IDEAS ON LIBERTY

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- Robert Higgs: How War Makes Government Bigger
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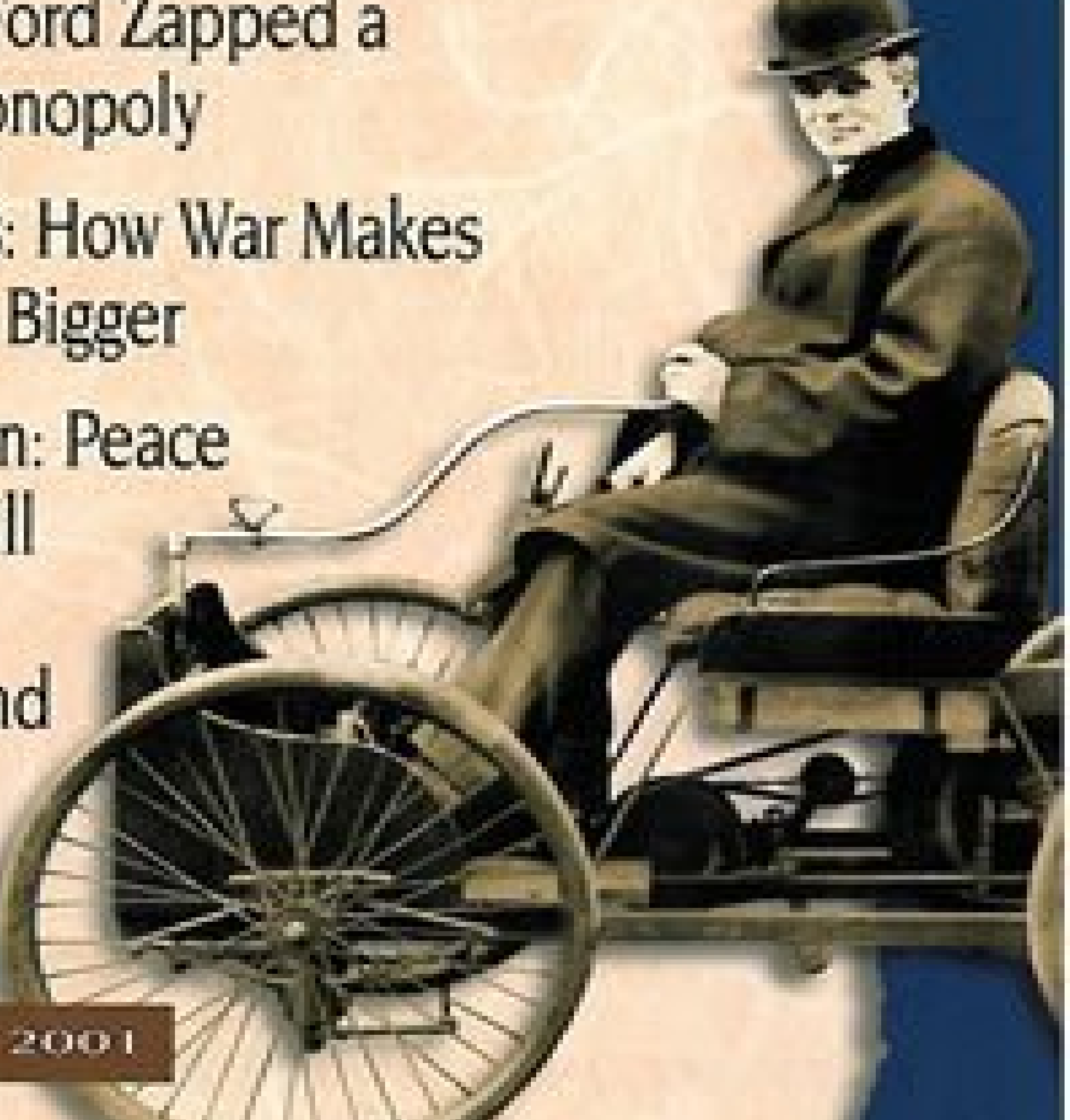

DECEMBER 2001

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How Henry Ford Zapped a Licensing Monopoly

All Ford Wanted Was the Opportunity to Compete Freely in the Market

DECEMBER 01, 2001 by Melvin D. Barger

Melvin Barger is a retired corporate public relations representative and writer who lives in Toledo, Ohio.

More books have been written about auto pioneer Henry Ford than any other person in the car business. Though he had critics, the judgment of history is that he put the world on wheels with his famous Model T. But less well known is the fierce independent streak that led him to wage a lone and heroic battle for the right to run his own business. It was a struggle against the kind of people who think they should have the power to determine what's best for the rest of us. They were private businessmen, but they were also smug social planners who counted on the assistance of the state.

One of the persistent delusions nourished by social planners everywhere is that elitists in high places can divine who will be the winners and losers in any developing industry. Sometimes called "industrial policy," this was touted as the secret of Japan's economic success until that country's fortunes went sour in recent years. Whether done by government officials or private firms with policing powers, any such planning is a bad idea.

But we don't have to go to present-day Japan for proof of such failure.

At the very beginning of the American auto industry, a group of carmakers made a blatant attempt to establish an industrial policy for their own benefit. In the guise of protecting the public from "unreliable upstarts" and "fly-by-nights," they formed the Association of Licensed Automobile Manufacturers (ALAM) in 1903. The industry was in its infancy, but there were already complaints about some of the crude entrepreneurs who were entering the field. The 11 car manufacturers who formed the ALAM promised to tidy things up a bit.

Their weapon was the 1895 Selden patent, and their claim was that it covered all gasoline-powered vehicles. By controlling this patent they asserted the right to decide who should be allowed to build and sell cars. Carmakers who didn't join the ALAM and pay royalties on each car sold could be sued and possibly forced out of business.

Like many such groups, it professed to be combining for the public's own good. As one of the members said of the ALAM, "It will not try to shut out reputable and established manufacturers who build a reliable vehicle; it will license all such, but it will license no unreliable upstarts. In this way the association will protect the public and be a boon to all purchasers of gasoline automobiles." Another auto manufacturer stated: "Those already licensed can more than supply the demand."[1]

With this form of industrial policy established, the ALAM was now positioned to choose the winners and losers for the future auto industry. And one of the first applicants to be refused a license was a known loser, Henry Ford. At 40, he was broke and appeared to be all washed up. His fledgling Ford Motor Company, formed on June 16, 1903, showed many signs of being the kind of "unreliable upstart" the ALAM sought to exclude from business. It was poorly financed, and paid-in capital of $28,000 had been nearly exhausted in its first month of operation. Ford himself had headed one failed automobile company and was eased out of another before persuading some investors to back him for a third try. Any rational observer would have called it a high-risk venture. So when he applied to the ALAM for a license, he was turned down on the grounds that he was only "an assembler," not a true manufacturer.

The rejection was the organization's way of telling Ford that he had no right to be in business. But after he was turned down a second time, he moved ahead to build and sell his own cars without a license. So the ALAM reacted by attacking him in newspaper advertising and then filing lawsuits, apparently in the hope of forcing him to quit.

But Ford and the free market for automobiles had other plans. At a time when most cars being built were expensive rich men's toys, he wanted to build low-priced vehicles for average-income people, making the car a "necessity rather than a luxury." It worked, and far from failing, Ford built and sold 1,700 cars profitably in his first 15 months of business. This was only a beginning, and in little more than ten years he would be building 300,000 vehicles yearly, more than half of all the motor-vehicle production in the United States. Along the way, he gathered the resources and support he needed to carry on his battle with the ALAM and the Selden patent.

It was not an easy victory, however, and the struggle went on from 1903 until 1911. At some point early in the fight, Ford probably could have negotiated a peace treaty with the ALAM, but that would have violated his principles. The definitive book on the Selden case is William Greenleaf's *Monopoly on Wheels*. As Greenleaf wrote, "'What is the greatest thing in the world—your greatest ambition?' Ford was once asked. 'To be free—a free man,' he shot back. . . . Ford knew that he could not be free so long as the Selden patent clouded the destiny he had marked out for himself."[2]

The shameless arrogance of the ALAM had also aroused his ire. By rebuffing him, Greenleaf noted, the ALAM had disparaged Ford's ability as a designer and builder of automobiles. Greenleaf added, "By the time the Selden challenge arose, Ford had devoted almost a decade of thought and labor to planning and building motor cars. He jealously prized as a hard-won creation the automobile which bore his name. That car, like those of other automobile manufacturers, owed nothing to the teachings of the Selden patent." Ford himself pointed out that the car was the product of his own brain and no man on earth was entitled to any "rake-off " from that particular car.[3]

The Selden Patent

What was the Selden patent, and how did it give the ALAM what amounted to policing power over the auto industry? It started with George Selden (1846–1922), a patent attorney in Rochester, New York, and also a sometime inventor. He was apparently a competent attorney and did the early patent work in photography for George Eastman of Kodak fame. Eastman's signature even appears as a witness to the Selden patent.

That was the only impressive thing about Selden's patent. It described an automobile, but later attempts to build a car to the patent's specifications ended in failure. Selden's was a patent for a car that wouldn't run more than a few thousand yards. Yet Selden and his later associates made the broad claim that the patent covered every gasoline-powered car built! This was an extraordinary claim, because none of the estimated 300 men who were trying to start car companies borrowed anything from Selden's patent, and the engine shown on his patent drawing was never successfully used on any commercial road vehicle. The only thing the Selden patent had in common with other cars of the day was its specification of gasoline as the fuel.

In processing his patent application, Selden engaged in what is now seen as a form of legal trickery. He made his application in 1879 but then delayed the actual date of issuance by filing amendments every two years. The patent did not go into effect until 16 years after his initial filing. The suspicion is strong that he used the amendment process to delay the starting date until something resembling an auto industry was starting to form. He had no way of knowing what would happen over the 17-year life of the patent, but he must have believed by 1895 that the industry was about to take shape and he would be able to collect royalties from the other manufacturers.

He was certainly right, for things were starting to happen. The automobile had actually been invented in Germany in 1889 by Gottlieb Daimler, with help from Karl Benz and Nicholas Otto's invention of the four-cycle internal combustion engine in 1876. In the 1890s, cars were built in the United States by Charles Duryea and Ransom E. Olds. Then, in 1896, only seven months after Selden had obtained his patent, Henry Ford rolled onto the streets of Detroit driving a strange machine called a Quadricycle. It was a far cry from anything the Ford company builds today, but it did run and it had the effect of making Henry Ford a minor celebrity in Detroit. During the months he drove it, Ford put about a thousand miles on the Quadricycle before selling it for $200. (He later bought it back for $65, and it's now displayed at the Henry Ford Museum in Dearborn, Michigan.)

Ford had displayed considerable ingenuity in building the Quadricycle, and he had even constructed his own gasoline-powered engine. But he was the first to acknowledge his debt to all the inventors and dreamers who had gone before him. "I invented nothing new," he conceded many years later. "I simply assembled into a car the discoveries of other men behind whom were centuries of work, and the discoveries of still other men who preceded them. Had I worked fifty or ten or even five years before I would have failed. So it is with every new thing. Progress happens when all the factors that make for it are ready, and then it is inevitable. To teach that a comparatively few men are responsible for the great forward steps of mankind is the worst sort of nonsense."[4]

It's highly unlikely that Ford or most of the other auto pioneers even knew about the Selden patent as they forged ahead with their plans. They would have quickly dismissed it because it contained nothing that they could or would use in designing and building their own cars. Selden had even committed the grave error of mounting the engine directly on the front axle. Even if the type of engine he specified had been suitable for cars, such a design wouldn't have survived more than a few miles of rough travel. So for the first few years, the Selden patent lay quietly in the files with no takers to manufacture Selden cars and thus pay the inventor a royalty.

Out of Obscurity

But in 1899 some strange things occurred that would bring the Selden patent out of obscurity and initiate one of the most celebrated cases in patent history. A Wall Street syndicate headed by financiers William C. Whitney and Thomas Fortune Ryan gained control of a firm called the Electric Vehicle Company. For a time it had seemed that there might be a future in electric-powered cars, partly because electric streetcars were performing well. But then as now, the problem was lack of a good lightweight battery with enough charge to do the job. So with electric vehicle sales plummeting, the firm's resourceful manager came up with the idea of acquiring rights to the Selden patent and then demanding all other manufacturers of gasoline-powered vehicles to pay royalties of 5 percent on each vehicle's retail price. They struck a deal with Selden that gave the inventor an initial payment and a portion of future revenues. With the patent under control, Electric Vehicle engaged a New York law firm to send out letters warning all manufacturers that they were infringing the Selden patent and should desist or make suitable compensation to the owner thereof.

The notice shocked the industry, and to drive home their point, Electric Vehicle sued several manufacturers, including the prestigious Winton Company of Cleveland. While Winton was fighting back, other manufacturers huddled to develop an answer to the Selden threat. Realizing that they had combined strength, the group met Whitney in New York and put forth three proposals: (a) They would pay a 1 1/4 percent royalty, with half going to Electric Vehicle and the rest to their association; (b) the association would decide who would and would not be sued under the patent; and (c) the association would say who would and would not be licensed under the patent.

Whitney, realizing he had been outmaneuvered by men who could put him to considerable expense in court fees, agreed to their demands, and thus the ALAM was born. The lawsuit against Winton was also dropped, and Winton joined the ALAM, switching from opponent to advocate of the Selden patent.

Some auto builders accepted the ALAM's terms and became licensed manufacturers. But others held out and looked to Henry Ford for guidance as the dispute lingered on for years. In the meantime, attorneys for both sides gathered depositions and took part in hearings as they prepared for trial. The issue was also debated in the press, and considerable sympathy grew for Ford as a David battling the Goliath of organized special interests. A number of the independents who were outside the ALAM were confident that Ford would win the federal court trial, thus invalidating the Selden patent. This would relieve everybody of the need to pay royalties or obtain licenses. It would also deny the ALAM the power to police the industry.

But Ford was in for a surprise that tested his tenacity and determination. The Selden patent case finally came to trial on May 28, 1909, before Judge Charles Merrill Hough in the federal court for the southern district of New York. Ford's attorney had been apprehensive about Judge Hough because the jurist did not seem to understand the technical issues in the case. Hough took all summer to review the evidence and then ruled in favor of the Selden interests—that is, the ALAM—on September 15, 1909. It was a crushing blow for Ford and the independent manufacturers who had hoped the patent would be ruled invalid. Most of them deserted Ford. The most important person to surrender was Billy Durant, who had founded General Motors the year before. He made his peace with the ALAM by joining and paying $1 million in back royalties for the car companies now in the GM tent. For most manufacturers, the battle was over, and they reconciled themselves to paying royalties until the expiration of the patent in November 1912.

Ford Holds Out

But not Henry Ford. Though he was now well on his way to great wealth and could have easily paid current and back royalties, he was not prepared to yield anything to the ALAM. Digging in his heels, he backed his legal team in filing an appeal. He was joined by a French company, because the ALAM had also demanded licensing of importers. The appeal was delayed for a time because the Electric Vehicle Company, which actually controlled the Selden patent, had gone bankrupt. The patent was then assigned to another firm and the appeal moved forward.

And now the gods of destiny smiled on Henry Ford. With the three-judge federal appeals court, he finally won vindication. The case opened on November 22, 1910, and the judges handed down their decision on January 9, 1911. They ruled that the Selden patent was valid, but only for cars made to its specifications. This was a total victory for Ford, because no working automobile had ever been built to Selden's design. Thus the appeals court actually ruled that no royalties were required of anybody.

Ford was suddenly a national hero. The decision even benefited the members of the ALAM, because they too were no longer required to pay royalties at a time when auto production was beginning to boom, though they undoubtedly felt some regret about having contributed to the $5 million paid in for royalties under the Selden patent. Selden himself had received about $200,000 of that amount, a tidy sum for a design that never added anything to the development of the gasoline automobile.

What lessons can be drawn from the Selden patent case? One lesson is that no elite group, whether government or private, can really determine winners and losers in an emerging industry. (But even if they could, the market should be open to all contenders.)

A second lesson is that the market has a mind of its own when it comes to rewarding or punishing specific producers. The eccentric Henry Ford ranked low in the esteem of other early carmakers and was one they wanted to weed out in advance of any actual market test. But with his development of the popular Model T in 1908, he went on to win the largest market of all, while most of his early rivals eventually failed and went bankrupt.

