THE FREEMAN
IDEAS ON LIBERTY

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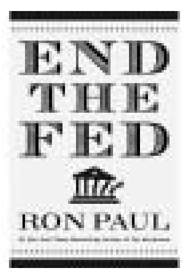

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THE FREEMAN
IDEAS ON LIBERTY

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Perspective

Murray Rothbard

In 1946 the fledgling Foundation for Economic Education published a pamphlet titled "Roofs or Ceilings: The Current Housing Problem" (www.tinyurl.com/cpluwy), a brief against rent control written by two unknown young economists: Milton Friedman and George Stigler. They would go on to win the Nobel Prize in economics in 1976 and 1982, respectively.

That's a remarkable story. But just as remarkable is what that pamphlet led to. When it was issued, Stigler, then teaching at Columbia University (his University of Chicago days still lay ahead), told a young student about it, perhaps changing American intellectual history.

The student was Murray Rothbard.

"Rothbard," writes Brian Doherty in *Radicals for Capitalism: A Freewheeling History of the Modern American Libertarian Movement*, "was delighted to learn of an organization promoting his political and economic values. . . . By 1948, Leonard Read had already noted young Rothbard's deep knowledge of market economics and libertarian principles (and their history) and began to lean on him to vet articles for FEE."

On visits to FEE Rothbard met Frank Chodorov, the prolific libertarian author who edited *The Freeman* the first year after Read acquired it. "Chodorov helped introduce Rothbard to the works of [Albert Jay] Nock, Herbert Spencer, Garet Garrett, and Isabel Paterson, among others," Doherty reports. It wasn't long before he encountered Ludwig von Mises, an adviser to Read.

Thus Rothbard, who went on to become one of the great natural-law libertarian figures in history and an indefatigable advocate/elaborator of Misesian (Austrian) economics in method and substance, can be said to have received vital intellectual nourishment at FEE's Irvington-on-Hudson estate.

Rothbard, who died 15 years ago, was at once a beloved and controversial figure. He was one of the very few individuals who shaped the modern freedom movement at its start. Even advocates of the freedom philosophy who never read a word he wrote have been influenced by him. With a passion nonpareil, Rothbard set out to create a self-conscious libertarian movement, which he accomplished through his activism and charisma, as well as through his writings—from the scholarly to the popular—in economics, history, political philosophy, and social criticism. For one man to have turned out *Man, Economy, and State/Power and Market*; *America's Great Depression*; *The Ethics of Liberty*; *Conceived in Liberty* (four volumes on American history through the Revolutionary War); *For a New Liberty*—and so much more—is something astounding. We probably won't see his likes again. (See David Gordon's *Freeman* article, "Murray Rothbard's Philosophy of Freedom," www.tinyurl.com/ycfbybb.)

I feel lucky to have known Murray. He was always a delight to be around, whether talking about some obscure historical figure, traditional jazz (before the electric guitar intruded), classic movies, or the future of liberty. He was unfailingly optimistic and ever ready for a laugh. He was what he called H. L. Mencken (whom he treasured): "the joyous libertarian."

To say that he was controversial even *within* the freedom movement is an obvious understatement. His application of libertarian and market principles to even the "traditional functions" of limited government—that is, his belief that the free market can and should provide *all* legitimate services competitively—stirs heated debate today. While his originality in the matter he called "anarcho-capitalism" is clear, he himself might say he was simply picking up the baton carried by the pioneering nineteenth-century free-market economist Gustave de Molinari, whose seminal essay, "The Production of Security," Rothbard first brought to American libertarians.

Whatever one thinks of Rothbard's answer to the question raised therein, there can be no doubting the value of the question itself; it forces one to examine the contours of liberty, the nature of the State, and therefore the very possibility of limiting its powers.

Those who cherish liberty cannot calculate their debt to Murray Rothbard.

* * *

We lead off with the winning essay in the second annual Eugene S. Thorpe writing competition: Richard Fulmer's "Legends of the Fall: The Real and Imagined Sources of Our Bubble Economy." Of the 182 entries addressing the causes of the current housing and financial debacle, Richard Fulmer's was judged the best. Congratulations, Richard!

As the practice of medicine becomes more bureaucratized by government intervention, the profession will change subtly and gradually, but patients will eventually notice the degradation in service. Such is where "reform" will lead, says Theodore Levy.

All during the debate over the reinvention of medical insurance, it was taken for granted that individuals should be forced to buy coverage. James Payne, who refuses, is ready to accept his status as a criminal.

Nien Cheng suffered unimaginable oppression at the hand of the Chinese communist regime but went on to be a passionate spokeswoman for freedom. On the occasion of her death, James Dorn offers a tribute to this heroic woman.

When people think of Africa, sadly, they think of poverty and oppression. But that has not been true for Botswana. Scott Beaulier explains this little-known success story.

Nassim Nicholas Taleb is a provocative writer who scoffs at the idea that human affairs can be predicted scientifically. Robert Murphy introduces us to the man who popularized the term "black swan."

Ethanol is still in our gasoline, and besides all the bad things you've heard about it, it also harms engines. Michael Heberling has the details.

Broadly speaking, there are only so many ways for society to be organized, and only one is in harmony with freedom and human nature. Paul Cleveland and Art Carden elaborate.

Here's what our columnists have whipped up: Lawrence Reed says he doesn't care what you call yourself as long as you oppose aggressive force. Donald Boudreaux defines the rule of law. Robert Higgs discusses capital consumption during World War II. John Stossel dissects crony capitalism. Charles Baird anticipates how health care "reform" will help labor unions. And Ivan Pongracic, Jr., reading Paul Krugman's claim that more government spending will fend off a 1937-style recession, responds, "It Just Ain't So!"

Books on private schools for the poor, political capitalism, Herbert Hoover, and the Federal Reserve occupy our reviewers.

In Capital Letters, Thomas Szasz answers a reader's concerns about religious identification and George Schwappach explains how carrying less health insurance saved him money.

—Sheldon Richman
srichman@fee.org

Anti-Force is the Common Denominator

BY LAWRENCE W. REED

Allow me to alter something the great humorist Will Rogers said: "I'm not a member of any organized group. I'm a libertarian." I wince a bit as I say that, though. Let me explain.

Labels such as "libertarian" aren't always illuminating. Sometimes they serve as expedient substitutes for thought—as in, "Oh, he's one of *those*!" When pressed to cough up a label to describe myself, I sometimes employ "libertarian" but not without adding a caveat or two so no one assumes I'm referring to a political party or that my position on certain hot-button issues must be this or that. On other occasions I call myself a "classical liberal," but unless I have time to explain it, confused listeners wonder how that differs from the "liberals" of today. "Voluntaryist" (of the British philosopher Auberon Herbert variety) describes my political, ethical, and economic leanings most accurately—unfortunately, though, few people have ever heard the term.

Labels such as "libertarian" aren't always illuminating. Sometimes they serve as expedient substitutes for thought.

I am also other things as well. I'm an "Austrian" economist (while appreciating numerous positive contributions from other schools of thought). I'm a Christian who is also a rationalist because I believe reason in an ordered universe is a divine gift. Though I don't embrace Ayn Rand's atheism, like her I am a fervent advocate of capitalism who endorses man's inalienable rights, the roles of the producer and entrepreneur, and the magnificence of the creative mind. I'm a conservative in the sense that I value many time-tested traditions, even if I oppose mandating them by legislative fiat. I'm a moralist because I think moral principles like honesty, independence, courage, and self-discipline are both good and indispensable ingredients for a free society. Readers might recall that in the January issue I happily labeled myself a latter-day "Locofoco" (www.tinyurl.com/ycvq6b3).

Each person's order of values, focus of attention, and expertise are unique to him—so one can be a libertarian, broadly speaking, and still call himself an Objectivist or an Austrian or a voluntaryist or a classical liberal or a Christian or an atheist or a moralist or a conservative or even two or more of those things.

Blessed with many friends in all these camps, I endeavor to make enemies in none. I lament those occasions when disagreement leads to hostility between people who are otherwise allies on most issues. If you aim to make progress for the larger cause, then tolerance, bridge-building, and finding common ground (none of which necessitates compromise on fundamental principles) seem more appropriate than picking fights. What's the point of self-righteous breast-beating?

While I don't label myself an Objectivist, I love this quote (and many others) from Ayn Rand: "When you see that trading is done, not by consent, but by compulsion—when you see that in order to produce, you need to obtain permission from men who produce nothing—when you see money flowing to those who deal, not in goods, but in favors—when you see that men get richer by graft and pull than by work, and your laws don't protect you against them, but protect them against you—when you see corruption being rewarded and honesty becoming a self-sacrifice—you may know that your society is doomed."

A friend posted this on Facebook recently: "If FEE and other libertarian-leaning orgs would drop all their

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religious baggage, I could support them wholeheartedly." I felt compelled to reply, "No one at FEE claims that you must be 'religious' to value and support liberty. We respect all people of faith, or no faith, so long as they do not initiate force against their fellow citizens. And because we judge people for the individuals they are, not for the 'group' someone says they're in or by the label somebody attaches to them, we don't condemn all people of faith for the wrongs of a few any more than we would condemn all atheists for the wrongs of a Stalin or a Mao. A person's faith or lack thereof is just that—*personal*—and not a requirement to support property rights."

I wasn't trying to convert that person to my faith, nor did I seek to escalate the exchange into a parting of the ways. I attempted to defuse it by emphasizing what I thought was friendly territory: Both of us would like to see much less initiation of force in society. We live in a world where lots of misguided people are not satisfied that there's enough of it yet. They advocate *more* initiation of force, as evidenced by their desires to deal with every problem under the sun by creating another tax-supported government program. I saw this Facebook acquaintance as an ally not an enemy. And that's the way it ought to be, it seems to me, if those of us who believe in liberty really want to win.

> I don't much care what you call yourself, but if you want to see a hefty reduction in the initiation of force in society, then you're an ally.

Allow me to share with you a few paragraphs from my May 2007 *Freeman* column (www.tinyurl.com/dltnal). They might form a basis for more amicable relations between factions that now see themselves as opponents:

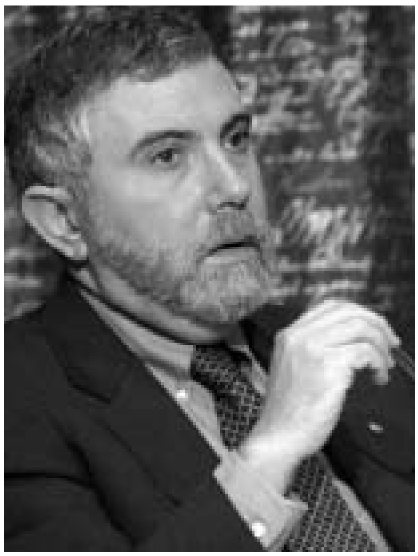
> A mature, responsible adult neither seeks undue power over other adults nor wishes to see others subjected to anyone's controlling schemes and fantasies: This is the traditional meaning of liberty. It's the rationale for limiting the force of government in our lives. In a free society the power of love, not the love of power, governs our behavior.
>
> Consider what we do in our political lives these days—and an unfortunate erosion of freedom becomes painfully evident. It's a commentary on the ascendancy of the love of power over the power of love. We have granted command of over 40 percent of our incomes to federal, state, and local governments, compared to 6 or 7 percent a century ago. And more than a few Americans seem to think that 40 percent still isn't enough.
>
> We claim to love our fellow citizens while we hand government ever more power over their lives, hopes, and pocketbooks. We've erected what Margaret Thatcher derisively termed the "nanny state," in which we as adults are pushed around, dictated to, hemmed in, and smothered with good intentions as if we're still children.

It boils down to this: I don't much care what you call yourself, but if you want to see a hefty reduction in the initiation of force in society, then you're an ally I want to collaborate with. Let's focus not on our differences but on changing the ideas of those who are working in the other direction. FEE

Government Must Stimulate to Avoid a 1937-Style Recession? It Just Ain't So!

BY IVAN PONGRACIC, JR.

It is rather unfortunate that the Royal Swedish Academy of Sciences' Economics Prize Committee chose to award the 2008 Nobel Prize in economics to Paul Krugman. It is not that Krugman did not deserve the prize—his contributions to international trade theory were indeed substantive and valuable. The problem is that by 2008 Krugman had long ceased to be a serious economist, becoming instead a common pundit. Thus the Nobel Prize gave his ideological and highly partisan *New York Times* column an imprimatur of economic credibility that it certainly does not deserve. Over the past ten years the economic analysis found in his column has regressed to Keynesian caricature, bereft of the depth or subtlety that one would expect from a Nobel laureate. Instead, the purpose of his column is quite clear: to justify expansion of government control of the economy under all circumstances, facts and good economics be damned.



Paul Krugman
Prolineserver (commons.wikimedia.org)

A Broken Record

"That 1937 Feeling" (January 14; www.tinyurl.com/y9etge7) is an excellent example. Krugman argues that the recent signs of economic recovery are very likely deceptive and therefore the government should not even think about easing up on the fiscal and monetary gas pedals anytime soon. He points to the 1937 recession as an example of the awful consequences of premature tightening. For the past year Krugman has insisted that the government's economic stimuli have been too small and more stimulus is urgently need. This is just another round of the same-old same-old.

Krugman's article exhibits the most simple-headed and mechanistic view of Keynesian economics: If the economy is in the doldrums, it must be because aggregate demand is too low, and therefore it is up to government fiscal and monetary policy to raise it to its proper level. The only mistake that the government could possibly make is to not do enough fast enough.

What Krugman fails to tell his readers is that it is widely accepted among modern economists that the 1937 recession was primarily caused by another kind of government mistake. The Fed did indeed start tightening in 1936, but the problem was *how* it did it. Instead of using open-market operations to gradually increase interest rates in order to contain any inflationary pressures, it chose instead to use its new power (granted by Congress the previous year) to set the banks' reserve requirements—the percentage of deposits that banks must hold either in their vaults or at the Fed. We now know that changing the reserve requirements is highly disruptive to bank operations and is simply too blunt of a monetary tool—even small changes can have a great impact on money supply.

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Rushing like fools where wise men fear to tread and clearly oblivious to the destructive potential of this new tool, the Fed engaged in *three* back-to-back increases in reserve requirements between August 1936 and May 1937, causing a severe tightening of the money supply in a very short time. It is no surprise that the American economy, just as it appeared poised for a modest recovery, was plunged into a serious recession—within the depression!

