about their love of the naked power they exercise over their captives.

Contemporary practitioners of psychiatry, enlightened by neuroscience, brag about their love of the naked power they exercise over their captives. In her book *Weekends at Bellevue,* Julie Holland explains:

> So why am I so attracted to this patient population? I've always been enthralled by insanity. . . . [N]ow I am the doctor in charge of Bellevue's psychiatric emergency room. . . . I run two fifteen-hour overnight shifts on Saturday and Sunday nights. They call me "the weekend attending." It feels just like rock-and-roll psychiatry to me. This is my Saturday night gig. . . . [The police deliver a prisoner receiving methadone detoxification.] I go inside to talk to Nancy [the nurse]. "The cop wants dead weight, the prisoner wants methadone. Looks like we should probably just take advantage of the situation." We agree to do something that everyone knows damn well is completely against the rules. I have never done it before or since: I tell the patient we are going to give him an injection of methadone, and we give him Thorazine. . . . [S]ometimes down here, the end justifies the means. This way, he calms down, the cop is happy, they both leave and we can go on with our night.

The State-sanctioned forcible control of one group of innocent persons by another group of persons authorized to control them is, of course, as old as civilization. We call its prototype "slavery." Justified by religious and philosophical authorities, the supporters of such systems of institutionalized domination-submission always felt morally superior to those who rejected their reasoning and opposed their power. Today, the system based on the same age-old rationalizations is called "psychiatry." I have renamed it "psychiatric slavery."

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"If slavery is not wrong," declared Abraham Lincoln, "nothing is wrong. I cannot remember when I did not so think, and feel." Slavery is wrong because it empowers one group of persons to deprive another group of liberty on the ground of who they are, not of what they do. I knew very little about Lincoln when I grew up in post-World War I Hungary. But I did recognize, as a gut feeling, that if the domination of the mental patient by the psychiatrist is not wrong, then nothing is wrong. I cannot remember when I did not so think and feel.

Wrong but Necessary

Many decades later I learned about Lincoln's more complex, confused, and conflicted opinions about slavery, and also about the inconsistency of libertarians' passionate commitment to the principle of self-ownership as a pillar of individual liberty and their penchant to turn their gaze away from psychiatric slavery as an integral part of the political-social fabric of modern Western societies.

> If domination of the mental patient by the psychiatrist is not wrong, then nothing is wrong.

In 1999 an editorial in the *British Medical Journal* warned, "The growing pressures on them [psychiatrists] to deliver public protection was perhaps inevitable, given the rise of biopsychomedical paradigms as explanations for the vicissitudes of life in modern Western society. Psychiatrists have played their part by assuming the authority to explain, categorize, manage, and prognose in situations where well defined disease (arguably their only clearcut remit) was not present."

Such warnings have not deterred prominent psychiatrists from making brazen claims about the nature of psychiatry as a *medical* specialty. In an editorial in the September 2010 issue of *Current Psychiatry,* titled "Integrating Psychiatry with Other Medical Specialties," psychiatrist Henry A. Nasrallah—professor of psychiatry at the University of Cincinnati College of Medicine (my alma mater)—writes, "As a specialty that deals with brain disorders, psychiatry is now much more integrated with other medical and surgical specialties than in the past. Psychiatry is no longer perceived as a 'different' discipline. . . ." Where is the outrage at this shameless mendacity? Nowhere.

Forgotten Human Rights Violations

The human-rights violations of chattel slavery, colonialism, the Inquisition, national socialism, and communism have been well documented. Sporadic reports of the human-rights violations of psychiatry abound in our newspapers and magazines. They are quickly forgotten as exceptional "abuses." More than 50 years ago I set myself the task of not letting the profession and the public forget that psychiatry—the oppression of the patient by the psychiatrist, today justified as the patient's liberation from an illness that robs him of freedom and responsibility—belongs in the same pantheon of brutal oppressions as do chattel slavery, colonialism, the Inquisition, national socialism, international socialism (communism), and institutions dedicated to the coercive betterment of humanity not yet invented.

Sixty years ago, when I was young, the psychiatrist was embarrassed by his role as coercer. Now, when I am old, he is proud of it. That, in my opinion, is the sum total of the "progress" achieved by modern, "scientific psychiatry." It is a fearful truism that we learn from history that we do not learn from history: "The time to guard against corruption and tyranny, is before they shall have gotten hold on us. It is better to keep the wolf out of the fold, than to trust to drawing his teeth and talons after he shall have entered." (Thomas Jefferson, 1782)

But this wolf does not enter. He is inherent in human nature, and we must purge it from our own souls, one soul at a time. FEE

Gold and Money

BY WARREN C. GIBSON

Nothing seems to arouse passions—pro and con—quite like suggestions that gold should once again play a role in our money. "Only gold is money," says one side. "It's a barbarous relic," says the other. Let's turn down the heat a bit and look into some propositions about gold. That should lead us to some reasonable ideas about whether or how gold might return.

Propositions About Gold

Gold has intrinsic value. Actually, nothing has intrinsic value. The value of any good or service resides in the minds of individuals contemplating the benefits they might derive from it. What gold does have is some rather remarkable physical properties that make it very likely that people will continue to value it highly: luster, corrosion resistance, divisibility, malleability, high thermal and electrical conductivity, and a high degree of scarcity. All the gold ever mined would only fill one large swimming pool, and most of that gold is still recoverable.

Nothing has intrinsic value. What gold does have is some rather remarkable physical properties that make it very likely that people will continue to value it highly.

Only gold is money. Although gold was once used as money, that is no longer the case. Money is whatever is generally accepted as a medium of exchange in a particular historical setting. Right now, government-issued fiat money, unbacked by any commodity, is the only kind of money we find anywhere in the world, with some possible obscure exceptions.

Perhaps people who say this mean that gold is the only form of money that can insure stability. That's what future Federal Reserve Chairman Alan Greenspan thought in 1967, when he wrote "Gold and Economic Freedom" for Ayn Rand's newsletter. "In the absence of the gold standard, there is no way to protect savings from confiscation through inflation," he said. When later asked by U.S. Rep. Ron Paul whether he stood by that article, Greenspan said he did. But he weaseled out by saying a return to gold was unnecessary because central banks had learned to produce the same results gold would produce.

The gold standard is too rigid. The gold standard makes it impossible for a government central bank to conduct monetary policy—hooray! Under the Fed's watch the dollar has lost more than 95 percent of its purchasing power and the economy was convulsed by the Great Depression of the 1930s, the stagflation of the 1970s, and the crash of 2008. Milton Friedman long ago explained the long and variable lags that follow monetary interventions and at one point called for replacing the Fed with a computer. The end of government economic manipulations in the form of monetary policy is a major potential benefit of a gold standard.

Gold is supposedly too rigid to accommodate increased demand for money at certain times of the year—historically harvest time and Christmas time—or in wartime. Falling prices are one way an economy can

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adjust to an increase in the demand for money, but this accommodation works best over a longer period. A short-term accommodation is possible when banks hold fractional reserves. On short notice and without any increase in monetary gold, fractional-reserve banks could simply issue more bank notes or their electronic equivalent during periods of high demand and retire them when demand subsided.

Inflation is impossible under a gold standard. Between 1897 and 1914 the gold stock rose at about 3.5 percent a year due to new discoveries and inflows from abroad. As a result, prices rose about 26 percent over this span, or about 1.4 percent per year. This was not a disruptive level of price inflation—but it was inflation.

The gold standard was tried and failed. This is a plausible proposition, not to be dismissed out of hand. Nor may we simply note that because we never had a pure gold standard, the concept was never really tested. We must do better than that.

During much of our history, money was linked to gold in some degree, and there were some serious monetary problems during that time. The record of gold is bound up with the institutional arrangements that prevailed at various times in our history. Snapshots from that history should help illuminate this claim.

The record of gold is bound up with the institutional arrangements that prevailed at various times in our history.

Before proceeding, we need a definition. Under a gold standard either private banks or a monopoly central bank issues notes (or their electronic equivalent) redeemable in gold. Gold coins may circulate as well. Notes may be fully or fractionally backed, meaning a note issuer may not have sufficient gold to redeem all outstanding notes at one time. In passing I assert, contrary to some "hard money" advocates, that fractional-reserve banking is an institution that is entirely compatible with free markets and the rule of law.

The period between the War of 1812 and the Civil War is commonly called the "free banking era." It is also called the era of "wildcat banks" because many banks were poorly capitalized, poorly if not fraudulently managed, and prone to failure. Conventional wisdom says that this era demonstrates conclusively the need for strict government regulation of money and banking. Like other free-market institutions, free banking rests on the sanctity of property rights, with no government involvement other than prosecution of theft or fraud. But there was substantial government involvement all along, so the "free banking" label is only accurate in relative terms.

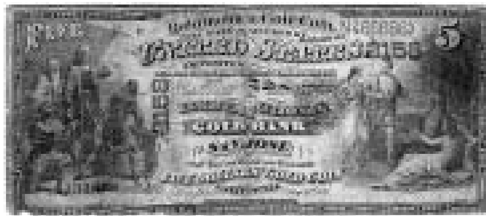
The most egregious departure from free-banking principles was the frequent suspension of specie payments: banks' refusal to honor their obligation to redeem their banknotes for gold. These breaches of contract, which should have triggered liquidation and perhaps criminal prosecution, were in many instances tolerated or even encouraged by government authorities, especially during times of war or economic contraction.

Second, the free-banking paradigm does not include a monopoly central bank. The Second Bank of the United States—roughly speaking, the U.S. central bank of its time—closed its doors in 1836. Its defeat, engineered by populist President Andrew Jackson, with wide support from a public that had been generally suspicious of banks since the founding of the Republic. But the end of the Second Bank was by no means the end of federal government involvement in banking. With the Second Bank gone, the federal government still needed depositories for its funds. Certain private banks, which came to be known as "pet banks," were selected for this privilege. This was one way in which the federal government continued to influence the banking system.

