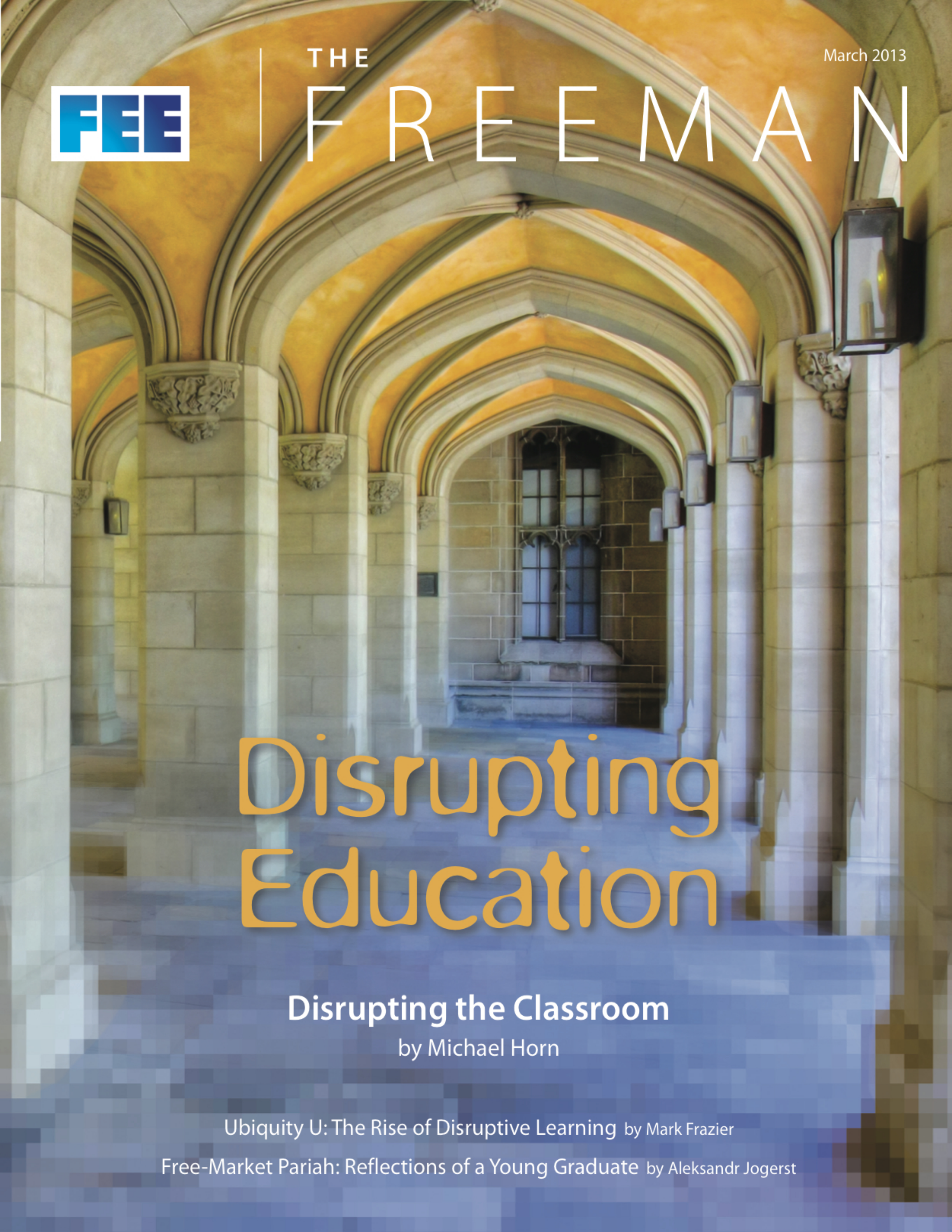

FEE

THE FREEMAN

March 2013

Disrupting Education

Disrupting the Classroom

by Michael Horn

Ubiquity U: The Rise of Disruptive Learning by Mark Frazier

Free-Market Pariah: Reflections of a Young Graduate by Aleksandr Jogerst

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Robert Shiller
Alastair Paynter
and
Brandon Maxwell

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Disrupting the Classroom

FEBRUARY 07, 2013 by Michael Horn

Why do our schools struggle to improve? One critical reason is that today's schools were not designed to do what we ask of them at present.

Today's schools were designed over a century ago to emulate the efficient factories of that era. By standardizing the way they teach and test, school systems could educate children as standardized plants produced widgets. The model—in which we batch students up in classrooms and teach the same thing to them in exactly the same way—worked well enough when most students went directly to industrial jobs.

In 1900 only 17 percent of all jobs required knowledge workers, whereas more than 60 percent do today. We now ask more students to master more challenging subject matter and develop more specialized skills. In the knowledge economy, people need to be more flexible on the one hand, while on the other they benefit from cultivating their individual talents and interests. Factory-style education falls short, therefore, as it is an ineffective way for most children to learn and to maximize their potential.

So, while the world has changed, our schools have not. As every parent knows, each child has different learning needs at different times. If we hope to have all children succeed in school and in life, then we need a system that can customize for different student needs—the exact opposite of standardization.

We have an education system that mandates the amount of time students spend in class but does not expect each child to master her learning. The result is that students don't receive the support they need to master each subject before they move on to the next one. This creates gaps in most children's education—gaps that haunt them later in their schooling.

How do we create change? For years, advocates of reform and choice for children and their families in education have tried to accomplish that goal by attacking the U.S. public school system head-on. For the most part, it hasn't worked. And in the notable exceptions where it has, it's been a bruising battle.

Attacking any dominant organization directly rarely produces transformative results. Taking a disruptive path instead—by going around and underneath the system—yields more successful outcomes. From the airline industry to the mail business and from banking to the trucking industry, the process of disruption has transformed countless regulated and unionized industries.

Disruptive innovations can transform a sector marked by expensive, inaccessible, and complicated products or services into one in which the products or services are affordable, convenient, and simple to use. They first take root in simple, undemanding applications within a new market or arena of competition. Little by little, disruptions predictably improve. At some point, disruptive innovations become good enough to handle more complicated problems—and then they take over and supplant the old way of doing things.

It is happening in education right now. Disruption, in the form of online learning, is beginning to sweep through the U.S. With its rapid growth and built-in ability to help students discover different learning pathways (along with rapid feedback to inform students what to tackle next), online learning has the potential to bring true choice and customization to millions of students and their families. And because these disruptive systems are also decentralized, they deliver individualized learning opportunities unbounded by school or geography.

Online learning started in areas outside of the heart of the K–12 education system, where the alternative was nothing at all. For example, some students wanted to take advanced courses districts couldn't afford to offer.

Other students needed to recover credits or earn degrees after they had dropped out of school. Of course, homeschool and homebound students came in search of the best and most flexible curricula.

Just as every disruptive innovation does, online learning is now improving and expanding its reach. One way it is improving is that it is accommodating the non-academic roles traditional schools once played. The vast majority of American families, for example, like schools because they keep children safe and protected and allow them to have social ties and fun with their friends. Many parents also work. As a result, although online learning initially was a distance-learning phenomenon, increasingly it's happening in blended-learning environments.

Blended learning is defined as a formal education program in which a student learns at least in part through online learning with some element of student control over the time, place, path, and/or pace of learning and at least in part in a supervised brick-and-mortar location away from home.

Top charter schools—including established ones from networks like KIPP as well as more recent startups like Carpe Diem and Rocketship Education—are leveraging blended learning to reach every single child and make education more affordable. Districts from Milpitas, California, to Quakertown public schools in Pennsylvania, from Los Angeles to New York City, are moving more aggressively to harness the power of individualized learning and escape from the conventional classroom system.

And states, including Louisiana and Utah, have created new laws that give students unprecedented choice to pick the online course from the provider that matches their needs. And providers of online courses only get paid their full fee upon a student's successful completion of the course—which builds in a new level of accountability.

Online learning is on the march. As it grows and improves in the coming years, it promises to disrupt and escape from the conventional classroom. If we leverage it correctly, online learning has the potential to provide each child with a customized learning experience that matches her needs and allows her to realize her fullest potential.

Ubiquity U: The Rise of Disruptive Learning

JANUARY 31, 2013 by Mark Frazier

Editor's Note: This article is just one way FEE is celebrating National School Choice Week, January 27–February 2. Even if policy change comes slowly, we want to challenge readers to look for creative ways to circumvent bloated, sclerotic systems in primary, secondary, and higher education.

Tax-funded systems of education face the end of an era. Soaring tuition costs and student loan burdens are crushing household budgets. Students steeped in social networks and entertainment-rich media skip or tune out in class. In an era of torrential change, moreover, what students do retain—perhaps 20 to 30 percent—is likely to be outdated within a year or two of graduation.

Traditionally, tax-funded schools have held out the prospect that stable careers await those who endure thousands of days of instructor-led classes. Yet this prospect too is fading. We can see glimmers of this future in the gales of creative destruction worldwide. Forces transforming the labor markets of developed economies include:

- technologies that enable firms to replace even high-cost service employees, allowing them to radically downsize workforces;
- a growing downdraft in salaries and wages for those employed in service and manufacturing industries due to the entry of China and India into the global market;
- burgeoning free markets for freelancers, with eBay-style reputation ratings and "reverse auction" systems that let users hire top talent at a tenth or less of former costs; and

- a move to “DIY” solutions that enable households to increasingly self-provide food, energy, and (soon) industrial goods through 3D printers.

Millions of people, in consequence, are seeing once-stable career paths in the corporate world or public-sector organizations come to an end. Current educational monopolies are doing little to help graduates prepare for an entrepreneurial economy with vast “anytime, anywhere” resources for lifelong learning. And they’re not acting quickly enough to adapt.