A third lesson is that we should never underestimate the power of a determined person with an intense belief in his own ideas and destiny. Such a person was Henry Ford in his determination to make the car "a necessity rather than a luxury." All he ever needed or wanted was the opportunity to compete freely in the market—and it's to our benefit that a blatant attempt to police him out of business didn't work.

Notes

1. William Greenleaf, *Monopoly on Wheels* (Detroit: Wayne State University Press, 1961), pp. 101–102.
2. Ibid., p. 112.
3. Ibid., p. 113.
4. From a 1934 article in *New Outlook*, quoted in ibid, p. 138. Interestingly enough, these thoughts by Henry Ford parallel the same arguments made by Leonard Read in his classic essay, "I, Pencil," from FEE and online at www.fee.org.

Socialized Medicine Is the Problem

Demand Continues to Exceed Supply in Canada's Health Care Market

DECEMBER 01, 2001 by Walter Block

Recently, Canadian Prime Minister Jean Chrétien changed his mind about his country's system of socialized medicine. After long and hard opposition, he now favors a two-tier health system, including user fees and private provision. This makes it all the more important to take another look, not just at the surface of state-run medical care, but at its basic principles.

Ever since Vancouver Canuck hockey player Daniel Sedin jumped the health-care queue with his herniated and ruptured lower back disc, there has been an outbreak of wailing and gnashing of teeth on the part of defenders of socialized medicine. Nor was this the only such high-profile case. About a year ago Grizzlies basketball center Bryant "Big Country" Reeves hurt his ankle and was similarly catapulted to the head of the medical waiting list. But beyond such headline-grabbing cases there are numerous other privileged characters; politicians and bureaucrats and their families and friends with political pull and doctors, nurses, other health-care professionals, and those who can rely on them for favors. This is called "professional courtesy."

Most complaints have focused on the unfairness of a system that allows the privileged to receive medical care within a few days of an injury, while forcing others to wait weeks and even months, if not years. But this is exactly backward. The problem is not that some few people are treated quickly, as they should be. It's that we aren't all dealt with like members of an advanced civilization, where quick service is always the order of the day. We all should be treated like paying customers—and if we were, we would be.

Why are there long waiting lines that do not dissipate quickly? In economic parlance, this comes about because demand is greatly in excess of supply. There is no other reason; that is it: supply's falling short of demand is a necessary and sufficient cause of long and enduring queues.

But to answer in this manner is only to put off the inevitable question: why does demand continue to exceed supply in some markets but not in others? Again, the answer comes straight out of Economics 101: a permanent shortage arises and endures if and only if prices are pegged at below-equilibrium levels and kept there through force of law.

Some people think there is something special about medical care. There is not. Yes, if we do not avail ourselves of it, we will be in dire straits. But no less can be said for food, clothing, shelter, energy, transportation—you name it. And economic law, just as in the case of chemistry or physics, is no respecter of how important an industry is to human well-being; it works just the same in medical services as for paper clips or rubber bands. Impose artificially lower prices in a market—let alone virtually zero prices as in medicine—and you guarantee a shortage.

If any evidence of this phenomenon were needed, it has recently been furnished in three completely separate markets. Rent control pegs rents below market levels; it reduces incentives to supply additional residential rental units and decreases benefits to tenants who economize on space. The energy shortage in California stems entirely from the fact that retail prices are fixed at artificially low levels, thus retarding incentives on the part of customers to decrease their usage, and on the part of potential suppliers to bring more energy to this market.

Last but not least, and most relevant to our present concerns, is the health-care market in Canada. Here, too, consumers are prevented by law from paying prices that reflect the scarcity value of medical services. We do this, of course, out of misguided compassion. But this policy is based on blatant economic illiteracy. Canadians think they can violate economic law with impunity. They cannot.

Our much-vaunted (in coercive socialistic circles, that is) health-care system is predicated on a violation of economic principles. It is built on a foundation of quicksand.

The only way to enable all citizens to enjoy the benefits now accorded only to a Sedin, a Reeves, or other medically privileged characters, is to completely rescind socialized medicine. It should be privatized and take its place among all other industries (cars, computers, chalk) that contribute mightily to our advanced standard of living, with no queues for anyone, thank you. This step would, with one fell swoop, radically reduce waiting lists and the brain-drain of Canadian doctors and nurses as well. Chrétien's recent conversion is too little too late if we want the health-care system to function as well as these other industries do.

Adam Smith's invisible hand of the market works its magic in every industry known to man. Health care is no exception. Those who take the opposite point of view are responsible for the needless suffering of the sick who cannot get timely help, thanks to medical socialism. This system did not work in the USSR. It cannot function with regard to Canadian health care either. Must we suffer through this for 70 years as the unfortunate Russians did? You don't like queue jumpers? Get used to it. It was part and parcel of the old Soviet system, and there is no way we can escape this if we copy the Soviets in health care.

At this point the critic will retort, "It is not fair to charge people market prices for health care; the rich will be treated better." But that is precisely the point of being rich in the first place. If the wealthy did not get better treatment, what would be the point in trying to amass riches? (And if they didn't try to amass riches, the entire economy would tank, not just health care.) In any case, the better off are already advantaged under the present system: they can jump queues in Canada or take their business to the United States.

Another objection: there's nothing for the poor in returning health care to the private sector. Nonsense. The poverty stricken are treated far better in capitalist countries than anywhere else, and medical service is again no exception. Yes, of course, the impecunious have to wait for the well-off to purchase MRIs (many small states in America have more of them than all of Canada does), but when they do, low-income people too can avail themselves of high-tech diagnostics. This is precisely why the poor have color televisions, computers, cars, and more. Had these too, been socialized, they would still be toys reserved for the rich.

Wire and Rails: Comparing the Web and Railroads

The Internet Has Little in Common with the Transcontinental Railroads

DECEMBER 01, 2001 by Larry Schweikart

Larry Schweikart teaches history at the University of Dayton.

Not long ago the television show *Silicon Spin* glumly reviewed the latest news of the cellular phone industry. The guests concluded that even if tech stocks, especially telecoms, had hit bottom, it would be 2003 before the experts thought the majority of them could again struggle back to profitability. Virtually all the problems, they concluded, stemmed from the industry's rapid advance into broadband at a time that the market did not yet exist.

On the heels of the *Silicon Spin* analysis, the *Wall Street Journal*, focusing on a pair of telecoms called Qwest and Level 3 Communications, came to a similar judgment. The Web was "overbuilt," resulting in a "fiber glut" that "underlies much of the uncertainty plaguing the telecom sector."[1] Claiming that only 2.6 percent of the capacity was actually in use, the *Journal* bleakly concluded that "much of [the fiber] may remain dark forever."

What was interesting in both the *Journal* and the *Silicon Spin* analyses was the comparison with the railroads in the nineteenth century and the argument that both the Web and the railroads were "built ahead of demand." It behooves investors—let alone anyone concerned with the future of high-tech America—to learn if telecoms indeed do have a similar historical pattern to that of the railroads, and if so, how they also differ.

America's first railroad construction came through private financing, although it didn't take long before the state governments got involved. Economic historians have argued that the capital demands of the railroads dwarfed those of any other industry. While that might have been true in the 1850s, it was not the case in the 1830s or 1840s. Founders of many early roads had simple objectives, often merely linking a single city to a river, or even building a shortcut between a long and difficult bend in a single river, as was the case in Alabama.

After the canal craze of the 1830s, in which many state governments subsidized construction by guaranteeing the canal companies' bonds, the precedent was set for the states to support railroads. A number did so enthusiastically, especially in the south. Still, private capital dominated the construction of the best—and most viciously fought-over—roads. Cornelius Vanderbilt's New York and Harlem Railroad, then later the Erie, attracted the attention of journalists and the general public, because of the titanic struggles between Vanderbilt and a bevy of opponents, including Jim Fisk, Jay Gould, and Daniel Drew.

Until that point, the extent of most governments' involvement with the railroads took the form of legislators' and aldermen's taking bribes in return for granting, or withholding, various rights to cross certain territory. This, in turn, allowed those with substantial railroad stock to manipulate the market in railroad securities. Of course, for every buyer there must be a seller, and to the dismay of Fisk, Gould, and Drew, the Commodore often would not be (pardon the pun) railroaded: quite the contrary, Vanderbilt sent his own agents into the securities market to sell when his opponents tried to drive prices up, or to buy when they tried to drive them down. His massive transactions often disrupted the schemes of stock manipulators, and in the process he taught the silent partners in Albany lessons they never forgot.

By the Panic of 1857, most railroads relied on private investment. The depression of that year put many of them into bankruptcy, however. Ironically, while economists have for years thought that the origins of that panic lay in disruptions of the wheat market or foreign instability, it turns out that the Dred Scott decision—which overthrew the Missouri Compromise and opened up all territories to slavery—so terrified investors that the bonds of east-west roads collapsed. (Significantly, none of the roads running predominantly north and south collapsed, because their future business and traffic would have been relatively unaffected by the decision.)[2]

What would have become of the rail networks had the Civil War not intervened, of course, is difficult to determine. It is likely that, had slavery been prohibited from the territories per the Missouri Compromise post-

1860, a normal construction program by private investors, largely absent state government intrusions, would have occurred. It is worth noting that the single most important business transformation in American history—the rise of the so-called "managerial hierarchies"—had already taken place in the private sector to address the capital needs of the railroads—a full decade before the first government-backed transcontinental railroad was launched.

Move Along, No Consumers Here

For many years, the nation had sought to support construction of a railroad to the Pacific for military reasons—largely to supply the forts on the frontier, but also to ensure quicker and more reliable support to California and Oregon. If there was agreement over the necessity of a transcontinental, there was disagreement over the route: southerners wanted a route running from Nashville or New Orleans, while northerners wanted a Chicago locus. It was Senator Stephen Douglas's introduction of legislation to build a railroad through Nebraska that had touched off "Bloody Kansas," and, eventually, the war itself. When the Civil War broke out, the Union government needed California's gold and silver as well as the endless supply of horses and cattle provided by the frontier west. Supply lines were secured by the army, and Congress, without southern opposition, immediately passed the Pacific Railroad Act of 1862, which became a badly flawed blueprint for most of the transcontinental railroads. Under the Act, the government gave the railroad a substantial land grant (which was within its constitutional authority to do, and fit the Articles of Confederation's provisions of the Land Ordinance of 1784 that reserved four sections of every township to the federal government).

Having the authority and using it wisely were two different things, however, and the free land proved as much a curse to the railroads as a blessing. But the other part of the Pacific Railroad Act involved a provision to give a subsidy to the construction of railroads in the form of United States bonds that the companies could sell on the market, then apply the proceeds to construction costs.

Under any circumstances, this was bad economics. The structure of the subsidies, though, proved even more short-sighted. For each mile of track constructed, the railroad received $16,000 worth of government bonds, rewarding the railroad for miles of track laid instead of actual services provided.

Despite what appear as lucrative inducements to modern Americans, few investors jumped at the opportunity to invest in a transcontinental railroad. People could do the math, and they concluded that it would be decades before such a project turned a genuine profit. There simply were not enough customers on the Great Plains to support the railroads. Congress thus sweetened the pot, doubling the land grant and allowing the railroads to sell their own bonds in addition to the government securities for construction. To make a long story short, this resulted in the infamous Credit Mobilier scandal.

After the government had sufficiently jump-started the Union Pacific and Central Pacific, another competitor subsidized by government land grants, the Northern Pacific, also entered the building frenzy. Whatever other feelings this must have evoked from Native Americans, the sight of these endless and obviously expensive tracks must have struck them as incredibly silly. The Indians, because they negotiated the Plains regularly, saw that even after the sodbusters arrived there were no people out there to speak of.

One railroad builder did not rely on government land grants or bond subsidies for his transcontinental railroad. James J. Hill, a Canadian who was blind in one eye, had started his own transcontinental by steadily marching across Minnesota. Hill recognized the simple economic fact that the other roads missed—largely because they were on the government dole—that there were no customers for the railroads to serve. To that end, Hill decided to create his own customer base, a strategy that would have remarkable implications for the telecom industry in the 21st century. He enticed future customers—in this case, farmers—to places where his railroad ran by offering them land. In a direct inversion of the practice of the other roads, namely getting land from the government, Hill bought land and gave it away! Hill also experimented with a variety of new wheat strains, cattle breeds, and agricultural advances that would keep his future customers profitable, in the process putting his railroad in the black. Burton Folsom's *The Myth of the Robber Barons* has thoroughly dealt with the stark differences between the government-funded transcontinentals and the Great Northern. For our purposes, the key factor is that Hill did not "build ahead of demand," but rather ensured through his own efforts that the demand would be there when he needed it. It was the ultimate essence of Say's Law.

Back to the Future

Jump ahead now more than a century to the late 1990s and the exploding telecom, wireless, fiber-optic, and high-tech boom. Once again, there are concerns that businesses are building ahead of demand. But the comparison to railroads doesn't hold water. The railroads—at least, all but the Great Northern—were subsidized by the government and had no incentive to develop a customer base.

Indeed, the government was the customer until the legislators finally took away the golden goose. By the 1880s enough people had moved into the Great Plains and onto the frontier to obscure what had happened: the government had constructed several roads that would not have been profitable if left to their own resources, or at least not using the strategies that operators employed with Uncle Sam.

Economists have beaten the railroad data to death, and while there is near unanimity on the fact that the railroads provided "social savings" in the neighborhood of 5 to 15 percent of GNP by 1890, these conclusions universally ignore the dynamics of a free market. "Social savings" is a term that postulates general benefits to everyone (lower travel costs and shipping prices) that might not have existed in the absence of the railroads. The best that economists have come up with to actually test these theories is an imaginary—but potentially real—system of interstate canals that could have been constructed in place of the railroads. Again, however, proving that no private investors would have built the railroads in the absence of subsidies is impossible. Moreover, it is unlikely none would have done so, given the history of not only Hill and Vanderbilt, but also of the intrastate railroad construction prior to 1860. In other words, absent the government, the railroad entrepreneurs in the 1800s knew their market and had a good grip on the size of the customer base.

For the telecom industry in the modern period, the pundits are solemnly nodding their heads in unison that the "fiber barons" do not know their industry or their customer base—that they "built ahead of demand." But is that the case? The *Wall Street Journal* has even argued that, to paraphrase Senator Fritz Hollings, "There's too much competin' goin' on out there."

Further, competitors came in, the *Journal* implied, because of the "easy availability of funding." Aha! All those stupid capitalists were so anxious to lose their money that they marched into fiberworld like lemmings, dumping millions into dark cable, all because of the "easy availability" of capital.

One must pause, then, to consider the warnings of tech guru and prophet George Gilder, who has for a decade warned that the high-tech industry (and bandwidth/cable in particular) is underfunded! The key to Internet growth has been the venture capital firms, the top 20 of which, from 1974 to 1995, beat even Warren Buffett's well-known Berkshire Hathaway returns of 32 percent per year. Following four years of George H. W. Bush and two years of Bill Clinton, the investment in technology firms began to wane.

Three things heated up the Internet economy after 1994, however. First, energy prices continued to remain low and as silicon chip companies gobbled up electricity at rapidly accelerating levels, this component of their price fell steadily. Second, Web browsers appeared in 1994, making the Internet genuinely commercial. Third, the GOP Congress lowered capital gains taxes to 20 percent, while the Fed kept the lid on inflation, with prices rising at a tolerable 2 percent in the 1990s. Low interest rates, low energy costs, and low taxes—you can't beat that combination for economic growth, and the sector that is on the cutting edge will grow the fastest.

Magnify all of this by the "Law of the Telecosm," which states that the value of a network grows by a square of the processing power of all the terminals attached to it, and "Gilder's Law," which postulates that bandwidth grows at least three times as fast as computing power, and the high-tech economy of the 1990s became a skyrocket. The United States rode this skyrocket, claiming some 80 percent of the Web domain names and dominating Internet traffic. At the same time, the cost of manufacturing the "nuts and bolts" of computer—chips—shrank to almost immeasurable proportions, falling at rates of nearly 70 percent a year and forcing the price of a bit down to a millionth of a cent. Although the *Journal* may question the claim that Internet bandwidth and traffic are doubling every few months, even its own position—that traffic is doubling more like once a year (based on a single AT&T researcher's paper)—if true, is still an astonishing growth rate. Given this incredible level of expansion, is there anyone out there—aside from the *Journal* staff—who seriously wants to argue that the availability of venture capital has grown at exponential levels to match the rest of the Internet?