A Terrible Record

The moral is *not* that the Fed shouldn't be tightening now. Rather, it is that when the Fed makes a mistake in monetary policy, the consequences are often dire. And the Fed's record over the past nearly hundred years is disastrously bad, with even its defenders admitting that it has often been a major destabilizing force in the economy.

Krugman also fails to note that the U.S. government is repeating other mistakes committed in 1935-36: attempting to radically reorganize key economic sectors, pursuing new soak-the-rich taxes, and vilifying businessmen and financiers in the process. The economy may be forced to fundamentally change how the health care sector operates, creating another enormous unfunded liability for the federal and state governments and possibly a major burden on individuals and businesses. The Obama administration has also vigorously pursued carbon cap-and-trade legislation, which would drive up energy costs, potentially by large amounts. On top of this, there has been much talk of completely revamping and tightening banking and financial regulation.

> The Fed's record over the past nearly hundred years is disastrously bad.

In short, we are in the middle of the most ambitious government-enlargement agenda since probably the New Deal. Does it come as much of a surprise that we are getting similar results?

After pouring massive amounts of money into the economy in the past two years—two fiscal stimuli totaling $952 billion, the $700 billion TARP program, the $102 billion increase in discretionary domestic spending by the federal government in the 2009 fiscal year, and the $1.2 trillion increase in the monetary base by the Fed, all together adding up to nearly $3 trillion, or more than 20 percent of GDP—the economy is still far from healthy. Unemployment is stuck at 10 percent, and nobody is expecting a quick recovery. But we did get the record federal budget deficit of $1.4 trillion (10 percent of GDP) in fiscal 2009, bringing the gross national debt to a record $12 trillion-plus, on track to hit 100 percent of GDP in 2011 and calling into question the future fiscal viability of the U.S. government. Add to the mix the unfunded liability time-bombs of Medicare and Social Security, and it becomes obvious that sky-high tax—or inflation—rates are inescapable. In addition, every one of the proposed government interventions—and many others being bandied about today—is likely to increase taxes on individuals and businesses, as well as significantly escalate regulatory oversight, making it more difficult and riskier to run a business. How many of these acts will pass into law and what forms will those laws take? No one can know. It is easy to see why entrepreneurs, who in the end are the ones creating economic growth and jobs, would be worried enough about the future to simply stop investing.

The dynamic at work here has been labeled "regime uncertainty" by economist and *Freeman* columnist Robert Higgs in his article "Regime Uncertainty: Why the Great Depression Lasted So Long and Why Prosperity Resumed after the War" (*The Independent Review*, Spring 1997). Higgs defines regime uncertainty as a state of "pervasive uncertainty among investors about the security of their property rights in their capital and its prospective returns . . . [due to] government actions." Higgs shows how the "Second New Deal from 1935 to 1940" scrambled the rules of the game to such an extent that many entrepreneurs simply withdrew from the economy rather than continue to attempt to create wealth.

Krugman needs to read Higgs's brilliant and detailed historical and theoretical analysis to understand the real reason we should worry about repeating the 1937 recession: government's doing too much rather than not enough. FEE

Legends of the Fall: The Real and Imagined Sources of Our Bubble Economy

BY RICHARD W. FULMER

Preface

The Foundation for Economic Education is pleased to announce that Richard W. Fulmer of Humble, Texas, is the winner of the second annual Eugene S. Thorpe writing competition. Mr. Fulmer holds a bachelor's degree in mechanical engineering from New Mexico State University and for over 20 years has worked as a systems analyst in the energy industry. With Robert L. Bradley, Jr., he is the author of *Energy: The Master Resource*. His article, "Legends of the Fall: The Real and Imagined Sources of our Bubble Economy," is published below.

We have for the better part of a century now lived in a world of fiat money, and fiat monetary systems are sophisticated versions of central planning. The belief system that supports them carries an inherent hubris that the planner's vision of the future is sufficiently precise to chart the path of the chaotic interaction of variables that made up an economy. It is a recurring myth, with consistent historical outcomes. Mr. Fulmer's paper goes directly to first causes and discusses the real estate bubble as a predictable consequence of our central-banking system.

One hundred eighty-two authors responded to FEE's call for papers in competition for the 2009 Eugene S. Thorpe Award, and many wrote eloquently of multiple secondary causes. The unintended consequences of the Community Reinvestment Act? Fannie, Freddie, Ginnie, and assorted ill-conceived cousins? Zigging instead of zagging by our central bankers? Political opportunism and legalized graft? All surely true. Greed and other venal motives? Of course. But it misses the point to blame either human motivation or human error. The problem is systemic and foundational. It's not what people do with or to the system—it's the system itself.

The selection committee thanks all the contestants for their contributions. The rules allow for only one winner, but special recognition and honorable mentions are in order for several of the runner-up contributors. Erin Mundahl of Independence, Minnesota, wrote of government policies that disrupted the natural brakes on risk taking: "Free-market policies naturally limit risk exposure. Regulations which encouraged or even mandated an expansion of risk counteracted this natural limitation." The risks were ultimately socialized to the taxpayers. The returns accrued to the congressional and bureaucratic elites that benefited both financially and politically. Government operates outside the confines of the natural constraints imposed by profit and loss, and grants political rewards based on the social choices valued by bureaucratic actors.

Charles N. Steele of Hillsdale, Michigan, observed that government not only did what it shouldn't; government also failed to do what it should. A free market cannot function without the supportive infrastructure of the rule of law, and one of the legitimate functions of government is to prosecute criminal activity. Mr. Steele observes that "Deception, false representation of products, and failure to live up to contractual terms are not legitimate methods of competition in the free market. They are criminal activity, and the free market requires that such activities be policed." Just so.

Richard Fulmer (richard_w_fulmer@hotmail.com) is a senior fellow with the Institute for Energy Research and coauthor (with Robert L. Bradley, Jr.) of Energy: The Master Resource.

From Nero to FDR, emperors and their kin have listened to the sirens of monetary manipulation. The voices are enchanting and sing of wealth without work. But the ships of many states have foundered on the rocky shores to which such fantasies inevitably draw them. Real wealth creation cannot be manipulated; it results from increased efficiencies of resource allocation and production. A drunken Saturday night party may be fun while it lasts, but the Sunday morning hangover that follows is a predictable consequence of the short-sighted behavior that created it. Unless and until our system of monetary creation and control is redesigned to benefit from the power of market pricing mechanisms, we can expect the recurring cycle of boom and bust to continue.

Congratulations to Richard W. Fulmer on his winning article.

Karl Borden
Professor of financial economics, University of Nebraska-Kearney
Chairman, Eugene S. Thorpe Writing Competition Committee

* * *

Businesses, competing for consumer dollars in a free market, must deal with the world as it is in order to survive. Politicians, competing for constituent votes, spin facts to recreate the world as they want it to be in order to gain support for their policies, hide mistakes, and shift blame. In this world of spun reality, the failure of government intervention provides the rationale for still more intervention. So spins the endless cycle in which legislatures create unintended consequences, condemn "market failure," and demand further legislation. Government grows in crisis, even if it created the crisis.

Our current financial problems provide an illustration of this all-too-familiar pattern. In response to the housing bust, politicians hid behind long-discredited myths, moving swiftly to lay blame variously on Wall Street greed, oil speculation, investors' animal spirits, deregulation, unrestrained capitalism, predatory lending practices, and, of course, the business cycle. Yet even a brief look at the facts reveals government intervention throughout.

The Monetary Cycle

Supply and demand regulate prices in a free-market economy. Increased borrowing (demand for loanable funds) or decreased saving (supply) leads to rising interest rates (prices). Conversely, lower interest rates stem from less borrowing, more savings, or both. More saving means that consumers favor future consumption over current spending. Banks, with rising deposits on hand, drop their interest rates to compete for borrowers. Capital investments deemed infeasible when interest rates were higher now appear attractive. Companies borrow to expand productive capacity, anticipating future rising demand made possible by rising present consumer saving.

Suppose, however, that the government intervenes to artificially lower the price of money. Reduced interest rates make saving less attractive and consumption more so. At the same time businesses, taking advantage of lower rates, borrow to fund expansion. Prices rise as consumers and producers compete for scarce resources—a sack of seed corn cannot be both eaten and planted. Sales increase and markets boom. Eventually, however, the central bank must raise interest rates to prevent inflation, and the boom goes bust. Businesses find that they have overinvested or invested in the wrong things.

Such malinvestment is an unsustainable allocation of scarce resources to create goods and services for which there is insufficient demand. A correction occurs when resources are reallocated to produce what people actually want. Corrections can be very painful as industries that overexpanded during the boom now downsize, shedding employees and suppliers. Avoiding the adjustments, however, simply postpones the pain. Resources often continue to be poorly invested, compounding the damage and making the inevitable correction that much more agonizing when it comes.

Boom and bust cycles nearly always result from monetary expansions that disrupt the price signals regulating an economy. Such expansions preceded Holland's Tulip Mania in 1636–1637, the nineteenth-century banking panics in the United States, the Great Depression, the dot-com bubble, and the current housing debacle.

Ironically, these monetary cycles are called "business cycles," as if they were an inherent part of the free market. Proponents of some business-cycle theories believe that, left unregulated, businesses will overproduce, creating a glut of unwanted goods. Factories must then reduce production or even shut down until the glut is eliminated.

Yet what mechanism would drive businesses in different industries across an entire nation to produce unwanted goods? How could, to cite the most recent example, home builders in California, Nevada, Arizona, Florida, and markets in between have simultaneously misread local demand to such an extent? A nationwide spike in greed? Irrational exuberance? Bankers' bonuses? A simpler, more rational explanation is that they were misled by government policies that artificially inflated housing prices, giving the appearance of greater demand than was actually there. Overproduction is a symptom, not a primary cause.

The Housing Bubble

Early in the new millennium, the Federal Reserve slashed interest rates in response to the dot-com collapse and the 9/11 attacks. Other nations' central banks soon followed suit. Now awash in liquidity, investors from around the world needed investments that would yield returns higher than the rate of inflation. Coincidentally, American local and federal policies—including land-use restrictions, preferential tax treatment, buyer subsidies, and regulations favoring low-income buyers—had made investing in residential housing more attractive than other options. Housing prices rose as homeowners upgraded and renters became owners.

Home loans were sold in the secondary mortgage market, which is dominated by the government-sponsored enterprises: the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae). Mortgages were then bundled into "packages" in order to diversify risk. Individuals and institutions worldwide purchased these packages as investments. "Derivatives" such as credit-default swaps (essentially insurance against bond or, in this case, loan failure) and other such securities created a "multiplier effect," as these investment vehicles were based on other vehicles that were, in turn, based on mortgages.

The complex system that resulted was inherently unstable and was made more so by regulations that coerced lending institutions into making home loans to borrowers who could not afford to repay them. In addition, Congress encouraged Freddie Mac and Fannie Mae to buy trillions of dollars worth of these "subprime" loans, enabling lending institutions to engage in even more such dangerous lending with little (or reduced) incentive to vet borrowers.

Credit-rating agencies, members of a cartel created by the Securities and Exchange Commission, gave unrealistically high ratings to packaged debt containing subprime loans. Basel II, an international banking accord, similarly understated the associated risks and encouraged banks to hold mortgage-backed securities by requiring them to keep smaller cash reserves to back such instruments than it required for traditional loans. Implicit government support for Freddie Mac and Fannie Mae and the "Greenspan put" (an unstated Federal Reserve policy of injecting liquidity into the economy in response to any serious difficulty) encouraged investors to take risks in the belief that the government would cover any losses.

> Government policies artificially inflated housing prices, leading builders across the country to believe that consumer demand was greater than it actually was.

Speculators exploited zero-down loans and "adjustable-rate mortgages," intended for disadvantaged home buyers, and began "flipping" homes (buying houses only to quickly resell them at a profit). In some cases, houses were built strictly as investments—built to be sold and sold again, not to be occupied. Such overbuilding could not be sustained and, when the Federal Reserve raised short-term interest rates—contracting the money supply—the bubble burst. The value of investments based on bundled home mortgages quickly plummeted.

Mark-to-market accounting rules enforced by the Securities and Exchange Commission (SEC) compounded the problem. SEC rules required financial instruments to be valued at current market prices, amplifying the effects of both boom and bust. Mortgage-based securities, overvalued when housing prices soared, became undervalued as the panic grew and financial institutions saw their assets become virtually worthless almost overnight.

The key intervention and primary cause of the entire cycle of events, however, was the Fed's initial monetary expansion. Government policies all but dictated that the resulting boom would be concentrated in residential housing and that the eventual bust would be far worse than it would otherwise have been. Even without these policies, though, a boom would still have occurred. Perhaps it would have been concentrated in another sector of the economy; or perhaps there would have been a general rise in capital investment. Either way, once the Federal Reserve triggered the expansion, a boom was inevitable. And, because the boom was artificial (that is, the credit expansion was not based on real savings), a bust had to follow.

> In response to the bust the Federal Reserve has moved quickly to re-inflate the economy. The result is more likely another overcorrection than a "recovery."

Government control of a nation's money supply guarantees boom and bust cycles. To illustrate this, imagine a car with some very special features. Its windshield is frosted so that the driver cannot see where he is going, and its side windows are just clear enough to allow him only a vague idea of where he is. The rear window alone affords an unobstructed view. Finally, the steering linkage is on a 30-second delay. The car will not change course until half a minute after the driver turns the steering wheel.

Now imagine trying to drive such a car. You steer a straight course as long as you see the highway stretched out behind you in the rear view mirror. When the road curves, you realize it only after the fact. You turn the wheel to get back on the highway, but nothing happens. So you turn the wheel some more. Again, nothing happens, so you turn the wheel still farther. Suddenly, the steering kicks in, and the car veers wildly. Desperately, you swing the wheel in the other direction, but the car continues turning the other way. What follows is a series of violent overcorrections ending in a crash.

Trying to regulate a nation's money supply works about the same way. Central bankers cannot see into the future. They see only dimly where they are, and it is only in hindsight that their vision is clear. The impact of adjustments they make to the money supply may not be fully felt for a year or more. Such a system, like our car, is inherently unstable.