As old prospects for careers and sinecures fade, young people from poor and middle-class households are choosing to avoid expensive tuitions and student debt for degrees that no longer lead to jobs. Tax-funded universities are especially at risk as student enrollment starts to fall. Moves to maintain or expand taxpayer subsidies to higher education, as the number of tuition-paying students dwindles, would amount to welfare for the rich, as their children have higher levels of university acceptance.

The Rise of Entrepreneurial Disruptors

Entrepreneurial challengers are now spreading low-cost innovations that can bring new learning opportunities within reach of all, even as fiscal strains grow in public schools and universities.

On-demand learning. The Khan Academy, MIT, Stanford, Yale, and dozens of their peers now offer a total of many thousands of hours of free lessons online for undergraduate and graduate level courses. These are available on an “anytime, anywhere” basis to students and job-seekers around the world.

Online tutors and teaching assistants. Falling bandwidth costs and the emergence of Skype are enabling personalized, one-on-one tutoring (often by highly skilled, low-cost entrepreneurs in developing countries) at all levels of education.

Growth of peer-learning networks. Facebook, Twitter, and Google+ are connecting almost a billion people in online communities of interest and practice.

New credentialing systems. Open source pioneers such as Mozilla (creator of the Firefox browser) are introducing “open badging” as a way for online learners and peer learning groups to demonstrate mastery in areas of knowledge.

As competition drives down communication costs across the planet, every place can become—as needed—a world-class classroom.

Fast-Forward: Vignettes of a Revolution

Let’s jump ahead to September 2016. As the new school year begins, entrepreneurial learning providers are overturning educational monopolies. Here are some imagined vignettes from this sort of future:

YOUTUBE CONTESTS TRANSFORM “DEAD AS HELL” CLASSES INTO GOLD

A coalition of learning entrepreneurs and education reformers this week invited college and high school students across the country to record, using their phones, unsatisfying lectures—and to transform the most boring of them into effective online learning resources. A newly launched “Gold from Garbage” YouTube channel, sponsored and supported by RateMyProfessor.com, seeks to attract hundreds of thousands of students each month to select the most dismal classes. Each student in the five classes voted as most dull will receive a small condolence prize. The second round of prizes will go to students around the world who research the topics ostensibly covered in the least engaging lectures and prepare brief videos or animations that impart the knowledge in a stimulating and accurate way. The top-rated eLessons will each earn their creators a prize of $200 and inclusion in the online curriculum of a newly launched online educational venture, inspired by Joseph Lancaster's nineteenth-century peer learning innovations . . .

KIDS GAIN SHARES IN ENTREPRENEURIAL SCHOOLS

A for-profit charter school has announced plans for radically realigning the incentives offered by public schools. The new NETS learning venture will welcome students in at-risk communities as co-owners of their schools and their associated virtual learning ventures. For students and parents alike, the size of their shareholding—and annual dividend distributions—will be linked to measurable gains in overall skills during the previous year by the students and to the success of each student's chosen peer groups in gaining skills and/or in staying out of trouble. "Such an approach will align the near-term, as well as long-term, interests of students and their families with individual and group learning success," said NETS venture founder . . .

"LAND GRANT" PARTNERSHIPS TO FUND PERSONAL LEARNING CONTRACTS AS SCHOOL SYSTEM RETRENCHES

The Uplift Academy Partnership has announced a new land grant endowment for learning in Sacramento. Over the past year, the partnership provided Personal Learning Networks to re-skill job-seekers in 100 households, delivering on-demand learning, work-study projects, and "open badge" certifications. The learning partnerships helped unemployed participants launch startups, find jobs, and deliver projects in online freelance markets, in return for a 3 percent share of their earnings for the next five years. In today's announcement, the Academy offered to release its contingent compensation claims on future earnings in return for a land grant by the municipality. The site, consisting of idle, municipally owned properties at the heart of a new economic revitalization zone, will endow an Uplift Partnership Community Land Trust to improve living and working conditions. The Personal Learning Networks will be funded via land development revenues from leasing . . .

GRAMEEN BANK TEAMS WITH SINGAPORE TO LAUNCH "LEARNING FOR ALL" INITIATIVE

Grameen Bank is extending the microfinance revolution to education. It is now partnering with Singapore's global initiative to spread free ports and special economic zones—"little Singapores"—on a success-sharing basis to endow grassroots microscholarship funds. The funds will cover the costs of Internet and cell phone access to the resources of global distance learning networks and universities. The rising land values, plus a share of revenues from associated green-card-style visas, will fund eLearning and online certification opportunities at no cost to people in sponsoring countries. Privately funded development of the new "world cities" will be done on a build-operate-transfer concession basis, conveying assets to microvoucher funds for eLearning and eHealthcare . . .

Conclusion

Although actual scenarios for disruptive learning ventures have yet fully to play out, disruptions are coming to tax-subsidized education. Virtual tools—in the form of anytime/anywhere learning, peer learning through social networks, and affordable credentialing systems—will enable billions who have been ill-served by legacy schools and universities to choose alternatives. For the first time, world-class learning opportunities are coming within reach for everyone on the planet.

Student Loans: Another Federal Debacle

JANUARY 29, 2013 by Jay Bowen

Even if you aren't considering going back to school, you're about to pick up the tab for a college education. The same cast of characters that brought you the housing crisis, a post office hemorrhaging billions, and a school system that gets more expensive as it gets worse has now brought us a student loan crisis.

A recent report from the Federal Reserve Bank of New York says the value of student loans outstanding is now close to $1 trillion, making it the largest and fastest-growing share of non-mortgage consumer borrowing. Unlike other forms of consumer debt, which have fallen, total student loans have grown by 75 percent since 2007.

The federal government has pushed relentlessly to expand access to college by cutting out the private sector in loan programs and by altering repayment terms for borrowers via executive order. It bears an eerie resemblance to the obsession with homeownership that got us into our current straits.

Like potential homeowners, students have been encouraged to borrow with impunity. It continues to intensify: The Department of Education lent $133 billion in 2010 and $157 billion in 2011. Late-payment trends are also following a similar pattern to the subprime mortgage crisis. With new programs geared toward "income-based" repayment plans and forbearance timetables, it is increasingly likely that the federal government and thus the taxpayer will eventually be on the hook for tens of billions of dollars of loans that will never be repaid.

This phenomenon has real social consequences. With two-thirds of college graduates possessing student loan debt of at least $25,000 and 53 percent of recent college graduates either unemployed or acutely underemployed, unproductive economic dislocations—putting off the purchase of a home or delaying marriage, for example—are rampant.

This misguided policy approach has produced more than a student loan bubble that could damage the economy. It has also triggered an inflationary spiral in tuition costs and provided college bureaucracies with incentives to become bloated and inefficient. As one critical report recently stated, “In no other industry would overhead costs be allowed to grow at this rate—executives would lose their jobs.”

The billions of dollars sloshing around the system have inflated the price of college. Since 2000, tuition at public, four-year colleges has risen by an inflation-adjusted 72 percent, and over the past 25 years, it has increased at an annual rate 6 percentage points higher than the cost of living. When prices rise, government loans increase to effectively subsidize the difference, allowing colleges to continue increasing tuition, thus completing the cycle.

One beneficiary is online education. While it will never completely replace the college campus, current economic realities make it a legitimate alternative. It provides an avenue of highly individualized instruction at a fraction of the cost of the traditional model.

Overspending on higher education has reached a tipping point. Just as aggressive government intervention in the housing market led to a variety of economic distortions and ultimately cost the taxpayers billions, the student loan problem is destined for similar results unless substantial reforms are implemented.

The government must exit the lending arena and be replaced by an active and innovative private market with sensible underwriting standards. A variety of arrangements would be possible in this environment, including contractual agreements between businesses and students that revolve around the future employment and cash flows of the borrower.

Before we can get to that point, however, it is essential that we grasp as a nation how unproductive and costly it is when federal authorities try to dictate outcomes by aggressively intervening in the marketplace.

We must return to first principles and continuously ask ourselves what the proper role of government is in a free society.

Reflections on My Grandfather "Muso" – An Interview with Pedro Ayau

JANUARY 28, 2013 by The Freeman

In case you've never heard of it, Universidad Francisco Marroquín (UFM) is an institution of higher learning based in Guatemala. It could very well be the most classical liberal university on the planet. UFM's founding president, Manuel "Muso" Ayau, had been inspired by FEE's work, had been a long-time personal friend of FEE's founder Leonard Read, and served for many years on the FEE board of trustees. Ayau remained an active champion of liberty until his death in 2010. FEE and UFM have worked together—both formally and informally— since UFM was founded in 1971. We decided it was time to share with readers some reflections on Muso Ayau. With inspiration from Lisa Hazlett, we thought: who better to offer these reflections than his grandson Pedro?
—The Editors

The Freeman: Don Boudreaux, a former FEE president, wrote in a December 2005 *Freeman* article that Muso possessed "an almost superhuman ability to get things done, to make good things happen, to move matters forward." What are some examples of that ability that readers may not have previously heard about?

Pedro Ayau: As a family, we had an amazing opportunity, growing up, to have lunch with our grandfather almost every Sunday. At one of these meetings I recall him telling us about how, one time, he was leaving a meeting—early in the afternoon. As he and a friend were driving away together, they were discussing what changes they thought should be made to economic policy in Guatemala. In mid-discussion, he said: "We should go talk to the Ministry of Economics." And they did. Without an appointment or previous call, they just showed up.

***The Freeman*:** Muso was such a devoted advocate for liberty that it's the supreme irony that his nickname comes from the Italian dictator, Mussolini. How did he get that nickname?