A third intervention, practiced by federal and state governments, was prohibition of branch banking. No banks were allowed to cross state lines to open branches, and there were significant restrictions within most states as well. The strictest state laws forbade any branching whatever, while others allowed branching within their states on a limited basis. The result was that many communities could only be served by small, poorly capitalized, and often poorly managed local banks. Stronger city banks might have established branches in areas where early banks had failed or where

none had emerged, particularly with the spread of the telegraph and railroads. But they were not allowed to do so. For confirmation of the ill effects of branch prohibition, we need only look as far as Canada, which has always had a few strong nationwide banks. During the Great Depression, when some 9,000 U.S. banks failed, not a single Canadian bank went under.

Fourth, many state governments required banks to hold their bonds as part of their reserves. This of course provided a captive market for such bonds. The National Banking System, established after the Civil War, imposed a requirement to hold federal Treasury securities. Thus the five-dollar gold note (see photo), issued by the Farmers Gold Bank of San Jose, California, in 1874 promises to "pay the bearer on demand five dollars in gold coin." But it also says the note is "secured by bonds of the United States deposited with the U.S. Treasurer at Washington." In other words, the government gave the banks incentive to substitute bonds for some of the gold they might have held as reserves.



The gold standard is to blame for severe downturns in 1893 and 1907. The panic of 1893 was quite severe. That year saw numerous railroad bankruptcies, bank failures, and declining stock prices. Among the causes were general overbuilding of railroads, the Silver Purchase Act of 1890, and the protectionist McKinley tariff of 1890. Perhaps a modern central bank, with unlimited money-creation power, could have mitigated some of the immediate pain. But as we have seen, the record of the Federal Reserve, which acquired that power in the following century, suggests a failed institution. As it was, the panic was over in fairly short order and economic growth resumed.

The Panic of 1907 was marked by bank runs, numerous bankruptcies, and sharp drops in stock prices. A trigger for the Panic was a failed attempt to corner the stock of United Copper using borrowed money. Other factors included the San Francisco earthquake and the Hepburn Act, which gave the Interstate Commerce Commission power to set maximum railroad rates, suppressing the shares of those companies.

The Panic was ended largely through the efforts of J. P. Morgan. Again, things turned around in fairly short order and growth resumed.

The dollar-gold link established by the 1944 Bretton Woods agreement didn't work. Indeed it didn't, at least not for long. Under Bretton Woods the United States and its currency were accorded a special role. The United States was obliged to redeem dollars for gold, but only dollars tendered by foreign central banks. No one else could get gold for dollars, and no other currencies were directly redeemable. There was a tacit agreement that foreign governments would not "abuse" their redemption privilege, but the French under Charles de Gaulle and his gold-oriented finance minister, Jacques Rueff, saw things differently and insisted on redemption—which, oddly enough, entailed moving gold bars from one part of the New York Fed's vault to another, since the Fed was storing gold as a service to the French. By 1971 it had become clear that far more dollars were likely to be tendered than could be covered by gold, and President Nixon unilaterally ended gold redemptions. This cut the last (very indirect) link between the dollar and gold. By then silver had disappeared from U.S. coins as well.

De Gaulle cannot be blamed for the failure of Bretton Woods. All he did was to point out the emperor's lack of clothing. As the Federal Reserve created more and more fiat money, some of which made its way overseas, the redemption promise rang more and more hollow. By the time Nixon took action there was no other choice but to slam the gold window shut.

Milton Friedman was one of the first to propose floating exchange rates. The notion seemed radical and unworkable at the time (around 1960). That of course is the system we have now, and while it has eliminated sudden devaluations, currency markets are much more volatile than Friedman anticipated. Nor did he anticipate the degree to which governments would enter the markets to manipulate their own currencies, as when the Chinese authorities sell their currency to keep it from rising too fast against the dollar. And he would have been appalled at the "race to the bottom" that

threatens to break out as governments seek to boost their domestic economies by driving down their currencies to make their exports more competitive.

In his wonderful little book *Money Mischief*, Friedman asked himself whether the pure fiat standard, which has been in force only since 1971, could endure. He didn't give a definite answer but expressed grave doubts. The possibility of a general loss of confidence in fiat money is reason to believe that gold could once again play a monetary role, as I will argue in the second part of this series.

The gold that was once locked up at Fort Knox is gone. It has been 40 years since the last indirect link between the dollar and gold was severed, and yet the government continues to hold some 8,000 metric tons of gold bullion—the world's largest single stash. Oddly enough it is valued at $42 per ounce, the last official price before it was set free to be established in free trading. At today's market price of around $1,300 per ounce, the hoard would be valued in the hundreds of billions of dollars, although that much gold could not be dumped precipitously without suppressing the price.

James Picerno, writing in a recent issue of *The Atlantic*, asked why the hoard remains. Three hundred billion dollars may not be a huge sum in this new era of trillions, but it's not chump change either. His conclusion: A selloff would be seen as a sign of weakness or even desperation and might trigger a loss of confidence in the government's money and/or its debt. He also cites a poll which indicates that 87 percent of Americans believe the government shouldn't sell its gold reserves. We can only conclude that gold still plays a very indirect role in maintaining confidence in the government.

But is the gold still there? Yes, almost certainly, though we hear occasional calls for an outside audit. A more plausible accusation is that some of it has been leased to short sellers. This is a common practice among central banks that offers distinct benefits to the government. First, it earns a bit of interest income. More important, it can covertly suppress the gold price. Rising gold prices annoy Treasury secretaries and central bankers because the rise implies falling confidence in their currency. Leased gold remains in the vault and on the balance sheet even though it (or rather a paper claim on it) has been sold to someone else. Although one can find rumors on the Internet, there is no way, short of a thorough audit, to know the extent of gold leasing by the U.S. government, if any.

With the global economic downturn continuing and the prospect of currency wars looming, scattered voices are again suggesting a role for gold in our money. One of those voices belongs to Robert Zoellick, president of the World Bank. Could gold stage a comeback in some form? In Part 2 we will examine those prospects. FEE

Economics Of a Pure Gold Standard

by Mark Skousen

"The financial crisis of 2008 and the subsequent Great Recession shook the very foundations of our current leveraged fiat-money system."

In this classic work, Skousen examines gold's unique ability to retain its purchasing power and limit the havoc governments can wreak on the global economy. By examining the history and mechanics of gold-based monetary systems, Skousen lays out the case for a workable--and urgently needed--return to the stability of gold.

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Ideological and Political Underpinnings of the Great Society

BY ROBERT HIGGS

The surge of federal economic interventions that occurred during Lyndon B. Johnson's presidency—the much-ballyhooed Great Society, whose centerpiece was the War on Poverty—differed from the four preceding surges, each of which had been sparked by war or economic depression. No national emergency prevailed when Johnson took office following John F. Kennedy's assassination on November 22, 1963. The nation was not engaged in a major shooting war, and the economy was on the mend after the mild recession of 1960–61. For the most part, the Great Society represented simply the culmination of economic, political, and intellectual developments stretching back as far as the nineteenth century.

After the Korean War armistice of July 27, 1953, the United States had enjoyed a decade of respite from the rapid growth of government power over economic affairs. The wartime wage, price, and production controls lapsed, although authority to reinstitute the production controls remained. No major extensions of the government's economic controls were enacted. Big government did not disappear, of course; many of the controls and other interventions put in place in the 1930s and 1940s remained in force. But businessmen, according to economist Herbert Stein, "had learned to live with and accept most of the regulations." Government spending, especially for Social Security benefits, crept upward. All in all, however, the Eisenhower and Kennedy administrations were placid in comparison with their immediate predecessors and successors.

Under Johnson, however, the federal government's intrusion into economic life swelled enormously. Major events included enactment of the Civil Rights Act of 1964, the Economic Opportunity Act of 1964, the Food Stamp Act of 1964, the Elementary and Secondary Education Act of 1965, and the Social Security Amendments of 1965 (creating Medicare and Medicaid), as well as establishment of the Office of Economic Opportunity (to oversee programs such as VISTA, Job Corps, Community Action Program, and Head Start), the Community Action Agencies, and many other bureaus ostensibly promoting poor people's health, education, job training, and welfare. In addition, broad-gauge economic regulatory measures were adopted in connection with traffic safety, coal-mine safety, consumer-products safety, age discrimination in employment, truth in lending, and other areas.

> Great social changes and an unusually large (and "leftist") Democratic majority set the stage for the Great Society's massive expansion of government into all areas of life.

What accounts for this multifaceted outburst? Do its various elements have a common denominator? Some scholars point to an intellectual development that Stein dubs "Galbraithianism," after its leading propagator John Kenneth Galbraith—a loose collection of socioeconomic analysis and evaluation hostile to the free market and favorably inclined toward more sweeping government controls. "There was," says Stein, "no demand for a new and different economic system" in the Galbraithian view. Rather, "[t]he ideological case for the old system, the free market, capitalist system, was punctured by the demonstration of exceptions to its general rules and claims, and this opened the way for specific policy interventions and measures of income redistribution without any visible limits."

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Galbraithianism's arguments and attitudes gained strength from a spreading conviction that the U.S. economy would continue to grow forever at a fairly high rate, thereby ensuring that new and costly government programs could easily be financed by drawing on the "growth dividend."

Economist Henry Aaron's description of the climate of opinion in the 1960s essentially agrees with Stein's. Aaron traces the widely held Galbraithianism back to previous crises: "The faith in government action, long embraced by reformers and spread to the mass of the population by depression and war, achieved political expression in the 1960s. This faith was applied to social and economic problems, the perceptions of which were determined by simplistic and naive popular attitudes and by crude analyses of social scientists."

At the same time, a so-called New Class—composed of scientists, lawyers and judges, city planners, social workers, professors, criminologists, public-health doctors, reporters, editors, and commentators in the news media, among others—viewed new government programs as outlets for their "idealism" and as opportunities to do well while doing good. Thus a multitude of left-leaning intellectuals and pseudo-intellectuals gave significant leadership, support, and voice to the government surge of the Johnson years.