In response to the bust the Federal Reserve has moved quickly to re-inflate the economy, just as it had done after the dot-com collapse. The result is being termed a "recovery," but more likely it is another overcorrection, the beginning of yet another boom and bust cycle, and a further misallocation of scarce resources. We cannot spend our way into prosperity. Production, not consumption, creates wealth.

The Road Back

We face two basic issues: How do we recover from the current recession, and how do we stop monetary boom and bust cycles? The answer to both is to increase economic freedom.

Our immediate problem stems from an imbalance between money and goods and from resource misallocation resulting from government interference with the market. The money-goods balance can be restored by shutting off the federal money spigot. This requires reining in government spending (which competes with the private sector for scarce resources), cutting taxes, and freeing markets. Correcting the misallocation of resources requires eliminating the policies that favor residential housing over other consumer needs.

The longer-term problem of taming boom and bust cycles can be addressed only by eliminating the Federal Reserve's money monopoly. Repealing legal tender laws (which grant a monopoly on the creation of media of exchange to the Federal Reserve) would free Americans to choose forms of money that both meet their needs and maintain their value.

Before any of this can happen, though, the myth of the "business cycle" must be dispelled. Legends are luxuries we cannot afford. Reality is not optional. FEE


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The End of Medicine: Not With a Bang, But a Whimper

BY THEODORE LEVY

Social change can be revolutionary, sudden, and swift, but more commonly it moves at a glacial pace. Yet glaciers work great change, and great damage, given enough time.

There has been much talk of people leaving the medical profession if government further bureaucratizes health care. But the odds are great that there won't be any dramatic job stoppage. No medical "Galt's Gulch" will form where masses of physicians on strike will live in peace and solitude, some building cars and others mining copper, all vowing never to return to medicine until their demands are met. Such is the stuff of fiction. But the reality is much worse.

What will happen is more insidious, though over time no less damaging. There will be an increase in early retirement, as more physicians tire of their jobs. More physicians will take time off and let their practices suffer at the margin. Patients will have slightly more difficulty making appointments . . . each year . . . year after year, though never so quickly as to lead to mass complaints or a recognition that things are obviously worse.

Coverage will be shunted to physicians' assistants, nurse practitioners, emergency department physicians, hospitalists, and partners. Fewer patients will feel they have their own doctors. This will not necessarily be worse—I don't feel I have my own McDonald's, yet the food remains as I expect—but it may be worse, to the extent quality of care depends on background knowledge of individuals.

The filter of who gets into medical school will change. Fewer will enter the field due to intellectual curiosity. More and more people who cannot tolerate bureaucracy will be weeded out. Questioning authority will become as dangerous in medicine as it is in policing or the military. The 40-hour physician work week, on the other hand, will become commonplace, and the type of person attracted to medicine will not be the type who is willing to work any longer, or any harder.

Health care will be less a service than a commodity. All your complaints will have answers, if not always the right answers. Workups will be standardized by "expert panels" allegedly educating physicians as to "best practices." And if the "best practice" is to not treat you because it is not cost-effective to society, the fact that you want and are willing to pay for the treatment will be seen as a problem rather than a solution.

These panels are designed to save money by making workups more efficient and uniform, but the reality is different. More expensive imaging tests routinely substitute for less expensive physical exams because the quality of physical exams varies and doctors have little incentive to improve their own abilities at examination. Not only is it becoming something of a lost art ("Why use a stethoscope to listen for a heart murmur when we can just see it on a cardiac ultrasound exam?"), but it takes time. And since doctors are paid by third parties more concerned about efficiency than quality, taking time with patients—improving one's diagnostic exam skills—is a luxury fewer and fewer physicians can afford.

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Does this sound unbelievable? It is happening already. In the 1990s the Office of Inspector General investigated major teaching hospitals in America. Taxpayers are billed by such institutions for training new generations of physicians. PATH (Physicians at Teaching Hospitals) audits found patients in these hospitals were commonly evaluated by medical students or interns *only*. Attending senior physicians were fraudulently simply "signing off," saying, "I agree," without ever seeing the patient. The University of Pennsylvania Hospital settled a PATH dispute for $30 million, and Thomas Jefferson University Hospital did so for $12 million. Anecdotes describing such problems abound, including hospital charts saying, "Physical exam shows both pupils equally reactive to light," when the patient had actually been blind in one eye for decades, a mistake much more easily attributable to the exam's never having been done than to error.

Slowly and gradually community hospitals will come to resemble VA hospitals. Centers of excellence will be advocated in theory—evidence-based medicine will be the byword to "bend the cost curve downward" by eliminating "inefficiencies." But will they really be excellent, or will they merely be better than whatever else is available? Will they be free to innovate? Will they be free to profit if their innovations are successful? Will they simply be the medical equivalents of the best cars on the road in Cuba?

> Slowly and gradually community hospitals will come to resemble VA hospitals.

Pharmaceutical innovation, produced by those evil for-profit companies that even doctors love to denounce, will drop off. Not precipitously, but eventually. And people will die, as they have died since time immemorial, without anyone ever knowing what drugs might have improved or extended their lives, if only there had been greater incentives to produce them.

As noted, imaging studies will become more important but will also become more difficult to schedule. And the quality spectrum between optimally interpreted exams and standardly interpreted exams will continue to widen. The Current Procedural Terminology (government billing) codes are the same, independent of the quality of the interpretation.

There is already a spectrum of quality available in medicine, and those with means can obtain better medical care than those without, just as O.J. Simpson was able to obtain better legal services than your average defendant—the first time. But that spectrum risks becoming more rigid, more settled. What has been, in America, health care for the poor will become health care for all but the very rich. But the cost curve will bend downward.

Or will it? Medical salaries will bend downward, certainly, but administrative costs associated with government programs are always huge, and always underestimated. Medicare spending now is an order of magnitude higher than the projections in 1965 of what it would be now. But we do know this: Bending the cost curve of medical care in either direction comes with costs.

If it's bent downward people will wait longer for health care that is not as good as it could have been. We often buy things "not as good as they could have been," Chryslers rather than Cadillacs, Range Rovers rather than Rolls Royces, but those choices are made at the individual level, not forced on us by "society." And those choices are, well, choices—not a byproduct of a system we cannot control.

Or the cost curve can bend upward, perhaps due to hidden governmental administrative costs, perhaps because AARP is a strong lobby. And we'll feel the pinch in other areas, as our debt grows, as our prosperity lags and falters and becomes a quaint piece of history we teach our children (or perhaps, in our guilt, hide from them).

We'll pride ourselves, as we do now, on "the best health care system in the world," even while we also brag that we have universal care, just like the great nations of Europe. And we'll suffer with double-digit unemployment, just like the great nations of Europe. And we'll have lower growth in productivity, just like the great nations of Europe. And we'll have smaller houses and cars, just like the great nations of Europe. But it will be all right, because we'll be able to wait . . . and wait . . . and wait . . . for our turn at the health care that is our right. FEE

On the Rule of Law

BY DONALD J. BOUDREAUX

Everyone agrees that the rule of law is good, both morally and economically. Almost no one—regardless of political ideology—dares to question the great goodness and importance of the rule of law.

I certainly don't question it.

But what exactly *is* the rule of law? In answering *this* question we uncover reasons why persons with vastly different views on the appropriate role of government all sincerely proclaim allegiance to the rule of law.

Here is what is *not* of the essence of the rule of law. The rule of law does not exist simply because the government that issues commands and enforces the law is legitimately and democratically elected. The rule of law does not exist simply because commands and laws are enforced according to their letter, without bias or exception or corruption. The rule of law does not exist simply because everyone in society, including those with political power, is subject to the government's commands.

Each of those traits of a decent political and legal system is desirable, but neither separately nor collectively are they the essence of the rule of law.

Almost no one—regardless of political ideology—dares to question the great goodness and importance of the rule of law.

Rules and Laws

The rule of law exists when, and only to the extent that, the rules enforced by government are in fact *law*.

My definition might sound like a tautology. After all, don't rules become laws precisely by being enforced by government?

No. But confusion over the meaning of "rule of law" springs from the widespread but mistaken belief that it is by virtue of being enforced by government that rules become law.

Law in fact emerges from the everyday actions of men and women in their ongoing efforts to thrive and to keep from bumping disruptively into each other. Law becomes embedded in the predominant expectations of persons in a community.

To pick an extreme example, the unprovoked killing of a peaceful person is not unlawful because government has declared the act illegal. Such an action is unlawful because it violates deeply held community norms and expectations. Striking from government's statute books all proscriptions against murder would not in the least make murder lawful.

In principle, in a classically liberal world, a government formalizes laws against murder, and uses some of its resources to police against murder, because government is the organization in society that has the comparative advantage at performing such policing. For much the same reason that Starbucks specializes in retailing coffee, government specializes in *enforcing* law. And just as Starbucks responds to prevailing consumer demands—just as Starbucks is not in business to tell consumers what they want and don't want, but instead is in business to serve consumers according to their specific tastes for coffee and pastries—a genuinely classical-liberal government is not in business to foist its demands and dictates on citizens, but instead to serve citizens by enforcing laws that exist independently of government.

Only by understanding law in this way can we make sense of the familiar stricture that "ignorance of the law

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is no excuse." Because true law is always embedded in prevailing community expectations, society is happier and more peaceful the more people act lawfully—that is, the more people act consistently with these expectations. So the rare person who in fact does not know what these expectations are is not permitted to violate the law simply by pleading—or even by proving—that he really didn't know that, say, it's unlawful to take another person's purse without permission.

There's no sense of injustice in punishing such a purse-snatcher. The laws that are violated in such cases are not in any way arbitrary; they grew organically within the community and are important to its continued peaceful existence. Also, because the expectations that are "law" are in fact so widespread, the probability of any given law-breaker really being ignorant of the law is so slim that it's not worthwhile to let his alleged ignorance stand as a potential defense against his prosecution.

Contrast this expectations-based understanding of law with the modern myth that laws are only those commands issued by the State. Would most of us be sanguine punishing, in the latter case, a law-breaker who really and truly was ignorant of the State's dictate? I think not.

While it's highly unlikely that, say, a purse-snatcher is unaware that purse-snatching is unlawful, it's not at all unlikely that, say, a property owner is unaware that the legislature or a bureaucracy has declared it a criminal offense to fill in a small water hole in his backyard. Also, the fact that community norms do not proscribe property owners from filling in their water holes is strong evidence that filling in such holes does little or nothing to disrupt the smooth functioning of society.

So while ignorance of the law, as it is embedded in norms and expectations, truly is no excuse for violating the law, ignorance of legislative diktats *is*—or ought to be—a defense against failure to behave as the legislature commands.

Undeserved Respect

Unfortunately, because legislative and bureaucratic diktats are mistakenly called "laws," they too often receive a degree of respect and esteem that they do not deserve.

One genuine feature of the rule of law, therefore, that common parlance *does* get right is that the rule of law is indeed contrasted with the "rule of men"—that is, with the rule of specific persons. The rule of law is the rule of norms that have evolved into widely held expectations. No person, no committee, no Congress or Parliament or even court created these norms—these laws. Like market prices and patterns of production, true laws (to use one of Hayek's favorite phrases) "are the result of human action but not of human design."

> Because legislative and bureaucratic diktats are mistakenly called "laws," they too often receive a degree of respect that they do not deserve.

The rule of law means general deference to those norms and expectations that emerge out of decentralized human action. The opposite—rule by diktat—always means rule by individuals exercising coercive power to override these norms and expectations. The fact that these individuals who exercise this power might be elected in no way transforms the diktats they impose into true law.

Law as it is defined here is never perfect. It can be, and historically has been, infected with any number of imperfections. But it has the great virtue of seldom being a tool of power-seeking, or power-wielding, human beings. The diktats that power-hungry rulers create—and which these rulers call "law" in order to drape their diktats with faux legitimacy—are almost always tools to further the specific ends of the rulers without much regard for the long-run welfare of ordinary men and women. FEE

A Health Insurance Criminal Pleads His Case

BY JAMES L. PAYNE

If mandatory health insurance goes through, it will turn me into a criminal. I don't have health insurance. I don't want it. And I will refuse to buy it even though I can afford it. Before they lead me to the cell, perhaps the prisoner may be allowed to say a few words in his defense.

It's understandable that politicians are eager to eliminate the medically uninsured. For years they've been told that we are the flies in the ointment of health care policy. It is said we are either a) wrecking the system by using services we don't pay for, or b) deprived of needed medical care and therefore objects of pity and subsidy.

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These points may apply to some uninsured but not to all. Some of us belong in what might be called the "successfully uninsured" category. We are not freeloaders. We believe we have an obligation to pay for the medical care we receive, and we always pay for it. I put no financial burden on doctors, hospitals, or taxpayers, and politicians are wrong to assume I am part of the country's health care problem.

Politicians are also wrong to assume that I am an object of pity. Like many Americans, I have significant savings and can afford medical expenses out of pocket. (Census Bureau figures for 2000 show that over 18 million households had assets in excess of $250,000). Our savings make it possible for my wife and me to decline both private insurance and Medicare (we are 70). Those without savings are in a different situation: They probably need insurance, or a subsidy, or charitable help. My point is that if you can handle your own medical bills through savings and personal responsibility, this is a sound approach. Politicians should encourage this state of self-reliance, not criminalize it.

There are many advantages to being insurance-free. The first is flexibility. Several years ago, my wife had a serious bout with cancer. The successful treatment involved surgery and local radiation therapy. After much study she refused the more massive radiation treatment recommended by the doctor and pursued alternative thera-

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pies, including acupuncture, nutritional therapy, massage, and naturopathic medicine. Every decision was made in terms of what seemed best to treat this illness. We were not drawn into using inappropriate therapies because they were "free," nor did we pass up desirable therapies because they were "not covered."

The second advantage of being insurance-free is we avoid bureaucracy. We don't fill out insurance forms; we don't make phone calls trying to find out what's covered; and we don't play games (with the collusion of doctors) trying to get things we need paid for by someone else. If an aching back suggests the need for a different mattress, we go out and buy one and don't waste time and money trying to prove to some clerk that it's covered. When the government offered a new piñata of benefits in the form of prescription drug coverage, we entirely escaped the frustration of figuring out how to deal with its staggering confusion. While other seniors were closeted with lawyers trying to decide what to sign up for, we went hiking.