Low interest rates have not sparked a torrent of new venture capital. Nor has anticipation of the desperately needed, but modest, Bush tax cuts. Part of the bottleneck in venture capital has rested in the Byzantine FCC laws governing bandwidth and the monopoly positions of the Bells. Supposedly the 1996 Telecommunications Act required the Bells to unload their networks and free up local areas to competitors, and in return the Bells would receive the authority to re-enter long-distance data transmission. A burst of new "competitive local exchange carriers" (CLECs) suddenly appeared, only to find that the Act did not provide a timetable for or fines for not allowing the competitors into the loops. Then U.S. Representatives Billy Tauzin and John Dingell introduced legislation to allow the Bells into long-distance data transmission regardless.

Complaining that the "companies focused on the easy part of building a network [while] too little money went into [getting] into homes and offices," or a phenomenon called the "last mile" connections, the *WSJ* nevertheless admitted that the culprit might be the Baby Bells, which owned most of the "last mile" connections, not venture capital. Where the *WSJ* sees plummeting prices for dark fiber and the tech stock leaders, however, analysts such as Gilder see nothing but opportunities and market-driven growth. Falling prices are to be expected and celebrated, Gilder would argue.

Internecine Debate

The proper course of action on the Baby Bells, for the time being, is the fulcrum of analysis, pitting free marketeers with different solutions and approaches to de-monopolizing against each other. On the one hand, the "pure" marketeers such as Gilder brushed aside the impact of anti-Bell legislation, arguing that it was irrelevant in the long run what the Bells did. The key, he maintained, was fiber, which "trumps both copper and the airwaves,"[3] and cable companies, not the Bells, command the fiber. And since the important regulations were those governing cable, the Bell monopoly-related legislation was a sideshow: the real action was under the ground.

Other bona fide free marketeers saw the Tauzin/Dingell legislation as a crippling blow to the telecoms. William Lehr, an MIT economist, and James Glassman of the American Enterprise Institute constructed a stock index of the CLECs and found that their market capitalization plunged in direct proportion to the Tauzin/Dingell legislation's progress.[4] However, Gilder responded in an "open letter" to the new FCC chairman that these CLECs were merely "litigation shops" intent on forcing the Bells to share their copper.[5] They were not, he maintained, interested in dynamic change.

Gilder's solution is perhaps politically unfeasible, but eminently sensible: let the cable companies make hay out of their temporary monopoly status. Forget the Bells, and give them the profits from copper. As he correctly notes, no Internet advantage will last more than a fleeting moment. Quit trying to level the playing field. The market is the ultimate groundskeeper. Competition from broadband, DSL, and other technologies will quickly eliminate any advantages the Bells ever held.

One thing is certain. The Internet, and the glass fibers on which it should travel, has little in common with the transcontinental railroads. One was built by entrepreneurs, one by the government. One caused prices to plummet and services to spread; the other allowed companies to pool and price fix with Washington's blessing. One still suffers from not enough venture capital, while the other nearly collapsed because of too much free money from the taxpayers. The most interesting result of the comparison of wires and rails is that to succeed, one must waste its resource, bandwidth, because bandwidth is potentially the cheapest commodity in the world, driving costs down. The other wasted material resources, because it was subsidized by the government, driving costs up. James J. Hill would have appreciated the differences.

Notes

1. Rebecca Blumenstein, "Web Overbuilt: How the Fiber Barons Plunged the U.S. Into a Telecom Glut," *Wall Street Journal*, June 18, 2001.
2. Charles Calomiris and Larry Schweikart, "The Panic of 1857: Causes, Transmission, and Containment," *Journal of Economic History*, December 1990, pp. 807–34.

3. George Gilder, *Telecosm: How Infinite Bandwidth Will Revolutionize Our World* (New York: Free Press, 2000), p. 266.
4. See James K. Glassman, "Look to Politics to Find Broadband's Market Cap Shortfall," www.techcentralstation.com, June 22, 2001.
5. George Gilder and Brett Swanson, "The Broadband Economy Needs a Hero," *Wall Street Journal*, February 23, 2001.

No Yahoo! for New Shareholder Plan

"Shareholder Rights" Plans Often Benefit Existing Management while Shortchanging Shareholders

DECEMBER 01, 2001 by Gary M. Galles

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Last March Yahoo! announced that its board of directors had adopted a shareholder-rights plan, which it described as "designed to deter coercive takeover tactics, including the accumulation of shares in the open market or through private transactions, and to prevent an acquirer from gaining control of Yahoo! without offering a fair and adequate price and terms to all of Yahoo!'s stockholders."

In other words, the directors were doing it to protect their owners. But the next day Yahoo! stock fell 11 percent (to a level more than 90 percent below its 52-week high). Why would stockholders react so adversely to something called a "shareholder-rights plan"? Why would they dislike getting extra rights for free? The more common term for such plans, "poison pills," points us to the reason.

Similar to many other shareholder-rights plans, Yahoo!'s plan essentially gives existing shareholders the right to purchase additional shares of the company's stock at a substantial discount below their market value if someone acquires more than 15 percent of the common stock or attempts a hostile takeover of the firm. Of course, whoever is seeking control is denied that right.

On the surface, such a plan would appear to benefit stockholders by allowing them to buy added shares for less than they are worth. But in fact they typically harm stockholders. The dilution of share value that would result from an attempted takeover by anyone not friendly with existing management means that such takeovers will not be attempted.

What’s wrong with that? When a firm’s management fails to maximize shareholder value, a takeover or merger can let the owners install new management that promises to perform better. Such takeovers pay shareholders a substantial premium over current share prices, a premium they would very much like to receive. But a takeover defense can prevent such a restructuring and protect the current management from the threat of being ousted. And poison pills are the most effective takeover defense allowed by the courts without shareholder approval. (If they were subject to shareholder approval, owners could defend themselves by voting them down.) As a result, despite the uniformly pro-shareholder rhetoric that accompanies poison-pill announcements, in fact they are often devices to benefit existing management and shortchange shareholders.

Courts have permitted poison pills in deference to the “business judgment” rule, which presumes that boards of directors act in the interests of their shareholders rather than to preserve the managers’ interests or their own positions on the board. But this is misguided in the case of unapproved poison pills. Allowing the management and board, which are delegated agents of stockholders, the right to preserve their jobs by halting takeovers that owners would approve effectively gives those bodies the right to change their employment contract unilaterally so that owners can no longer fire them in favor of another management team. Shareholders would never agree to a delegation of power to management that is so clearly contrary to their interests, which is why shareholder activists are pursuing anti-poison pill resolutions at many corporations.

This lays the blame for the abuse of poison pills squarely on the courts’ misunderstanding of shareholders’ interests. They have essentially viewed poison pills as something-for-nothing deals for current shareholders, and since (in their view) shareholders wouldn’t oppose them, they need not be asked for their permission before managements unilaterally adopt them. However, poison pills are really often nothing-for-something deals that current shareholders would reject—given the chance. As a result, the courts’ mistaken presumption that shareholders’ rights are automatically protected in such cases has led them to allow managements to implement poison pills without shareholder approval, undermining shareholders’ rights in the process.

The supposed additional shareholder rights granted by poison pills are nearly valueless, as their mere existence all but eliminates the takeovers that would trigger them. But they do take from shareholders the valuable right to the premium prices they could have received if hostile takeovers had remained possible. Taking away this valuable shareholder option without their consent is not in owners' interests, which is reflected both by owner opposition and by negative stock price changes when most poison pills are adopted without shareholder approval.

A Better Way

If Yahoo!'s board intends to protect stockholders from abuses that may occur in a takeover, there are far less restrictive ways to do so. It could, through a variety of indirect methods, require that any share purchase offer be made to all shareholders, rather than to just enough shareholders to acquire control. It could require that any offer for shares must remain in place for a period long enough to give other bidders a chance to counter with an even higher offer that would benefit current owners more. If the board is trying to extract a higher premium through the poison pill, it could void the pill if an all-cash offer with at least, say, a 25 percent premium was tendered. But such alternatives were not mentioned.

In the words of financial economists Andre Shleifer and Robert Vishny, "hostile takeovers are probably the most effective way for shareholders to get rid of non-value-maximizing managers" ("Value Maximization and the Acquisition Process," *Journal of Economic Perspectives*, Winter 1988, p. 11). Unilateral board adoption of poison pills short-circuits that mechanism. Given that there are alternative ways to protect stockholders from any abusive takeover tactics, poison pills are more likely a defense of bad management than a defense of stockholders' rights. They undermine the market for corporate control and, as a result, the value of stockholders' investments.

However there is hope that shareholders' rights will be reinstated. A 1999 ruling from the Denver-based Tenth Circuit Court of Appeals has begun undermining poison pills not approved by shareholders. Affirming the first-ever federal opinion on the issue, the appellate court ruled that unless a company's charter gives only directors control or state law explicitly gives directors the rights to create poison pills, shareholders can overrule their boards and revoke poison-pill takeover defenses.

The ruling is now binding only in the six states covered by the court, but it could be extended to others. While almost half the states give directors the right to create poison pills (which would not be changed by the ruling), California and Delaware (where most Fortune 500 companies are incorporated) do not. While threatened managements are seeking to protect themselves through changes in state law, anti-poison pill resolutions are being pressed in other states, effectively expanding the court precedent beyond the Tenth Circuit.

Knut Wicksell: A Sesquicentennial Appreciation

Wicksell's Ideas Have as Much Interest Today as When He First Penned Them

DECEMBER 01, 2001 by Richard Ebeling

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In the early months of 1889 a 37-year-old Swedish student named Knut Wicksell was walking through the streets of Berlin in Germany when he happened to notice in the window of a bookstore a recently published volume by the Austrian economist Eugen von Böhm-Bawerk: *The Positive Theory of Capital*.

Wicksell later wrote to a friend that,

> I procured a copy and was soon lost in the book. I understood most of it rather imperfectly, as can be seen from my notes in the margin. . . . Nonetheless the book came to me as a revelation. I had already tried on my own, with little success, to penetrate the phenomenon of interest and the general problem of economic distribution, when complicated by the existence of capital (as well as labor and natural resources). . . . It was as though I now saw with my own eyes the roof being put on a scientific construction, which no economist since the days of Ricardo had managed to raise above its lower floors.[1]

This discovery put Knut Wicksell on an intellectual path that led to his becoming one of the great economists of the twentieth century. Through his writings and personal influence Wicksell provided a framework for monetary and business-cycle analysis that has served as the starting point for several generations of Swedish and Austrian economists. Knut Wicksell was born on December 20, 1851, in Stockholm. The sesquicentennial of his birth offers an appropriate occasion for an appreciation of some of his important contributions to economics.

Wicksell was born into a middle-class Swedish family. His father ran a grocery business and wisely invested the profits in real estate. Knut's mother died when he was seven years old, and his father when he was 15. But he and his four siblings were left financially comfortable enough for them to get through high school and for Knut and his brother to attend the University of Uppsala, not far from Stockholm. He graduated with a bachelor of science degree, cum laude, after only two, instead of the usual four, years, having specialized in mathematics, physics, and astronomy.

But he began having doubts about his future. First, after an intense devotion to his Christian faith following his father's death, he increasingly came to have doubts, and at the age of 23 became a "free thinker," a position from which he never wavered for the rest of his life. Second, he doubted whether he could make any meaningful contributions to mathematics, if he chose that direction for his graduate studies.

At the same time, he began to be interested in the social and economic issues of the day, especially the relationship between drunkenness, prostitution, the condition of the poor, and overpopulation. The poor were driven to drink because of the apparent hopelessness of their economic condition. Many men in the lower middle class turned to alcohol and the services of prostitutes because they had no hope of earning a sufficient income that would make early marriage possible.

Wicksell concluded, therefore, that if these vices were to be ameliorated, population growth had to be slowed down so that the rate of capital formation would exceed the rate of increase in population, resulting in a relatively greater scarcity of labor in comparison to capital. This would raise the value of labor and wages relative to the value and price of capital. But Wicksell rejected Thomas Malthus's famous prescription of "moral restraint" on the part of the members of society. Instead, he made the case for a wide distribution of contraceptives, and in later years advocated the legalization of abortions during the first three months of pregnancy.

For these and other "radical" social views that he put into print in the early 1880s, Wicksell was condemned by the professors at the University of Uppsala, censured by the Uppsala medical association, and warned that he was following a dangerous path in publicly advocating these ideas.

He made his living during these years as a journalist and read economics on his own. But in the mid-1880s and then again late in the decade he was awarded travel grants to study abroad that took him to London, Strasbourg, and Vienna. In Vienna he attended the lectures of Carl Menger, founder of the Austrian school of economics. It was on the second of these travels that Wicksell came across Böhm-Bawerk’s work in a Berlin bookstore.

When he returned to Sweden he applied for a lectureship in economics at the University of Uppsala, but was turned down because of his political and social views. Nevertheless, he was recommended to apply to the university law school, where he was told that he could teach economics only if he had a law degree. So at the age of 45 he did what he had done as an undergraduate and crammed four years of study into two. He passed the law examination in 1899 and was appointed a lecturer in economics at the University of Uppsala the same year. The following year he accepted a professorship at the University of Lund, a position he held until his retirement in 1917 at age 65.

At Lund he continued to make controversial statements. At a May Day demonstration in 1904 he suggested that it was futile to imagine that Sweden could ever successfully defend itself against a determined, more powerful foreign enemy. Instead, he suggested that Sweden should abolish all military spending and invite Imperial Russia to annex the country. Russia would supply all necessary defense against would-be attackers, and the role of the Swedes would be to educate and civilize the rough and backward Russians in the ways of social freedom and democracy. He stepped back from this radical position after the First World War and became a strong proponent of the League of Nations.

Then in 1908 Wicksell took up the cause of an “anarchist agitator” who had “disturbed the religious peace” of the country with remarks declared to be blasphemous for which he was sent to prison. Insistent that this was a blatant and serious violation of freedom of expression and personal liberty, Wicksell delivered a public lecture in which, as an act of peaceful civil disobedience, he satirized the story of the Immaculate Conception. Wicksell was tried and convicted of blasphemy and after several appeals spent two months in prison in 1910.

He wrote widely on the problems of wartime inflation and postwar monetary problems following the First World War and suggested how the negative effects of the war could be minimized in neutral Sweden. He also turned out a string of seminal books on capital, money, interest, and public finance. On May 2, 1926, at the age of 74, he died from a stomach disorder that was complicated by pneumonia.

Major Works

Wicksell's first major work was *Value, Capital and Rent* published in 1893.[2] The classical economists, from Adam Smith through David Ricardo to John Stuart Mill, had attempted to show that the relative prices of goods and the distribution of income among the factors of production (land, labor, and capital) were all ultimately determined by the quantity of labor (along with a few auxiliary assumptions) that was required for the manufacture of goods and the production of food. The "marginalist revolution" of the 1870s had shown that the value of goods and factors of production are ultimately based on the subjective valuations of demanders. Their marginal (or incremental) decisions concerning tradeoffs between units of commodities determine relative prices in the market.

What Wicksell did in his first book was to synthesize the mathematical general equilibrium theory of Léon Walras with Böhm-Bawerk's theory of capital as a time-consuming, multistaged process of production. He explained how each factor of production received an income equal to its contribution (or marginal product) to the manufacture of a good. He also showed that even in a stationary equilibrium, interest income had to be earned as the incentive for replacing the capital consumed in the processes of production through time.