Pedro Ayau: His nickname was given to him when he was about three years old. His father was a good friend of the Italian ambassador in Guatemala, who brought a souvenir uniform of Mussolini's, and his father dressed him in the uniform. One of his uncles on his mother's side started calling him Mussolini, and being a child, the name stuck, with it having been shortened not much later.

The Freeman: How was your grandmother, Muso's wife Olga, helpful to him as he built the university and worked in other ways for liberty?

Pedro Ayau: Whatever I tell you cannot begin to explain the magnificent relationship between my grandparents. Two things come to my mind—which I think are amazing—and can begin to give you some idea of what they had. The first is, my grandmother helped spell-check every article my grandfather ever wrote. That showed me my grandmother's devotion to the cause of liberty, her support of my grandfather's vision, and the trust that they had in each other to fight together. The second thing is that, as a family, we saw the love and respect they had for each other. Their amazing relationship is reflected in the family they raised. We are truly grateful for their love and care, as well as their great example as spouses.

The Freeman: Your grandfather had many business interests, including involvement with cotton, rice, and ceramic tiles. What can you tell us about his reputation as a businessman? How did his experiences in business help him when he founded UFM in 1971, or with the university in the years after that?

Pedro Ayau: He was straight as an arrow. He was always respected, not only by friends, but also by people who did not agree with his ideas. His good sense of humor and ability to think quickly for an appropriate answer was incredible.

The Freeman: Did he enjoy his time as chairman of the Guatemala Stock Exchange?

Pedro Ayau: It was a challenge, especially with the prevailing ideas of the moment. I remember him telling us that he and his colleague Mr. Gutierrez were invited to respond to questions at an office, which would supposedly grant "permission" to start a bank. He told them that they could not "give permission" for starting a stock exchange, as money was not being exchanged, only private documents. He said all this with his characteristic humor. And with that, the Stock Exchange of Guatemala was begun—and it is still active.

The Freeman: Muso served two terms on the Guatemala Monetary Board. He certainly understood money and inflation from an Austrian perspective. Did he find his experience on that board frustrating or rewarding? How about the time he spent as a member of the Guatemala House of Representatives?

Pedro Ayau: For him, it was neither frustrating nor rewarding, particularly, but he enjoyed sharing with other members of the board his Austrian-influenced ideas about money and inflation—including his thoughts on central banking, [an institution] which, of course, he didn't think anybody needed.

He also served a four-year period at the House of Representatives in which he thought he could influence legislation with his ideas about limited government, rights, and the rule of law.

The Freeman: What did he think of Guatemala's politicians? Were there any that he thought had come to be particularly friendly to liberty?

Pedro Ayau: More than politicians, he had a very close group of friends who shared his ideas on liberty.

The Freeman: What can you tell us about Muso's friendship with FEE's founder, Leonard Read, and his relationship with and regard for FEE over the years?

Pedro Ayau: Muso heard of FEE through a publication that was given to him by his Mexican friend Agustín Navarro. I believe it was something written by Ludwig von Mises. I remember him telling us that he had finally found somebody with whom he could share his thoughts. He traveled to FEE at Irvington. It was during this time that he probably met with Leonard Read, with whom a very special friendship was established.

The Freeman: Muso spent a lot of time in the United States. He went to Louisiana State University and even owned a home in Florida, correct? Was he optimistic for the United States and its future?

Pedro Ayau: Yes, he graduated from LSU as a mechanical engineer. And yes, he owned an apartment in Florida. He was a great admirer of the American people. And he was optimistic, because he hoped that eventually government would go back to respecting the Constitution.

The Freeman: Our current FEE president, Lawrence Reed, knew your grandfather well and served on the FEE board with him. Reed remembers him as "a gentleman whose gentleness of demeanor belied nerves of steel and the courage of a lion." Does that square with your intimate knowledge of him?

Pedro Ayau: Yes, it does. He was a man of vision and of courage to pursue his dreams in a country in which there were a lot of people who opposed the ideals of liberty and individual rights. I will always admire his humility, even though I believe he has changed our country and the world as few people have.

The Freeman: Like you, everyone who knew Muso mentions his mischievous smile and sense of humor. Can you give us an example or two of this lighter side of him?

Pedro Ayau: He had a tennis court in his house and he very much enjoyed playing with whoever wanted to play—including all of his grandchildren and some of his prestigious friends as well.

The Freeman: How did Muso spread ideas of liberty within the Ayau family itself? For example, did he ever put a book in front of you with instructions to read it and discuss it with him later?

Pedro Ayau: We were fortunate enough to have him home every Sunday even though he traveled a lot. At these Sunday family meetings we'd have a lot of interesting guests that visited my grandfather and the university. There were always interesting talks about freedom [in] those days. He'd often recommend books to read, and he would know if we'd read them just by talking about the subjects around the table. His house was nicknamed "The Bahia School of Economics."

The Freeman: Under Muso's leadership and Giancarlo Ibarguen's afterward, UFM has achieved almost mythic status as the premier university in Central America and an institution committed from top to bottom to classical liberal ideals. Did Muso anticipate that it would become so well known and respected, and so sizable in its first 40 years?

Pedro Ayau: I believe that he knew that if the founder's intent was respected and followed through, UFM would prevail for many years to come, as it has.

The Freeman: Muso served for many years on the board of Liberty Fund, another superb organization committed to classical liberal ideas. Can you tell us anything about his experiences there?

Pedro Ayau: He was on the board of Liberty Fund for 20 years. He traveled monthly, and missed out very few times. For him it was a school of thought. Muso was a good friend of Mr. Goodrich, who invited him to join Liberty Fund initially.

The Freeman: Is it true that on occasion, Muso feared for his life and wore a bulletproof vest?

Pedro Ayau: Yes, he did. When the university was founded, the internal conflict in Guatemala was still a threat to everyone, especially those spreading the ideals of freedom and individual rights.

To learn more about Universidad Francisco Marroquín (UFM), contact Lisa M. Hazlett (lisa@ufm.edu).

If You Like Wikipedia, You Should Love Markets

JANUARY 30, 2013 by Gary M. Galles

I recently came across a celebratory article about Wikipedia by Sue Gardner, executive director of the Wikimedia Foundation. Gardner was helping to mark Wikipedia's twelfth birthday. It is impressive how ubiquitous and useful Wikipedia has become in such a short time, to the point that virtually everyone takes its availability for granted.

Members of my immediate family, for instance, have undertaken undergraduate and graduate training in mathematics, economics, philosophy, English, art history, theology, counseling, women's studies, education, and digital editing. All of us agree about Wikipedia's value. When used sensibly, it's very helpful, particularly as a place to start the learning process.

After reading Gardner's article, I went to the Wikipedia article on Wikipedia itself as a sort of test. I found a lengthy piece (which had last been updated just minutes before) in which the author(s) clearly strived for balance. There were twelve major headings, 286 footnotes, and many references for further study. I was impressed to discover that it is the most popular general reference work site on the Internet, with 365 million readers, 24 million articles (over 4.1 million in English) in 285 languages, and growing by about 800 new articles a day.

While almost everyone I know echoes Ms. Gardner's positive view of Wikipedia, as an economist, I found certain things she wrote particularly important. Her words remind me that anyone who likes Wikipedia should love markets. She writes:

An encyclopedia is one of humankind's grandest displays of collaborative effort, and Wikipedia takes that collaboration to new levels . . .

I don't know of a comparable effort, a more diverse collection of people coming together, in peace, for a single goal.

Wikipedia has become an indispensable part of the world's information infrastructure.

Each of those quotes pulls out something—the degree of collaboration, the extent to which it incorporates diversity, the degree to which it achieves its goal in peace, that it is an indispensable source of information—that reveals why voluntary exchange in markets is mankind's greatest accomplishment.

Vast Collaboration

Even Wikipedia, with its thousands of contributors, is only a demonstration of the beauty of collaboration. Market interactions bring everyone into collaboration, whether they intend to collaborate or not.

In markets, every participant's preferences and values are incorporated into the results. Everyone who chooses to buy does so voluntarily, reflecting the fact that they place a greater value on what they receive than on what they give up. Everyone who chooses to sell does so voluntarily, reflecting the fact that they, too, place a greater value on what they receive than on what they give up. And those market relationships move goods and services to more highly valued forms, locations, and time periods, as well as to owners who place higher values on them, which are the only changes all self-interested parties mutually agree to. That is a far vaster field of social cooperation than Wikipedia. And everyone who uses the prices that result as information about the tradeoffs others are willing to make—that is, everyone—benefits from it.

Because markets reflect the choices—and therefore the preferences, abilities, and circumstances—of their participants, they also reflect the changes that impact them, communicating information by way of relative price changes. While Wikipedia is far more nimble than other reference sources in incorporating new information, markets incorporate vastly greater amounts of useful new information far more quickly.

In fact, as Friedrich Hayek pointed out in his tin example in "The Use of Knowledge in Society," markets can incorporate information initially known only to one individual, even if she has no intention of benefiting others by that knowledge, because her self-interested market behavior will be reflected in price changes that communicate the consequences of that information, regardless of her intent.

Further, Wikipedia focuses on presenting facts that can be articulated and whose sources can be traced. But in markets, there is so much more information—including all the details of time and place that can change individual evaluations of goods and services—that it overwhelms our ability to know and process it. Much of the information is transitory and often not articulable, so markets pass on only the central thing most of us want to know about how they connect to our specializations or consumption choices: How much?

How much will someone else give me for something now, or how much will someone else demand from me for it now? Markets economize on information, sparing us all the infinitely complex combinations of who, what, when, where, and how, by communicating via price changes alone.