Spending my own money on health care helps me set a rational limit to medical spending, even on spending to preserve my life.

Refusing health insurance may have advantages, but what will happen if I face a medical problem that requires more than my savings? To understand my answer, consider a parallel question about some other commodity—say, housing. I announce that I believe in paying for housing from my own financial resources. Someone points out there might be a house I want that costs more than I can afford. That's just too bad: I don't get to buy it. I limit my housing consumption according to my resources.

I look at medical care the same way: If something costs too much, I do without. This position, so obvious and sensible in other areas, is considered untenable when it comes to medical care. In this realm the prevailing assumption is that everyone is entitled to all the health services he needs or wants.

It's one thing to announce this entitlement as an ideal, but quite another to make it work. In the real world medical resources are limited, and therefore all approaches to health care funding employ rationing.

In tax-based systems administrators establish waiting lists so that some patients die before their opportunity for treatment comes up. They ban the use of expensive treatments and alternative therapies. And, without exactly saying so, they underfund medical facilities, so that patients wait in the halls of emergency wards, for example. In commercial insurance plans rationing is implemented by restricting coverage to specific procedures and specific doctors—and by setting upper limits to coverage.

Paying your own medical bills is simply another way of limiting consumption: If a treatment costs too much, you don't buy it. The advantage of self-rationing is it is frank and open, and thus avoids the whining and blaming that characterize bureaucratic systems.

No Blame Game

Paying your own medical bills also lets you see that there are more socially constructive ways to use funds than spending on health care. Suppose that to fix your limping gait requires complicated care costing hundreds of thousands of dollars. If others pay for this care, you might accept it. But suppose you are paying for it with your own savings. Now you might think twice about spending the money on yourself. You might know of a school for autistic children that could put the money to good use. Or you might have a grandchild who needs the money to start a business.

Such decisions are indeed difficult, but we need to face them if we are to make sensible choices about health care. Today we are not facing them. We are hiding behind the confusion of a tangled government/corporate system that pretends we can have all the medical care we want.

Spending my own money on health care helps me set a rational limit to medical spending, even on spending to preserve my life. Not buying health insurance and not allowing politicians to force others to fund my needs helps me keep my consumption of medical resources within fitting bounds.

This way of looking at health insurance may be old-fashioned, but should it be a crime? FEE

The Wisdom of Nien Cheng

BY JAMES A. DORN

Nien Cheng, author of *Life and Death in Shanghai* (1986), died in Washington last November at the age of 94. She was an incredibly courageous woman and the embodiment of grace and wisdom.

She loved traditional Chinese culture, but her world was shattered on August 30, 1966, when the Red Guards ransacked her home and, on September 27, arrested her. She spent the next six and a half years in Shanghai's No. 1 Detention House, in solitary confinement.

Communist Party interrogators accused Cheng of being a spy, but her real "crime" was that she was viewed as a "capitalist roader." She had attended the London School of Economics (LSE) in the 1930s, where she met her husband, Kang-chi Cheng, who later became general manager for Shell Oil in Shanghai.

Nien Cheng outlasted Maoist torture, theft, and the murder of her only daughter.

When he died in 1957, Nien Cheng became a special adviser to the new general manager. She was the highest-ranked businesswoman in China at the time. Her skills in dealing with party officials were invaluable and helped Shell stay in China until the start of the Cultural Revolution in 1966.

During her imprisonment Cheng refused to admit any wrongdoing. She was tortured and nearly died, but her determination to survive and her deep faith gave her the strength to persevere. She was released from prison on March 27, 1973, only to find that the Red Guards had murdered her only child, Meiping, for failing to "confess" and denounce her mother as a "class enemy." Cheng's one hope in life was gone; she left China forever in 1980 and settled in Washington, D.C., in 1983.

Anyone who knew Nien Cheng could immediately see that she was special—even the doctor at the No. 1 Detention House said he never met a more "truculent and argumentative" prisoner. When she learned of her imminent release, she refused to leave the prison unless the authorities declared, in writing, that she was "innocent of any crime or political mistake." She insisted that they offer "an apology for wrongful arrest" and called the official statement "a sham and a fraud."

In that statement she was accused of conspiring with the British government because in a letter she signed in 1957, shortly after she joined Shell, "she divulged the grain supply situation in Shanghai." That accusation was ludicrous. Her secretary was merely conveying common knowledge to the incoming general manager, who was still in London—namely, that "the Shanghai government allows everyone twenty catties of grain per month."

After nearly seven years in prison she declared, "I shall remain here until a proper conclusion is reached about my case." The authorities refused, and two female guards had to drag her out of prison. It was not until later that Cheng learned that her interrogators were trying to get her to confess to being a spy so that

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Jiang Qing (Mao Zedong's wife) and other radicals could oust Premier Zhou Enlai, a moderate who favored allowing foreign firms like Shell to operate in China.

It was only after Mao's death in 1976 and Deng Xiaoping's decision to open China to the outside world that Cheng was officially declared innocent of any crimes against the State and "rehabilitated" in November 1978.

The Realities of Communist Rule

It is ironic that Cheng became enticed by socialism during her studies at LSE. In her essay "The Roots of China's Crisis" (in *Economic Reform in China,* which I edited along with Wang Xi), she wrote, "When I read a book on the Soviet Union by Sidney and Beatrice Webb, I thought, 'How wonderful and idealistic socialism sounds.'"

Later, after her husband had served in Australia as a diplomat for the Nationalist government, the Chengs made the fateful decision to return to China in late 1948. They and many of their Western-educated friends were seduced by Mao's call for democracy and wanted to help build a new China.

In her essay Cheng notes that while she had learned about socialist ideals at LSE—including the apparent success of Soviet egalitarianism, central planning, and state ownership—her professors never mentioned "class struggle" or "the realities of communist rule." What she painfully discovered was that in a society where individuals have no economic freedom and no genuine rule of law, no one is safe from the power of the State. Economic life is politicized, corruption is endemic, and inequality of power reigns, in stark contrast to promises of egalitarianism.

As Cheng wrote in her book, "The fact is that the Communist government controls goods, services, and opportunities and dispenses them to the people in unequal proportions." During the Maoist regime one's rank in the party determined one's economic status. "Though the salary of a member of the Politburo was no more than eight or ten times that of an industrial worker, the perks available to him without charge were comparable to those enjoyed by kings."

> What Cheng painfully discovered was when individuals have no economic freedom and no genuine rule of law, no one is safe from the power of the State.

The Chinese Communist Party under Mao's iron fist destroyed civil society and traditional culture. A new China was created after the Communist victory in 1949, but it was not the socialist ideal Cheng had envisioned. Rather, the party created "mindless robots, unburdened by the capacity for independent thinking or a human conscience."

Success depended on power, and justice vanished. "The result was a fundamental change in the basic values of Chinese society," she wrote.

Mao's mantra was, "Strike hard against the slightest sign of private property." Nien Cheng's property, including her priceless porcelain collection, was confiscated. Her daughter was murdered and her freedom destroyed by the State.

Crony Capitalism

While in jail, in 1971, the inmates were assembled and an official announced, "Many of you are here precisely because you worshiped the capitalist world of the imperialists and belittled socialist China. You placed your hope in the capitalist world and believed that one day capitalism would again prevail in China."

Today, mainland China is perhaps more capitalist than any other country, but it is "crony capitalism." The nation lacks full-fledged private property rights, especially in land; there is no independent judiciary to protect persons and property against the party's monopoly on power; and freedom of religion and expression are sharply curtailed. The battle for justice that Cheng fought has not yet been won.

In her book Cheng recognized the significance of President Nixon's visit to China in 1972 and the importance of engaging China. She witnessed the progress the mainland has made since Deng Xiaoping began to liberalize markets in 1978. She understood the critical role of trade and investment in linking China to the West. But she also understood that "Unless and until a political system rooted in law, rather than personal power, is firmly established in China, the road to the future will always be full of twists and turns."

Seeking Truth and Justice

Nien Cheng's journey from an idealistic Marxist liberal at LSE in the 1930s to a realistic market liberal—after living through Mao's upheavals and seeing the end of private property and the uncertainty and injustice caused by arbitrary and unlimited State power—gave her a great appreciation of America.

Near the end of her life, in a personal letter, she wrote,

> I can hardly believe I have lived so long. I think it is mainly because I am never angry nor am I ever worried. I believe in "constant change," so I always think a bad situation will change into a good situation or not so bad after all. In any case, there is always a solution. As for being angry, after what had happened to me in China, I think I have used up all the anger inside me. There is simply nothing to be angry about in America.

All Americans should be proud Nien Cheng chose to make America her home. She believed that here she would be free to choose and that her person and property would be protected by the law of the land.

Today, as the U.S. government grows in size and power, it would be well to remember the wisdom of Nien Cheng—and the danger to personal freedom when the State erodes economic freedom. FEE

Private Capital Consumption: Another Downside of the Wartime "Miracle of Production"

BY ROBERT HIGGS

Although the so-called miracle of production in the United States during World War II persuaded many economists and others to accept the validity of the basic Keynesian model, this interpretation rests on important errors of commission and omission to which I have called attention over the years. (See especially the studies brought together in my 2006 book, *Depression, War, and Cold War.*) Among these errors, one that has yet to receive adequate attention is the wartime consumption of private capital—as it were, a drawdown of the economy's private stock of seed corn to feed the soldiers.

Although official macroeconomic data for the war years have many problematic aspects, we may consult them as a point of departure. These data show that net private domestic investment plunged from $9.1 billion in 1941 to $0.3 billion in 1942, and for each of the following three years the amount (in billions of current dollars) was negative: –4.1, –2.9, and –0.2, for 1943, 1944, and 1945, respectively. Thus for the four war years combined, the private capital stock *fell* by $6.9 billion, or by an amount half-again greater than the amount *added* during best year of the 1930s (namely, 1937). This showing seems bad enough, but the actual decline was greater than the official data indicate.

> For the four war years combined, the private capital stock fell by $6.9 billion, or by an amount half-again greater than the amount *added* during best year of the 1930s.

While privately owned capital declined during the war, privately *operated* capital increased because the government spent more than $17 billion for manufacturing plants, equipment, and reconversions between July 1940 and June 1945—an amount equal to almost two years of net private investment at the 1941 rate. These plants were operated for the most part by private corporations under management contracts, and after the war some of the facilities were sold to their wartime operators or other private parties. Much of the government-financed capital would prove to be ill-suited to the profitable production of civilian goods in the postwar economic environment, however, and hence its postwar value was much less than the amount the government had spent to build it during the war.

In any event, the official figures overstate the increase in the privately owned or operated capital stock during the first half of the 1940s because the standard formulas for computing depreciation fail to take into account certain extraordinary conditions, especially "the accelerated depreciation resulting from intensive plant use and scarcity of replacement parts" to which economist Glenn McLaughlin called attention in the *American Economic Review* for March 1943.

According to a 1945 War Production Board report,

> Plant utilization in the munitions industries increased sharply after Pearl Harbor . . . . [T]he average utilization of facilities in the metal products industries late in 1944 was about two-thirds above the prewar level, after having reached nearly twice the prewar level in the spring of 1943; the increase in the remaining industries, though smaller, was still substantial. . . . *[T]he increased utilization of existing facilities contributed nearly as much to the increase of total industrial output during the war as did the construction of new facilities*; though the contribution made by more

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intensive utilization was much more important in the earlier part of the period, particularly in 1940 and 1941, than it was in 1943 and 1944. [Emphasis added.]

Double-shift and even treble-shift operation of plants became much more common during the war.

Writing in the *Survey of Current Business* in 1963, Murray Foss reported that in a comparison of conditions in 1940–44 with those in 1934–39, hours of usage per year increased by 53 percent for railroad freight cars, by 54 percent for freight locomotives, and by 34 percent for passenger locomotives. Hours of usage per year per spindle in the cotton textile industry increased by about two-thirds during the war years.

Repairs Forgone

While the capital stock was being used far more intensively, the lack of replacement parts and repair materials kept producers from doing even normal upkeep on their property. In the housing sector, rent controls induced landlords to forgo ordinary repairs. For apartment houses and small structures, index numbers of repair and maintenance expenditures fell some 20 percent during the war. According to a 1945 report of the director of war mobilization and reconversion, the motor-carrier industry during the three peak war years obtained "only 195,000 new trucks and buses," which amounted to "less than 10 percent of the number it would normally require for replacements and expansions," while increasing its loads each year and hastening wear and tear on its fleet of vehicles. For the overall economy, this report concluded, "wear and tear on plants has been far above normal, while repairs and replacements have been below normal."

In addition, official depreciation estimates fall short of the truth during the war years because they fail to correct for inaccuracies in the price indexes. In a situation of pervasive price controls, even if a firm tried to make adjustments for the declining purchasing power of money, the dollar amounts it allowed for depreciation understated the actual amounts it needed to set aside in order to replace its worn-out plant and equipment later, in the postwar environment, when prices would no longer be suppressed and actual market (that is, higher) prices would prevail. The statisticians at the Commerce Department apparently took the official price indexes at face value even for the years when price controls were in effect.

While the capital stock was being used far more intensively, the lack of replacement parts and repair materials kept producers from doing even normal upkeep on their property.

According to official estimates published in the *Survey of Current Business* in April 1970, the private stock of fixed business capital lost more than 7 percent of its real value between 1941 and 1945. After inclusion of the government-financed additions to the industrial capital stock, the privately *operated* total increased in value by an estimated 15 percent.

However, by taking into account the measurement errors in the wartime depreciation estimates incorporated into the official figures—errors caused by inaccurate price indexes and by the inappropriate application of uniform, standard depreciation schedules during a period of accelerated actual depreciation—we may conclude that the true drop in the privately owned stock of capital was even greater than the official figures show during the war years and that the increase in the stock during the second half of the 1940s was greater than shown. Moreover, depreciation figures applied to the industrial capital stock the government financed during the war are too low for the same reasons. Thus for the capital stock, as for the economy's real output, the official data have misled us by making the wartime expansion appear bigger than it really was and the postwar expansion smaller than it really was. FEE

Botswana: A Diamond in the Rough

BY SCOTT BEAULIER

Over the past 40 years Botswana has been sub-Saharan Africa's fastest-growing country and one of the fastest-growing countries in the world. Though it started off as one of the poorest countries in the world, its per capita income now compares favorably with many Mediterranean counterparts. Like most countries, the financial crisis has slowed Botswana's recent economic growth, and large "stimulus" packages have ostensibly been introduced to reverse that direction, but, even with Botswana's poor economic performance in 2008 and 2009, its contrast with the rest of sub-Saharan Africa is stark. As the graph on the next page shows, sub-Saharan Africa (SSA) as a whole (with Botswana included) has seen dismal growth since 1965, while Botswana has enjoyed more than a 15-fold increase in real gross domestic product.