In his next major work, Studies in the *Theory of Public Finance* (1896), Wicksell innovatively applied the theory of marginal cost-benefit analysis to the process of government taxing and spending.[3] Nobel laureate James Buchanan has emphasized Wicksell's original and important contribution to political decision-making on fiscal matters:

> Among fiscal theorists, Knut Wicksell holds the unique position of having carried his theoretical ideas through to an examination of the political structure within which fiscal decisions must be made and implemented. . . . Wicksell proposed, first of all, that the bridge between tax and expenditure sides of the fiscal account be made explicit. When a specific expenditure project was presented, a whole array of possible distributions of the required tax bill were also to be presented, with each array estimated to produce revenues sufficient to cover the outlay. The expenditure project was then to be voted on in the legislature, along with each one of the tax allocations, and when one such combination secured the unanimous approval of the assembly, it was to be adopted. If no single combination received unanimous support, the expenditure project was not to be undertaken and no tax was to be levied.[4]

Wicksell stepped back from the full unanimity principle to a less restrictive super-majority rule. But Buchanan highlighted that what was crucial to Wicksell's contribution was his focusing on government fiscal issues in terms of the individual members of society who would either receive the expenditure benefits or bear the taxation costs. The preferences of real people affected by government fiscal policy could no longer be ignored, and economists could not simply view themselves as "proffering advice to nonexistent benevolent despots."[5]

But the contribution for which Wicksell has received the most international recognition among economists for over a century now is his book *Interest and Prices: A Study of the Causes Regulating the Value of Money* (1898).[6] In the first half of the nineteenth century a number of leading classical economists, including David Ricardo, had defended "the quantity theory of money" in understanding the inflation experienced during the Napoleonic Wars. They reasoned that a general rise in prices could not occur unless there was a sustained increase in the quantity of money. And they further argued that the only way to restrain government's temptation to abuse the printing press was to link the currency to a commodity, such as gold. Thus they advocated the gold standard as an institutional means to prevent government-caused inflations. For a variety of reasons many economists had turned away from the logic of the quantity theory of money by the end of the nineteenth century.

Wicksell set about the task of rehabilitating it.[7] He used Böhm-Bawerk's idea of a period of production between the application of inputs and the availability of outputs to serve as the framework for restating his version of the theory. In a nutshell, Wicksell argued that if goods were traded directly in barter, there would be a tendency for market forces to establish an interest rate that balanced the supply and demand for real capital for investment purposes. And this equilibrium rate of interest is what Wicksell called the "natural rate."[8]

However, in a complex economy goods are traded through a medium of exchange—money. If lenders lent their savings to borrowers in the form of money at a similar equilibrium rate of interest, then money would be "nothing more than a cloak" for the savings and investing of real resources for productive purposes. However, Wicksell says, "Liquid real capital (i.e., goods) are never lent. . . . [I]t is money which is lent, and then the commodity capital is then sold in exchange for this money."[9]

Depressed Interest Rate

Since it is money that is lent, and not real capital, the monetary authority is able to increase the supply of money available for lending and lower the money rate of interest below the "natural rate" to attract borrowers. Anticipated yields or profits on potential investments will now seem greater than before the fall in the money rate of interest, meaning that at the margin some production projects will now appear attractive that did not seem profitable at the previous higher rate of interest. However, not all types of investments are affected equally by the change in the rate of interest. Those with longer time horizons—longer periods of production before their completion—will be influenced to a greater degree because the lowering of the rate of interest increases the present value of these longer-term investment projects.

Developing several different models using slightly different assumptions, Wicksell presents his theory of how this lowering of the interest rate affects market processes.[10] But the crucial one that served as a springboard for later developments of the theory by other Austrian and Swedish economists is his two-period model.

Suppose, he says, that production processes normally take one year. But with the fall in the rate of interest because of the monetary expansion, two-year investment projects now appear profitable to some entrepreneurs. Using borrowed money, these entrepreneurs purchase and hire factors of production by bidding them away from their present employment in one-year projects. This means that at the end of the first year fewer goods and services will have been produced than would have been, because the required resources were drawn into projects that will not be completed for another year.

This greater scarcity of consumer goods, reflected in higher prices, "forces" society to save—that is, do without consumption goods they normally would have desired to purchase, but which are not available. But according to Wicksell, at the end of the second year, when the longer-term projects have been completed, society will be rewarded for this forced waiting with more and better goods made possible by the longer period of production.

Wicksell argued that if the monetary authority were to keep the money rate of interest constantly below the "natural rate" through continuous monetary expansion, a "cumulative process" of rising prices would be generated. The additions to the money supply would be borrowed by entrepreneurs who bid up the prices of the factors of production to keep or add them to their sectors of the economy. The workers and resource owners receiving those higher money incomes period after period would in turn, and in sequence, bid up the prices for the consumer goods they desire. Only an end to the monetary expansion and a rise in the rate of interest back to its "natural" level could bring the process to an end.

A few years later Wicksell restated his formulation of the Austrian theory of investment and the period of production, as well as his theory of money and how monetary changes influence production processes in his two-volume *Lectures on Political Economy*.[11]

Wicksell's outline of the way in which changes in the money supply modify the market rate of interest and influence the allocation of resources through the processes of production became the starting points for the Austrian and Swedish schools of economics in monetary and business-cycle theory. Ludwig von Mises in *The Theory of Money and Credit*, *Monetary Stabilization and Cyclical Policy*, and *Human Action*, and F.A. Hayek in *Monetary Theory and the Trade Cycle* and *Prices and Production* adopted Wicksell's framework for developing a theory of the business cycle.[12]

Mises's and Hayek's innovation was to demonstrate that there were market forces set in motion in Wicksell's "cumulative process" that would bring it to an end before many of the longer-term investment projects could be brought to completion. Thus the inflationary upturn in investment activity carried with it the seeds for an eventual downturn and correction when these capital projects were shown to be malinvestments resulting from misdirection of resources due to the lack of real savings needed to bring them to, and maintain them after, completion.[13]

In the 1930s Wicksell's ideas were developed in a slightly different direction by the Stockholm school of economists.[14] Two of the most important contributors from this period were Gunnar Myrdal and Erik Lindahl. Myrdal formulated a theory of "monetary equilibrium," in which he suggested the conditions that were required for avoiding Wicksell's cumulative process.[15] Lindahl accepted Wicksell's basic framework and then analyzed the change in the cumulative process if there were less-than-full employment in either the consumer-goods or investment-goods sectors of the economy or both; Lindahl also developed a "period analysis" of sequential change over time.[16] And in the late 1930s Bertil Ohlin defended the Swedish Wicksellian approach against the emerging Keynesian theory.[17]

Both the Austrian and Swedish variations and developments of Wicksell's seminal ideas on money and the business cycle were submerged in the tidal wave of Keynesian macroeconomics during most of the post-World War II period.[18] But in recent years there has been a renewed interest in Wicksell and his continuing relevance as found in the Austrian and Swedish variations on his themes.[19] And most especially the new generation of Austrian economists has begun a revival of this insightful tradition.[20]

Thus on the 150th anniversary of Knut Wicksell's birth, his ideas have as much interest and offer as much insight at the beginning of the 21st century as when he was first penning them at the start of the twentieth.

Notes

1. Torsten Gardlund, *The Life of Knut Wicksell* (Stockholm: Almqvist & Wiksell, 1958), p. 118. The following account of Wicksell's life and career are taken from Gardlund's book and Carl G. Uhr, *Economic Doctrines of Knut Wicksell* (Berkeley: University of California Press, 1962).
2. Knut Wicksell, *Value, Capital and Rent* (New York: Augustus M. Kelley, 1970 [1893]).
3. This work has been partly translated as, Knut Wicksell, "A New Principle of Just Taxation" [1896], in R.A. Musgrave and A.T. Peacock, eds., *Classics in the Theory of Public Finance* (London: Macmillan, 1958), pp. 72–118.
4. James M. Buchanan, *Public Finance in Democratic Process: Fiscal Institutions and Individual Choice* (Chapel Hill: University of North Carolina Press, 1967), pp. 115–16; see also Duncan Black, "Wicksell's Principle in the Distribution of Taxation," in J.K. Eastman, ed.,

Economic Essays in Commemoration of the Dundee School of Economics, 1931–1955 (London: Economists Bookshop for the LSE), pp. 20–21: "Inside Parliament Wicksell's principle, by requiring a high majority for an increase of expenditure and a very small minority for a reduction, would make increases of expenditure far more difficult and reductions far easier than with the normal requirement of a simple majority. The bias would be toward curtailment and reduction."

5. James M. Buchanan, *Better than Plowing and Other Personal Essays* (Chicago: University of Chicago Press, 1992), p. 6.
6. Knut Wicksell, *Interest and Prices: A Study of the Causes Regulating the Value of Money* (New York: Augustus M. Kelley, 1965 [1898]). The ideas in this work were also summarized by Wicksell in journal form in "The Influence of the Rate of Interest on Commodity Prices" [1898] in *Selected Papers on Economic Theory* (New York: Augustus M. Kelley, 1969 [1958]), pp. 67–89, and "The Influence of the Rate of Interest on Prices," *Economic Journal*, June 1907, pp. 213–20.
7. See Richard M. Ebeling, "Knut Wicksell and the Classical Economists on Money, Credit, Interest and the Price Level" *American Journal of Economics and Sociology*, July 1999, pp. 471–79.
8. Wicksell's use and meaning of the "natural rate" of interest is not without ambiguity. See Arthur W. Marget, *The Theory of Prices, Vol. 2* (New York: Augustus M. Kelley, 1966 [1942]), pp. 201–204. Marget discerned at least eight different definitions of the concept in Wicksell's writings.
9. Wicksell, *Interest and Prices*, pp. xxvi, 135.
10. A detailed breakdown of Wicksell's analysis of different "periods" under "stationary" and "cumulative" conditions, as well as some of the inconsistencies to be found in his exposition, is presented in Uhr, pp. 235–45.
11. Knut Wicksell, *Lectures on Political Economy*, 2 vols. (Fairfield, N.J.: Augustus M. Kelley, 1977 [1901 and 1906]).
12. Ludwig von Mises, *The Theory of Money and Credit* (Indianapolis, Ind.: Liberty Classics, 1981 [1912; 2nd ed.,1924; 3rd ed., 1953]); "Monetary Stabilization and Cycle Policy" in Percy L. Greaves, ed., Ludwig von Mises, *On the Manipulation of Money and Credit* (Dobbs Ferry, N.Y.: Free Market Books, 1978 [1928]) pp. 57–171, and in Israel M. Kirzner, ed. *Classics in Austrian Economics: Samplings in*

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13. For an exposition of the Austrian theory of the business cycle in contrast to the traditional Keynesian theory of the Great Depression, see Richard M. Ebeling, "The Austrian Economists and the Keynesian Revolution: The Great Depression and the Economics of the Short-Run," in Richard M. Ebeling, ed., *Human Action: A 50-Year Tribute* (Hillsdale, Mich.: Hillsdale College Press, 2000), pp. 15–110.
14. For an overview of the Swedish economists and their literature, see Richard M. Ebeling, "The Stockholm School of Economics: An Annotated Bibliography," *Austrian Economics Newsletter*, Winter 1981, vol. 3, no. 2.
15. Gunnar Myrdal, *Monetary Equilibrium* (New York: Augustus M. Kelley, 1965 [1933; 1939]).
16. Erik Lindahl, *Studies in the Theory of Money and Capital* (New York: Augustus M. Kelley, 1970 [1939]).
17. Bertil Ohlin, "Some Notes on the Stockholm Theory of Savings and Investment" [1937], reprinted in Howard S. Ellis, ed., *Readings in Business Cycle Theory* (London: George Allen & Unwin, 1950), pp. 87–130.
18. For a comparison and contrast of the Swedish and Austrian contributions on the basis of Böhm-Bawerk's and Wicksell's theories, see Richard M. Ebeling, "Money, Economic Fluctuations, Expectations and Period Analysis: The Austrian and Swedish Economists in the Interwar Period," in Willem Keizer, Bert Tieben, and Rudy ven Zijp, eds., *Austrian Economics in Debate* (London/New York: Routledge, 1997), pp. 42–74.
19. See David Laidler, *Fabricating the Keynesian Revolution: Studies of the Inter-war Literature on Money, the Cycle, and Unemployment*, Part I on "The Wicksellians," (Cambridge: Cambridge University Press, 1999), pp. 25–75.
20. Most recently, Steven Horwitz, *Microfoundations and Macroeconomics: An Austrian Perspective* (London/New York:

Routledge, 2000); and Roger W. Garrison, *Time and Money: The Macroeconomics of Capital Structure* (London/New York: Routledge, 2001).

Rolling Back the Market: Economic Dogma and Political Choice by Peter Self

Another Critique of the Free-Market System

DECEMBER 01, 2001 by Michael D. Mallinger

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Reviewed by Michael D. Mallinger

Critiques of the market system are a dime a dozen. Authors of these critiques typically choose to gloss over most of the theory underlying classical economics and classical-liberal political philosophy. However, what sets Peter Self apart is his willingness to examine how the writings of modern scholars like F. A. Hayek and James Buchanan relate to the original views of political economy developed by Adam Smith, John Stuart Mill, and others.

Although Self is able to uncover some of the bridge between contemporary and historical supporters of economic liberty, he is unwilling to explain how the academic ideas of classical economists have led Public Choice scholars to question the efficiency of the political allocation of resources in an economy.

Self's chapter on philosophy begins on a positive note. He characterizes the origin of political liberalism this way: "Liberalism is basically an individualist tradition. It celebrates the rights and responsibilities of individuals. Its strong attachment to individual freedom stresses the right of individuals to choose and make their own lives and to take responsibility for the outcomes. It also endorses equality in the sense of the equal moral worth of all individuals and their entitlement to respect and consideration. As a child of the Enlightenment, liberalism has always had strong belief in the value of human reason and in the possibility of human progress."

From this he explains how the writings of Smith and John Locke enabled individuals to progress from a social system based on personal status to a system based on contractual relations made possible by the spread of market-based principles. He notes that Mill formally laid down the framework of how market economies function, but claims his unhappiness with the outcomes of those economies led him to advocate a guaranteed basic income for all workers. Thus, like Jan Narveson, Self claims that Mill's work led to a split between "negative" liberals who accept market-based outcomes and "positive" liberals who believe that states should enable individuals to maintain their personal autonomy, but must also provide them with a "minimum of resources and opportunities."

Self cites Hayek and Herbert Spencer as the key scholars who sounded the alarm on the growth of government. He rightfully credits Hayek for anticipating the tyranny of fascist and communist totalitarian regimes; he also credits Hayek with issuing "a comprehensive warning of the destruction of liberty, which results from the complete concentration of political and economic power in the same set of rulers." As a result, he states that separating and dispersing political authority among autonomous individuals is necessary for liberty to persevere.

Unfortunately, although Self emphasizes the links from Smith and Mill to Hayek and Buchanan, he is unable to comprehend the logical consistency among all of their arguments. He asserts that individuals who lived in the era when the classical economists wrote had strong moral standards regarding their personal and family lives that are largely absent today. That may be true, but it doesn't weaken the case for laissez faire. In addition, he claims that the growth of capitalism occurred to serve a specific moral mission—to lift the poor out of misery and exploitation. Had Self better understood Hayek, he would know that spontaneous orders do not grow to serve particular purposes.

While Self's analysis of the philosophy of liberalism provides some insight into how markets produce wealth, his discussion of various policy issues leaves much to be desired. His section on the failure of the price mechanism to take account of environmental costs reads like a summary of *Earth in the Balance* rather than serious scholarship. His critique of free trade repeats much of the mindless rhetoric used by the various groups that demonstrated against the World Trade Organization in Seattle. His case against Gordon Tullock's theory of rent-seeking rests on the assertion that certain interest groups seek to remedy social or environmental problems that "transcend the market" rather than pursuing their own selfish interests. But there is far too much evidence that idealistic groups are eventually captured by those who use them for personal gain to take Self's argument seriously.

Overall, Self's examination of the philosophy underlying classical economics and classical liberalism is more fair and enlightening than one would expect in a critique of the market system. Unfortunately, much of the rest of the book is gravely flawed.

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Peace on Earth, Good Will Toward Men Through Capitalism and Freedom!

Open Markets and Competition Bring Peace and Prosperity

DECEMBER 01, 2001 by Mark Skousen

"A great multitude of religious sects . . . might in time [become] free of every mixture of absurdity, imposture, of fanaticism." —Adam Smith[1]

In this time of thanksgiving and holiday cheer, we here at the Foundation for Economic Education wish everyone peace, prosperity, and happiness. Leonard Read, our founder, wrote that freedom of choice is one of the essential agents of peace and harmony.