When one thinks carefully about the beyond-remarkable feats of social coordination markets make possible, it is not hard to understand why Hayek concluded,

I am convinced that if [the market system] were the result of human design, and if the people guided by the price changes understood that their decisions have significance far beyond their immediate aim, this mechanism would have been acclaimed as one of the greatest triumphs of the human mind.

Add to these marvels the fact that the market's amazing feats of cooperation are also accomplished in peace. When one's property rights are well defined and defended, only voluntary arrangements are possible. Or as Leonard Read put it in his most famous book, only anything that's peaceful is allowed. Force is imposed only if necessary to stop those who would violate others' rights.

Indeed, early leaders of the free trade movement, such as Frédéric Bastiat, John Bright, and Richard Cobden, emphasized not just markets' advantages for society in general and the poor in particular, but for the advancement of peace. In Cobden's words:

[We] advocated Free Trade, not merely on account of the material wealth which it would bring to the community, but for the far loftier motive of securing permanent peace [with] people . . . brought into mutual dependence by the supply of each others' wants.

The peaceful nature of market interactions is all the more amazing in view of the fact that unlike Wikipedia, markets do not advance a single goal. They do improve social cooperation, but that cooperation is in service of individuals' widely disparate, often conflicting, particular goals. For example, we all desire food, clothing, and shelter, but we do not want the same kinds of food, clothing, or shelter, nor do we want them at the same time or in the same place.

Not only are markets a far more "indispensable part of the world's information infrastructure" than Wikipedia, they function under a greater handicap: Our government does not constantly attack and undermine the information Wikipedia provides. In contrast, the information infrastructure provided by markets is widely undermined by government through a panoply of intrusions, including price ceilings and floors, taxes and subsidies, protectionism (tariffs, quotas, and non-tariff barriers), and regulations that deter entry and stifle innovation.

Wikipedia is certainly an impressive success story. It's collaborative, diverse, and peaceful—and people increasingly rely on Wikipedia to acquire information. It is worth celebrating. But it is not humanity's greatest collaborative effort, nor our greatest source of useful information. Those come from the direct and indirect benefits of the peaceful, voluntary arrangements referred to in shorthand as “market interactions.” Yet while we laud Wikipedia for what it provides, we should also remember that the benefits of voluntary association in the market are under attack on many fronts. Giving markets the kind of respect Wikipedia currently enjoys would be a major step forward for humanity.

Free-Market Pariah: Reflections of a Young Graduate

JANUARY 30, 2013 by Aleksandr Jogerst

December 15, 2012, was a unique day. At noon I found myself behind a curtain. Dressed in a black robe and adorned with blue and gold chords representing honors, I confidently walked across a stage. Toward the front of the stage stood the president of my university, offering both a handshake and a diploma. After three and a half years I had graduated from college. As I returned to my seat to watch fellow graduates walk, I had a realization: By walking across the stage, we were all more valuable in the eyes of society—at least, conventional wisdom would say so. Throughout college, however, I held a much more skeptical view.

Some Background

My father began instructing me in the ways of free markets and liberty on the way to hockey practices when I was just 10 years old. He encouraged me to get involved with a group known as The Foundation for Economic Education. I attended three FEE summer seminars following my high school graduation. While the knowledge and reading materials obtained at the seminars have been priceless additions to my development, the greatest reward has been the opportunity to form friendships with like-minded individuals.

That's why I wanted to write this piece: I want to assure those liberty-minded individuals already pursuing their degrees that there is light at the end of the tunnel. I also want to prepare liberty-minded individuals for the trials ahead in continuing their education. Thinking back, I recalled three unique classroom events that should illustrate how mainstream educators react to arguments based on principles of liberty and free markets.

Privilege and Pillage

The first took place during my freshman year. The class fulfilled a generic requirement and focused on different life choices. We also looked at society as a whole. As innocuous as that sounds, the class devolved quickly into demagoguery toward markets and the perceived "privileged." The source of inequality and injustice was declared to be a marketplace devoid of government stewardship. We covered all the familiar bases—environmental, economic, and social "justice." All required government action, or the consequences would be pillaging by the privileged in a zero-sum world.

In one particular instance, the professor invited a guest speaker. The speaker showed us a YouTube video called "The Story of Stuff." To save you time and frustration, the punchline of "Stuff" is: too much production, too much consumption, the poor are disenfranchised by the rich, and we all rape and sully the environment. Squirming in my seat, I thought up a few questions that would make my point in a respectful manner. The speaker mentioned that most of the purchases an American makes do not last one year. My question was, "Does that stat take into account durable versus non-durable goods?" She looked puzzled and asked for clarification. I expanded, "As a student, my biggest purchases are housing, food, and gasoline; none of which last a year." She nodded, scanned the classroom, and admitted she didn't know the specifics of the stats in the video.

Business School?

The second story I want to relate occurred in business school, of all places. In this class we focused on purchasing and logistics strategy. While reviewing a story from *The Wall Street Journal* in class, the professor presented us with a standard scenario where quantity demanded suddenly doubles. "What do you do?" he asked.

While my classmates generally agreed that a waiting list should be established, I proposed a different strategy. By using basic supply and demand economics, I suggested a tiered pricing strategy that would respect the oft-forgotten value of time: "Charge higher prices to those that need the product now, and offer the original price to those who can wait for delivery."

From an economic and business standpoint, this solution made tremendous sense to me. You charge for the urgency because those who have a greater need for the product place a higher value on it. (This certainly is not an original business strategy.) But my classmates and professor disagreed. The students decried this strategy as taking advantage of misfortunes and therefore unethical. The professor declared that "supply and demand are not relevant." After a short exchange, I concluded the argument for my plan with a concise statement.

"In the short run," I said, "we can only raise prices OR ration our products; we can't increase production. So either everyone waits, or those that have an immediate need pay for the urgency." The class ended without settling on any final course of action, but I left with a valuable lesson: Very few people learn how to combine economics and business to make sound decisions.

"Critical Thinking"

The third example comes from a political science class. It was described as a course in "critical thinking" and was conducted online, so I never met the professor or any of my classmates. The students were assigned two articles per week to critique and debate. The articles covered the usual university topics: identification requirements for voting, racial bias against President Obama, and so on. The assignments also included some new topics: cockfighting in Puerto Rico and religion versus science. Students generally followed party lines in their debate contributions. The liberal students repeated the usual left-wing rhetoric, while conservative students repeated the usual right-wing rhetoric.

The real test came during our writing assignments. When asked to write a short essay regarding the topics in discussion, I supported the limited government and free market system that I have long believed in. I wrote short papers about gun control, recycling, foreign policy, and current events. The feedback from the professor was less than encouraging—especially after grades were posted. Normally a mechanism designed for improvement, the professor used the feedback format largely to attack my viewpoints and my cited sources. "Improvement" meant starting to write the things the professor wanted to read. Here is an example of actual feedback on a paper regarding the Federal Reserve banking system:

However, the thing that struck me is that on the one hand you want to maintain the virtue of a free market economy and then dismiss one of the few means of controlling the inherent inefficiencies and non-rational anarchic character of the free market. This seems to be a common theme for you. The social consequences of accepting the unmitigated results of market play have been consistently rejected by pretty much ever[y] liberal since the great depression. I'm not sure how you can argue that mechanism[s] of control are so bad. What would happen without them? The fed provides foresight to an otherwise radically out of control force.

And there you have it. My professor did not want to see that my arguments were valid and that my logic was sound—that is, that I exhibited true "critical thinking." The professor wanted to convince me not only that the market could be controlled, but that it must be controlled.

There are countless examples like the previous three that go beyond just my experience. Schools, both K-12 and college, have a vested interest in an interventionist, “do something” government. And the reverse is also true: Just think how many government bureaucracies rely on these activist education programs. Any student proposing limited State action is at odds with the system itself and is immediately dismissed. He or she is perceived as a virus. And a reputation—a stigma—develops that spreads and lingers among the faculty.

Some professors have resolved to eliminate in-class discussion entirely, relying on PowerPoint slides to cover lessons. Other professors go so far as to ban classroom recording devices under penalty of a failing grade in the course. The system is certainly geared against those who speak in defense of liberty. This situation should not surprise us. And, of course, the professors most receptive to messages in support of markets and voluntary association are exceedingly rare.

Advice to Rising Students

My message to current and future college students with leanings toward liberty is this:

- Consider your classmates and professors as stones upon which to sharpen your debating and reasoning skills; they are opportunities rather than obstacles.
- Pour your energy into becoming the best at what you study. There are 35,040 hours in a four-yeartime span; spend 10,000 of those on your most marketable skill (read Malcolm Gladwell’s *Outliers* for more on this recommendation).
- Meet people and stay in touch. You never know when paths will cross again.
- Take advantage of every opportunity. College goes by fast--faster than you might think.

Fracking, Controversy, and Water Markets

JANUARY 22, 2013 by Joel Watts

When a Hollywood star like Matt Damon makes a movie aimed at exposing the alleged dangers of otherwise technical and esoteric business activities, you know you've got a controversy on your hands. (*FrackNation*, though less star-studded, may also be coming to a theater near you.)

The controversy, of course, is about hydraulic fracturing, or "fracking." In my home state of Colorado, you'd have to be living under a rock to know nothing about fracking. But if you happen to be living under a rock next to a chamber of trapped natural gas, then watch out: You're about to find out what fracking is, first hand.

Fracking is a process by which water and other chemicals are used to fracture underground rock so that workers can access fossil fuels like natural gas and petroleum. Anti-mining environmentalists share a number of concerns about fracking, ranging from worries about groundwater pollution and degradation of surface vegetation to claims that fracking can turn neighbors' kitchen faucets into blowtorches.