Growth and development in every direction.
Geof Wilson

While many attribute the country's success to diamond revenue and a homogenous population, Botswana's success actually has resulted, first and foremost, from economic freedom. Until last year Botswana was the most economically free sub-Saharan African nation in the Fraser Institute's Index of Economic Freedom; Mauritius has nudged ahead of Botswana in the most recent report. The country's marginal tax rates are some of the lowest in the world; its borders are more open than those of many other African countries; and the government has a long tradition of respecting private property and upholding the rule of law. As historian Robert Guest sums up Botswana's postcolonial policies, "Since independence, Botswana has been governed sensibly, cautiously, and more or less honestly."

The honesty in policy described by Guest has helped Botswana escape the so-called "African tragedy" of poverty. By conventional standards the country is an upper-middle-income country, and throughout my time in Botswana a few years ago I was struck by how normal the country seemed. It is safe to walk around after dark, and violent crime rates are quite low. The drinking water is generally fine. Its capital city, Gaborone, is buzzing with commerce, and a number of shopping malls there have high-end merchandise and quality restaurants similar to those found in any Western country. According to government officials, no Batswana (the appropriate term for people of Botswana) has ever died from the country's frequent droughts, and basic education levels and public road networks are far superior to those in neighboring countries. As one tourist put it, "This place is really quite boring." (To which I replied, "Yeah, maybe that's an idea for a paper: "Botswana: The Beauty of Being Boring.")

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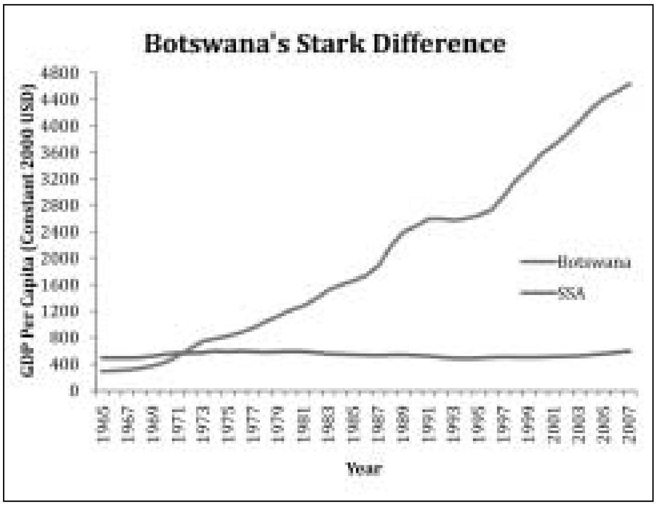

Source: *World Development Indicators, 2008*

In 1965 the country, a former protectorate of Great Britain, was a newly independent nation of desert land and cattle herders. Its future was deemed grim by the experts, and many expected Botswana to remain poor and heavily dependent on South Africa. Yet much like the Asian "tigers," Botswana's success stands out as one of the truly exceptional sustained growth runs in the twentieth century. It has averaged 7 percent annual growth in per capita income since independence.

Racial Harmony

Attempts to explain Botswana's development as the result of a relatively homogeneous culture are flawed. If cultural and ethnic homogeneity played such a crucial role in promoting development, why then was Botswana so poor at the time of independence? It probably did not hurt reformers to be dealing with a homogeneous population during the postcolonial period, but culture in and of itself was not enough to guarantee Botswana's growth explosion. Becoming free from Great Britain and subsequently promoting sound economic policies were the additional and far more important ingredients of Botswana's success.

Botswana's pursuit of racial harmony, however, did help it avoid the turmoil that other sub-Saharan countries saw.

In the early years of Botswana's postcolonial development the leadership behaved much differently from many other African leaders. Botswana's first president, Seretse Khama, was a charismatic leader who sought racial harmony and welcomed the advice of British expatriates. Rather than follow the lead of most other African leaders and embrace Marxism, Khama and his majority coalition in the Botswana Democratic Party (BDP) chose to sit down with British expatriates and minority stakeholders when formulating policy. The small, informal meetings held by the BDP made policies more legitimate and served as an implicit compact between the BDP and other important interest groups.

The tolerance and cosmopolitanism of Khama and the BDP were more than lip service. When it came to border issues, for example, the government welcomed thousands of refugees being persecuted by racist regimes in Rhodesia and elsewhere. The official position of the government was to recognize the basic dignity of all individuals and maintain open borders.

Tolerance also shaped domestic policy, as the new government was careful to incorporate traditional indigenous institutions throughout the reform process. For example, its *kgotla* system, which predated colonialism and encouraged dissent in the public realm and unanimity in decisions, remains part of modern-day Botswana. Its precolonial tribal system of law and dispute resolution was brought into modern-day institutions to some extent through the House of Chiefs, which serves as an advisory body to the legislature. While the postcolonial reforms did not completely embrace the traditional institutions of the precolonial and colonial periods, steps were taken to preserve valuable parts of Botswana's history and culture. By contrast, in many other sub-Saharan African nations so-called "modernization" meant the complete dismantling and elimination of all things traditional.

Tight Spending Control

As the new government was being formed in the mid-1960s, few resources were available for significant "public" spending. Rather than tax people excessively, the government kept tax rates low and predictable. Low taxes encouraged entrepreneurial activity and reduced tax evasion and corruption. Khama and the BDP could have borrowed substantially, but they had a fear of accumulating debt and instead kept spending on traditional government programs like defense and education to minimal levels. The government could not afford a national defense force early on in the reform process, so the country simply went nearly ten years without it.

The government sought to constrain longer-term spending by introducing five-year National Development Plans (NDPs) to set government spending priorities. Once agreed on, they can only be amended with overwhelming support from parliament. In addition to establishing NDPs, the government constrained spending by applying strict cost-benefit standards to expenditures.

The generally free-market approach to economic development taken by Botswana's leadership in the early years had the effect many pro-market economists would predict: rapid growth and serious quality-of-life improvements for average Batswana. This development was most rapid during the first ten years as an independent nation—years that *predated most of the diamond discoveries and extraction*. Moreover, diamonds are not normally viewed as a boon to development. In much of the "natural resource curse" literature in economics, things like diamonds are said to hamper development because they lead to weak institutions and rent-seeking. As Fareed Zakaria puts it in his popular book, *The Future of Freedom*,

When given a chance, economic freedom can produce beneficial long-run growth results in poor African countries.

> Why are unearned riches [like oil, diamonds, and gold] such a curse? Because they impede the development of modern political institutions, laws, and bureaucracies. Let us cynically assume that any government's chief goal is to give itself greater wealth and power. In a country with no resources, for the state to get rich, society has to get rich so that the government can then tax this wealth. In this sense East Asia was blessed in that it was dirt poor. Its regimes had to work hard to create effective government because that was the only way to enrich the country and thus the state. Governments with treasure in their soil have it easy; they are "trust-fund" states. They get fat on revenues from mineral or oil sales and don't have to tackle the far more difficult task of creating a framework of laws and institutions that generate wealth.

Thus Botswana has not grown because of, but rather despite, its diamond wealth.

To be sure, Botswana faces some serious challenges. First, government spending as a percentage of GDP in Botswana is too high and it has been growing rapidly. The "hands off" approach of leadership in the early years has largely been forgotten and given way to big government. Botswana's large, bloated government now funds a large national defense, covers education through college, and has extended health care coverage in the wake of a serious HIV/AIDS crisis. The government's steadily increasing scale and scope has made Botswana a less economically free country in recent years, and it could be stifling to future growth.

Second, Botswana's courts and property rights have not been free from interference. The rule of law, in particular, has sometimes been relaxed in cases involving government officials. Indigenous groups, such as the Kalahari Bushmen (also known as the Sans, among other names) have consistently been oppressed by the government and unfavorable legal rulings. And the government's attitude toward foreigners, particularly Zimbabweans, has grown increasingly xenophobic. Continued shifts away from the cosmopolitanism of Khama in recent years make Botswana's future growth far from certain.

The chief lesson to take from Botswana's postcolonial success is the following: When given a chance, economic freedom can produce beneficial long-run growth results in poor African countries. Many leaders in sub-Saharan Africa dismiss good policy stories like the one being told here as "Western ideas and models" unsuitable for Africa. From where they sit, Africa's history is unique and different. The differences are significant enough to make "standard approaches," such as economic freedom, futile endeavors. While there is much to be said for not imposing external institutions on people, Botswana is a case of Africans finding economic freedom on their own. As a result, Batswana have enjoyed higher living standards. FEE

The Improbable Prose of Nassim Nicholas Taleb

BY ROBERT P. MURPHY

As I get older and more cynical, I tend to look down on the latest "hot" idea or person. Sure, teenage pop stars and the novelist Dan Brown are talented, but they're not nearly as extraordinary as their popular status would suggest. Every once in a while, though, something impresses me despite such cynicism. Nassim Nicholas Taleb, for example, lives up to the hype surrounding him. Libertarians—especially those versed in Austrian economics—will find Taleb well worth reading.

Taleb is the author of the international bestseller *Fooled By Randomness* and the blockbuster *The Black Swan: The Impact of the Highly Improbable*. The books largely overlap, but the second (the focus of the present article) is less liable to misunderstanding, probably because of confusion among readers of the first.

Nassim Nicholas Taleb.
Sarah Josephine Taleb

The black swan is a metaphor for the limits of our knowledge and, perhaps more important, our unfounded confidence in our knowledge. The metaphor draws on the familiar notion that before discovering counterexamples in Australia, people in the Old World would have been certain that all swans were white. To be more precise, Taleb lists three attributes of the black swan event his book addresses:

> First, it is an *outlier*, as it lies outside the realm of regular expectations, because nothing in the past can convincingly point to its possibility. Second, it carries an extreme impact. Third, in spite of its outlier status, human nature makes us concoct explanations for its occurrence *after* the fact, making it explainable and predictable.

Both of Taleb's books are filled with "fun facts," just as Malcolm Gladwell fills his own (bestselling) work. Yet the difference is that Gladwell—in such romps as *The Tipping Point* and *Outliers*—never has much of a coherent theory for which his amazing anecdotes are relevant.

Taleb, on the contrary, tells us his thesis up front, then draws on his vast knowledge to illustrate his points. One of his central claims is that people *place too much confidence in their estimates*. Taleb stresses that the issue is not how smart or how dumb people are. "We certainly know a lot, but we have a built-in tendency to think that we know a little bit more than we actually do, enough of *that little bit* to occasionally get into serious trouble."

Taleb strings together sentences of surprising profundity while packing his prose with interesting statistics and stories. When reading *The Black Swan*, I had to stop noting every "interesting" paragraph in the margins, lest I fill them up.

The book's prologue alone is an interesting essay, containing such standalone gems as the following:

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> What is surprising is not the magnitude of our forecast errors, but our absence of awareness of it"; "We do not spontaneously learn that *we don't learn that we don't learn*. . . . Metarules (such as the rule that we have a tendency to not learn rules) we don't seem to be good at getting"; "Who gets rewarded, the central banker who avoids a recession or the one who comes to 'correct' his predecessors' faults and happens to be there during some economic recovery?

Taleb openly despises those in "suits"—very often mainstream economists or students of finance—who make predictions without bothering to study the record of their previous forecasts. Taleb declares, "Anyone who causes harm by forecasting should be treated as either a fool or a liar. Some forecasters cause more damage to society than criminals. Please, don't drive a school bus blindfolded."

Of perhaps most interest to the Austrian reader, Taleb champions Friedrich Hayek and mocks Paul Samuelson (who died in December). In a section titled, "They Still Ignore Hayek," Taleb lauds the Austrian focus on the pretense of knowledge. Yet of Samuelson, the epitome of the neoclassical mainstream, Taleb issues harsh judgment indeed:

> In orthodox economics, rationality became a straitjacket. Platonified economists ignored the fact that people might prefer to do something other than maximize their economic interests. This led to mathematical techniques such as "maximization," or "optimization," on which Paul Samuelson built much of his work. . . . I would not be the first to say that this optimization set back social science by reducing it from the intellectual and reflective discipline that it was becoming to an attempt at an "exact science." By "exact science," I mean a second-rate engineering problem for those who want to pretend that they are in the physics department—so-called physics envy. In other words, an intellectual fraud.

Coming from a philosopher (or an academic Austrian economist, for that matter), such criticism would not mean much to the so-called experts in various fields. Yet Taleb's criticisms come with a harsh sting, for he is a respected contributor to the field of quantitative finance; Taleb (and a coauthor), for example, offered a more intuitive derivation of the Black-Scholes formula for option pricing.

Far more important to some readers, Taleb (allegedly) made a boatload of money as a trader. True to his philosophical views, one of his strategies involved using options that went up in value when the underlying asset fell in price. If people really do systematically underestimate the likelihood of improbable (but significant) events, as Taleb claims, then it should be possible to make long-run profits by losing small amounts of money on most wagers but earning large payoffs on a few outliers.

Other Austrian-oriented writers such as Gene Callahan have criticized Taleb for throwing out the baby with the bathwater. Taleb seems to think that the fabric of reality itself is governed by randomness; that much is true. Yet as his discussions of Poincaré's "three body problem" and modern chaos theory make clear, the central lessons of the book don't depend on whether the world is "really" determinist or "really" uncertain. It is enough that from a human actor's limited knowledge, he can never truly predict what is coming down the pike.

Finally, Taleb does not simply throw up his hands in despair. "We cannot truly plan, because we do not understand the future—but that is not necessarily bad news. We could plan *while bearing in mind such limitations*. It just takes guts."