According to Read, true freedom means practicing the Golden Rule and preserving the God-given rights of the individual as declared in the Declaration of Independence. "Everyone is completely free to act creatively as his abilities and ambitions permit; no restraint in this respect—none whatsoever."[2]

The latest edition of the *Index of Economic Freedom,* published by the Heritage Foundation and the *Wall Street Journal*, shows that many parts of the world are "mostly unfree" or "repressed," as judged by the level of corruption, taxation, protectionism, inflation, black markets, and government interventionism. Of the 155 nations surveyed, over half (81) receive a negative grade. Most telling, the area of the world with the highest concentration of "repressed" freedom is the Middle East, particularly Iran, Iraq, and Libya (Afghanistan was not ranked).[3] Judging from recent events, the Middle East confirms Read's thesis. Most of the Arab world continues to suffer from economic dislocation, political turmoil, and military conflict. "When the wicked rule, the people mourn" (Proverbs 29:2). Henry Hazlitt summed it up well: "It is socialist governments, notwithstanding their denunciations of imperialist capitalism, that have been the greatest source of modern wars."[4]

Commerce and Trade Breaks Down Barriers—and Intolerance

The Middle East is also known for dictatorships and religious intolerance. It seems that economic repression goes hand in hand with political and religious repression, just as economic freedom leads to political and religious freedom.[5] Montesquieu, Adam Smith, and other classical-liberal thinkers made the case that liberalized trade and the spirit of capitalism break down cultural and social mono-theism and destroy fanaticism and intolerance. Montesquieu saw many virtues in doux commerce, stating that the pursuit of profit-making serves as a countervailing bridle against the violent passions of war and abusive political power. "Commerce cures destructive prejudices," Montesquieu declared. "It polishes and softens barbarous mores. . . . The natural effect of commerce is to lead to peace."[6] Adam Smith seconded Montesquieu and taught that the commercial society moderates the passions and prevents a descent into a Hobbesian jungle.

Business encourages people to become educated, industrious, and self-disciplined. As economist Albert Hirschman observes, "The spirit of commerce brings with it the spirit of frugality, of economy, of moderation, of work, of wisdom, of tranquility, of order, and of regularity."[7] Business people are the ultimate in practicality—they are by nature compromisers and tolerant of other viewpoints. They will wheel and deal to sell and produce a product. As John Maynard Keynes once said, "It is better that a man should tyrannise over his bank balance than over his fellow-citizen."[8]

The Case for Religious Competition

The Middle East is also famous for its lack of religious freedom and diversity. A few Protestant Christians live and worship there, but proselyting is prohibited, even in Israel. Egyptians are divided into only two Muslim sects; there are virtually no Jews in the country, and no missionaries. Islamic fundamentalists hate the West's idea (as expressed originally by John Locke) of a free religious society where churches compete for members. According to Andrew Sullivan, America has achieved “one of the most vibrantly religious civil societies on earth,” and America “is living, tangible rebuke to everything they [Taliban and bin Laden] believe in.”[9]

Adam Smith contends that a state religion breeds fanaticism, intolerance, and persecution. There are numerous examples of holy wars waged by state-supported Christianity, Islam, and other religions that demonstrate Smith’s thesis. But Smith goes further.

He argues that creating a free, competitive environment in religions would be beneficial. Natural liberty, he said, favors “a great multitude of religious sects” which would generate interest in religion and encourage higher attendance at church. “In little religious sects, the morals of common people have been almost remarkably regular and orderly: generally much more so than in the established church.”[10] According to Smith, religious competition would reduce zeal and fanaticism and promote tolerance, moderation, and rational religion.

In short, a good dose of open markets and competition in all walks of life could go a long way toward bringing peace, prosperity, and good will in this dangerous part of the world. Until that happens, many will shout “peace, peace, when there is no peace” (Jeremiah 8:11).

Notes

1. Adam Smith, *The Wealth of Nations* (New York: Modern Library, 1965 [1776]), p. 745.
2. Leonard Read, *Anything That’s Peaceful*, 2nd ed. (New York: Foundation for Economic Education, 1998), p. 30.
3. Gerald P. O’Driscoll, Jr., Kim R. Holmes, and Melanie Kirkpatrick, *2001 Index of Economic Freedom* (Washington, D.C.: Heritage Foundation and the *Wall Street Journal*, 2001), pp. 2, 4.
4. Henry Hazlitt, *The Foundations of Morality*, 3rd ed. (New York: Foundation for Economic Education, 1998 [1964]), p. 339.
5. See Milton Friedman, *Capitalism and Freedom* (Chicago: University of Chicago Press, 1962), chapter 1.
6. Charles Montesquieu, *The Spirit of the Laws* (Cambridge: Cambridge University Press, 1989 [1748]), p. 338.

7. Albert O. Hirschman, *The Passion and the Interests*, 2nd ed. (Princeton: Princeton University Press, 1997), p. 72. I highly recommend this brilliant book. For more discussion of the peaceable nature of capitalism, see Mark Skousen, *The Making of Modern Economics* (New York: M. E. Sharpe, 2001), chapter 1.
8. John Maynard Keynes, *The General Theory of Interest, Money and Employment* (London: Macmillan, 1936), p. 374. Today we might say, "Better that a person tyrannize over his favorite sports team or his favorite stock than over his fellow citizen."
9. Andrew Sullivan, "This Is a Religious War," *New York Times Magazine*, October 7, 2001, p. 53. I highly recommend this article.
10. Smith, op. cit., pp. 747–48.

Don't Expect Much From Politics

Where Else Is Such Nonsense Allowed to Flourish?

DECEMBER 01, 2001 by Lawrence W. Reed

The older I get and the more I learn from observing politics, the more obvious it is that it's no way to run a business—or almost anything else, for that matter. The deficiencies, absurdities, and perverse incentives inherent in the political process are powerful enough to frustrate anyone with the best of intentions. It frequently exalts ignorance and panders to it. And a few notable exceptions aside, it tends to attract the most mediocre talent with motives that are questionable at best.

Recently, the ninth child of Robert and Ethel Kennedy, Max Kennedy, flirted with the idea of running for political office. A story in the July 15 *New York Times Magazine,* recounted his ill-fated attempt at a stump speech riddled with trite one-liners like these: "I want to fight for all of you. I'll commit myself heart and soul to be the kind of congressman who cares about you. I'll dedicate myself to fighting for working families to have a fair chance. I make you this one pledge: I will always be there for you."

Kennedy's handler pressed him repeatedly for a "take-away message," something of substance that his audience would remember. "What do you want people to take away from it?" he asked several different ways. The would-be candidate stammered and couldn't think of much other than "I'm a nice guy" until finally he admitted, "I don't know. Whatever it has to be."

Eligible for public office? Certainly, though in this case the subject fizzled out before his campaign was ever lit, and he has presumably found useful work elsewhere. Hundreds just like Max Kennedy get elected every year. But would it ever occur to you to put someone who talks this way in charge of your business? Outside of politics, is there any other endeavor in which such nonsense is as epidemic?

Welcome to the silly side of politics. It's characterized by no-speak, doublespeak, and stupidspeak—the use of one's tongue, lips, and other speechmaking body parts to sway minds without ever educating them, and deceiving them if necessary. The serious side of politics comes afterwards when the elected actually do something, even if—as is often the case—it bears little resemblance to what they promised. It's serious business in any case because it's the part where coercion puts flesh on the rhetorical bones. What makes a politician a politician, and differentiates politics from all other walks of life, is that the politician's words are backed up by his ability to deploy legal force.

This is not a trivial point. After all, in the grand scheme of life there are ultimately only two ways to get what you want. You can rely on voluntary action (work, production, trade, persuasion, and charity) or you can swipe. Exemplars of voluntary action are Mother Teresa, Henry Ford, Bill Gates, J.K. Rowling, and the kid who delivers your newspaper. When someone who isn't elected or appointed to any post in government swipes something, he's a thief.

If acting in his capacity as a government official, one who might otherwise be thought of as a thief is considered at least by many to be a "public servant." And he's not swiping, he's "appropriating."

Neither Reason Nor Eloquence

No generation ever grasped the meaning of this better than that of America's Founders. George Washington is credited with having declared that "Government is not reason. It is not eloquence. It is force. Like fire, it is a dangerous servant and a fearful master." In other words, even when government is no larger than what Washington wanted and does its job so well as to be a true "servant," it's still "dangerous."

Indeed, it's on this point that all the difference in the world is made. Things that rely on the regular affirmation of voluntary consent don't look at all like those that rest on force. Whereas mutual consent encourages actual results and accountability, the political process puts a higher premium on the mere promise or claim of results and the shifting of blame to other parties.

To win or keep your patronage and support, a provider of goods or services must manufacture something of real value. A business that doesn't produce or a charity that doesn't meet a need will quickly disappear. To get your vote, one politician only has to look or sound better than the next, even if both of them would renege on more pledges than they would keep. In the free marketplace, you almost always get what you pay for and pay for what you get. As a potential customer, you can say, "No, thanks," and take a walk. In politics the connection between what you pay for and what you actually get is problematic at best.

This is another way of asserting that your vote in the marketplace counts for so much more than your vote in the polling booth. Cast your dollars for the washing machine of your choice and that's what you get—nothing more and nothing less. Pull the lever for the politician of your choice and most of the time, if you're lucky, you'll get some of what you do want and much of what you don't. And the votes of a special-interest lobby may ultimately cancel yours out.

Some politicians like to rail against a practice in the private sector they call "bundling." If you want to buy a company's computer operating system, for example, you may also have to buy his Internet browser. That's not much different from what happens at your local bookstore: you may only want chapter one, but you've got to buy the whole book. But if "bundling" is a crime, then politics is Public Enemy No. 1. In some elections the options range from Scarface to Machine Gun Kelly. Politics may not be the oldest profession, but the results are often the same.

These important distinctions between voluntary, civil society and coercion-based government explain why in politics the Max Kennedy-types are the rule rather than the exception. Say little or nothing, or say silly things, or say one thing and do another—and your prospects of success may only be enhanced. When the customers are captives, the seller may just as easily be the one who whispers seductive nonsense in their ears as the one who puts something real on their plates.

Like it or not, people judge private, voluntary activities by a higher standard than they do public acts of the political process. That's all the more reason to keep politics a small and isolated corner of our lives. We all have so many more productive things to tend to.

Let Our Allies Defend Themselves

The United States Is Under No Obligation to Put the Interests of Other States or People First

DECEMBER 01, 2001 by Doug Bandow

Doug Bandow, a nationally syndicated columnist, is a senior fellow at the Cato Institute and the author and editor of several books.

When U.S. Defense Secretary Donald Rumsfeld and Secretary of State Colin Powell visited Canberra for the annual AUSMIN (Australia-US Ministerial) consultations earlier this year, mutterings of disappointment were heard. Peter Hartcher of the Australian Financial Review wrote of “a climate of deflated expectations.” But it is time for not just Australia, but countries around the world, to expect less of the United States and do more themselves.

American security obligations are breathtaking. The U.S. government maintains 100,000 troops in western Europe, to defend populous and prosperous states from phantom security threats. Washington helps garrison the Balkans, an area never of strategic interest to the America people. That commitment continues to expand, with NATO recently introducing forces into Macedonia.

The Bush administration wants to further expand NATO, bringing U.S. security guarantees ever closer to Russia. Some analysts have even suggested bringing Russia into the alliance, turning Moscow, too, into an American security dependent. The U.S. government has conducted military exercises in the Caucasus, a region where American forces have never before been engaged.

Washington does its best to dictate affairs in Central America, having directly intervened in Grenada, Haiti, Nicaragua, and Panama in recent years. It shows occasional flashes of interest in Africa, blundering into Somalia, for instance. Washington’s support for Israel and demand for oil has led to multiple interventions in Lebanon, war against Iraq, and permanent garrisons in Kuwait and Saudi Arabia.

Another 100,000 troops occupy East Asia. In the view of the Clinton administration, at least, they had to remain essentially forever, irrespective of changes in the region. Guarantees, treaties, and informal relationships litter the region. Among the most important are with Japan, South Korea, Taiwan, Philippines, Singapore, Thailand, and Australia.

Some people don't seem to have noticed that the Cold War ended. The Soviet Union and Warsaw Pact are gone. Wretched Soviet Third World surrogates have turned into wretched isolated Third World states. Everywhere the threats have changed, and Western industrialized states are stronger than their potential antagonists.

Of course, a decision to change policy would be considered by some to be arrogant and "unilateral." The latter is the newest term of opprobrium, seemingly replacing isolationist as the insult of choice.

What is really amazing is how seldom the U.S. government is ready to act unilaterally. It subsidizes every international aid agency, participates in almost every international organization, ratifies most all international treaties, and dominates all of the leading military alliances. Other governments routinely act unilaterally when they believe it to be in their interest. So, too, should the U.S. government when it is in the American people's interest.

Ultimately, Washington owes loyalty to the citizens of America, not to those of Japan, Germany, Uzbekistan, Kosovo, or Australia. The lives of people abroad are no less valuable than those of Americans, but the primary duty of the U.S. government is to serve the latter. It is under no obligation to put the interests of other states or people first. Especially when they are able to advance their own interests.

So it is with AUSMIN. Washington has good reason to act unilaterally and transform the alliance into a much looser cooperative relationship.

For what purpose does the alliance exist?

The precursor to AUSMIN was ANZUS, the Australia-New Zealand-U.S. agreement. It was obsolete when it was signed, being directed at a Japan that had been thoroughly defeated.

Even during the Cold War the Soviets posed no threat in the south Pacific, lacking both the will and the capability to invade such isolated states. There are no more serious threats today.

The former Red Navy is rusting in port. Japan is a most unlikely repeat aggressor. China is far away from deploying a serious military capability, let alone one capable of threatening Australia. Indeed, invading nearby Taiwan is likely to remain beyond Beijing's ability for years.

Vietnam and Malaysia make unlikely attackers. India's reach may grow, but not in that way. There is only Indonesia, but it threatens a flotilla of refugees, not soldiers, if it implodes.

What Australia most needs, then, is not a superpower alliance, but a more robust military and stronger regional ties. Local organizations, such as ASEAN—the Association of Southeast Asian Nations—are better situated than the United States to handle a messy breakdown in Indonesia.

Cooperation with India and Japan, as well as the ASEAN states, could substitute for reliance on the U.S. government in forging a naval force to deter a future aggressive China from interfering with international navigation. Although the U.S. naval presence is more convenient, it will never be as reliable as that from countries that have more at stake in the region. In a crunch, Washington may—indeed, should—prefer to sacrifice allied interests than confront nuclear-armed China.

No doubt, it is easier for the Australian government, and many other nations as well, to rely on the U.S. government than to spend the money and take the effort to develop military forces and regional relationships. But a preference to be subsidized by Uncle Sam is no reason for him to oblige.

This latest meeting, like other AUSMIN consultations, was filled with the usual platitudes and terms of endearment. But the American and Australian people have divergent interests. The Australians' concerns are largely local. Instability in Indonesia, Fiji, and Papua New Guinea could spill over. Hostility among ASEAN states could greet Australian activism. None of these issues matter much to us.

Americans and Australians have many cultural, economic, and political ties that should form the bedrock of their relationship. But instead of maintaining a formal security arrangement based more on nostalgia than necessity, they should leave military ties to informal cooperation, such as intelligence sharing. Then Americans won't be promising to defend yet another distant dependent, and Australians will begin moving on a more independent course that will provide the greatest long-term security.

Tethered Citizens

The Welfare State Is Immoral

DECEMBER 01, 2001 by Sheldon Richman

The welfare state exists to transfer resources from those who produced them to those who did not. There can be countless motives for effecting a transfer: to equalize incomes; to feed and house the poor; to eradicate drug use; to promote exports; to inhibit imports; to subsidize business and agriculture; to certify the safety of food, medicines, toys, and appliances; to make buildings sturdy; to discourage smoking or drinking; to preserve wetlands and animal habitats; to ensure retirement income; to guarantee safety in the workplace; to advance research; to educate children; to provide affordable medical care; to control rents; to end racial discrimination; to plan residential development.

Whenever the state attempts to do those things, by definition it accumulates and exercises power. The power of government always comes down to physical force. Someone is either compelled to do something he wishes not to do, whether it is paying taxes or complying with decrees, or stopped from engaging in the peaceful pursuit of his choice.

Since the welfare state is built on devices that increase the power of government at the expense of the liberty of individuals, it contradicts basic moral precepts. The issue isn't whether people ought, in some sense, to donate money to good causes. It is rather whether they should be legally compelled to do so. Who would have the state compel everything that "ought" to be done?