A spreading belief that the U.S. economy would grow forever at a high rate made new and costly programs seem even more appealing.

More prosaic political developments also played an important role. Lyndon Johnson, who had begun his political career as a New Dealer and political horse-trader in Texas, possessed not only boundless ambition but also keen political instincts and skills; he knew how to move Congress in the direction he wanted it to go. Moreover, the elections of 1964 gave the Democrats huge majorities in both houses of Congress and brought into office an extraordinarily leftish group of freshman legislators. According to Aaron, "No administration since Franklin Roosevelt's first had operated subject to fewer political constraints than President Johnson's."

The specific forms the Great Society took reflected the increasing diversity of animals in the political jungle. While longstanding lobbies for business, labor unions, farmers, and middle-class professional groups continued to operate, many new interest groups organized and gained political clout on behalf of women, Indians, Chicanos, students, homosexuals, the handicapped, the elderly, and many others, none of whom had been directly represented as such to an important extent in U.S. politics. These groups demanded that the federal government solve a variety of racial, urban, employment, and consumer problems, real and imagined.

Galbraithianism, Marxism, and other varieties of critical socioeconomic analysis also helped to justify the displacement of antiwar and pro-civil-rights enthusiasms onto a diverse set of anti-market causes, giving rise to heightened support for environmental, consumer, and zero-risk regulations. No perceived social or economic problem seemed out of bounds in this cacophonous new political environment.

Although the Great Society established critically important new federal powers and agencies, it did not cause federal domestic spending to increase tremendously at first. A portentous sign might have been seen, however, in the quick acceleration of federal transfer payments, which increased from $34.2 billion in 1963 to $65.5 billion in 1969. Over time this locomotive gained more and more momentum. According to Michael D. Tanner of the Cato Institute, between 1963 and 2010, "the federal government spent more than $13 trillion fighting poverty."

Almost everyone now acknowledges that federal entitlement programs, crowned by the enormously costly health-care systems the Great Society spawned, have promised much greater benefits than the government can fund, and hence that many of these benefits will have to be cut, notwithstanding the political fury such cuts surely will elicit. This impending socio-political tumult represents one of the Great Society's bitterest fruits. FEE

What Economic Freedom Indexes Leave Out

BY KEVIN A. CARSON

In a syndicated column last October, television journalist John Stossel lamented the downgrading from sixth to eighth place—"behind Canada!"—of the United States on the Heritage Foundation/*Wall Street Journal* Index of Economic Freedom. The Index is based on several metrics, including freedom of movement of capital, the degree of business regulation, and levels of taxes and spending. Apparently increased government spending, coupled with the bailouts and/or purchases of banks and auto companies, was the primary cause of the U.S. decline.

For the first time in 16 years the U.S. economy was reclassified from "totally free" to "mostly free." But wait: The United States was *totally free* economically until 2010? That's enough to suggest that the Index focuses on quite a narrow range of "economic freedom" criteria, rather than looking critically at the forms of State intervention most structurally important to the survival of big business and corporate power.

The United States was *totally free* economically until 2010?

For example, by any valid measure of economic freedom, the passage of the WIPO Copyright Treaty, the Uruguay Round TRIPS (Trade-Related Aspects of Intellectual Property Rights) Accord, and the Digital Millennium Copyright Act would have been considered an upward surge in statism and protectionism unequaled since (at least) the Smoot-Hawley Tariff. "Intellectual property" is every bit as much a form of protectionism as are tariffs. Patents and copyrights serve exactly the same protectionist function for transnational corporations that tariffs did for the old national industrial corporations; in both cases they restrict who is permitted to compete in offering a given good to a given population.

But among the inside-the-Beltway "free market community," Heritage is one of the staunchest advocates of global "intellectual property" enforcement expansion. Indeed, two lines out of six in its summary concerning its metric for "Property Rights" in the United States are taken up by this: "A well-developed licensing system protects patents, trademarks, and copyrights, and laws protecting intellectual property rights are strictly enforced."

One-Sided Index

There are other suggestions of the one-sided nature of the Index, as well. For example, under "Labor Freedom" it simply states that "dismissing an employee is not burdensome." Never mind for the moment that, from the standpoint of an employee, a bit of contractual security might be a good thing. (I doubt if the people at Heritage would generalize this disdain for contracts to all their other commercial dealings.) What's important is what the article *doesn't* say: "Quitting without notice is not burdensome." In fact it is not burdensome; workers in most states are at-will employees unless a union contract specifies otherwise. But Heritage doesn't consider the contractual burden on the worker or lack thereof a sufficiently important issue even to bear commenting

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on—and this in a section titled, mind you, *Labor* Freedom, not *Employer* Freedom.

The problem is that an index, ostensibly put forward as a general survey of economic freedom as such, is really a survey of economic freedom primarily as it affects the minority of the population that owns considerable amounts of capital and employs others. The idea that being employed is an economic activity, and that those who are employed have economic interests as much as those who do the employing, doesn't even appear on the radar.

Yet another example of the Index's bias is its "concerns" regarding bailouts of automakers over "expropriation and violation of the contractual rights of shareholders and bondholders." Bill Beach, director of the Heritage Foundation's Center for Data Analysis, laments that "the rule of law declined when the Obama administration declared some contracts to be null and void. For example, bondholders in the auto industry were forced to the back of the creditor line during bankruptcy."

But note the glaring lack of concern for contractual rights guaranteed under GM's contracts with the UAW. This one-sided concern with impairment of the obligation of contracts is fairly widespread on the "free market" right. The same people who protested the loudest about bailout "blackmail" in interfering with CEO salaries and benefits, oddly enough, were by and large also the source of the most strenuous calls for using Washington bailout money as a hammer to "impose discipline" on auto workers. So apparently, for a certain breed of "free market" advocate, the differential between a GM and Toyota assembly line worker is problematic—but the differential between a GM and Toyota CEO isn't. What's that thing I was saying before? Contractual security is a good thing—for everybody but workers.

This shortcoming is compounded by Heritage's endorsement of Bush Treasury Secretary Henry Paulson's original TARP program. Stuart Butler and Edwin Meese, in a 2008 article entitled "The Bailout Package: Vital and Acceptable" (www,tinyurl.com/368oyuv), did express concerns lest the bailout take the form of a blank check—to the government, that is.

So they favored TARP, as such—a Hamiltonian program of using taxpayer money to prop up the bubble-inflated value of financial assets and preventing them from being marked down to market value. They just objected to any conditions on how the free money could be spent once the banksters got hold of it. I wonder how they feel about workfare. I understand that it was probably different people composing the different passages in question, but still it would be nice if the right hand knew what the further-right hand was doing.

> The Index fails to distinguish between the primary interventions that prop up corporate power and the secondary interventions that attempt to moderate the side effects.

Ignoring Primary Interventions

The Index fails to distinguish between the primary, structural forms of government intervention that prop up corporate power and the secondary, ameliorative forms of intervention that attempt to moderate its side effects. The State enforces a whole host of artificial property rights and artificial scarcities that serve as sources of economic rent to privileged firms, and maintains all sorts of regulatory cartels. The cumulative effect of these privileges, artificial scarcities, and cartels is to sustain corporate power on a global scale and create vast disparities in wealth.

These forms of intervention, these primary grants of privilege, don't show up very prominently on the Index of Economic Freedom. What *does* show up is mainly the kinds of fiscal and welfare-state interventions that serve to *limit* the exercise of State-granted privileges and make corporate power less galling to average people. Is it only "statism" when it benefits someone besides the rich?

In fairness, while Heritage supports many of the legal privileges that serve as entry barriers at the national level, the Index does at least acknowledge barriers to small business formation at the state and local levels, comparing them favorably to other places: "The

overall freedom to start, operate, and close a business, regulated primarily at the state level, is still strongly protected [in the United States]. Starting a business takes six days, compared to the world average of 35 days. Obtaining a business license takes less than the world average of 218 days. . . ."

The same critique applies to other indices of "economic freedom," as well. For example, Like Heritage, the Economic Freedom of the World Index (Fraser and Cato institutes) treats voting for anything called a "free trade agreement" as a proxy for supporting free trade. Economist Dean Baker ridicules mainstream journalists for taking the "free trade" label at face value when the primary purpose of such agreements is to boost "intellectual property" protectionism rather than to reduce tariff protectionism. In the introduction to *The Conservative Nanny State*, Baker writes:

> [N]ews reports routinely refer to bilateral trade agreements, such as NAFTA or CAFTA, as "free trade" agreements. This is in spite of the fact that one of the main purposes of these agreements is to increase patent protection in developing countries, effectively increasing the length and force of government-imposed monopolies. Whether or not increasing patent protection is desirable policy, it clearly is not "free trade."
>
> It is clever policy for proponents of these agreements to label them as "free trade" agreements (everyone likes freedom), but that is not an excuse for neutral commentators to accept this definition.

Several other indexes also treat voting for anything called a "free trade agreement" a a proxy for supporting free trade.

Nicholas Hildyard had a pretty good handle on what's actually entailed in the neoliberal "free market" agenda promoted by these indices. The effect of the agenda "has not, in most cases, been to diminish either the state's institutional power or its spending. Instead, it has redirected them elsewhere. It has also strengthened the power of many Northern nations to intervene in the economic affairs of other countries. . . ."