By focusing on the extremely improbable outlier, Taleb isn't warding off theoretical explanations—he is merely rejecting the regrettable tendency of *overgeneralization* in our theories, where we overfit based on a limited sample size. As Taleb says: "If you want to get an idea of a friend's temperament, ethics, and personal elegance, you need to look at him under the tests of severe circumstances, not under the regular rosy glow of daily life. Can you assess the danger a criminal poses by examining only what he does on an *ordinary* day?"

There are many areas where the typical libertarian reader might take issue with Taleb, but this doesn't detract from the value of his work. For what it's worth, in response to our correspondence on Benoit Mandelbrot's work in economics, Taleb sent me a signed copy of his book. The inscription read: "Hope freedom prevails—Nassim." FEE

Opaque by Design

BY SHELDON RICHMAN

"The House and Senate plan to put together the final health care reform bill behind closed doors, according to an agreement by top Democrats."

That less-than-startling piece of news was delivered by House Speaker Nancy Pelosi back in January. She was at the White House when she said it, so it looks like it's okay with President Obama.

Thus, as the CBS News headline had it, "Obama Reneges on Health Care Transparency."

Anyone who is really shocked (shocked!) that this is happening should avoid talking to strangers on the street. You'll wind up believing you own a bridge.

In other words, no one really thought Obama and his cronies were going to make government transparent by conducting business on C-SPAN. As the head of the Council on Foreign Relations said admiringly about Obama in another context, "He's learned the difference between campaigning and governing." Indeed. Even if he wanted to, there was no way Obama was going to get our misrepresentatives in Congress to do it.

The phrase "transparent government" is just this side of a logical contradiction. A really transparent government would barely qualify as a government at all.

The phrase "transparent government" is just this side of a logical contradiction. A really transparent government would barely qualify as a government at all. Imagine if you could witness all the backroom dealing, logrolling, outright bribery, and the rest of the shenanigans that go on under the laughable rubric of "governing." It wouldn't last a week.

Once in a while we get a glimpse of what goes on. When Sen. Ben Nelson's vote on the health-insurance takeover was cynically bought with the promise that everyone but Nebraskans would pay Nebraska's new Medicaid bill, there was genuine disgust—even in Nebraska. The payoff to Louisiana Sen. Mary Landrieu got a similar reception. But that was just the tip of the iceberg. Did you hear that under the Senate bill (now dead) companies with fewer than 50 employees would have been exempt from the health-insurance mandate—except for construction companies? There the threshold would have been five. It was a little favor to the construction trade unions. According to the *New York Times*:

> Labor unions that have negotiated health benefits for construction workers lobbied for the provision. Without it, they said, small nonunion employers would have an unfair competitive advantage over companies that they say do 'the right thing' by providing health benefits to plumbers, electricians, carpenters, roofers and other workers in the building trades.

This sort of thing happens every day. As Michael Kinsley once said, the real scandal in Washington is the legal stuff, not the illegal stuff, that goes on.

We can't say we weren't warned. A few years ago a great scholar named Charlotte Twight explained it all in her book *Dependent on D.C.: The Rise of Federal Control over Ordinary Americans*. I'm a huge fan of this book, and everyone concerned with liberty should read it closely. What I said about it in 2003 still holds:

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If I may be blunt, this is a subversive book—in the sense that if average Americans were to read and grasp it, they would turn into libertarian revolutionaries. Why? Because Twight documents the ways that officials systematically mislead us about what government does. In many cases, she uses their own words to convict them of mass deception aforethought.

The key to her thesis is the concept of political transaction costs. In economics, transactions costs are the expenses one accepts to engage in exchanges. To use Twight's example, if you hire someone to plant a tree in your yard, the transactions costs include any expenses you would not have incurred had you planted the tree yourself.

There are transactions costs associated with politics too. These, Twight says, are "the costs to individuals of reaching and enforcing political agreements regarding the role and scope of government . . . [t]he costs to each of us of perceiving, and acting upon our assessment of, the net costs of particular governmental actions and authority . . . of learning the likely consequences of proposed government programs and taking political action in response to such programs. . . ."

We could sum up the idea with the phrase "eternal vigilance," which takes time, effort, and money. Or as others have put it, "freedom isn't free."

Of course the higher the political transactions costs, other things equal, the less monitoring people will engage in. Keep in mind that any one person's clout is small, so the payoff from absorbing the costs and engaging in the monitoring is also small. That results in a government watched closely by those who stand to gain a lot (the special interests) and not so closely by those who stand to pay, in the aggregate, a lot (the mass of taxpayers).

For some unfathomable reason, most pundits don't want us to worry our little heads knowing that politicians may intentionally make it more difficult for us to see what's really going on or to do anything about it.

Contrived Costs

Twight points out that there are "natural" transactions costs, as with any economic activity, but also "contrived" transactions costs—the ones "*deliberately created* by government officials to increase our costs of assessing and responding to government policies" (emphasis added).

You're not apt to read about *these* in textbooks or the establishment apologies on most newspaper editorial and op-ed pages. For some unfathomable reason, most pundits don't want us to worry our little heads knowing that politicians may intentionally make it more difficult for us to see what's really going on or to do anything about it.

But it's hard to conclude the politicians would want it any other way. How else to explain 2,000-page bills laden with impenetrable legislatese—which no member of Congress will read in their entirety—and 800-page amendments? Have you tried reading the federal budget? Such output mocks the ideal of an "informed citizenry." That's the last thing the misleaders in Washington would want.

As Oscar Wilde said, "Nowadays to be intelligible is to be found out." FEE

Government Moonshine

BY MICHAEL HEBERLING

From its minor role as an oxygenate additive for gasoline, ethanol has become the darling of Washington. Politicians embrace ethanol as a miracle elixir. All the fashionable energy buzzwords can be applied to it. It is "green power"; it's "renewable" and will provide "energy independence" for America. Legislation has been promoting ethanol nonstop. The Energy Policy Act of 2005 required that our fuel supply have four billion gallons of ethanol in 2006 and then increase to 7.5 billion by 2012. Next came the Renewable Fuel Standard Act of 2006 calling for even more ethanol in our fuel supply. Building on the old adage that you can never have too much of a good thing, the Energy Independence and Security Act of 2007 increased the ethanol requirement even more. It mandates using 36 billion gallons of biofuels in our gasoline by 2022.

Given the euphoria over ethanol, it is hard to imagine that there could be a downside. Unfortunately, ethanol has numerous and significant problems.

For starters, ethanol is an inferior energy source. Ethanol has 35 percent less energy by volume than regular unleaded gasoline. One gallon of E-10 gasoline (which contains 10 percent ethanol) is 3.6 percent less efficient than pure gasoline (ethanol-free, E-0). In other words, as the percentage of ethanol in a gallon of gas goes up, the realized miles per gallon go down. As a result, E-15 is 5 percent less efficient than E-0 gasoline and E-20 is 7.7 percent less efficient. E-85 gas is between 25 and 30 percent less efficient than pure E-0 gasoline.

> Ethanol is an inferior energy source. E-85 is 25 to 30 percent less efficient than regular, ethanol-free gas.

On average, E-10 gas is 10 cents per gallon cheaper at the pump than regular E-0 gas. E-85 is even cheaper—70 cents per gallon less. This cost-per-gallon comparison is, unfortunately, very deceptive. A more telling measure would be to compare the cost per mile driven for each fuel type. Craig Clough notes that a "flex-fuel" 2007 Chevy Tahoe (capable of handling any ethanol-blend fuel) averages 14 MPG on regular E-0 gas and 10 MPG on E-85 gas. What would it cost to go on a thousand-mile trip using these two different types of gas? The cost of the trip using regular E-0 gasoline (at \$3.70 per gallon) would be \$264.29. Using the cheaper E-85 gas (at \$3 per gallon), the same thousand-mile trip would cost \$300—that's \$35.71, or 13.5 percent, more. Translation: Because of the lower energy content in ethanol, consumers actually pay more because they will need more gallons to go the same distance. So if a gallon of ethanol burns cleaner than a gallon of regular E-0 gasoline, but you need to burn more gallons of the ethanol-blended gasoline to go the same distance, how does this result in less pollution? Or does it? Ethanol has another pollution problem. It is more volatile than gasoline (meaning it evaporates far more rapidly), making it a major contributor to smog.

Ethanol also has some nasty properties that politicians and the Big Corn lobby would rather not talk

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about. For starters, ethanol is corrosive to some metals, rubber, fiberglass, and plastic. This leads to higher maintenance costs and the need to replace parts sooner than would otherwise be the case. Older car engines, boat engines, motorcycles, snowmobiles, and small gas-powered tools (chain saws, snow blowers, lawn mowers, and weed whackers) are especially vulnerable to ethanol corrosion. Fine particles of rubber, plastic, or metal flow through the fuel system. These particles eventually clog the engine's fuel lines, fuel filter, carburetor, and fuel injector. Ethanol can also cause an engine to burn out because it runs hotter.

Later-model cars and trucks were supposed to have been re-engineered to mitigate the corrosive properties of the E-10 ethanol-laced fuel. Ed Wallace, writing in *Business Week*, finds that this is not necessarily true. "Not only is ethanol proving to be a dud as a fuel substitute, but there is increasing evidence that it is destroying engines in large numbers." He goes on: "It now appears that in just a few years since the government forced ethanol use on the country, engine and fuel system failures caused by ethanol are causing major damage to more and more new and used vehicles." Wallace concludes: "Sadly, when a truly bad idea is exposed today, Washington's answer is to double-down on the bet, mandate more of the same, and make the problem worse. Only this time around motorists will be able to gauge the real cost of ethanol when it comes time to fix their personal cars."

Ethanol also has some nasty properties that politicians and the Big Corn lobby would rather not talk about. For starters, ethanol is corrosive to some metals, rubber, fiberglass, and plastic.

Ethanol has two other properties that further complicate the process. Ethanol and gasoline do not bond chemically. They simply coexist in the fuel system in an "oil and vinegar" relationship. While ethanol may hate gasoline, it loves water. The term to describe this is "hygroscopic," or "water soluble." Ethanol attracts and absorbs water. As long as the amount of water in the fuel system is small, this can be a good thing: In the winter it limits the possibility of a fuel line freeze-up. However, as the water content gets higher, the new ethanol/water compound sinks to the bottom of the fuel tank. This process is called "phase separation."

If we continually drive our cars (or cut our grass every week or so) these ethanol-unique characteristics will not normally be an issue. But after about 90 days (the shelf life of E-10 gasoline), problems begin to manifest. The result: "bad gas." The engine won't start or there will be "missing" or "sputtering" problems. This is the reason you don't want to leave gas containing ethanol in the lawn mower over the winter.

Because of the separation and corrosion problems, ethanol cannot be transported through pipelines. It requires its own separate and costly distribution channel dominated by rail and trucks to keep it apart from the gasoline as long as possible before retail.

Unconscionable Burning of Food

Ethanol's biggest problem is largely ignored. Burning food as an energy source is unconscionable in these circumstances. Using corn to feed humans and livestock, and to fuel cars, is having obvious negative implications. In 2007 we burned 15 percent of our corn crop as ethanol. According to the *Investor's Business Daily* (IBD), "Ethanol and its subsidies amount to a hidden and nefarious tax on food. The higher use of ethanol accounted for up to 15 percent of the rise in food prices between April 2007 and April 2008." Congressional mandates to increase the use of ethanol even more will only exacerbate this problem. To meet the massive artificial demand for corn created by this government energy program, we can either: 1) switch crops (soy to corn) and keep the cropland acreage the same (which will cause all food prices to skyrocket) or 2) increase the amount of acreage available through large-scale pristine habitat destruction. Neither is satisfactory.

According to IBD, "[I]t takes about 1,700 gallons of water to produce one gallon of ethanol. Each acre of corn requires about 130 pounds of nitrogen and 55 pounds of phosphorous. Increased acreage means increased agricultural runoff, which is creating aquatic 'dead zones' in our rivers, bays, and coastal areas."

Ironically, a case could be made that ethanol is not really "renewable green power" at all but rather a "fossil fuel" in disguise. You don't just squeeze corn to make ethanol. The distilling process to convert corn starch to ethyl alcohol is energy intensive. According to Matthew Wald in the January 2007 *Scientific American*, to create 100 units of ethanol energy in the distillation process, you need 45 units of fossil-fuel (coal or natural gas) energy. Michael Wang, an environmental scientist at the Argonne Laboratory, calculated that the amount of fossil fuels is even greater if you look at the whole process (planting, fertilizing, harvesting, and distillation). According to Wang, to produce 100 units of ethanol energy, you need 74 units of fossil fuels.

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Hide the True Cost

Given all these expenses—energy to make energy and a separate logistic system—how does the ethanol industry make any money? It doesn't.

Were it not for the massive government tax preferences (a 51-cent-per-gallon tax break) and government protection (a 54-cent tariff on imported ethanol), this industry could not survive. That's in part because countries like Brazil—the world's largest ethanol producer—can produce it more efficiently using sugar cane. On a yield-per-acre basis, the amount of ethanol produced from Brazilian sugar cane is nearly double that derived from U.S. corn.

Even with all this help, the industry asks for still more. Last year the ethanol producers' association, Growth Energy, petitioned the EPA to allow ethanol blends as high as 15 percent. For the majority of the cars and trucks in the United States, the highest ethanol level allowed by the EPA is the 10 percent blend. Anything above that could void existing car warranties. The exceptions are flex-fuel/dual-fuel vehicles, which can use E-85 gas because they have special stainless-steel fuel tanks and other upgraded fuel system parts. Besides the overused environmental and energy independence angle, Growth Energy claims that this change will create thousands of new jobs.

Revealingly, there is always one reason missing from the case for ethanol. We always hear that it is good for the environment, or it's good for family farmers, or it creates jobs. But no one ever says that ethanol is good for the consumer. That's because it isn't. At the pump the consumer pays more to get fewer miles per gallon than with gasoline. Behind the scenes the consumers' tax dollars are used to shore up a failing industry that drives up the cost of food and of maintenance of all engines that ethanol touches. It is time to admit that promoting ethanol as a fuel source has been a catastrophic mistake. We need to cut our losses and let the free market, not the government, determine winners and losers in the energy sector. FEE

How Shall We Live?