Thus the welfare state is immoral. It also is destructive of processes that create wealth and prosperity.

Why then did America turn to the welfare state from its individualist and libertarian origins? That is a complex question with a large range of correct answers. It is surely the case that people, wishing to economize on their scarce time and effort, look for the path of least resistance. If they can get what they want through political transfers, many people are happy to do so.

Collecting tax-financed benefits doesn't feel like receiving stolen property, although that's what it is. Citizens find themselves in a seemingly amoral arena in which they might as well get what they can before someone else takes it. In the animal jungle the rule is eat or be eaten. In the political jungle it's subsidize or be subsidized.

Another motive propelling the welfare state is insecurity about change and ignorance of the future. One's economic position ultimately depends on the tastes and preferences of free and fickle consumers. Someone making a high income today can be living paycheck to paycheck tomorrow—and vice versa. No one is guaranteed a particular position in the marketplace. That can be discomfiting. But there is a bright side. "In an unhampered market economy the absence of security, i.e., the absence of protection for vested interests, is the principle that makes for a steady improvement in material well-being," Ludwig von Mises wrote. The freedom that permits change and failure is also what makes innovation, discovery, and inventiveness possible. Those things improve everyone's welfare.

Related to the fear of uncertainty is the fear of what is called atomism. This is the concern that in the unfettered marketplace of individualists, with no government safety net, too many people will be left to fall by the wayside. In 1997 President Clinton tempered his declaration that the era of big government was over by adding that we couldn't go back to the time when "people fended for themselves." Juxtaposing the two points implies that big government was established so that people wouldn't have to fend for themselves. Clinton undoubtedly had in mind the second definition of the term "fend" in the American Heritage Dictionary, third edition: "to attempt to manage without assistance."

If to fend is to attempt to manage without assistance, it has little relevance to the free market. The marketplace is characterized by the division of labor and exchange for mutual benefit: you make shoes, I'll make bread, and we'll trade. Does that sound like fending for oneself? One becomes suspicious of capitalism's enemies when their model of an individualist resembles Theodore Kaczynski, who was hostile to everything associated with capitalism.

The conjured-up era of fending is simply part of the anti-capitalist folklore designed to make us fear liberty and look to the state for protection. Atomistic individualism is a straw man. It was never part of the classical liberal, or libertarian, picture of the world. That world is better described as embodying "molecular individualism."

The Primacy of Property

The antipode of the welfare state is the system of private property. If subsidy tethers, property liberates.

It is hard to overstate how radical the idea of private property is. According to the Scottish Enlightenment writer Adam Ferguson, man ceased to be a savage when the idea of property occurred to him. Mises has shown that without property in the means of production, there is no trade; that without trade, there are no prices; and that without prices there can be no economic calculation, which is indispensable for determining how to get the most value from resources. Thus central planning is impossible, and property rights are required for people to prosper.

Although opponents of private property have rhapsodized about freedom, it is difficult to know what they mean. What would freedom without property rights look like? When government owns the presses, ink, and newsprint, freedom of the press is impossible.

Similarly, enemies of property have advocated personal autonomy and self-determination. Yet how can those things be realized without private property? In a world of collective property—which in fact would mean state-controlled property—everyone is a tenant and employee of a monopoly landlord and employer. That's serfdom. It is true that in a market society, many people are both tenants and employees. The difference is that in a market, multiple landlords and employers compete to attract tenants and employees. And every tenant and employee has the freedom to work to become a homeowner and an independent entrepreneur.

Some will ask: But must we go to extremes? Sure, socialism is bad and unworkable, they will continue, but a complete free market—laissez faire—cannot be the only alternative. Isn't there a third way?

State and market are opposites, embodying, respectively, force and creativity. That is why the search for a third way is misconceived. There can be no such thing. We live in the digital age, in which powerful devices accomplish their wonders through electronic switches that have only two positions: on or off. There is no middle position. It is time we brought our political thinking into the digital age.

This article is excerpted from Mr. Richman's new book, Tethered Citizens: Time to Repeal the Welfare State (Future of Freedom Foundation, 2001).

Energy Production versus Conservation

Free-Market Prices Communicate How Much to Produce and How Much to Conserve

DECEMBER 01, 2001 by Dwight R. Lee

One of the most important insights in economics was made by F. A. Hayek in a famous article titled "The Use of Knowledge in Society" (*American Economic Review,* September 1945). Hayek's insight was simple, but powerful: the information necessary for making sensible economic choices is far too dispersed and difficult to articulate ever to be possessed by any one person or group of experts. Hayek emphasized in his article that only through market prices can people become sufficiently informed to direct resources into their most valuable uses. Eliminate market prices, or distort them with politically imposed ceilings or floors, and you systematically destroy the information that people need to avoid wasting resources.

Unfortunately, most people seem immune to Hayek's point. This immunity is particularly strong among politicians and journalists. The prevailing view seems to be that when an economic problem arises, the solution lies in ignorance.

The most recent example of this view concerns the production-versus-conservation debate over energy policy. It is widely accepted that the decision on the right mix of production and conservation is best made by Congress after it has imposed "market-based" price caps on important energy prices. Consider an editorial comment in the May 28, 2001, *Business Week:* "No one, except for a handful of eco-extremists, believes that conservation is the only answer to the energy crisis. But few believe that conservation plays no role either. It is up to Congress to negotiate a balance in the weeks ahead." (Emphasis added. I should point out that price controls were not recommended in this editorial.)

If politicians could only resist the urge to control energy prices, there would be no need for them to worry about "negotiating a balance" between energy production and conservation. But having yielded to the urge to control those prices, neither politicians nor anyone else can have the foggiest idea how much production and conservation is appropriate.

Every time we get worried about the availability of energy, a debate breaks out over conservation versus production. It happened in the 1970s and early '80s in response to the export restrictions of OPEC and then again earlier this year in response to less drastic OPEC cutbacks coupled with the politically induced electricity shortages in California. One side argues that we should drive smaller cars, make more use of mass transit, buy more energy-efficient appliances, do a better job insulating our homes and offices, and keep them warmer in the summer and cooler in the winter; the list of possibilities goes on. The other side argues that we can't conserve ourselves to prosperity, so we should produce more energy by drilling for more oil, mining more coal, building more electric generating plants, and bringing more nuclear plants on line.

Of course, on both sides of the debate reasonable people acknowledge that some mix of conservation and production is necessary. But all insist that their policy recommendations will result in the right mix, or that the other side's recommendation will result in the wrong mix.

Which side is right? What is the best combination of production and conservation? The answer is, no one knows. No one! No individual or group of experts in Washington, D.C., or anywhere else, has a clue about how much energy we should conserve or produce.

But We Can Find Out

But the information necessary for determining the best balance between conservation and production does exist, partly in the form expert knowledge on the technical details of recovering energy resources, converting those resources into usable energy, and transporting it to users. This information is possessed by tens of thousands of people scattered all over the world, few of whom have direct contact with each other. Yet somehow, if energy decisions are to be sensible, it all has to be collected, given proper weight, and communicated to those who can make the best use of it.

Equally important information has nothing to do with expert knowledge and is even more widely scattered: the information that millions of people have about their circumstances and preferences, and the tradeoffs they are willing to make. Some can easily take the bus to work, while others live in areas or have jobs that make taking the bus extremely difficult. Some wouldn't mind shifting to smaller cars, while others with growing families and special needs would. Some would suffer little discomfort from a wider range of inside temperatures, while those with certain health concerns would suffer more than discomfort. Some people are simply afraid of the dark and are willing to sacrifice other things to keep the lights on at night. This information is not only more fragmented and dispersed than the expert information, it is highly subjective and impossible to articulate precisely, if at all. This information may seem rather mundane, but it is just as essential to sound energy choices as is the scientific knowledge possessed by experts.

Fortunately there is no need to collect all this information in one place so it can be run through a computer to determine the right amount of conservation and production—even if all the information were collected, no computer could process it all—and even if it could, by the time the processing was done, the information would have changed.

The only way that the information needed to make sensible energy decisions can be communicated by those who have it to those in the best position to respond appropriately to it, and communicated in a way that motivates appropriate responses, is through market prices—assuming these prices are not distorted by politically imposed caps.

Market prices allow consumers to inform producers, and one another, how much they value different energy uses, and allow producers to inform consumers how much it costs to provide different types of energy. In response consumers will decrease their energy use in ways that minimize their inconvenience when that inconvenience is less than the value of the energy saved. And producers will expand production of energy sources that provide the most value to consumers for the cost required, and will expand those sources as long as consumers value the additional energy by more than the value sacrificed to produce it. The result is a combination of conservation and production that best harmonizes the interests of us all.

Price communication doesn't work perfectly, and even without price caps it can be argued that markets don't guarantee exactly the right amount of energy conservation and production. But energy decisions made in response to the information provided by market prices are far better than those that will be made by politicians and bureaucrats in the informational vacuum they create by imposing price caps.

The Ultimate Externality

Government, by Its Very Nature, Is a Source of Negative Externalities

DECEMBER 01, 2001 by Donald Boudreaux

Pick an economist at random and ask him or her, "What is government's chief role?"

The likely answer will be, "To correct market failures."

Economists have long understood that markets aren't textbook perfect. Sometimes they fail, most notably when part of the cost of a person's actions is shifted onto others who don't consent to bearing this cost. Economists call such problems "negative externalities." The term indicates that genuine problems arise whenever a decision-maker can foist at least some of the cost of his decision onto others who are external to it—onto unconsenting, peaceful adults.

Preventing such externalities is held to be the principal purpose of the state. Just as the state is duty-bound to prevent Jones from stealing Smith's wallet, the state must also prevent Jones's steel plant from pumping toxic chemicals into the air that Smith breathes, or at least compel Jones to get Smith's permission before polluting.

While genuine externalities no doubt exist in markets, research shows that they are not so common as Economics 101 textbook authors and newspaper editorialists typically assume. For example, prior to the enactment of the Clean Water Act in 1970—which largely substituted bureaucratic regulation for the private property rights that previously governed uses of inland waters—the extent of water pollution in the United States was surprisingly modest and under control. American rivers and streams were emphatically not filthy dumping grounds.

A free people are remarkably creative in devising ways to peacefully "internalize" what would otherwise be externalities.

Government is certainly not the only feasible mechanism for dealing with such potential problems. As Professor Elinor Ostrom reports, "Extensive fieldwork has by now established that individuals in all walks of life and all parts of the world voluntarily organize themselves so as to gain the benefits of trade, to provide mutual protection against risk, and to create and enforce rules that protect natural resources."

But even conceding that some externalities defy private, voluntary solutions, giving the state the power to deal with them by no means reduces their extent and severity.

First, merely giving government power is insufficient to ensure that this power will be used as intended. To believe that writing words on paper —"the Department of XYZ shall do such and such"—is all it takes to ensure that bureaucracies will carry out a task (and nothing but that task) is to believe in magic. Even if the tasks are not impossible, they are unlikely to be carried out unless government officials have the proper incentives, which they too often lack. One of the greatest follies of our age is the widespread gullible faith that words inscribed on paper following a particular type of ceremony performed in marble-domed buildings will automatically result in the outcomes described by those words.

Second, government by its very nature is itself a source of negative externalities. Even if it carried out every task assigned to it with great efficiency, reliability, and precision, it would unavoidably also create negative externalities—costs imposed on unconsenting, peaceful adults.

Sunday Sales

Consider a simple example: In some U.S. states people cannot buy alcohol on Sundays. As in many other instances, the majority here uses the state to bend the minority to its will without taking adequate account of the desires of the minority.

Imagine someone entering a voting booth to vote on a ballot initiative to outlaw Sunday alcohol sales. Perhaps this person has a genuine religious belief that no one should drink on Sundays. He votes for the initiative.

But what has this person done but unilaterally act to satisfy his own desires at the expense of others who wish to enjoy the option of buying alcohol on Sundays? Just like the factory owner who robs his neighbors of clean air, this voter robs his neighbors of something valuable. And the reason is that, when casting a vote, this person (just like the factory owner) doesn't have to take the interests of his neighbors into account. He can costlessly impose his will on unconsenting third parties.

Careful readers might object, "No! Every adult citizen can vote. The voting process registers the preferences of both the proponents and the opponents of the ban. The losers in an election had their say. Their preferences just happen to conflict with those of the majority."

This objection fails. The mere ability to express opposition to behavior that imposes costs on you does not alone protect your interests if those who wish to impose these costs remain free to do so. Suppose that you tell the owner of the polluting factory that you object to his stealing your clean air. Without an effective ability to prevent him from continuing to pollute, he will likely do so. That you spoke out against the pollution to the factory owner—that "your voice was heard"—doesn't change the fact that the ongoing pollution imposes a negative externality on you.

It's the same with bans on Sunday sales of alcohol. Each person who votes to ban these sales does so without having to take account of the preferences of others. By simply pulling a lever, each voter acts to inflict his moral views on peaceful others, making them worse off. The votes cast against the ban don't stop its proponents from voting for it without taking account of the interests of others.

The greater the scope of government power, the greater the number of instances in which each of us, as a voter, can impose our preferences on others. Moreover, because the personal consequences to each voter of yanking this lever rather than that lever are nil, each voter is fundamentally irresponsible. Each can express his views about how others should live without in the least taking serious heed of the consequences to others. And whenever those who prefer to restrict the freedom of others are in the majority, the minority are obliged to obey.

A state that stands ready to coerce those with less political power to do the bidding of those with greater political power is a constant source of negative externalities to the losers. To promote the state as the solution to what few private externalities exist is a bizarre irony and a dangerous hoax.

America and the World's Resources

The World Is Not a Zero-Sum Game

DECEMBER 01, 2001 by Russell Roberts

At the heart of almost all economics is the idea of mutually beneficial exchange. When two people voluntarily engage in an activity, economists assume that both parties are better off. Otherwise, one of them would have refused the deal. It doesn't mean people don't make mistakes—sure they do. And sometimes people regret the choices they make. But, in general, people do what they do because they get pleasure or satisfaction or some kind of benefit from their actions.

Not everyone is comfortable with this view of the world. A lot of people see the world as a zero-sum game—any benefit I receive comes at your expense. In this view, corporations take advantage of their workers and their customers and the economic marketplace is a battlefield where the "haves" are always routing the "have-nots," where the rich get richer and the poor get poorer.

Sometimes this view gets applied to the economic success of America versus the rest of the world. In the '60s this view condemned American corporate imperialism. We took the raw materials from poor countries and profited. The complaint was that there was no investment. Today, American multinationals do invest in foreign countries. Still, they are condemned.

One proof offered by these critics of how rapacious America is in the rest of the world is the observation that America consumes more than "its share" of world output. We are only 5 percent of the world's population, yet we consume x percent of the world's resources. Usually x is given as 25. I recently found a commencement address online by a noted writer that put the number at 75. The implication is that this is somehow unfair. It implies that some sophisticated form of theft is at work.

The usual response by the economist to this kind of remark is that, well, after all, the United States produces a healthy share of the world's resources. And when you take that into account, it's not so unfair anymore.

This response, which I've given myself many times, misses making the most important point about the issue. The real point is that the world's resources, however you define resources, are not finite, to be split like a pie into slices. The world is not a zero-sum game where America's wealth comes at the expense of others.

One way to see this is on an individual level. Bill Gates is a wealthy man. He is only able to take money from millions of people because he provides something in return—software—which the consumers value more than the money. Suppose Bill Gates's lakeside villa in Seattle burns down and the blaze also consumes a few boats and cars. Gates has less wealth. Does anyone else have more? Sure he might rebuild the house and benefit some builder, but as Bastiat points out, something else that Bill would have spent money on isn't going to happen, so that's a wash. The world is poorer if Bill Gates's house burns down, even though his share of the world's wealth has gotten slightly (very slightly) smaller.

Let's make the impact more dramatic. Suppose Bill shrugs. Tired of the government's lawsuits, he decides to sabotage Microsoft and destroy the company. As a major stockholder, his wealth would fall dramatically. Would the rest of the world be richer?

Now take it to the national level. Let's say Americans go through a religious or philosophical transformation and suddenly decide to work half as hard, accept lower pay, and spend more time reading, swimming, hanging out with their families, and so on. We would still be 5 percent of the world's population. We would no longer have command over 25 percent of the world's resources. But those resources wouldn't be magically freed up to go to poorer citizens of other nations. The resources created in the past when we worked harder simply wouldn't exist.