Add the fact that Colorado is in a severe drought, and you get a compounded concern—mostly from an uninformed public—that oil and gas companies are going to buy up all the municipal water. That's the concern we'll focus on here, as there have been plenty of other pieces devoted to debunking environmental hysteria. Still, with conservation and "sustainability" in vogue these days, running out of water is on everyone's minds. This is especially the case in the arid West, where economic growth has been putting increasing stress on water supplies for decades.

It’s true that some of the water used for fracking is being sourced from municipal utilities. But most H2O is purchased from the wholesale market, where—unlike with public utility sources— prices reflect supply and demand. Who are the major players in this market? Public water utilities, of course, but mainly farmers, who rely on irrigation out here.

This means that drillers will be competing for water primarily with agricultural users. Water rights—which means access to a given flow volume of water drawn from a specific location on a stream (and which are subordinate to “senior” claims if water levels are low)—are typically sold at auction. Oil drillers are bidding for water against other drillers and against farmers. They will only be willing to pay more if they value the water more highly than the farmers do, which has recently been the case due to the fracking-based oil boom.

Case in point: Earlier this year the *Aurora Sentinel* reported that the city will sell $9.5 million worth of water to an energy company. Why? Because the company is offering four times the price offered by other customary buyers. Potential profits in oil and gas make the water highly valued by drillers. Of course, this valuation is subject to change along with the prices of oil, crops, and all of the other resources required to produce them. If oil prices decline relative to crop prices, drillers will bid less for the water and farmers more, and water will flow to its most highly valued use. In other words, when markets are allowed to work, it’s a beautiful thing.

Public utility customers aren’t used to, and don’t really understand, how a free market works when it comes to water. Because a local water utility is seen by most economists as a natural monopoly, retail costs are fixed at low levels despite potential fluctuations in supply and demand. These low costs are accomplished not only through price fixing, but also through rationing (the public utility regulates when and how much water can be used, rather than consumers responding to true prices).

Water rationing usually affects what the utility considers a low-value use of the good, such as lawn watering. You are permitted to water your lawn only during certain hours, on certain days, and for a certain amount of time. Even if you have a prize-winning English garden in the middle of a desert and would gladly pay more for water, you aren't given that opportunity. The guy next door with the dandelion lawn, whose sprinkler spends more time spraying the sidewalk than the grass, has no incentive to be more careful with his water, except when he’s forced to follow the directive of the local authority and water his sidewalk on Tuesdays and Thursdays between the hours of 6 and 8 p.m.

Because there is no price incentive for the average public utility water customer to respond to, there are very few creative conservationists. Instead, public utilities resort to ridiculous advertising campaigns aimed at persuading their customers to use less of their products. You’ve probably received the flyers or seen TV ads sponsored by your water and electric utilities offering tips on how to use less. A more direct way to economize on water and energy use might be to let prices fluctuate for public utility customers like they do for customers in the wholesale market.

Imagine if other businesses operated on the public utility model of rationing and/or persuasion campaigns. You might receive a flyer from a Shell or a Conoco suggesting several ways you could economize and use less gas, and offering you a rebate if you cleaned your fuel injectors or switched to a standard transmission. The last line of the flyer might read, "Working together, we can use less gasoline and help preserve this precious resource for the future." (Not to give the government any ideas.) In any case, because oil refiners are not heavily protected monopolies, they’d soon go out of business.

But industrial and agricultural water consumers don't have to bother with this. In these sectors, wholesale water markets are alive and well. And what’s going on in these markets? As noted above, in Colorado oil and gas companies are making big buys in the wholesale water markets, and the use of water for fracking is expanding. But currently, the water used in fracking amounts to just 0.1 percent of annual water use in Colorado. Agriculture and irrigation, including for golf courses, use 85.5 percent. When it comes to annual precipitation, Colorado ranks 45th among the states, with 15 inches. Most Heartland states that we think of as agriculture's top performers average more than twice that. So maybe irrigated farmland isn't the best use of Colorado water or land. How much room is there for diversion of Colorado wholesale water supplies out of agriculture and into fracking and energy production? Nobody knows for sure, but with a free market in water, we're sure to find out what the highest-valued uses are. The price mechanism will tell us.

Here’s a final point that the anti-fracking folks should consider: The demand for water for fracking is a boon to farmers and even to municipalities who have stocked up on water rights. According to *The New York Times*, in Colorado, "Despite the drought and worries about water supplies, several cities—and even farmers with water to spare—are starting to line up as eager sellers." So if farmers have water to spare, they can easily sell it to drillers at a profit.

Like farmers who realize that collecting royalty payments from their mineral leases is more profitable than growing crops, perhaps some will learn the same about water rights for fracking. Still, the same farmers getting rich on oil wells complain that it is the end of agriculture. You can't have it both ways. I say, why not double-dip? Lease mineral rights and water rights to the same energy company and start cashing the checks. Iowa can grow the corn.

The Tilting Point: “Robbing Peter to Pay Paul”

JANUARY 16, 2013 by Bruce Yandle

In medieval times, taxpayers in England’s St. Peter’s parish were required to subsidize parishioners of St. Paul’s who fell behind in providing support for the established church in their region. At least that’s how the story goes. Put another way, the good folks in Paul’s didn’t mind at all when those in Peter’s were fleeced. And so “robbing Peter to pay Paul” entered the vernacular, according to one interpretation of the phrase’s origin.

Whatever the origin, it is safe to say that Paul will generally support higher taxes on Peter that seem to improve Paul’s well-being. Any politician who pushes such schemes can count on getting Paul’s vote. The point was communicated endlessly in the press in recent coverage of the fiscal cliff debate. Time and again, a news story would say something like this: “[S]ixty percent of registered voters in a new Politico/George Washington University poll said they support increasing taxes on households earning more than $250,000.” Well, duh. Sixty percent of registered voters no doubt make less than $250,000.

Paul smiles as he goes to the bank. Meanwhile, Peter frowns.

Tension between those who support expansion of the welfare state and those who seek to constrain government’s growth is as old as the republic. Politician John C. Calhoun in 1810 famously described the welfare state problem this way:

[I]t must necessarily follow, that some one portion of the community must pay in taxes more than it receives back in disbursements; while another receives in disbursements more than it pays in taxes . . . The necessary result, then, of the unequal fiscal action of the government is, to divide the community into two great classes; one consisting of those who, in reality, pay the taxes, and, of course, bear exclusively the burthen of supporting the government; and the other, of those who are the recipients of their proceeds, through disbursements, and who are, in fact, supported by the government; or, in fewer words, to divide it into taxpayers and tax consumers.

Calhoun might not have gotten away with saying such things in 2012, but his quote does have a little more finesse than Mitt Romney's “47 percent” remark during the 2012 presidential election.

Looking at the Data

In recent work with my Presbyterian College colleague Jody Lipford on taxpayers and tax consumers, we examined IRS data from 1979 to 2007. Our results show a strongly significant relationship between growth in welfare expenditures and the decline in the share of taxes paid by the bottom 40 percent of taxpayers.

We found that the share of total federal taxes paid by the bottom 40 percent of households fell from 9.3 percent in 1979 to 5.2 percent in 2007, while the shares of the tax burden borne by the top 10 percent and one percent, respectively, have risen steadily. The trends for the income tax diverge even more sharply. Due to refunds to the bottom 40 percent, their income tax liability has been negative since 1995, as Mr. Romney ineloquently suggested. In 2007, the top 10 percent paid over 70 percent of total income taxes.

As the bottom 40 percent has paid less and the top 10 percent has paid more, entitlement spending on Social Security, Medicare, health, and income security programs has increased from 43.2 percent of the budget in 1979 to 58.4 percent in 2007. From our statistical work, we learned that when the share of tax liability of the bottom 40 percent of household incomes falls by one percentage point, entitlement spending as a share of the budget rises by over four percentage points.

We thus seem to have a systemic problem. Robbing Peter to pay Paul is built into the system.

Final Thoughts

We're not quite there yet. But the U.S. political economy is quickly approaching the tilting point at which there are more income tax spenders than tax payers. If we could somehow include transfers made by regulation and government grants in the calculation, we might find that those on the receiving end far outnumber the net tax payers. If we looked even closer, we might discover that we are all net losers. Our ability to produce new wealth may be compromised to the point that though transfers come our way, the gains received are added to an ever-diminishing income stream. John C. Calhoun's deepest fear regarding a divided country may have been realized.

Robbing Peter to pay Paul may be a delightful idea so long as Peter produces new wealth at an ever-increasing pace. That is no longer the case. Maybe it is time for Peter and Paul to pull their own weight.

The Futility of Tax Increases

JANUARY 21, 2013 by D.W. MacKenzie

In the wake of Washington's unsavory fiscal cliff deal, Americans, unsurprisingly, will be taxed more—particularly wealthier Americans. Politicians have determined that income taxes should be raised on those earning more than $400,000 annually. Other changes—for example, eliminating some deductions and exemptions—could still raise taxes for people making $250,000 or more. Many Americans believe that such tax increases are "good policy" or "fair," and a good percentage of those Americans are happy for someone else to pay the bill. President Obama has stoked this sentiment.

But get ready: There are several unavoidable problems with increasing tax rates.

One and All

The most important thing to note is that it's impossible to isolate the costs of any tax. Most people think each person pays his tax, but this belief is demonstrably false. Whenever government imposes a tax on incomes, employers and employees compete to see who will actually bear that burden. That is, some upper-income workers will negotiate higher salaries or wages. Some employees will be more successful than others in shifting tax burdens to their employers, but employers incur higher labor costs when income taxes rise. Higher labor costs increase the prices of goods and services. Therefore, some percentage of taxes levied against higher earners will be passed on to all consumers—and often to the least well off.