Of the kind of "privatization" that prevailed, for example, under Chile's Pinochet and has since been promoted by assorted "structural adjustment" programs, Hildyard wrote:

> While the privatisation of state industries and assets has certainly cut down the direct involvement of the state in the production and distribution of many goods and services, the process has been accompanied by new state regulations, subsidies and institutions aimed at introducing and entrenching a "favourable environment" for the newly-privatised industries. ["The Myth of the Minimalist State," *The Corner House*, March 1998; www.tinyurl.com/22uu8fm]

In practice, such "privatization" involves, first of all, spending taxpayer money on upgrades of State property to entice corporate buyers to take it off their hands—with the new outlays to make the property salable frequently exceeding the purchase price. The bidding process itself for State-owned industries and utilities has usually been governed by what Joseph Stromberg calls "funny auctions, that amounted to new expropriations by domestic and foreign investors" ("Experimental Economics, Indeed," Mises.org, Jan. 7, 2004; www.tinyurl.com/3x873rt). The first order of business, subsequently, is massive asset stripping by the new corporate owners. And as Hildyard suggested, the newly "privatized" functions are carried out within a web of special regulations and protections to make sure the "private" firms are insulated from anything resembling genuine market competition.

A genuinely libertarian privatization policy, as recommended by Murray Rothbard in "Confiscation and the Homestead Principle" (*Libertarian Forum*, June 15, 1969), would treat State-owned utilities as the homesteads of those working them.

The same is true of so-called "deregulation," which (as Hildyard pointed out) can more accurately be called *re*regulation. The nature of most so-called utility deregulation can be illustrated by the mid-1990s electrical "deregulation" in Texas, home of "free market" champions like Dick Armey and Tom DeLay. Writing at Mises.org, Tim Swanson stated:

[I]n the mid-90s, regulators, consumers and energy producers began to rearrange the market for "deregulation" in Texas. Incumbent providers such as TXU and Reliant were restructured in the name of free markets, but when the dust cleared, the only winners were members of the political class and corporations that had been State-sanctioned monopolies prior to the "deregulation."

TXU was separated into two companies, Oncor and TXU Energy. Oncor was given the monopoly on all services including meter reading, energy delivery, etc. Additionally they own all of the poles and wires and are protected by law from competition. TXU Energy became a billing company (and owner of power plants), merely forwarding all of the customer service questions and problems to Oncor, and therefore providing no services themselves.

This is akin to the following: splitting AT&T into two separate companies, one (Nexis) that owns all of the cables, wires, PBXs, switching stations, call centers, etc. and provides all of the services, repairs, installations, etc., and the other company (Willy) whom [sic] simply sends you a bill at the end of the month, providing no value-added service.

Not only is it not deregulation (the same players exist with State protection) but more overhead is created through the creation of another billing company. ["Texas Sized Tomfoolery," Sept. 9, 2003; www.tinyurl.com/25f2jr7]

When the mainstream press and mainstream politics identify the narrow analysis associated with the indices as "economic freedom," it's no wonder that most people are wary of "free markets." If I didn't know better—if I didn't know that real free markets were like kryptonite to corporate power—I'd hate them myself. FEE

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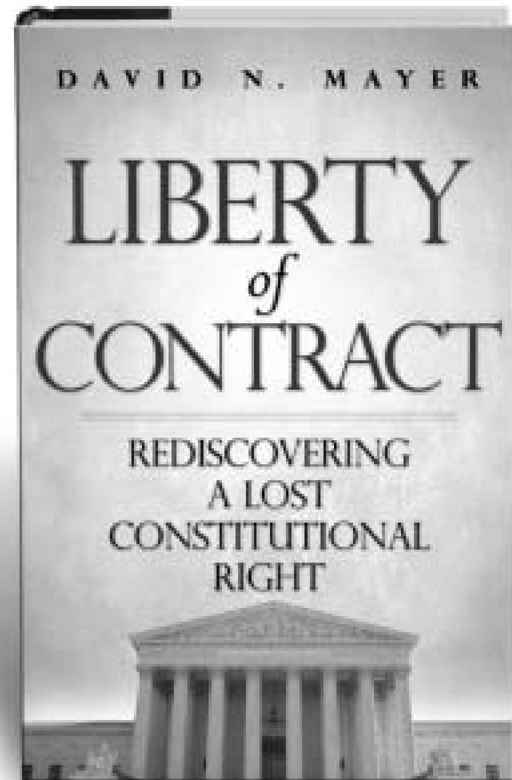

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Seasteading: Striking at the Root of Bad Government

BY PATRI FRIEDMAN AND BRAD TAYLOR

Libertarians have done a wonderful job of pointing out the inefficiency and cruelty of government and identifying some of the causes. We know that current policies are bad; we know that such policies are the inevitable outcome of unrestrained democracy; and we even have some ideas about what would work better. The most fundamental problem with government and the most promising form of activism have been largely ignored, though. If we want liberty in our lifetimes, we need to think more carefully about why we have bad government and how best to improve things.

To think about this question, we need to avoid being either too romantic or too cynical about governance. While readers of this publication are at no risk of being romantic about government, there is a chance of excessive cynicism. Government currently works very poorly, but this doesn't need to be so. Competition would force providers of governance to offer high-quality rules and public services at a reasonable price, unleashing institutional innovation and making the world a much better place.

So far, most libertarians have been hacking at branches, while a few come tantalizingly close to striking at the root. We're going to try to convince you that the root at which we should be striking is a tangled mess of barriers to entry and costs of switching in the governance market. The ax we should be using is the technology to settle the ocean.

> The root we should be striking at is a tangled mess of barriers to entry and costs to switching in the governance market.

Rules Matter

Rules governing interaction and resolving disputes are an essential part of free and prosperous human life. It's difficult to stress strongly enough the importance of good rules. There are enormous differences in living standards around the world, and affluence is largely determined by the geographical lottery of birth. The average American earns about $47,000 a year, while the average Zimbabwean gets by on a little more than $300. This doesn't mean that Americans simply have more stuff, but also more health, security, and peace.

The difference between the United States and Zimbabwe is that the former has relatively good institutions that allow trade and specialization, while the latter does not. An even starker demonstration of the power of rules comes from the Korean peninsula. Before World War II, North and South Koreans shared a common culture, history, and set of rules. With the arbitrary division of the country based on the strategic maneuvering by the United States and the Soviet Union, this all changed. The South became more free; the North less. The result of this natural experiment is those in the South are now almost 15 times richer than those in the North.

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Of course, even relatively rich countries have their problems, and libertarian policy activists have spent countless hours and pages describing areas for improvement. Patri's grandfather Milton Friedman, for example, painstakingly laid out the problems caused by many government programs and argued that giving people greater freedom would lead to dramatic improvements. While such reforms would certainly be desirable, simply insisting that we need particular reforms ignores the incentives of the political system.

This neglect is rather odd: Libertarians are well aware of systemic incentives and unintended consequences at the policy level, but most ignore similar problems in the higher-level political system. They will chide statists for assuming they can bring about a particular social or economic outcome through top-down planning, and then go on to specify how they'll change the rules from the top down to allow bottom-up interaction.

Public Choice applies as much to writing constitutions as it does to governing under them.
commons.wikimedia.org

Policy activists are forgetting that the same problems that prevent statist policies from working as advertised also block desirable reforms. The political system is itself a spontaneous order in which the interaction of many individuals operating under various constraints and incentives determines the policy decisions that will eventually be reached. This is where Public Choice theory is helpful: It allows us to analyze the incentives of political actors and suggests a more fundamental level of intervention.

Meta-Rules Matter

Public Choice begins with a simple, indisputable, but somehow widely rejected idea: Politicians, voters, and bureaucrats are not angels. Political actors do not selflessly strive to pursue the common good but respond to incentives. James M. Buchanan describes Public Choice, a field he jointly founded, as "politics without romance."

The theory makes a distinction between two levels of politics. At the first is the to-and-fro of everyday politics in which rules are created, amended, and repealed. This is the level at which policy activists concentrate their efforts. The behavior at this level, though, is determined by the incentives created at the constitutional level. Public Choice theorists argue that if we want to improve policy, we need to do so indirectly by changing the constitutional meta-rules (rules about rulemaking) through which ordinary rules are established.

This has led many to advocate constitutional limits on the power of government. While this approach is better than lobbying for particular policy changes, since the results are likely to be more robust, Public Choice-influenced constitutionalists have not entirely rid their analysis and approach to activism of romance.

The familiar problems of unintended consequences also arise at the constitutional level. Even if we could design the perfect constitution, we'd need to find a way of implementing and enforcing it. Given that this would need to happen through existing political channels, we're unlikely to end up with anything good. Constitutional politics is still politics, and those drafting the new constitution have the same foibles as anyone else.

The problem of crafting better meta-rules is the same as that of crafting better rules: We know what the problems are and might even have some good ideas about how things can be improved. What we don't have is a mechanism for improving things. The interests and passions of people do not disappear when they start

drafting constitutions, and political behavior, whether at the policy or constitutional level, emerges from the interaction of various agents. We need to think about the incentives that structure all political behavior, including that of the constitutional level.

The Governance Industry Matters

An extremely useful way to think about the incentives that structure the political game is to consider the market for governance. Rules have economic value, and people would be willing to pay for them. We can think of the bundle of rules and public goods provided by government as a product, governments as producers, citizens as consumers, and taxes as prices.

This seems counterintuitive, especially to libertarians—who realize that markets provide choice whereas governments as we know them do not. There are, however, a number of benefits to this view. It allows us to analyze the industry structure for government and learn why governance quality is currently so low. The current market for governance is dominated by a series of large geographic monopolies not subject to competition. In a competitive market those organizational forms that are not conducive to producing high levels of customer satisfaction are weeded out by natural selection. Without competition, this selection mechanism is absent and we end up with what we have today: bad firms producing bad products.

The providers of governance face little real competition because of the difficulty in switching from one to another.
Aotearoa [Wikimedia.org]

This is why we have bad constitutional structures.

A number of scholars have already recognized this. The idea of market anarchism is to have governance services such as rulemaking, adjudication, and protection provided on the open market. This would force providers to compete and the incompetent would go out of business. Patri's father, David Friedman, provided what is, in our unbiased opinion, the best description of how such a polycentric system would work in his book *The Machinery of Freedom*. Market anarchism is not simply a system of good rules or even a system for producing good rules. It is a system for producing good rule-making organizations.