Maybe what people really have in mind when they complain about our disproportionate share of the world's resources is that we should give more of it away. We have too much. The same complaint is often heard about Bill Gates. He has too much.

This is the only sense in which there is something of a zero-sum game. Things I decide to keep and not give away to you are things you don't have.

Implicit in this strange understanding of the world is again a very static view of wealth creation.

The Product of Luck?

I remember hearing a prominent economist say that wealth was not the product of wisdom or skill but of luck. Therefore, we can tax wealth at 100 percent and redistribute it to those without wealth. I wasn't sure whether the word "therefore" was a moral statement or a practical one, but taking the practical interpretation, I thought, sure, you can do that. Once. After the first time, even the wealthy who are merely lucky are going to stop trying to accumulate wealth. Similarly, I don't think American citizens are going to continue to accumulate wealth for the purpose of giving it all away. Sure they give some of it away. For me, charity is a moral imperative. But I know of no religion or moral system that demands you give all of it away. There is a name for that: slavery.

There is one more possible interpretation of the 5 percent/25 percent criticism: it is referring only to physical resources like oil, energy, tin, titanium, and so on. Such resources, the critics would argue, are surely finite, and therefore every barrel of oil left in the ground is a barrel for someone else to have. So America consumes "too much."

This analysis is also flawed. It assumes that the natural resources of the world are miraculously sitting in some giant pile, waiting to be distributed. In fact, natural resources have to be found and uncovered at great expense. If we didn't consume them or use them to produce other products, they wouldn't be freely available to the poor. But there is a bigger flaw. As Julian Simon pointed out (see *The Ultimate Resource 2*, for example), there is no real sense in which the world's physical resources are finite. Due to the unlimited creativity of humanity, we are able to discover new sources and use old ones more effectively.

I suspect what motivates those who complain about America's unfair share is a particular measure of fairness—simple egalitarianism. No one should have more than anyone else. If that is their true goal, the only way to achieve it is through force and the impoverishing of not just the United States but those we trade with around the world.

Imperfect Knowledge

From the Very Beginning, the Austrian School Put Uncertainty and Error at the Center of Economic Theory

DECEMBER 01, 2001 by Sheldon Richman

Three economists have won the Nobel Prize in economics for studying the "asymmetric" (uneven) distribution of information in markets. The winners are Joseph Stiglitz of Columbia University, George A. Akerlof of the University of California at Berkeley, and A. Michael Spence of Stanford University.

As the prize committee and various commentators see it, Stiglitz, Akerlof, and Spence deserve the honor for recognizing that markets, contrary to the textbooks, do not consist of people possessing perfect knowledge about the future and one another. Some people know more than others. A used-car seller likely knows more about a car than a prospective buyer does. Someone buying medical insurance likely knows more about his health than the company does. As the *New York Times* put it, "Their theories incorporated 'imperfect information' into economics—a concept at odds with the mainstream view that markets are all-knowing and self-correcting."

But that's not all they did, according to the commentators. Alan Krueger of Princeton University said, "The three of them really pioneered the view that markets, when confronted with imperfections, may not be the best way to allocate resources."

And what might be a better way? The government, presumably. And since imperfect information is ubiquitous, the role for government is comprehensive. Professor Stiglitz has taken just such a position with only occasional qualifications.

There are a few problems with all this. The trio did their separate work in the 1960s and '70s. Yet neoclassical economics has been under attack for its assumption of perfect knowledge for a lot longer than that. From the very beginning, the Austrian school put uncertainty and error at the very center of economic theory. After all, if one is trying to describe how real people grapple with the real world, one must take ignorance into account as thoroughly as one does scarcity.

Carl Menger's path-breaking *Principles of Economics* (1871) did so. The same goes for Ludwig von Mises, who wrote in *Human Action* (1949, but based on earlier work), "The uncertainty of the future is already implied in the very notion of action." And for F. A. Hayek, who in the 1930s and '40s published articles titled "Economics and Knowledge" and "The Use of Knowledge in Society," it is precisely the absence of the "given data" of which neoclassical economics is so fond that is the key to understanding markets as we actually encounter them. The "knowledge problem" was central to Hayek's elaboration of Mises's critique of socialism in the 1930s and to Hayek's own pioneering work on markets in the 1940s. (Hayek's Nobel prize in 1974 was partly in recognition of his work on the knowledge problem.)

Stiglitz, Akerlof, and Spence are indeed neoclassicals-come-lately.
Moreover, the neoclassical attempt to catch up to the Austrians has been half-hearted. For those who wish to see why, read Esteban Thompson's *Prices and Knowledge: A Market-Process Perspective* (Routledge, 1992), based on his dissertation written under Israel Kirzner, whose own work on entrepreneurship has always incorporated the phenomenon he calls "utter ignorance" and the profit-driven effort to dispel it.

Finally, there are the policy implications of the work of Stiglitz et al. We are asked to believe that since the economy is riddled with ignorance, government can be better at allocating resources than markets. But markets are people (with an incentive to seek out the information they need). Just who will be staffing those government bureaus?

* * *

It's well known that Henry Ford overcame large odds to launch a great automobile company that catered to the average consumer. What is less well known is that he had to overcome a formidable legal obstacle as well. Melvin Barger tells the story.

Virtually all government policy directed at health care is premised on the notion that the law of economics doesn't operate in that realm. Walter Block, a part-time resident of Canada, knows better.

The concept of "feedback" is critical both in the micro and macro sense —that is, from the factory floor to the economy at large. William Conerly tells us why.

The recent hard times for Web-related high-tech firms have prompted comparisons of that industry to the nineteenth-century railroads, which were said to have been "built ahead of demand." Those comparisons miss the mark, according to Larry Schweikart.

In response to the atrocities in New York and Washington last September 11, the U.S. government is prosecuting a war in Afghanistan and promises long-term operations against perpetrators and enablers of terrorism elsewhere. The demand for justice, however, should be tempered by a realization that any war is costly in terms of liberty at home. To that end, we reprint an article that Robert Higgs wrote for *Ideas on Liberty* (then known as *The Freeman: Ideas on Liberty*) in 1999 during the war in Serbia.

When a corporation announces a shareholder protection plan that causes the stock price to drop, something is awry. Gary Galles looks at the case of Yahoo! and how the courts compromise the rights of owners.

This month marks the 150th anniversary of the birth of the great Swedish economist Knut Wicksell, who influenced the Austrian school's view of the business cycle. Richard Ebeling contributes an appreciation of this seminal thinker.

Have we got columns this month! Mark Skousen praises religious diversity. Lawrence Reed says we shouldn't expect much from politics. Doug Bandow reevaluates American security guarantees to Australia. Dwight Lee ponders how much energy to conserve. Donald Boudreaux examines an overlooked externality. Russell Roberts can't find signs of American piggishness. And Roy Cordato, seeing commenators proclaiming a bright side to terrorist destruction, protests, "It Just Ain't So!"

In the book department, our reviewers report on new offerings dealing with why socialism as a movement failed in the United States, Austrian macroeconomics, education, the Civil War, and critiques of capitalism and liberalism.

—Sheldon Richman

Terrorism Is Good for the Economy?

The Broken Window Fallacy Lives

DECEMBER 01, 2001 by Roy Cordato

Following the disastrous attack on New York, Washington, and our country, the purveyors of economic quackery began spilling gallons of ink in describing how they think the tragedy will affect the U.S. economy. One of the most prominent views to emerge, and also the most wrongheaded, is the idea that the destruction of the World Trade Center (WTC) and all the wealth embodied in it will be good for the economy.

According to Timothy Noah, writing for Slate.com, "[I]n seeking to harm America, terrorists will probably end up making it more prosperous. They can make us die, and they can make us weep, but they can't make us poor."[1] And in the words of economist Larry Kudlow, "[W]e may lose money and wealth in one way but we gain it back many times over when the rebuilding is done." Kudlow states that "in economics, it's called the broken window effect."[2] In fact, Kudlow is not only ignorant of economic theory, he is also ignorant of economic terminology. The "effect" that he describes is actually known as the "broken window fallacy"—from the destruction of wealth comes prosperity. It is the same ignorance of economics that leads some to conclude that wars are good for economies.

The "broken window fallacy" stems from the observation that when wealth is destroyed, through war, natural disaster, or, as told by nineteenth-century French economist Frédéric Bastiat, a hoodlum throwing a brick through a shop window, it is usually replaced. As the story goes, in replacing this destroyed wealth, jobs are "created." Money is spent on hiring construction workers, plumbers, electricians, glaziers (in Bastiat's original story), and so on. In turn employment and economic activity are stimulated in all the industries those people do business with, and so on. This is why Kudlow concludes that from the ashes of the WTC we will gain back the lost wealth "many times over" and Noah concludes that we will actually end up being "more prosperous." In the case of the WTC and Pentagon disasters, the impetus for all this economic growth will not only come from the private sector but from the government as well. According to Noah, "we live in a very wealthy nation that responds to horrible disasters by spending large sums of money. In this case, the spending will come from both the private insurers and from the federal government's Federal Emergency Management Agency" (FEMA).[3]

The Fallacy

The problem with this argument is that it ignores what economists call opportunity costs. The entire analysis assumes that all the money and resources which must go into rebuilding the WTC and the Pentagon would, had the terrorists not been so kind as to destroy these buildings, have lain idle. Of course this is a ridiculous assumption. All the money and resources —the lumber, steel, oil, labor, human capital, and more—would have gone elsewhere in the economy.

Consider the massive sums that insurance companies must now pay in claims. Those funds would not have been left in a mattress somewhere. That money would have been invested in the insurance companies' portfolios of stocks and bonds. This means that it would have been used in productive ways somewhere else: building new homes or financing new business expansion or new research into life-saving drugs. This investment and the resulting improvements in our lives are now lost as a result of the terrorist attacks.

The same is true with any money that is spent by FEMA or other government agencies. Taxpayers, if allowed to keep that money, would be spending it on themselves or their families, or saving and investing it. In either case, the money would be going toward other productive uses that would be stimulating growth in the economy. It is truly goofy economics to assume that if bureaucrats don't use the money, the people from whom they must first take it would be doing nothing with it.

Indeed, that is the fallacy. It assumes that if people and resources weren't employed in fixing the broken windows and the blown-up buildings, they would be unemployed. In reality, if the windows didn't have to be fixed and the buildings rebuilt we could have more buildings, more windows, and more of all of the products that we desire and that make our lives better. The true absurdity of the “broken window fallacy” is that if it were true we could make the entire economy wealthy by constructing buildings, blowing them up, and then rebuilding them.

Discounting Human Productivity

In this particular situation, where many thousands of obviously productive and hard-working people have lost their lives, invoking the broken-window fallacy has implications that are somewhat different from the typical natural disaster. Even if the analysis of those who claim that the destruction of wealth brings more wealth had merit, at the very least it would depend on having the ability to replace what was lost. But what was lost in this terrorist attack was not just physical capital, like tall office buildings, but massive amounts of human capital. Kudlow and Noah, in their assessment of the situation completely discount the future productivity of those whose lives were lost. This is productivity that is gone forever. It is human capital that can never be rebuilt and that would have been productive for many years to come. To say that the economy will be better off because of the terrorist attack is equivalent to saying that the economy will be better off without these thousands of human minds and bodies and their productive output.

The destruction of wealth can never be good for the economy, whether the destruction occurs through natural disasters, terrorists, or hoodlums. And certainly war, which is clearly the most destructive force invoked by man, should never be considered a conduit for economic growth. Resources used to replace destroyed wealth are resources that cannot be used to create additional wealth. To invoke this broken-window fallacy is to ignore both economic and human reality.

Notes

1. Timothy Noah, “Will Terrorism Resuscitate the U.S. Economy?” at http://www.slate.com/articles/news_and_politics/chatterbox/2001/09/will_terrorism_resuscitate_the_us_economy.html.

2. As quoted in David Seifman and Lisa Marsh, “N.Y. Urges Bizmen: Stay!” nypost.com, September 17, at www.nypost.com/business/2229.
3. Noah.

It Didn't Happen Here: Why Socialism Failed in the United States by Seymour Martin Lipset and Gary Marks

Did Socialism Really Fail in America?

DECEMBER 01, 2001 by George C. Leef

W.W. Norton & Company · 2000 · 379 pages · $26.95

Reviewed by George C. Leef

Readers of this magazine will automatically be inclined to look askance at the title of this book. The United States slid into socialism, sometimes at a rapid pace and sometimes slower, during most of the twentieth century. Things don't appear to be changing in the new century. To say that socialism has failed here is to overlook an enormous amount of socialistic law and regulation. But what political scientists Lipset and Marks mean by their title is that there never developed the kind of powerful political party overtly committed to nationalization of industry and redistribution of wealth that arose in most of the rest of the Western world.

It's true that we have not seen anything like the Labor Party in Britain or the Socialists in France. Lipset and Marks endeavor to explain why that is so. So long as they stick to the terrain of political and sociological explanation, their book succeeds. Unfortunately, when they leave that terrain for a discussion of the implications of socialism's "failure" here, *It Didn't Happen Here* runs into grave difficulties.

Lipset and Marks advance several answers to their "Why did socialism fail?" question and also reject some that others have put forth. In the latter category, for example, is the political repression argument. Some hard-bitten socialists have contended that socialism was nipped in the bud by arrests, trials, and jailing of firebrands in the early twentieth century as well as judicial crackdowns on union activity. The authors reject that argument, observing that there were pockets of socialist success despite the repression —which was never widespread or systematic—and that judicial interference with union activity before the New Deal was rare.

The causes of "American exceptionalism" that Lipset and Marks posit are several. First, something in the American character created a barrier to the appeal of socialism. "Socialism," they write, "with its emphasis on statism, socialization of the means of production, and equality through taxation, was at odds with the dominant values of American culture." This point is certainly correct. Compared with Europe, where, owing to the rigidities of their economic structures, people had little opportunity to improve their lives, upward mobility was a well-known fact in America. Naturally, fewer people were ready for the socialists' appeal to envy and advocacy of coercion.

Another explanation the authors advance is the fact that suffrage, for men at least, was widespread before the beginning of the socialist movement. They observe that in the United States (and also such countries as Switzerland and Australia), major nonsocialist political parties "had already sunk roots into the working class," making it difficult for a new, avowedly socialist political party to gain much headway. That point, too, rings true.

Another convincing point the authors make is that the great diversity of the American population hindered the rise of the kind of militant workers party envisioned by socialists. Lipset and Marks write, "[E]thnic, religious, and racial cleavages were more powerful sources of political identity for most American workers than was their commonality as workers." Whereas European workers were a pretty homogeneous lot possessing something of the "class consciousness" that Marxists are always talking about, Americans were a far more heterogeneous group and the thought "I'm a worker" was less common than the thought "I'm an Italian" or "I'm a Jew."

There is much more to their explanation, and it's perfectly sensible. Lipset and Marks go astray, however, when they discuss the implications of socialism's "failure;" they believe that American policy has been less desirable than it would have been if we had had a powerful socialist party. They write, "[T]he organizational strength of the lower class of a society is decisive in determining the relative life chances of poorer people." In their view, it's bad that socialism didn't develop in the United States because "those toward the bottom of a society must rely on political power if they are to influence the laws of their society."

Lipset and Marks have swallowed that great piece of sucker bait that socialists dangle in front of people concerned about the poor—that they are doomed to a squalid and unfair existence unless the state disembowels the market economy with redistributive programs.

Nowhere do they recognize that many extremely poor people rapidly worked their way out of poverty in America prior to the advent of the welfare state. Nor do they see that the supposedly pro-poor programs of socialist states induce an economic arteriosclerosis that makes it far more difficult for poorer people to succeed. And they are blind to the fact that even in the hands of socialists, government policy inevitably comes to favor some groups at the expense of others. In France, for example, socialist policy is very pro-farmer, keeping food costs artificially high for everyone.

Too bad the authors tarnished their work with ill-informed prattling about the consequences of the "failure" of socialism in America.

George Leef is the book review editor of Ideas on Liberty.