An omnipotent tax authority could achieve a specific target for increasing taxes on a group. But without such authorities, any tax increase on one group will be shared by everyone. There is nothing that any state official can do to change this fact. Upper income Americans will pay only some part of any increases in “their” tax rates. This important insight is seldom recognized. And it’s just one way that a tax on one is a tax on all.

Avoidance

The second problem with increasing taxes is that some people simply avoid paying higher taxes. Gerard Depardieu just left France to avoid paying this nation's 75 percent tax rate. This instance is not the first one of self-imposed tax exile. Two decades ago the British Parliament increased taxes on high-earning Britons. The Parliament raised the highest income tax rate to 83 percent. The British government also raised taxes on investment income by an extra 15 percent. What was the result of this tax?

Ringo Starr and Roger Moore moved to Monaco. David Bowie moved to Switzerland. The Rolling Stones roamed the world in search of tax havens. Phil Collins, Michael Caine, Pink Floyd, Led Zeppelin, Freddy Mercury, Sting, and Sean Connery left the United Kingdom, at least temporarily, as tax exiles.

Monaco alone has thousands of British tax exiles. It is already the case that some Americans renounce citizenship to avoid taxes. The fact of the matter is that the people with the highest earning potential are also the most mobile. Efforts to shift tax burdens to high-income persons will drive more of these persons out of America.

Leaving a country to avoid taxes is a drastic measure. There are less drastic ways of avoiding income taxes. People with high incomes can work fewer hours per year, use tax loopholes, and retire earlier. There is evidence that people do act this way. Most European nations have higher effective tax rates and shorter average work weeks than the United States does. The first and second problems here are two sides of the same coin. Some people withdraw labor from a labor market that is heavily taxed. Withdrawal of some labor from a labor market gives those remaining increased bargaining power, and this advantage raises their before-tax incomes. It is naive to think that high-income persons will simply accept and pay any tax rate.

Spending and Debt

The third problem with raising tax rates is that politicians have run up debts that American taxpayers cannot pay. The annual federal deficit has been over $1 trillion during each of the past few years. The official national debt is approaching $17 trillion. Economist Lawrence Kotlikoff originally estimated the present value of the real long-term debt at $202 trillion. The projected debt has swelled to $220 trillion in just the past few years. Real national debt includes costs of unfunded entitlements, federal pensions, and veterans' benefits. Who will pay for all of this? Who can pay for all of this? $1.6 trillion of extra revenue over a decade might seem like a large tax increase, but it is quite small compared to our real fiscal problems.

Annual federal spending is close to $4 trillion. The federal government has been wasting money on inefficient programs throughout its history. Why should anyone pay more while State officials spend recklessly? Waste should never be tolerated, but our waste is nearing crisis levels. Proposals to raise taxes on wealthy individuals are, as the saying goes, "rearranging the deck chairs on the Titanic."

Implications

The three aforesaid problems with tax increases have at least two important implications:

First, efforts to "make the rich pay their fair share" are futile. It is all too easy for people to either shift the burden of legal tax rates or to avoid taxes altogether. Some people like to believe that taxes can be used to achieve "social justice," but the reality is that we do not know how real tax burdens are borne; we only know that markets shift such burdens around according to relative bargaining power. Social justice is itself an elusive notion, because true tax burdens are unknowable.

Second, efforts to solve our fiscal problems with tax increases are futile. Tax rates are not too low; projected spending is far too high. The only realistic solution to our long-term fiscal situation is to enact severe cuts in federal spending programs and to privatize Social Security and Medicare. In short, efforts to solve fiscal problems with tax increases are futile.

On Paying Our "Fair Share"

JANUARY 24, 2013 by Charles W. Baird

President Obama often asserts that fairness requires everyone "to play by the same rules." He then calls for raising tax rates paid by "millionaires and billionaires," but no one else. Well, Mr. President, you cannot have it both ways.

Logically, if we are to enjoy what the Constitution calls "equal protection of the law," government must treat us equally. But what does equal treatment (everybody playing by the same rules) mean when it comes to taxing income?

Present law imposes a progressive income tax—higher income earners must pay higher tax rates than lower income earners. Proponents of a progressive income tax justify this inequality of tax rates in two ways—equality of sacrifice and ability to pay.

Proponents argue that a progressive tax is needed because, for example, a $100 tax bill is more of a sacrifice to a low-income earner than it is to a high-income earner. But this example, which I think is likely to be true, does not justify a progressive income tax.

Sacrifice cannot be directly measured. If I pay $100 in income taxes, the sacrifice I experience is the significance my mind attaches to the loss, not to mention the effects on me in my particular circumstances. $100 may be more (or less) significant to me than to some other taxpayer. Thus, two people who each pay $100 in taxes do not necessarily experience the same sacrifice.

If the loss of $100 is a bigger sacrifice to a low-income earner than it is to a high-income earner, playing by the same rules likely requires that if a low-income taxpayer pays $100 in taxes, a high-income taxpayer must pay more than $100. But how much more is required to achieve equality of sacrifice?

If the tax collector were Mr. Spock of Star Trek fame, he could do a mind meld with each taxpayer and feel the pain of taxes. He could feel the pain a low-income taxpayer feels from paying $100 in taxes. He could then take more and more dollars away from a high-income person until that taxpayer feels the same pain.

Maybe that would be fair. But, so far as I know, neither President Obama nor any member of Congress comes from the planet Vulcan.

In most areas of human action, there is a widely shared opinion that proportionality—equal percentage increases and decreases—is fair. Proportionality appeals to our moral intuition.

For example, suppose there is not enough water this year to allow everyone to consume as much water as they did last year. Water prices must rise (the best solution) or water must be rationed. In the latter case, what is fair? The admittedly unscientific answer that comes to mind is that everyone should cut back by the same percent of last year's consumption. Equal rates suggest equal treatment. Everyone is playing by "the same rules."

A proportional income tax would tax all income earners at the same rate. If the tax rate were 20 percent, a taxpayer with $100,000 in income would pay $20,000 in tax. A taxpayer with $10,000 in income would pay $2,000 in tax. If you earned 10 times more income than another person, you would pay 10 times more in tax.

Any set of progressive tax rates is arbitrary. If the set 10%, 20%, and 30% is unfair, would the set 20%, 30%, 50%, and 90% be fair? How could anyone ever know? It's all a matter of opinion—or a matter of politics.

It's therefore difficult to see how any progressive tax can be justified at all. There is certainly no scientific rationale for such a tax. Teddy Roosevelt and

Barack Obama to the contrary notwithstanding, a progressive income tax is unfair precisely because it is deeply and unavoidably arbitrary.

Applying the same percentage tax rate to all taxpayers, in order to raise a given amount of tax revenue, is indeed also an arbitrary rule. But it is a whole lot less arbitrary than imposing any one of an infinite set of progressive tax rates that could raise that same tax revenue.

Moreover, with one tax rate applied to all amounts of income and with an unchanged number of taxpayers, everyone would pay more taxes when more tax revenue is raised. No one could be a free-rider. Everyone would have the same proportional skin in the game. That sounds fair to me.

The second argument used to justify a progressive income tax is ability to pay. Here the sacrifice experienced by taxpayers is irrelevant. Politicians simply assert that if you have more to take, they will take it no matter how that affects you. There is no guiding principle that limits how much they should take. No amount is too much. The ability-to-pay justification for a progressive income tax is simply justification for legalized theft.

Society and State in Modern Britain

FEBRUARY 12, 2013 by Alastair Paynter

[A]n innovation which is a response to some specific defect, one designed to redress some specific disequilibrium, is more desirable than one which springs from a notion of a generally improved condition of human circumstances, and is far more desirable than one generated by a vision of perfection.
—Michael Oakeshott

When the State seeks to perform the duties that ordinarily would be carried out through people's voluntary social bonds, it damages these bonds and weakens civilization.

Under normal conditions, there is a clear line of demarcation between the State and society. Former British Prime Minister Margaret Thatcher once famously declared that there was "no such thing as society." Her remarks referred to the nonexistence of a collective entity.

No Society, Lady Thatcher?

Many on Britain's left attributed a kind of moral bankruptcy to these remarks. Unfortunately, taken out of context, the phrase provides ammunition for collectivists who wish falsely to portray libertarians as uncaring, egotistical individualists interested only in maximum economic efficiency (or worse—profit). According to such critics, libertarian-minded individuals believe, contra John Donne, that each man is an island, and that what “society” exists at all is only a disconnected assortment of competing atoms, zealous only for their own interests at the expense of all others.

This straw man has proven to be a dangerously effective way of scaring many into collectivist thinking. In reality, any sound description of practical liberty places great importance on the role of society. Society consists of a complex array of fundamental structures, such as the family, as well as myriad other voluntary associations and institutions that tend to grow up organically—that is, without central planning. In fact, the path of modern history demonstrates that unwarranted and immoral State intervention has been the actual cause of social atomization.

Welfare State Atomization

While both classical liberals and conservatives stressed the importance of separate roles for society and State, the twentieth century saw tremendous growth in the latter at the expense of the former.

One prominent—but by no means solitary—example of this diminution of society is the replacement of private charity with the welfare state. From 1987 to 2012, in Britain, State funding of charities rose to such an unprecedented level that some 27,000 charities are now dependent upon the government for more than 75 percent of their incomes. The so-called “voluntary” sector receives more money from the State than from private donations.

This unnatural intervention weakens the sense of duty, custom, and manners that animate an organic system of civil society. State intervention has not only debased the very concept of charity, but reduced individual responsibility to others to what Kenneth Minogue has called mere “politico-moral posturing.” Such involves merely the desire to project one's decency. By having the correct socially approved opinions, one needn’t act at all. The morality of crowds is replaced by the burgeoning of bureaucracies. Once we have signaled our rectitude, we can go on behaving as atoms.