Similarly, though less radically, some have argued that we need to geographically decentralize political power. With smaller units of governance among which citizens could move based on quality and their idiosyncratic preferences, we'd see governors constrained by the threat of exit and the quality of governance would improve. This was an important argument underlying the federalism of the U.S. Constitution: There would be competition among the several states, and Americans would enjoy better governance.

While market anarchists and decentralists are correct that we need more competition if we are to improve government, they have generally failed to address the reasons we have such an uncompetitive market for governance and therefore provide no route for getting from here to there.

The Technological Environment Matters

When we think of governance as an industry, the problem with policy and constitutional activism becomes clear: Policy advocates are demanding better products without providing a mechanism for products to improve, while constitutionalists are demanding better firms without providing a mechanism for firms to improve. The problem with the arguments of anarcho-capitalists and decentralists is less obvious but simple enough: They demand a better industry structure but have provided no mechanism for the industry structure to improve.

Think about the operating-system (OS) industry. This is one of the least competitive industries around (though it's still orders of magnitude more competitive than the governance industry). We all know it's uncompetitive, but simply insisting that we need to increase

competition is not useful. It is uncompetitive for a reason. Creating an operating system is an expensive undertaking, and network effects and switching costs mean that consumers are reluctant to change.

If someone genuinely wanted to make the OS industry more competitive, she wouldn't go about it by simply insisting that we need more competitors. Rather, she would attempt to change the underlying technological factors that cause the OS industry to have high barriers to entry and switching costs. We can see this happening with the open-source software movement, which does not simply create a new competitor to Microsoft, but rather opens a range of possibilities for improvement by making it easier for hackers to build custom OSes. Over time this has produced new versions of Linux that are more user-friendly and compatible with Windows, lowering the cost of switching.

This is the sort of technological activism libertarians need to engage in if they really want to change things. Some are doing this already. Crypto-anarchists aim to help people escape State control by developing more secure communication technologies; agorists aim to develop non-State institutions that would allow people similarly to avoid dealing with the State; and Julian Assange's WikiLeaks project uses technology to make government more transparent. While we applaud these efforts, we don't think they are going to get us to a radically freer world. The State is a powerful and resilient institution, and it will fight back against these internal threats to its existence. Fortunately, there is another way that has the potential to fundamentally change things.

If the ultimate problem with the governance industry is high barriers to entry and switching costs, we need to find a way to dismantle these obstructions to competition.

Seasteading

Developing the technology to create permanent, autonomous communities on the ocean seems like a strange way to solve the problem of bad governance, but we're convinced it's the best chance we have for liberty in our lifetimes. This is why Patri established The Seasteading Institute with the mission of developing the technological, political, and economic knowledge we need to revolutionize the governance industry.

If the ultimate problem with that industry is high barriers to entry and switching costs, we need to find a way to dismantle these obstructions to competition. In the past, frontiers have provided the means for disenfranchised groups to start their own country. Unfortunately, we've run out of frontier on land. Every square inch of land on the planet is claimed by some existing State, and none is going to give up its claim.

The ocean is a vast frontier unclaimed by States. While they claim some jurisdiction over resources in large areas of ocean, there is much space for political experimentation within these zones and plenty of space outside any State's practical reach. Starting your own country on the ocean will be difficult and expensive, but at least it's possible.

The ocean is not yet ready for settlement by most people. It is harsh and unforgiving, and long-term life on the sea is currently limited to only a few pioneers in the fishing, offshore oil, and cruise industries, as well as a handful of dedicated live-aboard sailors.

Technology, though, has the potential to make the ocean a feasible alternative for more people. Early pioneers will learn lessons that will make life on the ocean easier, thus prompting previously unwilling pioneers to make the move. Over time the costs in comfort, safety, and access to civilization will fall and the ocean will be just another place to live. This is the path we see on any frontier. Living in the harsh environment of North America would not have seemed like an attractive proposition to most Europeans a few centuries ago. Eventually, the wilderness was tamed, and North Americans now enjoy higher standards of life than many in the old world.

As it happens, the ocean has another important benefit. Water makes it easy to shift large objects around cheaply. This is what allowed the global shipping industry to prosper, and it could also help make

government more competitive. We normally think of buildings as being tied to land, and this has serious implications for competition. Government can do a lot of harm before it becomes worthwhile for someone to move away. The fluidity of the ocean, in contrast, allows people to vote with their house by sailing to a neighboring jurisdiction. If a seasteading government announces an unpopular policy, it could find that it rules over nothing but empty waves. This would allow bad governments to die without bloodshed and force governors to think about what people really want.

The challenges and uncertainties in settling the ocean are large, but there are only a few core problems and none are insurmountable.

While the challenges and uncertainties in settling the ocean are large, there are only a few core problems and none are insurmountable. To make seasteading a reality we need to take a pragmatic, incremental, and business-focused approach. Rather than creating a multibillion-dollar vessel straight away without any clear way to finance it, we encourage seasteading entrepreneurs to think carefully about the business case for particular industries for which seasteading has a comparative advantage. Many industries are overregulated, and a seastead off the coast of a major U.S. city offering medical treatments not yet approved by the FDA, for example, would be a very lucrative proposition.

We know it is possible to live on the ocean; we know there are ways to make money there, and our mission is to drive down the costs of seasteading to transform the ocean from potential frontier into real frontier and eventually into just another option with some serious advantages. This will lead to experimentation and innovation in governance and force existing States to improve or wither away for a lack of residents. The challenges are large but the potential payoffs are much, much larger. By transforming the political problem of bad governance into a hard but achievable technological problem, which humans have a knack at solving, we make success possible. FEE

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The Canard of "Underutilized Resources"

BY TYLER WATTS

Last November the Federal Open Market Committee announced plans to purchase, by printing money, $600 billion of long-term government bonds over the next 6 months. This "Quantitative Easing," Fed Chairman Bernanke assures us, is necessary to aid an economy that is suffering from "a very high level of underutilization of resources." In other words, there's a whole lot of unemployment out there, of both labor and capital, and it will take a huge jolt of monetary stimulus to get these "idle resources" back to work.

This massive money injection is supposed to work as follows: buying up Treasury bonds will make their prices rise, and their yields—hence long term interest rates in general—fall. (Recall that previous monetary stimulus has already pushed short-term rates close to zero.) Lower interest rates mean investment capital will be even cheaper than it already is, pushing idle investment money "off the sidelines" and into productive, labor-demanding business activity. And because all the fresh money starts its life as bank reserves, banks will be in a position to extend new loans six ways from Sunday.

Keynesians insist that this kind of massive stimulus is the only weapon the monetary authorities have left in their struggle to cure unemployment. This is a short-term fix, mind you; all economists realize that printing money does not call new goods or services into existence, and not even Keynes himself would tell you that straight-up money printing is a recipe for long-term prosperity. But can printing money induce entrepreneurs to expand output? Can it make unemployed resources suddenly employable? The answer depends on why those resources became unemployed—"underutilized" in fedspeak—in the first place. This is precisely the question that Austrian economists are asking: What exactly went wrong in the economy such that so many resources are now not being utilized? By addressing this crucial question, only the Austrian perspective can adequately dissect the very concept of "underutilization" and offer a coherent critique of this mad-hatter monetary stimulus.

Let's deconstruct this notion of resource "underutilization." Resources are only resources to the extent that they have value, or usefulness, to somebody. Resources, properly speaking, are components of a broader plan of entrepreneurial action that brings more and better goods into existence, which people can use to improve their lives. Not all *things* are resources—things that can't be used to enhance life aren't resources, just objects; things that used to be resources but are now worn out, obsolete, or otherwise have lost their usefulness *aren't* resources. They're just junk.

> Things that can't be used to enrich life aren't resources.

Context matters when we're talking about resources. The mere fact that a good was produced at some point and sold for some price does not mean it is still as valuable as originally anticipated. For example, if I took the trouble to fatten 100 steers in hopes of selling 50 tons of beef, only to later discover that everyone has become a vegetarian in the meantime, the beef I

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produced, economically speaking, would not be a resource. Nor would the beef-producing equipment, tools, and knowledge I invested in have the same value to me once I found out the true state of people's dietary preferences. While some cattle-raising equipment could be converted to other uses, much of it—like the squeeze chute used for medicating and branding cattle—was highly specific to beef production and would be worth no more than its scrap-metal value in a world where nobody wanted to consume beef. My plan to be a cattleman turned out a big mistake entailing a loss on investment. Losing investments mean economic waste has occurred—to some degree, resources have been turned into junk.

This example may be ridiculous, but is it really that far-fetched? It is highly unlikely that people's preferences would change so drastically or that entrepreneurs would be so clueless at forecasting market trends. But a strong enough outside influence might induce enough entrepreneurs into misreading the true state of the market such that they become overoptimistic and invest too much. If, for instance, politicians were dedicated to stimulating the beef industry and promoting beef consumption, and built policy on policy to that purpose over the decades—a labyrinthine mixture of subsidies, tax breaks, and cheap credit—they just might generate an investment boom in beef production. The boom, however, would be destined to end as soon as the policy changed or, more likely, the oversaturation of the market became evident.

At this point, with declining beef prices and (now-apparent) excess capacity in beef production, market forces would oust marginal producers from the industry and induce even the large, established operators to scale back production. As for the now "underutilized" resources, it would take some time and a lot of extra work to melt down those excess squeeze chutes, to convert cattle pasture into other crops, and for the reluctant surplus cowboys to eventually accept city jobs mopping floors, answering phones, ringing up sales, and so on.