Microfoundations and Macroeconomics: An Austrian Perspective by Steven Horwitz

An Excellent Foundation of an Austrian-School Approach to Macroeconomics

DECEMBER 01, 2001 by Gene Callahan

Routledge · 2000 · 276 pages · $100.00

Reviewed by Gene Callahan

Professor Steven Horwitz of St. Lawrence University has written an important new book laying the foundation of an Austrian school approach to macroeconomics. Horwitz is not addressing only fellow economists: While this book is certainly not an introductory work (don't give it as a gift instead of *Economics in One Lesson*), it is readily accessible to any reader who follows the economic arguments put forth in this magazine.

Horwitz begins by stating his agenda. He hopes to advance Austrian macroeconomics, seeking to demonstrate to mainstream macroeconomists that a viable alternative vision exists, one that adeptly treats many problems ignored by the mainstream approach. He explains that the Austrian themes of subjectivity, methodological individualism, and the market process focus macroeconomic explanation on the behavior of the individual in response to economy-wide disturbances, such as inflation or deflation.

Following the introduction is an excellent chapter that traces the development of a distinctive Austrian approach to economics and describes the history of Austrian interaction with the emerging neoclassical paradigm, which since has come to dominate the profession. Horwitz highlights the time when these two traditions nearly merged, before diverging again. In the 1930s Lionel Robbins incorporated certain Austrian insights into Marshallian economics, helping to define the neoclassical school. This Austrian-Marshallian synthesis focused on the properties of equilibrium markets, which were taken to be a good approximation of the real world.

However, Hans Mayer's critique of price theories that simply assumed equilibrium foreshadowed F.A. Hayek's work on knowledge and prices. Austrians moved away from Robbins's formulation of economics, emphasizing the freedom and unpredictability of human action. Austrians came to view general equilibrium as a model of an unreal and unobtainable world, which nevertheless aids our view of the market process.

Horwitz goes on to discuss the role of capital in macroeconomics. As Ludwig von Mises, Ludwig Lachmann, and Israel Kirzner have pointed out, the salient aspect of capital goods is that they are a part of someone's plan to produce one or more consumer goods. Because of the goal-oriented nature of capital goods, it won't do to aggregate "society's capital" and confine economic analysis to this aggregate. Many entrepreneurial plans contain elements incompatible with others' plans, so it is not possible for them all to succeed. Horwitz faults both neoclassical and Keynesian analysis for neglecting this heterogeneity of capital.

The next topic taken up is the theory of monetary equilibrium. Horwitz uses this equilibrium construct as a foil to highlight the consequences of inflation and deflation, a classic Austrian use of static constructs. He defines monetary equilibrium as a situation where the supply of and demand for money are in balance. This seems trivial, until we realize that the means by which most markets move toward equilibrium, a change of price for the single good in question, cannot work for money—as Leland Yeager points out, money has no market, and no price, of its own. After a disturbance in the supply of or demand for money, all prices in the economy must adjust. This process takes time and does not occur uniformly across the economy.

Horwitz goes on to highlight the effects of this time lag in this adjustment process, employing the classic Austrian theory of the business cycle, as developed by Mises and Hayek, and the theories of "Austrian fellow travelers" Yeager, Axel Leijonhufvud, and W. H. Hutt. The section on the unjustly neglected Hutt was especially enlightening, focusing on the importance Hutt placed on the institutional barriers to rapid price adjustment. Horwitz closes by speculating on the policy implications of Austrian macroeconomics, deciding that free banking offers the best hope of smoothly adjusting the money supply as needed.

I have a couple of quibbles with the book. Horwitz is mistaken, I think, when he contends that Mises was firmly against fractional reserve banking. Also, while in one chapter Horwitz refutes Hans-Hermann Hoppe's ethical argument about the relative wealth effects of inflation, he employs nearly the same argument in another chapter. However, these are minor blemishes in an otherwise excellent book.

Gene Callahan is an adjunct scholar with the Ludwig von Mises Institute and author of Economics for Real People.

Education in a Free Society edited by Tibor Machan

Is Human Individuality Compatible with Coercive Public Education?

DECEMBER 01, 2001 by Karen Y. Palasek

Hoover Institution Press · 2000 · 149 pages · $16.95 paperback

Reviewed by Karen Y. Palasek

Editor Tibor Machan states in his introduction to this collection of four essays that "The primary concern in this book is whether human individuality is compatible with coercive public education." Each of the four perspectives offered takes a unique approach.

The late E. G. West's contribution, "Public Education and Imperfect Democracy," takes an economist's-eye view of the topic. It is a well-thought-out discussion of voucher plans in particular, focusing finally on the policy possibilities for an evolution toward a free-market alternative to public schools, including the near-complete withdrawal of government from education. Professor West's conclusions are that market diversity and parental authority, as evidenced in the Milwaukee experiment, are sufficient indicators of the success that a fully market-oriented educational system can provide.

Psychologist Carol B. Low's essay on "Schools and Education: Which Children Are Entitled to Learn?" focuses on the goals of public education in contrast to the quite different goals of traditional private education. Low, looking at the group makeup of girls versus boys, the treatment of gender differences as "disorders," and the methods in which public schools deal with these issues, argues those schools' primary aim is equalization, homogenization, and socialization among all members. As Low remarks, "Our children are unable to discover who they are and what they are and where they are going in life because there is a system in place with the power to tell them." In contrast to the public-education model of a good student, Low presents the expectations of a traditional private education: the ability to think and to understand, the expansion of individual knowledge, and the presumption that one strives to rise to his or her highest potential. What should education in a free society be like? Education that knows our children as more than public-school students. The final somber note of the essay reflects on the sad and pernicious system of social conditioning that crushes individuality instead.

Philosopher J. Roger Lee writes an exposition entitled "Limits on Universal Education." Only when we come to the very end do we comprehend the method in Lee's approach. He presumes a universal education, but wants to enlighten us as to what moral, religious, or political ideas it may legitimately include. He summarizes, "Given that we may include these topics in the domain of whatever universal education we provide children, should we do so? The answer is yes—but not much."

Lee could improve the appeal of his essay immeasurably if readers could grasp its direction at the outset. It reads like a long, meandering stroll, and some will need to be convinced of the value of making the journey in the first place.

Sheldon Richman's essay is the final contribution to the book. I would have preferred that it be the opening essay, as it would have helped lend a framework to the collection as a whole. "Individuality, Education, and Entrepreneurship," would be best, however, as a stand-alone work, perhaps a book in itself.

There is an urgency in the quest for alternatives to government's role in education, says Richman, because children "languish" in a system that is not responsive to individual differences. Private education can both afford to use trial and error to weed out unsuccessful methods, and has a strong incentive to do so.

Government-directed education distributes rewards regardless of success in meeting client demands, while private education is an entrepreneurial activity—rewarded only if it serves clients' wishes.

Schooling is seen as "a service offered to competent buyers (parents) in the marketplace, . . ." and not "the missionary or therapeutic work of an enlightened elite mercifully bestowed on the benighted and unappreciative masses." Richman's essay argues that only the complete divorce of government from all aspects of education, including vouchers and charter schools, is likely to effect significant change. Parental rather than governmental oversight acknowledges the rights of parents, encourages them to make competent assessments of their children's needs and progress, discourages continued parental ignorance, complacency, and irresponsibility, and restores liberty, with the accompanying risks and rewards, to citizens and families in our society.

As a volume, *Education in a Free Society* strays from its mission. There is more discussion of reform than of freedom in three of the four essays, and more dissimilarity than cohesiveness. If there is any theme which emerges from every essay, it is the conviction that governmental schools are doing very badly by children in our society, a society that claims individuality, freedom, and personal enterprise as its ideals, but fails to apply them to its youngest citizens.

Karen Palasek is a professional economist and home-schooling mother.

When in the Course of Human Events: The Case for Southern Secession by Charles Adams

A Multifaceted Critique of the Most Central Event in American History

DECEMBER 01, 2001 by Joseph R. Stromberg

Rowman & Littlefield · 2000 · 272 pages · $24.95

Reviewed by Joseph R. Stromberg

Some reviewers have had a hard time with the present book. They imagine that there is a single historical thesis therein, one subject to definitive proof or refutation. In this, I believe they are mistaken. Instead, what we have here is a multifaceted critique of what must be the most central event in American history.

This is not Mr. Adams's first book. His *For Good and Evil: The Impact of Taxes on the Course of Civilization* (1999) lives up to its title and underscores the importance of a matter frequently ignored by conventional historians. Taxation and other fiscal matters certainly play a major role in Adams's reconstruction of the War for Southern Independence.

Those who long for the simple morality play in which Father Abraham saved the Union (always capitalized) and emancipated slaves out of his vision and kindness have complained that Adams has ignored slavery as a cause of the war. That is incorrect. Slavery and the racial issue connected with it are present; they do not, however, have the causal stage all to themselves.

In chapter one, Adams sets the American war over secession in a global context by instancing other conflicts of similar type. He plants here the first seeds of doubt that political separation is inherently immoral. Chapter two deals with Fort Sumter and Lincoln's successful gamble to have the Confederacy "start" the war. Here one learns that the Fort was primarily a customs house—a nice bit of symbolism, especially since the South paid roughly four times as much in tariffs as the North did.

Given that, Lincoln was very concerned about his tariff revenues in the absence of the Southern states. After Fort Sumter, the (Northern) President unconstitutionally established a blockade of Southern ports on his own motion. Soon, Lincoln had robbed Maryland of self-government and was making other inroads on civil liberty—his idea of preserving the Constitution via his self-invented presidential "war powers" (of which there is not a word in the actual document).

In chapter four, Adams unfolds his revenue-based theory of the war. The shift from a pro-peace to a pro-war position by the New York press and key business interests coincided exactly with their realization that the Confederacy's low tariffs would draw trade away from the North, especially in view of the far higher Northern tariff just instituted. There is an important point here. It did not automatically follow that secession as such had to mean war. But peace foretold the end of continental mercantilism, tariffs, internal improvements, and railroad subsidies—a program that meant more than life to a powerful Northern political coalition. That coalition, of which Lincoln was the head, wanted war for a complex of material, political, and ideological reasons.

Adams also looks at what might well be called Northern war crimes. Here he can cite any number of pro-Lincoln historians, who file such things under grim necessity. Along the way, the author has time to make justified fun of Lincoln's official theory that he was dealing with a mere "rebellion" rather than with the decision of political majorities in eleven states.

Other chapters treat the so-called Copperheads, the "treason trial" of Jefferson Davis (which never took place, quite possibly because the unionist case could not have survived a fair trial), a comparative view of emancipation, and the problems of Reconstruction. The author's deconstruction of the Gettysburg Address will shock Lincoln idolaters. Adams underlines the gloomy pseudo-religious fatalism with which Lincoln salved his conscience in his later speeches. This supports M. E. Bradford's division of Lincoln's career into Whig, "artificial Puritan," and practical "Cromwellian" phases—the last item pertaining to total war.

To address seriously the issues presented by Adams requires a serious imaginative effort, especially for those who never before heard such claims about the Constitution, about the war, or about Lincoln. Ernest Renan wrote that for Frenchmen to constitute a nation, they must remember certain things and were “obliged already to have forgotten” certain others. Adams focuses on those things that Northerners, at least, have long since forgotten.

What Adams’s book—with or without a single, central thesis—does, is to reveal that in 1860 and early 1861 many Americans, north and south, doubted the existence of any federal power to coerce a state and considered peaceful separation a real possibility. In the late 1780s The Federalist Papers, for example, laughed down the notion that the federal government could coerce states in their corporate, political capacity. For much of the nineteenth century Americans saw the union as a practical arrangement instrumental to other values. That vision vanished in the killing and destruction of Mr. Lincoln’s war. Americans paid a rather high price for making a means into an end.

One Market Under God: Extreme Capitalism, Market Populism, and the End of Economic Democracy by Thomas Frank

Frank Seems an Old-Fashioned Socialist

DECEMBER 01, 2001 by Brian Doherty

Doubleday · 2000 · 414 pages · $26.00

Reviewed by Brian Doherty

Thomas Frank is the hippest leftist theorist around. He publishes *The Baffler*, a journal of cultural criticism mostly aimed at the evils of corporations. Frank is a hero at *Harper's* and gets his books—essay collections of social criticism, not generally considered hot properties—published by the biggest New York publishers. His first book, *The Conquest of Cool*, lamented that corporations and advertisers have co-opted the language of radicalism and rebellion, tamed them, and made them meaningless.

Frank is one of the most well-known exponents of a widely spreading trope among socialists: that the laissez-faire free-market mentality has completely conquered the worlds of intellect and policy; that we live in a free-market dystopia where everyone is poor and getting poorer, on the verge of unemployment, and where no one dares suggest, much less act on, the idea that unfettered corporations in an unbounded free market should be interfered with in any way.

This may strike actual advocates of radical laissez faire, who haven't noticed their decisive victory, as peculiar. It might be interesting to actually see the evidence this intellectual wunderkind musters to buttress this notion. Alas, Frank thinks his assertions are beyond argument. His book's almost infinite ratio of derisive summation to actual argument against his opponents indicates that, despite his weird claim that free-market ideology reigns uncontested, Frank believes his readers already agree with him. He's merely the high priest at the ritualized verbal flaying of the heretics.

He starts with the assumption that laissez faire has triumphed, and says his book will tell "the story of . . . how the American corporate community went about winning the legitimacy it so covets, persuading the world that the laissez-faire way was not only the best and the inevitable way, but the one most committed to the will and the interests of the people."

What this means, in practice, is hundreds of pages of witlessly ironic summations of writers to whom Frank attributes this supposed laissez-faire rout. People who say the Internet could be liberating, like George Gilder, or that the microchip has profoundly changed the world, like Kevin Kelly, are gibbering jerks. Those who hyped the '90s stock-market boom and growth in mutual-fund ownership are enemies of the people, from Peter Lynch to the Motley Fools to the Beardstown Ladies. Those who suggest even partial privatization of Social Security are deluded dupes of Wall Street barons. Boosters of the changing nature of business management, from the Body Shop's Anita Roddick to pop-management consultants like Tom Peters or Peter Senge, are all liars and charlatans.

Frank is correct that the triumphalist blatherings of certain neo-globalists like the *New York Times's* Thomas Friedman are overdone, and that the contentless "constant change" rhetoric of pop-management consultants is frequently laughable. Alas, it's hard to get a chuckle even out of those parts since Frank's relentless tone of haughty sneering leaves little room for the joy of a skilled, witty evisceration of the deserving.

Like most post-Soviet leftists, Frank avoids explicitly articulating his vision of a just and proper world. In effect, Frank argues, the only valid definition of "radical" is: that which is opposed to those with more money than me. (One couldn't say Frank thinks radicalism should be aimed at "the rich," since by any objective definition the American workers whose burden Frank assumes are fabulously wealthy compared to the overwhelming majority of humans, living or dead.)

Frank believes that the world of business and work is one of pure coercion and the destruction of the weak. No one who works is doing what he wants to do, and attempts to make the workplace more appealing—casual days, free juice, a more decentralized structure—are laughable attempts to paper over this reality. And yet, he simultaneously seems to think that losing one's position in this hellish system of coercion is a crime, too, as witness his excoriations of anyone who dares lay off an employee for any reason.

Though he doesn't spell it out, Frank seems an old-fashioned socialist looking forward to the day when no one has to work because the government is—somehow, some way—giving them everything they want. He's the ultimate anti-Hayek, whom Frank singles out for typically unargued derision: Frank believes that, through the glories of labor unions and activist government, the people have the power and ability to manipulate the market and the world to get everything they want, at the expense of everyone wealthier than they are. That vision no longer holds much power; perhaps the error at the root of this misguided and dull book is mistaking the collapse of pure socialist doctrine for the victory of unbridled laissez faire.

Brian Doherty is an associate editor at Reason *magazine.*

About Melvin D. Barger

FEE

About Walter Block

About Larry Schweikart

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About Gary M. Galles

Gary M. Galles is a professor of economics at Pepperdine University. His recent books include *Faulty Premises, Faulty Policies* (2014) and *Apostle of Peace* (2013).

About Richard Ebeling

Richard M. Ebeling is BB&T Distinguished Professor of Ethics and Free Enterprise Leadership at The Citadel in Charleston, South Carolina. He was president of the Foundation for Economic Education (FEE) from 2003 to 2008.

About Michael D. Mallinger

About Mark Skousen

About Lawrence W. Reed

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

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

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

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

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

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

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

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