Crowdout

Proponents of the welfare state tend to ignore the plain evidence that wherever State interference hasn't cramped or enervated them, voluntary assistance and mutual aid have been the norm. Before the advent of the welfare state, this assistance came in the form of charity and mutual associations called friendly societies.

In 1911, the year the Liberal government introduced compulsory national insurance, around 9 million people (of the 12 million covered by the scheme) were already members of such mutual aid associations. That's 75 percent. During the nineteenth century, there had been a vast proliferation of friendly societies, which sought to provide social security and sometimes medical assistance to their members. Sadly, the imposition of the welfare state, particularly with the post-World War II Labour government, helped undo much of this positive work. (There are similar stories of crowdout in the voluntary sector in the United States.)

The Coalition currently governing Britain has just reached the halfway point in its term. In that time, there has been much debate over the respective roles for society and the State. Prime Minister David Cameron has made much of his flagship policy (known as "The Big Society"), which is ostensibly aiming to "create a climate that empowers local people and communities" that will "take power away from politicians and give it to people." While this policy sounded to many like a refreshing change, few commentators cottoned onto the inherent contradiction in a bottom-up, grassroots movement being started by a Prime Minister.

Despite the quasi-Burkean rhetoric, the "Big Society" still places the State in role of Nudger. Like most political approaches, it ignores the very edifice upon which a genuine functioning society truly rests: liberty. People do not require prodding from the State to fulfil the roles that society has traditionally performed. Left alone, people in "society" will function entirely naturally because they are capable of crafting effective civil society from the bottom up. Whenever the State assumes a role in this sphere it will have the opposite effect: Voluntary service will be viewed as superfluous, local non-State authorities redundant, charity itself corrupted.

Inculcation

It is remarkable how a once-liberal (i.e., liberty-loving) country could be so steadily inculcated with social democratic ideals. What was once considered healthy and good has come to be seen as aberrant and alien. Thankfully, a persistent germ of the individualist spirit still remains in Britain. Given adequate support, liberty could flourish once more. If Britain is to recover its former freedoms, the voting population must be informed and convinced of the superiority of spontaneous order over statist planning. The Big Society notwithstanding, government will not likely inspire its people to voluntarism.

Hip Hop: A Free-Market History

FEBRUARY 06, 2013 by Brandon Maxwell

Hip hop is not just music. It's a culture. It includes dance, apparel, perfumes, jewelry, cinema, radio, television, books, magazines, and even beverages. That is, there are very few trades that hip hop hasn't touched. And while hip hop's lifeblood may be the complex grouping of rhythms, beats, vocals, tones, and lyrics, it was abetted at every stage by the free market.

Twenty-four million people around the world listen to hip hop each day. A half-million people see hip hop live in concert each month. And 28 million people purchase hip hop in stores each year. It is a $10 billion industry and growing. And yet its story resembles one familiar to *Freeman* readers: Leonard Read's description of the vast complexity that goes into making a simple pencil.

Pass the Mic

Hip hop did not become a commercial and cultural powerhouse overnight. The free market acted as a catalyst. The market's processes—competition, refinement, and augmentation—shaped the genre and the culture over time. They complemented the recording, mixing, and mastering process and aided hip hop in discovering new listeners. And, as is the way of the market, it helped listeners discover hip hop.

Hip hop's free market venture first began 35 years ago in the northernmost borough of New York City with a handful of bored, mostly lower-income kids. They improvised lyrics over funk and soul music generated by DJs at block parties. As simple as it may seem to point out, none of this would have been possible without a variety of tools devised and made available through commercial means.

As spoken-word artists matured, New York City witnessed the advent of "emcees" (noun) bidding to "emcee" (verb) over personalized beats. With this development emcees needed additional tools, like samplers, synthesizers, and drum machines accompanied by tape players and record needles. "Rap" as a subgenre was born.

Likewise, emcees began to compete with each other. They contended not just for esteem, but for listeners in and around the neighborhood and city. This early competition elevated certain performers and improved the product overall, eventually allowing a select few to become famous. Throughout this process, as they competed with each other, emcees and DJs had to keep their customers satisfied. The audience could refuse to show up, walk out, heckle, or maybe even come up onstage and perform better themselves.

And consider the bedrock of hip hop: the beat. Going through old records—some forgotten, others much-beloved—artists found beats and breakdowns, extracted them, and turned them into the basis for an entirely new industry. To put it another way: They made gasoline out of oil refinery "waste." And they made it possible for one person, or a handful, to put together music that would have required an expensive array of musicians just a few years before—and might not have been conceivable without the availability of new instruments like samplers and drum machines.

More Tools, More People

But these were far from the only tools hip hop purveyors and enthusiasts would need. On the contrary, hip hoppers would still have to have millions more tools, arbitrageurs, and entrepreneurs to carry them on their journey from block party boredom to billboard dominance. The process involved the collaboration of millions of people around the world and across time, very few of whom had any idea that they were, in fact, involved in the same endeavor—and no single one of whom could have created this force on his own.

Consider the millions of television sets and radios and the hundreds of radio stations it took to propel hip hop beyond its Bronx origins. Ponder the millions of power lines and hundreds of radio waves it took to transmit hip hop to those television sets and radios. And contemplate the number of television and radio station employees it took to ensure everything was transmitted properly. All of this is to say nothing of the level of productivity necessary to give millions of people both leisure time and disposable income to use on filling that time.

East Coast, West Coast, Dirty South

As hip hop spread across the United States, new emcees emerged, each meticulously tailoring variations on the music for a different audience. The result of these subtle adaptations was that hip hop gave rise to diverse qualities and styles, with each style suiting a different demographic or geographic location. That is, while hip hop could be heard in different cities across The United States, its sound in New York City, which found inspiration in energetic artists such as James Brown, did not often mirror its sound in Los Angeles, which found inspiration in the laid back funky basslines of Zapp and Roger. Its sound in Los Angeles was considerably different from the sound that emerged in the Deep South, which experimented outside of the usual 4/4 time signature. And its sound in the Deep South could be contrasted with the Midwest sound, which used faster tempos.

But in order for each different geographic location and demographic to continue to access hip hop over the decades, yet more tools were required. These tools consisted of millions of record players, tape players, CD players, mp3 players, and computers—not to mention millions of pairs of headphones, ear buds, and ¼-inch jacks, each meticulously designed to be used in conjunction with one another. It would require thousands of retailers across the world to transport and carry these accouterments. Thousands of companies would have to promote, advertise, and vend records, tapes, CDs, and mp3s. And as each new innovation appeared, it opened up new creative possibilities for entrepreneurs alert to the opportunity and for artists seeking new modes of self-expression. (And made it even easier for one person to play both entrepreneur and artist simultaneously.)

Production Value

Before arriving at this juncture, hip hop had to first achieve a polished and professional sound. This meant people had to design and build recording studios, which in turn meant the involvement of construction companies, masons, engineers, and architects. Construction workers use numerous power tools, thousands of nuts and bolts, hundreds of pounds of concrete, and dozens of beams for structural support—all of which had to be transported to a location. Once constructed, these recording studios would then be outfitted with mixing boards, microphones, monitors, preamps, limiters, compressors, and sound insulation—each item manufactured by a different company excelling in a distinct area of sound and recording (with components coming from all over the world).

In addition, a great number of people would be needed to assist in the actual recording process, with each individual wielding a select set of skills—e.g., producers and often separate engineers for sound, recording, mixing, and mastering.

And what about people who want to record from the comfort of their own homes? Can the free market help?

The evolution of the digital audio workstation (DAW) alone is a testament to the free market and Adam Smith’s division of labor. Dozens of individuals and companies have had to carefully work together in order to conceive a way to allow individuals the freedom to record from the comfort of their own homes.

The first precursor to Pro-Tools (the software most used in modern digital recording) was conceived in California by two college undergraduates. The result was a worldwide revolution in recording and an affordable way for millions of aspiring emcees to create quality music without commissioning the use of otherwise expensive mixing boards, effects processors, and analog tape machines.

Markets vs. Magistrates

Could hip hop as we know it today have been possible in a country devoid of a free market economy? Could any one man or government have rightfully determined and differentiated the kind of hip hop the West Coast wanted to hear from the kind of hip hop the East Coast wanted to hear? Could any one legislator or body of legislators have predicted the way hip hop would evolve—including the countless variations, textures, and styles? Could anyone have known beforehand that there was this unsatisfied—even undiscovered—hunger for a new kind of music, let alone offshoots in fashion and other industries?

Liberation

A free market does not inhibit, it liberates. A free market has no prejudices or preferences as to who benefits or who doesn't. The market, rather, is a system that people animate with their creativity and service. The quality of the product rests solely on the shoulders of the entrepreneur—nobody else. And yet it is driven by communities.

The free market affords individuals and companies a platform to advance mutual interests. And in return, it offers consumers a variety of choices, options, and avenues, which sustainably advance yet more mutual interests.

It is because of these mutual interests that hip hop has become a household name. It’s even easier to access than water in some countries. And yet, it remains only one facet, one story, in an invisible agglomeration of individuals and businesses voluntarily collaborating across every hour of every day.

Public Choice—A Primer

FEBRUARY 14, 2013 by Eamonn Butler, Victor Stepien

Eamonn Butler has earned his libertarian credentials: He cofounded the Adam Smith Institute, of which he is the director, and served as vice president of the Mont Pelerin Society. But *Public Choice—A Primer* was not written for a libertarian audience.

Instead, it's a remarkably approachable and inquisitive overview aimed at the mainstream reader who may know nothing at all about Public Choice. In a little over a hundred pages—including a concise glossary and a useful timeline—Butler manages to summarize the history of Public Choice theory and offer details on its main expositors.