The *value* of capital—both capital equipment, or physical capital, and people's knowledge, experience, and training, or human capital—is critically dependent on how well it can fit into the structure of actual consumer demands and the structure of existing complementary capital (both physical and human). It is precisely this kind of interconnectedness among different kinds of resources that mainstream economists tend to disregard. Yet the extent of economic losses revealed by the recent financial crisis and recession is making the malinvestment (waste) of resources hard to ignore. Even at the Fed, some people show signs of understanding the relevance of the *structure* of capital resources, as opposed to sheer quantities or supposed dollar values. As Naranya Kocherlakota, president of the Minneapolis Fed, recently stated: "[T]he Fed does not have a means to transform construction workers into manufacturing workers. . . . Most of the existing unemployment represents mismatch that is not readily amenable to monetary policy."

No amount of money-printing will change the real relationship of any particular object to its economic context.

In other words, no amount of money-printing will change the real relationship of any particular object to its economic context. But the term "mismatch" implies mistakes have been made—entrepreneurial error—and raises the question: What went wrong to cause such massive mistakes in the first place? Again, Austrian capital theory provides the answer: The Fed itself, with its cheap money, along with a host of government "affordable housing" policies, severely overstimulated the housing construction market in the years of the boom.

Entrepreneurs always have many options for how to employ their time, labor, and capital. During the housing boom the amazing increase in home prices relative to construction costs made projects like new home construction and even flipping condos seem an obvious profit opportunity. Following the price signals, people expanded their investments appropriately: Young entrepreneurs learned about real estate and construction management, and new workers learned construction trades; building companies were started and existing companies expanded, purchasing more new equipment

like nail guns, Skilsaws, and pickup trucks; upstream suppliers similarly expanded investment in things like cement plants, timber plantations, sawmills, and the like.

Regardless of whether these workers and entrepreneurs were cognizant of the temporary, cheap credit- and subsidy-induced nature of the boom, the lure of high prices and high profits proved irresistible. In retrospect it is easy to see how the Fed's cheap money policy, along with a host of government subsidies to homebuyers and lenders, set the stage for an unsustainable boom—a boom that did not match well the actual, long-term consumer demand and for which the credit that financed it was not fully funded by actual savings. (For an excellent explanation of the government's role in the housing boom and bust, see Peter Boettke and Steven Horwitz's FEE publication "The House That Uncle Sam Built," www.tinyurl.com/yjnptej [PDF]). Nonetheless, the slew of political interventions into the housing market led these entrepreneurs on for years before the inevitable market correction occurred. The net result was that too much investment capital went into home building, and not enough into other economic activities—a mistake of grand proportions.

The housing bust revealed that many of the capital investments of the boom period—from concrete trucks on up to skilled construction tradesmen—were actually malinvestments whose value turned out to be less (in some cases much less) than anticipated. The capital resources created to build houses are, to varying degrees, ill-suited to other tasks. They will necessarily be underutilized relative to the boom era, precisely because they have lost value (usefulness) in light of the new economic reality. Indeed, economic reality in the bust indicates that many of these resources will have to find other ways to be productive, as attested by the overbuilt housing market. (According to National Association of Realtors figures, there were between 1.02 and 1.77 million "excess" homes as of September. Supply was converted into excess units on the basis of six-to-eight months' supply representing "normal" conditions.)

But this adjustment takes time, and the more specialized the resource, the longer the wait. Some excess concrete trucks can be sent overseas or converted to other industrial uses, but many will simply sit, awaiting the next boom or the scrap heap. Indeed, in some cases, when a particular resource loses its usefulness, leaving it idle can be its optimal "use." Likewise, the surplus low-skilled construction laborers can perhaps get jobs washing dishes, but skilled tradesmen, engineers, and jobsite managers must retrain to find different jobs that match their boom-era earnings. Not surprisingly, some choose to wait (and take unemployment benefits) rather than risk retraining. For those who have thrown in the towel on a construction career, retraining and reemployment can take years. No amount of money-printing can change this reality.

Political efforts to "stimulate" economic activity will necessarily alter the capital structure of the economy. Government-based stimulus for industry Z necessarily detracts from what the market would have provided industries A through Y. Even a nonspecific stimulus, if such is possible, will only stimulate the investment fad du jour; there is no such thing as neutral government policy. The key policy implication of Austrian capital theory is that any attempt to stimulate the economy will, by spurring malinvestment, doom some resources to superfluousness. From a statistical standpoint this may look like underutilization; from an economic standpoint, however, it's simply the waste that results from too many investment plans gone bad. Attempting to undo the waste by further stimulus will only exacerbate the problem: more stimulus, more malinvestment, more wasted resources.

> The optimal monetary policy is not to have one.

So what should the wise and munificent monetary central planners do? Ironically, the optimal monetary policy is not to have one, but to let the competitive market process function for money and credit the way it does for countless other goods. If we must have central banking, the ideal policy is simply this: First do no harm. FEE

Why Do the Poor Stay Poor?

BY JOHN STOSSEL

Of the six billion people on earth, two billion try to survive on a few dollars a day. They don't build businesses—or if they do, they don't expand them. Unlike people in the United States, Europe, and Asian countries like Japan, South Korea, Hong Kong, etc., they don't lift themselves out of poverty. Why not? What's the difference between them and us? Hernando de Soto taught me that the biggest difference may be property rights.

I first met de Soto maybe 15 years ago. It was at one of those lunches where people sit around wondering how to end poverty.

I go, but I'm skeptical. There sits de Soto, president of the Institute for Liberty and Democracy in Peru, and he starts pulling pictures out showing slum dwellings built on top of each other. I wondered what they meant.

As de Soto explained, "These pictures show that roughly 4 billion people in the world actually build their homes and own their businesses outside the legal system. . . . Because of the lack of rule of law [and] the definition of who owns what, and because they don't have addresses, they can't get credit [for investment loans]."

They don't have addresses?

"To get an address, somebody's got to recognize that that's where you live. That means . . . you've a got mailing address. . . . When you make a deal with someone, you can be identified. But until property is defined by law, people can't . . . specialize and create wealth. The day they get title [is] the day that the businesses in their homes, the sewing machines, the cotton gins, the car repair shop finally gets recognized. They can start expanding."

That's the road to prosperity. But first they need to be recognized by someone in local authority who says, "This is yours." They need the rule of law. But many places in the developing world barely have law. So enterprising people take a risk. They work a deal with the guy on the first floor, and they build their house on the second floor.

"Probably the guy on the first floor, who had the guts to squat and make a deal with somebody from government who decided to look the other way, has got an invisible property right. It's not very different from when you Americans started going west, [but] Americans at that time were absolutely conscious of what the rule of law was about," de Soto said.

> Commerce between total strangers wouldn't happen without a deed protecting propery.

Americans marked off property, courts recognized that property, and the people got deeds that meant everyone knew their property was theirs. They could then buy and sell and borrow against it as they saw fit.

This idea of a deed protecting property seems simple, but it's powerful. Commerce between total strangers wouldn't happen otherwise. It applies to more than just skyscrapers and factories. It applies to stock markets, which only work because of deed-like paperwork that we trust because we have the rule of law.

Is de Soto saying that if the developing world had the rule of law it could become as rich as we are?

"Oh, yes. Of course. But let me tell you, bringing in the rule of law is no easy thing."

De Soto says we've forgotten what made us prosperous. "But [leaders in the developing world] see that they're pot-poor relative to your wealth." They are beginning to grasp the importance of private property.

Let's hope we haven't forgotten what they are beginning to learn.

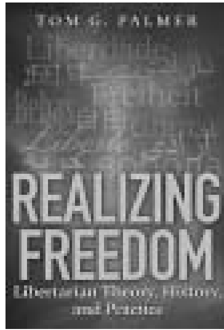
John Stossel hosts Stossel *on Fox Business and is the author of* Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong. *Copyright 2010 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

Book Reviews

Realizing Freedom: Libertarian Theory, History, and Practice

by Tom Palmer
Cato Institute • 2009 • 496 pages • $29.95

Reviewed by Ben A. Rast



Every generation faces the struggle for freedom anew, but not alone. To be successful it must draw on its inherited ideas of freedom, then reformulate them into a message that is relevant and inspiring to the people of a particular time and place.

Success in this task requires both a message and a messenger: something worth saying and someone who can say it well. *Realizing Freedom*, a collection of 20 years of his published writing, shows that Tom Palmer has been among the most successful messengers of liberty. At the risk of crossing the fine line between praise and hyperbole, Palmer is a tireless apostle of international liberty.

Realizing Freedom demonstrates Palmer's versatility as a writer as well as his avoidance of narrow political pigeonholing. The collection includes scholarly analyses of intellectuals like John Rawls and G. A. Cohen and guest editorials in publications as diverse as the conservative *Washington Times* and the not-so-conservative *Washington Blade*, a gay newspaper.

Palmer's writing is a call to social action in the name of human freedom. Liberty, he argues, is for *everyone*, not just those who manage to control political power. He feels that liberalism lost the battle of ideas (and humanity consequently suffered) because libertarians shrank from the debate and left the field to the enemies of freedom. His message is uncompromising: Do not concede; do not flee. Take the enemies of freedom seriously—as seriously as they take their fight against it.

Palmer warns us that defending liberty is not easy. It is not a parlor game played by polite intellectuals. Enunciating ideas is not enough. They must be acted on, at home, at work, and in public policy. And there is no one-size-fits-all formula for liberty. What works in one cultural context may not work in another. Every attempt to foster a free society must find roots in the way people live.

Realizing Freedom is divided into four sections: libertarian theory, history, practice, and books and ideas. In his section on theory, he addresses the connections between liberty, rights, and the rule of law. Hardly a surprising theme, he admits, but "the rule of law is the key to freedom." When theorists pursue "social justice," they weaken or even eliminate the rule of law.

One such theorist is John Rawls. Rawls's theory of justice is one of the most influential products of the twentieth century, but Palmer eviscerates it. Rawls derived his theory from a set of "thought experiments." Palmer points out a fundamental flaw in these experiments, a flaw so large that it compromises all of Rawls's conclusions: Rawls assumes an individual cannot exit an undesirable social contract. Palmer writes, "Slamming shut the exit door creates the problem to which fairness is alleged to be the answer, but it also makes it impossible to put the solution into practice. Not only is the game rigged; it is not even possible to play it by the rules stipulated." Instead of fairness, Palmer shows that Rawls's thought experiment ends in a closed system of forced labor.