BY PAUL CLEVELAND AND ART CARDEN

What is civilization and how is it to be achieved? How can we live together in peace and social harmony? What is wealth and how do we acquire it? Why are so many people poor and why do they remain poor? Finally, are there objective standards of behavior that must be respected if societies are to thrive?

These questions are fundamental to human life. In this essay we discuss some ways societies have organized themselves and consider the consequences of such efforts. This allows us to conclude that a society based on secure private property rights, trade, and the division of labor is not only economically efficient, it is morally superior to all other types of organization.

Legitimate charity requires someone to part voluntarily with his money.
Donald Macleod

The Welfare State

Let us first consider the welfare state. In theory it aims to use government force to redistribute property in order to achieve a more equal consumption of economic goods. Advocates of this manner of social organization argue that it is based on the ideal of charity. However, this cannot be so since the logical implication of this form of organization is not the promotion of charity but the promotion of theft. Genuine charity involves the voluntary sacrifice of the giver. When the force of government is employed to redistribute property, there is no voluntarism in it. Rather, there is only forced sacrifice, which is the essence of theft.

Fundamentally, the welfare state is a type of social organization in which some people subsist off the fruits of other people's labor by the use or threat of force. There are three ways to enjoy the fruits of others' labor. The first is to receive legitimate charity. In this case, the producer has voluntarily parted with his product for the benefit of someone else. The second means is through voluntary exchange. In this case someone must make an attractive offer of something desired by producer. The third method is to use violence or the threat thereof to appropriate the product. This form of getting what you want is especially pernicious when it is perpetrated by government, for then the victim has little recourse. (Fraud is a subtle form of theft—that is, of obtaining someone else's product on terms other than those he would agree to.)

Theft and fraud cannot be logical foundations for economic behavior because they suffer from the fallacy of composition. It is possible for a single individual to prosper as a looter, and indeed it may be possible for

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many people to prosper as a robber band. However, it is impossible for everyone to prosper as thieves since all thieves must have someone to steal from. The problem with thieves is that they do not produce anything, and if everyone is a thief then there is nothing to steal.

For this reason the welfare state rests on a very sandy foundation. It assumes there will always be something that can be looted from a productive class. Moreover, it assumes the productive class will continue to produce valuable goods and services even as they are being victimized. Pay-as-you-go entitlement programs like Social Security and Medicare are built on this shaky assumption. It relies on the notion that future generations will rise to meet the claims of older generations. In other words, to use Ayn Rand's metaphor, the welfare state assumes that the harder it presses down on Atlas's shoulders, the harder Atlas will work to hold the world aloft.

> The welfare state assumes that the harder it presses down on Atlas's shoulders, the harder Atlas will work to hold the world aloft.

As an alternative, people can live as the beneficiaries of charity, but this too is unsustainable. There are certainly legitimate cases in which charity and gift-giving are appropriate, such as when someone suffers some unforeseeable calamity or when someone wishes to promote the interests of his friends and family members. When people get married or begin their families, for example, gifts are often very helpful and much appreciated. There are limits, however, to our charitable impulses, limits to our ability to discern need, and limits to our ability to feed others before we feed ourselves. In addition, it should be noted that the purpose of true charity is to promote the independence of the recipient. In this regard, charity is a noble, benevolent institution that is quite appropriate to a society of free, responsible, flourishing people.

But even charity can be carried too far. When someone expects to enjoy his bread by the sweat of another's brow, he becomes what Rand called a moocher. Such a person claims the right to the fruits of others' labor solely on the basis of his alleged need. He seeks to make himself dependent on someone else's labor and is not interested in his own independence.

Mooching too is unsustainable because it presupposes that something has been produced. Therefore, we cannot all expect to live this way. Mooching *as such* provides no way for goods to be produced and in fact encourages the wasteful use of resources. If someone wishes to depend entirely on the kindness of strangers, he or she must invest in ways to elicit that kindness. In his 2007 book, *Discover Your Inner Economist*, Tyler Cowen points out tragic examples of places in India where people fight over begging turf or actually pay to have limbs amputated in order to increase their begging income. To borrow the terminology of William J. Baumol, these are exercises in destructive entrepreneurship. They create no new value; instead, they destroy value in an effort to appear more dependent and helpless so as to effectively attract the sympathies of others.

This has implications for how we understand what is known as paternalism. As we have already seen, proper charity treats people with dignity and directs them toward independence rather than dependence. Examples from fatherhood (or motherhood) are appropriate. The right goal for a father is not to give his children everything they want or to see that they are blissfully happy all the time. Rather his goal is to help his children flourish as independent, responsible people in an imperfect world. At every stage in their development, he is trying to help them achieve new levels of independence. When a young adult is capable of interacting socially through the process of voluntary exchange—thereby increasing his own range of opportunities by increasing opportunities for others—then the parenting has been a success. In other words, proper human life includes production and exchange. While there are cases when such autonomy cannot be achieved due to severe disability, nevertheless, the affirmation of human dignity and independence remains the goal as far as it can be achieved.

Production, Autarky, and Trade

Another way to acquire wealth is to produce it yourself and ask your neighbors for nothing; however, total individual autarky is impossible in its logical limit. There is no such thing as an autonomous, self-made person in a market economy, and people are social creatures not because of disposition only but out of necessity. It is not a psychological propensity to truck and barter that leads us to exchange, but a praxeological truth regarding the vast increase in productivity that arises from specialization, division of labor, and division of knowledge.

Leonard E. Read's classic example showed that no single individual knows how to make something as simple as a pencil (www.tinyurl.com/98wl7b). This fundamental insight applies to a vast range of goods. Any kind of existence greater than that of the lowest animals requires exchange, and as exchanges increase, so too do the division of labor and division of knowledge.

Even before Adam Smith, economic thinkers had been well aware that trade creates wealth by making us more productive. We argue, however, that this is only part of the story. The criticism of *homo economicus* as an autistic and antisocial maximizer of pecuniary profit to the exclusion of all else is simplistic and naive. The economic person cannot take care of himself without taking care of others; indeed, the person who wishes to maximize his own profit can only do so by thinking constantly and deeply about the needs and wants of others. To be sure, *homo economicus* does not have to care about the people with whom he interacts in a deep moral sense. But this does not stop him from caring about them in a practical sense.

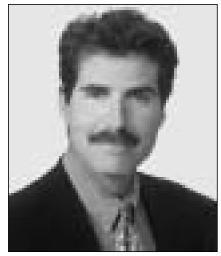
Even before Adam Smith, economic thinkers had been well aware that trade creates wealth by making us more productive.

The Bible enjoins us to feed the hungry and clothe the naked, among other charitable endeavors. We do this most effectively through the market process. Indeed, the very act of buying low and selling high moves resources to areas where they are more valuable. While the entrepreneur does not have to know about the people he serves, he can only expand his own set of opportunities by creating opportunities for them.

In a lecture at the 2009 Austrian Scholars Conference at the Ludwig von Mises Institute, Rabbi Daniel Lapin made this point explicitly by considering the economic and social function of peddlers, people who would go through towns buying and selling. The good peddler was better off when he left town, but he only found himself in this happy circumstance by making the townsfolk better off as well. To borrow Lapin's example, a peddler might show up at a house and ask if the residents had anything they were willing to sell. Suppose for a moment that they said yes and pointed to an old table with a wobbly leg that they were planning to throw away. The peddler might offer to buy it for $5, which they would gladly accept. They would now be better off by $5. At this point the peddler could repair the table and find another family that was planning to buy a similar table for $20. If the peddler offered to sell them the repaired table for $15, they would find themselves better off. And so it goes: With every transaction the peddler makes people better off and enables them to feed and clothe themselves. In a word, the peddler makes a direct contribution to their ability to flourish.

Of all the ways for societies to organize themselves, the free market is the only system that is simultaneously sustainable, prosperous, and conducive to human flourishing. We cannot live together as a community of thieves, nor could we sustain ourselves as a community of beggars, moochers, or wards of charity. Further, anything that can be properly defined as a human existence must necessarily rely on specialization, trade, and division of labor. This has the happy consequence of maximizing our ability to do well and do good by our neighbors. When we focus our attention on production and trade, we necessarily feed the hungry and clothe the naked because self-interest properly understood requires a degree of focus on the wants and needs of others that is conspicuously absent from other forms of social organization. To adapt a phrase from Harvard economist Claudia Goldin, life in the pre-market world was nasty, brutish, and short. In the world of free enterprise, life is long, healthy, and rich. FEE

Let's Take the "Crony" Out of "Crony Capitalism"



BY JOHN STOSSEL

When Judge Richard Posner, the prolific conservative intellectual, released his book *A Failure of Capitalism: The Crisis of '08 and the Descent Into Depression* last year, you might have thought the final verdict was in: Capitalism caused the economic downturn and high unemployment.

That this verdict was pronounced by someone like Posner, who is associated with the free-market law and economics movement, gave moral support to all the politicians who were intent on exploiting the recession (as they exploit all crises) to increase government control of the economy.

But what exactly is this "capitalism" that is blamed?

The word "capitalism" is used in two contradictory ways. Sometimes it's used to mean the free market, or laissez faire. Other times it's used to mean today's government-guided economy. Logically, "capitalism" can't be both things. Either markets are free or government controls them. We can't have it both ways.

The word "capitalism" is used in two contradictory ways.

The truth is that we don't have a free market—government regulation and management are pervasive—so it's misleading to say that "capitalism" caused today's problems. The free market is innocent.

But it's fair to say that *crony capitalism* created the economic mess.

What is crony capitalism? It's the economic system in which the marketplace is substantially shaped by a cozy relationship among government, big business, and big labor. Under crony capitalism, government bestows a variety of privileges that are simply unattainable in the free market, including import restrictions, bailouts, subsidies, and loan guarantees.

Crony capitalism is as old as the republic itself and we don't have to look far to see how crony-dominated American capitalism is today. The politically connected tire and steel industries get government relief from a "surge" of imports from China. (Who cares if American consumers want to pay less for Chinese steel and tires?) Crony capitalism, better known as government bailouts, saved General Motors and Chrysler from extinction, with Barack Obama cronies the United Auto Workers getting preferential treatment over other creditors and generous stock holdings (especially outrageous, considering that the union helped bankrupt the companies in the first place with fat pensions and wasteful work rules). Banks and insurance companies (like AIG) are bailed out because they are deemed too big to fail. Favored farmers get crop subsidies.

If free-market capitalism is a private profit-and-loss system, crony capitalism is a private-profit and public-loss system. Companies keep their profits when they succeed but use government to stick the taxpayer with the losses when they fail. Nice work if you can get it.

It's time we acknowledged the difference between the free market, which is based on freedom and competition, and crony capitalism, which is based on privilege. Adam Smith knew the difference—and chose the free market.

What's taking us so long? FEE

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

Capital Letters

Who Is a Mormon?

As a long-time reader and supporter of *The Freeman*, I express my enjoyment in reading the articles by Dr. Thomas Szasz. I appreciate his critical thinking and his skill in constructing the written word in a most efficient and powerful style.

However, I take issue with part of his December 2009 article, "The Shame of Medicine: Conviction by Psychiatry." He states that Brian David Mitchell is a "devout Mormon." The word *Mormon* is a nickname for members of the Church of Jesus Christ of Latter-Day Saints. Given that Dr. Szasz claims to have obtained his facts "as reported in the press," he apparently did not bother to read the reports of Mr. Mitchell having been excommunicated from the Church well before the Elizabeth Smart saga. He therefore was not and is not a "Mormon" at all, let alone a devout one. Whatever Mr. Mitchell is devoted to, it is obviously not the practices or teachings of The Church of Jesus Christ of Latter-Day Saints, which openly speaks out against child abuse in any of its forms, whose tenets deny the validity of self-appointments to the ministry, and which believes in obeying and sustaining the laws of the land without exception.

My statements are easily vertified at http://tinyurl.com/byx5zv and http://tinyurl.com/yb2qyso.

So Mr. Mitchell was denied his day in court. If that is a failure of the legal system and of psychiatry, Dr. Szasz's attempt to vilify Elizabeth Smart is unfair.

The Freeman is great. Our country needs it now more than ever. Keep up the good work.

—LAVAR CLEGG
Scottsdale, AZ

Thomas Szasz replies:

I thank Mr. Clegg for his kind words about my *Freeman* columns. His letter highlights the inherently and pervasively rhetorical character of everyday language.

Understandably, Mr. Clegg is concerned that the Smart story casts Mormonism in a poor light, an unavoidable consequence of any reference to it. My comments had nothing to do with the Mormon or any other religion. A Hungarian proverb wisely cautions, "If it's not your shirt, don't put it on."

Every act of classifying a person—as Mormon or Muslim or atheist or whatever—enhances his or her image in the minds of some and diminishes it in the minds of others. Accuracy and fairness require that the writer inform the reader whether the classificatory category is an identity the subject assumes voluntarily or is one that the writer or others attribute to him. I should have characterized Mitchell as a "self-styled devout Mormon."

Mr. Clegg asserts that because the Church of Jesus Christ of Latter-Day Saints had excommunicated Mitchell, "He therefore was not and is not a 'Mormon.' . . ." Was Baruch Spinoza, famous in part for having been "excommunicated" (an act for which there is no authority in Jewish law), not a Jew?

Characterizing Mitchell's excommunication as having occurred "well before the Elizabeth Smart saga" is also an overstatement. From the evidence available, it is not clear when the excommunication occurred, not that it matters for the subject of my column. (See the official website of the Church of Jesus Christ of Latter-Day Saints, www.tinyurl.com/y9pdfzd, as well as www.tinyurl.com/ycfhwsl and www.tinyurl.com/yb2beda).

Mr. Clegg's conclusion requires close attention. He states: "So, Mr. Mitchell was denied his day in court. If that is a failure it is a failure of the legal system and of psychiatry. Dr. Szasz's attempt to vilify Elizabeth Smart is unfair." I neither vilify nor glorify Ms. Smart. I am skeptical about her belated account of her life in "captivity," as I am skeptical about nearly everything else about this baroque tale.

Mr. Clegg does not question my claim that "Mitchell was denied his day in court" and attributes that outcome to "a failure of the legal system and of psychiatry." Institutional systems are set in motion and are operated by individuals with their own agendas. These individuals are moral agents responsible for their actions.