Butler draws upon a long tradition of Public Choice theorists. Starting with Duncan Black's 1942 essays on Count Charles de Borda and Marquis de Condorcet's eighteenth-century contributions, he moves on to the most seminal text of all: James M. Buchanan and Gordon Tullock's 1962 *Calculus of Consent*. Butler reminds us that Buchanan and Tullock gave us a simple but powerful definition of Public Choice theory: self-interest is the primary driving force behind all human actions. While this theory could include some business people who create jobs, Public Choice theorists like to stress that politicians, bureaucrats, and union leaders are driven by the same human trait. In other words, big government is also driven mostly by self-interest; it is not merely regimented by some ethereal "public interest."

Beyond this straightforward reiteration of the origins of Public Choice theory, Butler aptly shows that the theory is perfectly in keeping with the essence of free-market capitalism. Indeed, it offers a critique of this economic modus operandi in the same way as its godfather, Adam Smith, once suggested it should. As Butler reminds us, Adam Smith warned us as early as 1776 about the special relationships that could occur between government and business. To this end, Public Choice theory emphasizes the pitfalls of logrolling, pork-barrel politics, and crony capitalism. Butler goes to great lengths to describe and explain these unsavory yet necessary political side effects of mingling market forces with political power. He adds a touching anecdote about a time when, as an intern in the folly of youth, he was surprised at the kind of bartering ubiquitous in the United States Congress.

Butler goes into great detail to explain that there are three main schools of Public Choice theory. The first, started by Buchanan and Tullock, is known as the "Virginia School." It focuses on constitutional theory and political institutions. The "Rochester School," whose main figurehead is William H. Riker, relies heavily on mathematics and statistics and paved the way for the use of game theory. Finally, "Chicago School" practitioners—best represented by Gary S. Becker and George J. Stigler—look at the economic theory of collective decision-making and political institutions.

Such detail leaves the reader with the opportunity to actually choose a school. Butler is subtle enough to embrace none explicitly, and his impartial summary of different Public Choice theory interpretations gives the more tenacious reader the welcome opportunity to explore more deeply, starting with the Further Reading section at the end of the volume.

Over the course of a short book, Eamonn Butler has managed to capture the attractive aspects of Public Choice theory and hint toward its still-nebulous areas. Like any theory, it has its shortcomings. Yet it is also a powerful tool to contextualize events and to better understand the seemingly nefarious actions of our political leaders and their supplicants. Indeed, Public Choice theory rejects an oversimplified view of the political arena and encourages what some might regard as a cynical outlook on human action. Buchanan himself, after all, described Public Choice theory as "politics without romance." But it also, particularly with the help of this volume, equips the reader with new lenses through which to see the world.

Reforming U.S. Financial Markets

FEBRUARY 06, 2013 by Mark Calabria, Randall Kroszner, Robert Shiller

In April of 2009 Harvard University's economics department hosted a symposium on the financial crisis, featuring as the main event Professors Randall Kroszner and Robert Shiller. This "face-off," along with the comments of four discussants, more or less constitutes the text of *Reforming U.S. Financial Markets*.
While the intent was to offer differing "ends of the spectrum," the symposium inadvertently illustrates the narrowness of the conventional wisdom on both diagnoses of and responses to the financial crisis. Perhaps it is due in part to having the symposium so soon after the crisis, but the solutions and analysis offered appear only remotely informed by the events of 2008; instead they reflect more the conclusions and biases held by the participants prior to the crisis.

After a brief and informative introduction by Harvard's Benjamin Friedman, the first chapter, "Democratizing and Humanizing Finance," offers a comprehensive overview of Yale Professor Robert Shiller's research in behavioral finance. Shiller is best known for his book *Irrational Exuberance* and for a long, distinguished academic career. This chapter largely updates *Irrational Exuberance*. It also serves as a nice summary of the arguments advanced in Shiller's 2008 book *Subprime Solution*, which was, if not the first pop-academic book published on the crisis, certainly close.

The thrust of Shiller's position is that neither financial markets nor the existing regulatory structure incorporates how economic agents really make financial decisions. Shiller is quite explicit in seeing the efficient markets hypothesis (EMH) as a driver of both deregulation and lack of regulatory response to the speculative forces that led to the housing bubble. Since the

EMH, in its simplest form, rejects the possibility of asset prices deviating from their fundamentals over long periods, Shiller sees the dominance of modern finance in the thinking of financial regulators as explaining the refusal of regulators to prick the housing bubble. Certainly the comments of regulators such as then-Chairman of the Federal Reserve Alan Greenspan lend credence to this view.

Unfortunately, Shiller does not consider other alternatives that could explain the same set of observed facts. Nowhere does he discuss the possible relationship between low interest rates and high home prices. Nor does he consider Public Choice explanations for the reluctance of regulators to address the growing housing bubble. As someone who spent that time as staff on the U.S. Senate Banking Committee, I can say those of us who attempted to get regulators to address the growing bubble were a small minority. Those opposed to restraining the housing market were not making efficient markets arguments; they were enjoying the political advantage that comes with trying to prolong an asset bubble. And in seven years on the Banking Committee staff, I never once heard a member of Congress or regulators invoke the EMH or anything resembling it. To lay the responsibility for the crisis at the feet of the University of Chicago's economics department is to grossly exaggerate the influence of academia on actual policymaking.

Like *Subprime Solution*, Shiller's analysis here is an important part of the debate over both the crisis and how financial markets work in general. Unfortunately and also like *Subprime Solution*, Shiller offers and endorses a variety of policies that either do not actually flow from his own analysis or that had almost no relationship to the crisis. For instance, he praises Dodd-Frank's creation of a Consumer Financial Protection Bureau, but leaves out the important detail that almost everyone involved in the crisis, like Fannie Mae and your local real estate agent, is actually exempt from this agency's rules. Shiller further praises Dodd-Frank for increasing the discretion given to financial regulators. He argues that effective regulation "depends on the judgments of skilled regulators" while ignoring that these same regulators had a tremendous amount of discretion and power before the crisis yet still failed to effectively regulate. Perhaps this is Shiller's greatest flaw; he correctly sees imperfect markets everywhere, but builds his solution on the false premise of perfect government.

What is ultimately so frustrating about Shiller is that while behavioral analysis is certainly an important part of the explanation, he too easily dismisses the explanatory power of market participants responding rationally to incentives. Why is a borrower, who is not being asked to make a down payment and is immune from recourse, somehow irrational in speculating in the housing market? And as Public Choice analysis demonstrates, the actions of both politicians and regulators, while socially irresponsible and reckless, were perfectly rational from their individual perspectives. Given the perverse incentives facing market participants, it should not be a mystery or challenge to modern economics why we observed so much perverse behavior. The mystery is: Why is the role of incentives, in both the private and public sectors, almost entirely absent from Shiller's narrative?

The second chapter, by University of Chicago's Randall Kroszner, appears to be intended to represent the Chicago efficient markets approach to financial regulation. In addition to his long history of scholarship in the area of banking regulation, Kroszner served as a governor at the Federal Reserve. This past is both a strength and a weakness. Having had a seat at the table during the crisis certainly provides Kroszner with some unique insights. But holding a leadership position at one of the institutions whose failures contributed to the crisis potentially biases his views.

For example: Not only do Kroszner's remarks fail to even mention monetary policy; it is difficult to find any comment that challenges the current policy preferences of the Federal Reserve. The bulk of his remarks is essentially a laundry list of action items, such as reform of the credit-rating agencies, "improving" the resolution of financial institutions, encouraging centralized clearing for derivatives, and "improving" consumer protections. Where Shiller offers a sweeping theory of the crisis along with broad reform, Kroszner takes an incremental approach, keeping almost all of the current regulatory structure in place.

The most prominent feature of Kroszner's chapter is actually what is missing: the influence of his own body of research. From this chapter you'd never guess, if you did not know already, that Kroszner has written on the ability of private markets to control financial market risk in the absence of government regulation. Despite his own research questioning the role of Glass-Steagall, he makes no mention of such. He advocates for centralized clearing of derivatives, again in contradiction of what his own research would suggest. One can only conclude that the chapter was written at a time when Kroszner expected to remain on the board of the Federal Reserve, for it appears to far more reflect the institutional biases of that entity.

Perhaps the most striking feature of *Reforming U.S. Financial Markets* is how much agreement, implied and otherwise, one finds in Shiller and Kroszner. Both appear to support the path ultimately taken in Dodd-Frank and both also accept a broad and expansive role for the federal government in regulating the financial markets. There is clearly far more agreement here than disagreement. But then that, I believe, is the real lesson of the symposium. Both left-center and right-center fail to see that this was not a crisis of markets, but of government-imposed distortions.

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Mr. Bowen joined Bowen, Hanes & Company, Inc. in 1986. As the firm's Chief Investment Officer and economic strategist, he is responsible for the formulation and implementation of the firm's economic and investment strategies. Subsequent to his association with the company, he received extensive training in economics and investments. He attended graduate school at The London School of Economics, London, England, where he completed his thesis on the international economy in 1989.

He concluded an economic and investment research project in 1990 on monetary, trade and tax policy at the Cato Institute, one the of nation's leading public policy foundations in Washington, D.C. Mr. Bowen is a member of The National Economists Club and the National Association for Business Economics and is a Trustee for the Foundation for Economic Education (FEE). He has provided commentary on economic and financial issues for CNBC, the Fox News network, and the Fox Business network. Mr. Bowen holds a B.A. degree in English from the University of North Carolina at Chapel Hill, which he received in 1984.

About The Freeman

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About Randall Kroszner

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