In his section on history Palmer covers the tradition of classical liberalism, introducing his readers to its great exponents and the battles they fought. Even longtime libertarians will learn much about their intellectual heritage.

The book's "practice" section covers many specific issues, such as the proclivity of governments to engage in needless wars and to whittle down even supposedly sacred rights, such as freedom of speech. Palmer's final section on key books and ideas is extremely valuable to those just getting into libertarianism who want to learn more.

Palmer's essays are always cogent and range over a wide array of topics. The utility of the book, however, would have been improved by better documentation of each essay's original publication. A collection of his essays like this, written over 20 years

and for different periodicals, is risky business. It must overcome the obstacles of ideas presented out of context and out of time. A short introductory paragraph explaining the time, context, and audience of the piece would have made the reading experience more enjoyable.

But that's just a quibble. Tom Palmer is a modern Bastiat: a scholar, a public intellectual, and an indefatigable defender of liberty around the world. His message is simply this: Freedom is not a unique cultural product. Every nation has a native set of ideas about liberty. The intellectual's task is to identify and cultivate those ideas that promote the expansion of freedom and to boldly oppose those ideas that constrict it.

Realizing Freedom is the record of Palmer's remarkable contributions toward that endless task. I strongly recommend a studious reading of this book. FEE

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Too Big to Fail: The Inside Story of How Wall Street and Washington Fought to Save the Financial System—and Themselves

by Andrew Ross Sorkin

Viking Penguin • 2009/2010 • 624/640 pages • $32.95 hardcover; $18.00 paperback

Reviewed by Chidem Kurdas

Books about the 2008 financial crisis keep coming, and *New York Times* reporter Andrew Ross Sorkin offers one of the better accounts of the meltdown. Using a large number of interviews, he reconstructs the words and acts of key people during the six months from the near-collapse of Bear Stearns in March to the bankruptcy of Lehman Brothers in September.

The book is somewhat bloated, but the tale is compelling. It starts as Bear Stearns, the smallest of the five Wall Street investment houses, wobbles on the edge of bankruptcy. Treasury Secretary Henry Paulson and the Federal Reserve facilitate JP Morgan's takeover of Bear, leaving Lehman the smallest of the remaining investment banks. Its stock drops precipitously.

From a huge cast of characters, one man emerges as a tragic figure—Lehman chief executive Richard Fuld. He became obsessed with short sellers (traders who borrow and sell shares to profit from a future price decline), blaming them for spreading malicious rumors about Lehman instead of confronting the bank's real weakness. That was one in a series of dreadful mistakes. With Fuld's backing, Lehman president Joseph Gregory had pushed the bank into mortgages, commercial real estate, and leveraged loans. He put inexperienced managers in charge of those activities and got rid of specialists who warned of danger. Catastrophic losses from the real-estate slump were killing Lehman by 2008. Short selling the stock was a symptom rather than a cause of the disease.

Sorkin recounts Lehman's destruction, which occurred despite Fuld's increasingly frantic efforts to raise capital or sell the company. Bank of America bought Merrill Lynch instead of Lehman, with the blessing of the Treasury and the Fed. A deal was worked out with Barclays Capital but scuttled at the last minute by British regulators, a debacle their American counterparts could almost certainly have prevented.

Timothy Geithner, then head of the New York Federal Reserve, was fixated on merging other banks. During a tense phone call, he effectively ordered Morgan Stanley chief John Mack to sell his company to JP Morgan for almost nothing. "I just won't do it," Mack said and hung up. There was no good business reason for the merger, and JP Morgan chief Jamie Dimon did not want it either.

Mack managed to save Morgan Stanley by getting capital from the Japanese bank Mitsubishi. Had Geithner succeeded in bulldozing Mack into selling, tens of thousands of employees would have lost their jobs and the too-big-to-fail problem would have been exacerbated. The incident does not inspire confidence in Geithner, currently Treasury secretary.

Another bad shotgun marriage was arranged by Sheila Bair, head of the Federal Deposit Insurance Corporation, who decided to sell Wachovia to Citigroup with a government guarantee for toxic assets. Fortu-

nately, Wells Fargo chief Richard Kovacevich, who was interested in Wachovia all along, took action just in time. Wells Fargo was willing to pay a higher price without a taxpayer guarantee.

These events raise the question of why government agents can dispose of other people's property. They certainly don't seem to worry about preserving the value of businesses or reducing taxpayer liability.

What's the lesson in this? Unfortunately, Sorkin doesn't make the big picture clear. The boom-and-bust happened because the Fed opened the floodgates to easy money. That's what got everybody, from the second-mortgaged homeowner to Lehman Brothers, to leverage up. Our supposedly expert government players apparently never realized this: Their conceit that they know how to manage the economy is the root of our trouble.

They might avoid fueling bubbles, but let's leave that aside, since Sorkin doesn't dig that deep. He describes interventions notable, among other things, for their sheer arbitrariness. The Fed and Treasury backstopped Bear Stearns debt in the acquisition by JP Morgan, but would not do the same for Lehman. The first action created expectations that the same support would be available for other banks and led to a false sense of security. There is no obvious reason why two sets of bond holders should be treated differently. It would be vastly better if government officials were deprived of the authority to bail out anyone.

Our financial system has suffered tremendously as a result of capricious interventions by government officials who themselves never bear any costs from the adverse effects of their decisions. If anything, they benefit. Though the entire boom-bust cycle provides evidence that government agencies, from the Fed on down, should have far less discretion, the massive financial regulation law passed this year rewards them with greater powers and wider room to do whatever they want. We should be afraid of the economic and social damage their arbitrary actions will wreak in the future. FEE

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The Hesitant Hand: Taming Self-Interest in the History of Economic Ideas

by Steven G. Medema

Princeton University Press • 2009 • 248 pages • $35.00

Reviewed by Sandy Ikeda

"The focus of this book," according to its author, "is the interplay of self-interest, market, and the state in economic analysis from the mid-nineteenth century up through the latter stages of the twentieth."

Much of this well-written study, however, is devoted to describing the intellectual origins of the approach to political economy known today as "Public Choice"—the economics of politics. Nevertheless, its subject is the history of the analysis of nonmarket activity generally.

Modern economics offers two separate grounds for interventionism. One traces its origins to John Maynard Keynes, the other to Arthur Cecil Pigou. Both were students of Alfred Marshall; both were fellows of King's College, Cambridge, in the 1930s; and both proposed theories of "market failure." Pigou was probably the first to examine so-called "market failure" within a Marshallian, microeconomic framework, pointing out how self-interest can produce systematic inefficiencies. His intellectual descendants often use the framework he created to conduct "welfare analyses" of positive and negative externalities, as well as of the taxes, subsidies, and other measures that are supposed to fix them.

Steven G. Medema deals with the Pigouvian legacy in this fascinating intellectual history. But Pigou lies somewhere in the middle of the story Professor Medema tells.

The book presumes familiarity with economic theory and contemporary ideas in political economy, so I would not recommend this book for the general reader. But anyone who has taken an introductory course in microeconomics should be reasonably comfortable with the discussion. The book opens with a short overview of Adam Smith's explanation of how self-interest promotes the general welfare via the "invisible hand," contrasting that view with the more statist

approaches of the earlier French Physiocrats and English Mercantilists. In the hands of Smith, self-interest "had finally found legitimacy." But this is not the Smith of laissez-faire caricature. Medema offers an impressive list of interventions Smith advocated, from regulating public hygiene to taxes on liquor. For Medema, Smith's great achievement, however, was to make laissez-faire capitalism the "default mode" of government policy.

The next two chapters trace the swing from widespread support for laissez faire among British intellectuals back to a more interventionist proclivity in the latter nineteenth century in the writings of Jeremy Bentham, J. R. McCulloch, J. E. Cairnes, and especially John Stuart Mill and Henry Sidgwick. However, despite important reservations, the default remained laissez faire capitalism, more or less.

In chapter four we see how, beginning with the Italian *La Scienza delle Finanze* and the work of the Swedish economist Knut Wicksell, some economists by the mid-twentieth century were beginning to integrate political incentives into the area that we today call "public finance," something British political economy (Keynes included) had neglected to do. This gave rise to a systematic examination of the causes and consequences of "government failure."

Chapter five discusses the contributions of Ronald Coase, who opened inroads into the study of nonmarket phenomena. What later became known as the "Coase theorem" emerged from an explicit critique of the Pigouvian market-failure theory (though, as Medema argues, not of Pigou himself), and is the basis of the "economic analysis of law" tradition and modern theories of regulation.

Chapter six addresses the Public Choice school itself, moving in a most welcome and informative way from intellectual to institutional history. It chronicles the beginnings of Public Choice from the University of Virginia in the late 1950s, to the ideological tensions that may have scattered its most important scholars in the 1960s, to its reestablishment at Virginia Polytechnic Institute and the founding of the Center for the Study of Public Choice, as well as the journal *Public Choice*, in the late 1960s.

Finally, chapter seven could actually stand alone as an essay on how, largely in the masterful hands of Richard Posner, the law-and-economics tradition evolved into the "economic analysis of law."

This book reads a bit like a "Whig interpretation of the history of political economy," in that it gives the impression that the developments in political economy after Smith have led to Public Choice as not only the predominant but perhaps the sole market-based theory of government failure.

Thus there is only the briefest, nonsubstantive reference to F. A. Hayek and his influential book *The Road to Serfdom* and none at all to Ludwig von Mises, who wrote many tracts critiquing the doctrine of interventionism. While their take on government failure does appreciate the role of (perverse) incentives in the political process, its main focus is on how knowledge and calculation problems tend to thwart interventionism by systematically creating negative unintended consequences.

But these are really nits I'm picking here. I wholeheartedly recommend this informative book to anyone with a little background in microeconomics who is interested in a history of Chicago and Virginia political economy told in a clear, scholarly, and engaging way. FEE

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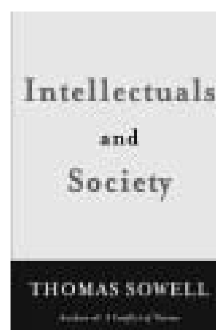
Intellectuals and Society

by Thomas Sowell
Basic Books • 2010 • 416 pages • $29.95

Reviewed by George Leef



If you trace back to the origins of almost any damaging public-policy idea in America, you find it rooted in the imagination of some intellectual. Just to pick one field, consider housing. Why do we have huge tracts of depressing, unsafe, unclean public housing in some of our largest cities? That did not simply *happen*—the idea for such projects came from "Progressive" intellectuals who were certain their thoughts

on how cities should be planned would make life immeasurably better.

Eventually, politicians sensed there would be votes coming their way if they put supposedly expert and compassionate ideas like public housing into effect. The result was that many people were displaced into worse housing than they'd previously had and those "lucky" enough to get into the new government housing projects soon found them abominable. But what about the intellectual progenitors of public housing? They suffered in no way. No professorships were lost; no reputations were damaged. If any intellectuals who had advocated "urban renewal" had any pangs of conscience over it, they issued no *mea culpas*.

In *Intellectuals and Society* Thomas Sowell essays a devastating assessment of the role that intellectuals play in modern life. Their impact, he argues, is overwhelmingly detrimental and stems from their ability to use their primary skill ("verbal virtuosity," he terms it) to get those in power to reorganize the world in accordance with their theories about how society should function. Those theories usually entail government coercion euphemistically called "planning" or "regulation."

When it's good, this book is magnificent. Here is one of many excellent, quotable passages: "Intellectuals are often extraordinary within their own specialties—but so are chess grandmasters, musical prodigies and many others. The difference is that these other exceptional people seldom imagine that their talents . . . entitle them to judge, pontificate to, and direct a whole society." That sums up the problem with intellectuals very nicely.

Intellectuals are usually so absorbed in their visions for a better world that they have no patience for the gradual change that comes through market processes and voluntary action. Why wait for "social justice" outcomes such as the elimination of poverty or the end of discrimination if the government can simply mandate higher wages or outlaw "unfair" hiring practices? Sowell acknowledges that some intellectuals understand that State coercion, no matter how splendid the intentions behind it, is counterproductive. Most of them, however, continue advocating programs built around mandates, prohibitions, and taxes. Power is their opiate.

Sowell highlights a curious feature of many intellectuals: namely, their indifference to evidence that questions the wisdom of their pet policies. Gun control is a good example. Do gun control laws actually reduce violence? A wealth of data shows that antigun statutes have precisely the opposite effect. You might expect that people who are ostensibly committed to rationality would change their minds when faced with such evidence, but that is almost never the case. On the contrary, if you challenge a pro-gun-control intellectual, you are apt to be met with condescension and invective.

It is the same with scores of other issues in which intellectuals adhere dogmatically to cherished beliefs about the benefits of government intervention, no matter how strong the case that they're actually harmful.

There is, however, a serious flaw in the book. Although Sowell quite correctly observes that the "Progressive" intellectuals managed to embroil the United States in needless wars (especially World War I, but also other conflicts), he cannot or will not see that "right-wing" intellectuals have done similar damage by providing the rationales for our disastrous military escapades this century. Sowell doesn't explain why the influence of interventionist intellectuals who favored war in the former era was harmful, but the influence of interventionist intellectuals who favor war today is good.

Or we might turn this around and ask why the aversion to conflict and efforts at "nation-building" that characterized Woodrow Wilson's opponents was sensible, but when (some) intellectuals today question the same sorts of policies, Sowell regards them as blind ideologues. It is the pro-intervention crowd here that is oblivious to the consequences of their favored actions. Convincing a neoconservative intellectual that our "war against terrorism" is counterproductive seems to be on the same order of difficulty as convincing a Progressive that rent-control and minimum wage laws are counterproductive.

Aside from that serious blind spot, however, *Intellectuals and Society* is a sharp and enlightening book. FEE

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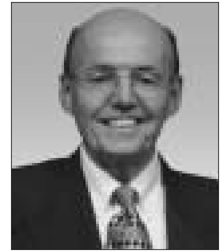

Card Check Without Congress

BY CHARLES W. BAIRD

In 2009 I made a bet with fellow *Freeman* columnist David R. Henderson that before the Obama presidency expires, Congress would enact substantial freedom-reducing changes—such as card check—to American union law. David, ever the optimist, didn't think so. Inasmuch as Speaker Nancy Pelosi is just a bad memory from a horrible dream, and it is now very difficult for Obama and his allies to break filibusters in the Senate, it seems that David will win our bet when Obama leaves office in January 2013. (I can be an optimist, too.)

The 112th Congress is not likely to enact the sort of changes to American union law preferred by the bosses of the Service Employees International Union (SEIU), but Obama is very likely to try to do so through administrative and executive fiat. As Shelby Steele says, Obama's "policymaking has been grandiose, thoughtless and bullying." Two non-union examples (mine not Steele's): Obama, when faced by Senate opposition to his grandiose cap-and-tax war against carbon, deliberately went around Congress to his thoughtlessly green appointees in the EPA to attack carbon through administrative fiat. Again, when faced by two court decisions that told him he could not shut down offshore oil drilling in the Gulf of Mexico, he deliberately went around the court decisions to his EPA and his Interior Department effectively to prevent drilling by holding up the permitting process.

> Obama is very likely to try to enact freedom-reducing changes to union law, with or without Congress.

The five-member National Labor Relations Board (NLRB) is appointed by the president, with concurrence of the Senate, to five-year terms. At this writing there are only four members. Three of them—Wilma Liebman, Brian Hayes, and Mark Pearce—are serving Senate-approved terms. Liebman, the chairman of the Board, is a former union lawyer with a long record of serving the interests of unions. Her term expires August 27. Obama may reappoint her, but the new Senate may not go along. While in private practice Hayes represented management interests in labor disputes. His term expires in 2015. In private practice Pearce represented union interests in labor disputes. His term also expires in 2015.

Becker Versus Workers

The other member, Craig Becker, was never approved by the Senate. He is on the Board because in 2010 Obama used his recess appointment power to get around Senate confirmation. He may have to do the same to keep Liebman on the Board when her term expires. Becker is unique in his pro-union, anti-worker sympathies. As I will show below, he is an Obama kind of guy. While a package deal between Obama and sufficient Senate Republicans involving Liebman and a Republican appointee to fill the fifth seat may be put together, there is no way Becker can avoid a Senate filibuster against his appointment to a regular term.

Right now there are three reliably pro-union votes on the NLRB. They can do what they want in each case that comes before them. The imminent danger to worker freedom is best understood by examining the views of the most articulate and forceful of the three—Becker. When he was appointed, Becker was associate general counsel to the SEIU. Earlier, as a professor of law, he published many articles in scholarly journals in which he promulgated his pro-union vision.

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He doesn't think any worker should be allowed to be union-free. In his own words, "Just as U.S. citizens cannot opt against having a congressman, workers should not be able to choose against having a union as their monopoly-bargaining agent." Apart from the obvious rejoinder that unions are not governments, Becker, like Obama, doesn't believe in the consent of the governed. They are Mountaintop people—that is, elitists.

In a 1993 article in the *University of Minnesota Law Review*, Becker argued that existing union law can and should be interpreted to strip employers of any "legally cognizable interest" in the process by which their employees unionize. When faced with aggression, employers should be forced not to resist. Just after Obama's inauguration, Becker composed executive orders that the President then imposed on workers and employers. For example, if a union-impaired federal contractor supplying services to the federal government loses a contract to a union-free firm, the latter must extend preferential hiring offers to the unionized workers of the former and recognize and bargain with the unions representing those workers.

The NLRB seems likely to try and impose compulsory card check.

Reversing Course

Last August 27, Becker, Liebman, and Pearce voted to reconsider two earlier NLRB cases that displeased union bosses. Existing law allows, but does not compel, an employer to turn his employees over to monopoly-bargaining unions on the basis of card check. In *Dana Corp.* (2007), the NLRB said that such workers had 45 days to request an election to void a card-check recognition. *MV Transportation* (2002) addressed the following: Suppose firm A is unionized and has to go out of business because it cannot effectively compete. Union-free Firm B buys A's assets and hires workers, a majority of whom are former, unionized employees of A. Does Firm B have to recognize those workers' union as a monopoly-bargaining agent for all of B's employees? In 2002 the NLRB said that workers themselves should decide the question by an election.

In both cases the NLRB decided that a secret-ballot election, not administrative fiat, should determine the fate of workers. Now a majority of the Board wants to "reconsider" whether the two cases were correctly decided. It appears that Liebman and Pearce want to join Becker and Obama on the Mountaintop. When this NLRB reopens these two cases it is likely to reverse both, and those reversals will be the first steps on the road to compulsory private-sector card check without Congress. I have no doubt that Becker and the others will try to take the whole trip.

As voters across the country gave us the new Congress, voters in Arizona (Prop. 113), South Carolina (Amendment 2), South Dakota (Amendment K), and Utah (Amendment A) adopted amendments to their respective state constitutions that prohibit compulsory card check whether imposed by Congress or from the Mountaintop. States control the rules of unionism as they pertain to their state and local government employees, so these newly adopted amendments will protect those employees from card check. However, the National Labor Relations Act (NLRA) sets the rules for private-sector workers, and my guess is that federal courts will decide federal law preempts state law on card check.

In sum, David wins the bet, but workers are still exposed to the tyranny of the Mountaintop. The short-run consolation for workers who want to become and remain union-free is that a future NLRB can reverse what the existing Board does. The better, long-run, solution is the permanent repeal of the NLRA in favor of genuinely voluntary unionism. FEE