Calling the denial of Mitchell's Sixth Amendment rights an institutional "failure" misses the point I have long tried to make: namely, that "therapeutic jurisprudence"—the name given to the psychiatric subversion of the law by persons who approve of that arrangement—is *inherently flagitious*.

Kudos to Stossel

I would like to congratulate John Stossel [regarding his] point on competition saving medicine ("Competition Would Save Medicine, Too," September, www.tinyurl.com/lxtzgv). I am living proof that this works. In 1996 I moved my family to a high-deductible catastrophic policy that *did not* include baby delivery (rightfully so, the insurance doesn't see this as a medical accident; we know where babies come from).

Already having four children, my wife and I didn't see any reason to stop. For child #5, I went to each of the hospitals in the area (there were two) and explained that we had no insurance for deliveries and would prepay for a reasonable amount. Well, the hospital closest to our home agreed to our use of the labor and delivery facility, the nursing staff, and a 24-hour stay for $350 (which was probably more than they got paid by Medicaid or insurance). We negotiated a trade with the OB/GYN to do the delivery. The surprise was the prime rib dinners we each enjoyed after the baby was born—a special the hospital was promoting to attract more deliveries.

For #6, we hired a midwife and had the baby at home. For me, that was the most fantastic of all six deliveries I'd attended; [my wife] delivered our son sitting on my knees while I sat on the edge of the bed. At ten minutes old, he was in bed with his mom and his brothers. (As a side note, the OB/GYN who cared for her had to dismiss her as a patient before the midwife delivery as a requirement of his malpractice insurance).

Having this high-deductible, catastrophic policy has proven a boon for me and the health care industry. Incidentally, I have changed jobs three times since I got it, and each time, after I had negotiated my salary, I got an additional $500 or $600 per month in compensation for *not* taking the employer's insurance.

—GEORGE SCHWAPPACH
Dade City, Fla.

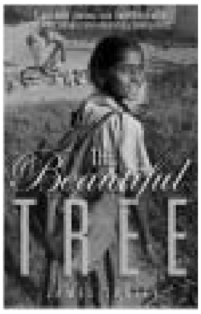
We will print the most interesting and provocative letters we receive regarding articles in *The Freeman* and the issues they raise. Brevity is encouraged; longer letters may be edited because of space limitations. Address your letters to: *The Freeman*, FEE, 30 S. Broadway, Irvington-on-Hudson, NY 10533; e-mail: freeman@fee.org; fax: 914-591-8910.

Book Reviews

The Beautiful Tree

by James Tooley
Cato Institute • 2009 • 302 pages • $19.95

Reviewed by Max Borders



In the poorest parts of the world you'll find private education. From Ghana to India to China, private schools are sprouting up everywhere. There are new schools opening where none were before. There are also new schools where government "free" schools already exist but languish. Why? Simple: Parents want the best for their children. They realize that one of the keys to escaping poverty is a good education. The best education, they understand, comes from entrepreneurs who offer higher quality to stay in business and prosper.

But how can desperately poor people afford it? How can the education market work in countries rife with corruption and institutional barriers to innovation? Why haven't we heard about this phenomenon before? And if private education can rapidly spread in the developing world, couldn't it also in the rich West?

In *The Beautiful Tree,* James Tooley answers those questions. He offers readers a firsthand account of schools all over the developing world. The book isn't just academic research; it is also a kind of travelogue. We meet the real teachers, students, and parents who constitute the delicate educational ecosystems under constant threat from bureaucrats, do-gooders, and naysayers. Tooley, a former university professor who now works full-time to help start free-market schools, tells their stories as if at our side, coloring straightforward prose with rich stories and quotations from people he has met.

In the end he arrives at what many may think is a highly counterintuitive conclusion: "Private schools for the poor are burgeoning across the developing world. In many urban areas they are serving the majority of schoolchildren. Their quality is higher than that of government schools provided for the poor—perhaps not surprisingly given that they are businesses dependent on fees to survive and hence are directly accountable to parental needs."

Tooley's work suggests that the deep yearning parents have to give their children the very best is nearly universal. Unfortunately, it also reminds us just how much education can be fetishized by those who would like it to be removed from the market utterly—which also means removed from the entrepreneurial environment that yields both quality and innovation. Again and again we encounter "experts" who say that education *must* be under government control and who get in the way of educational entrepreneurs who think otherwise.

A common obstacle faced by private-school entrepreneurs is government regulation used to protect special interests. "We find it possible to meet all of their regulations," says plaintive Nigerian educator Bawo Sabo Elieu, "but we can't possibly afford them all." Elieu is one of many among the world's private educators who are trying to do something for poor children, despite the encroachment of the regulatory (and in Nigeria, predatory) state.

Rather than dwelling on the well-known reasons why government schools serve students so poorly, Tooley concentrates on the innovations that are possible when the passions and preferences of human hearts to educate the young go unsatisfied. Parents work extra and scrimp to afford the modest fees at makeshift schools. School founders and teachers continually search for ways to do better. Tooley reports that in his visits to these schools, he was usually asked for advice on ways to improve them—when he had come to learn from them! We should take inspiration from the stories of parents, teachers, and kids unwilling to settle for ineffective government schools despite the many obstacles to educational freedom.

Many of Tooley's third-world stories echo the issues we face here in the United States. Private schools for the poor must compete with "public schools" that charge nothing. Teachers' unions engage in favor-seeking and protectionism. Government officials and experts argue that schools that charge fees cannot, by definition, be "for the poor." Regulations make it hard for educational entrepreneurs to challenge the status quo. The politics of guilt and envy are played to the advantage of the educational elites and at the expense of ordinary people who know that government schools handicap their children.

If caring parents and educators can build private schools that work in Kenya, Nigeria, and other poor nations, we can do the same here in the United States. Our circumstances are different, but the desire to have the best for our children is universal. No government can quell that desire.

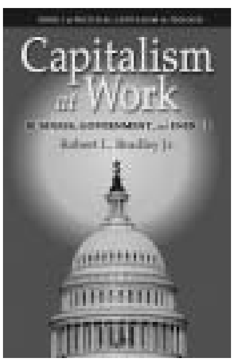
The Beautiful Tree has a profound and universal message: Freedom works in education. It's time for Americans to follow the example of the poor people Tooley writes about and invest in private schools, growing that sector enough to hasten a brain drain from "public" to private. The contrast between high-cost, ineffective government schools and low-cost, effective private schools will be too great to ignore. Tooley's book deserves a thunderous round of applause for showing that the government education empire can be outflanked by determined people. FEE

Max Borders (maxborders@gmail.com) is executive editor at Free to Choose Network.

Capitalism at Work: Business, Government, and Energy

by Robert L. Bradley, Jr.
M & M Scrivener Press • 2009 • 502 pages • $39.95

Reviewed by Michael Beitler



Capitalism at Work by Robert L. Bradley, Jr., looks at the destructive force of cronyism (or what Bradley calls "political capitalism") in America. Though people keep saying—especially in the wake of the bursting housing bubble and subsequent financial meltdown—that "capitalism failed," the book makes the exceedingly important point that what prevails in the United States is not true capitalism (free enterprise, no government impediments to success nor bailouts for failure), but rather a badly deformed mutation. When critics blame capitalism, they're blaming an innocent bystander. It's political capitalism they should indict.

Bradley, who worked for 16 years at Enron, becoming a confidant of CEO and Chairman Ken Lay, devotes many pages to the company, perhaps the most spectacular business failure in American history. Many readers will be surprised to learn that Enron was extraordinarily dependent on political favors, a perfect example of crony capitalism. Bradley digs deep to expose the real causes of Enron's demise, but he goes much further, showing that Enron was but one instance of the ruinous relationship between government and business.

Bradley makes his case in three parts: Heroic Capitalism, Political Opportunism, and Energy and Sustainability.

Each chapter in Part I is devoted to an individual whom Bradley considers a heroic, as opposed to a political, capitalist—that is, an advocate of free markets. Readers of *The Freeman* will be familiar with Adam Smith and Ayn Rand, but most likely will be unfamiliar with the Scottish moralist Samuel Smiles, whom Bradley calls "the father of the self-improvement movement." Bradley's profiles help delineate the positive moral ground of capitalism: self-reliance, respect for the rights and property of others, cooperation, abiding by one's contracts, and so on.

In Part II Bradley drives home the point that political capitalism is the "intersection of business opportunity and political opportunism." Here he vividly contrasts the positive features of free markets with the grubby, furtive nature of political capitalism, which hinges on "connections," favoritism, and secret deals to make profits, injure competitors, and pin losses on taxpayers.

Bradley throws a wider net than we usually see in the pro-market literature. In chapter 4, for example, he discusses the influence of business writers such as Gary Hamel, Peter Drucker, and Jim Collins. He even includes a well-informed section on accounting principles, where he warns against the "invited manipulation" of fair-value accounting. And chapter 6, "U.S. Political Capitalism," includes numerous examples of industry representatives scheming with politicians to establish government rules and regulations (and entire agencies) to limit competition for the benefit of the current members of the industry at the expense of new competitors, consumers, and taxpayers. The alarming truth is that political capitalism is slowly strangling heroic capitalism.

In Part III Bradley enlightens the reader on many issues relating to the production of energy. "The Dark Decade," for example, focuses on the foolish governmental meddling in energy from Nixon to Carter. It's an especially timely topic, given the Obama administration's infatuation with "green energy" schemes that require government financial support.

At the end of the book Bradley turns to Enron. He describes its founder, Ken Lay, as a "Ph.D. economist, interested in the big picture and the ways of political power. His résumé was top-heavy with Washington experience, acquired at three federal jobs, the last two regulating the energy industry." As Enron's CEO he was the master of the government-favor game.

Bradley gives examples of how Enron played both sides of the political aisle and how it "politicized" its tax and accounting systems to create the illusion of profitability. Bradley states that Enron "was a logical, albeit grotesque, outcome of the mixed economy writ large." Most Americans think that Enron's collapse shows some inherent weakness in capitalism, but what Bradley shows is that it rose only because Lay and others in the firm knew how to game the political system. Equally important, Enron's collapse came about because investors in the world of real capitalism finally discovered that the company was a hollow shell and dumped its stock.

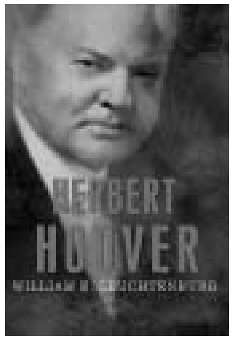
Bradley's *Capitalism at Work* is actually the first book in a planned trilogy called *Political Capitalism*. The forthcoming volumes are titled *Edison to Enron* and *Enron and Ken Lay: An American Tragedy*. I'm looking forward to both of them.

Michael Beitler (mike@mikebeitler.com) is the host of "Free Markets With Dr. Mike Beitler," a libertarian Internet radio show, and the author of Rational Individualism: A Moral Argument for Limited Government and Capitalism.

Herbert Hoover

by William E. Leuchtenburg
Times Books • 2009 • 208 pages • $22.00

Reviewed by Jim Powell



William E. Leuchtenburg is among the last surviving literary lions who played a major role shaping the reputation of Franklin Delano Roosevelt. His book *Franklin D. Roosevelt and the New Deal* (1963) stood out amidst the postwar deluge of worshipful works about FDR, including those by James MacGregor Burns, Arthur M. Schlesinger, Jr., Frank Freidel, and Kenneth S. Davis. Leuchtenburg, professor of history emeritus at the University of North Carolina, is an engaging author who knows how to tell a good story.

This new biography of Herbert Hoover is a prelude to the morality tale that Leuchtenburg has already presented—namely, the heroic New Deal narrative. According to Leuchtenburg, the 1920s were a failure, and the worst failure was Herbert Hoover. He was a "heartless" man, a "dogmatic reactionary," "a right winger of deepest dye" who preached "minimalist" government. Hoover wouldn't spend enough money on relief because of his unwarranted "faith in voluntarism."

Yet Leuchtenburg provides evidence aplenty that Hoover wasn't quite the laissez-faire champion he has been made out to be. While criticizing Hoover for wanting to balance the federal budget, Leuchtenburg acknowledges that Hoover "was running a historic deficit—nearly a billion dollars." Leuchtenburg mentions how Hoover's Grain Stabilization Corporation tried to help farmers by purchasing agricultural commodities at above-market prices, only to find that farmers responded by producing more. Overwhelmed with unwanted surpluses, the Corporation dumped these commodities on the market, driving farm prices even lower than they had been before. Furthermore, Hoover's Reconstruction Finance Corporation bailed out banks, railroads, insurance companies, and building and loan associations, but still the depression deepened.

In 1932 Hoover signed the Norris-LaGuardia Act, giving labor unions immunity from antitrust laws, private lawsuits for damages, and injunctions from federal courts, which enabled union bosses to push aggressively for monopoly bargaining power and forced dues.

I would agree with Leuchtenburg that two of Hoover's biggest blunders were signing the Smoot-Hawley tariff in 1930 and tax hikes in 1932. The problem is that it's impossible to square all of this federal activism with the notion that Hoover believed in "minimalist" government.

Nor does Leuchtenburg comment on the striking similarity between the policies of his demon Hoover and his hero FDR. Hoover and FDR both raised taxes. Both spent money on public works that didn't provide many jobs for unskilled people. Hoover signed the trade-stifling tariff. FDR effectively embraced it; he never spent any of his formidable political capital trying to repeal it, which he might have been able to do soon after he was sworn in, when a desperate nation was at his feet waiting for leadership and inspiration. Powerful protectionist interest groups would have opposed FDR, but he had an appealing personality and formidable communications skills, and was a political genius. I think he could have exploited the deep resentment against Hoover to eliminate his monstrous tariffs and taxes, providing a much-needed stimulus for the economy. Apparently, he was content with Hoover's anti-trade policy.

FDR, like Hoover, spent much effort trying to prop up wages and prices. This prevented markets from fully adjusting to the severe contraction. Maintaining above-market prices discouraged consumers from buying, and above-market wages discouraged employers from hiring. Also, like Hoover, FDR expanded the power of labor bosses (especially with the 1935 National Labor Relations Act). Unemployment dragged on under Hoover, and it dragged on even longer under FDR—until 1940, when the government began mobilizing for World War II and conscripting young men.

These striking similarities create more than a few problems for the heroic New Deal narrative. If Hoover was bad and FDR was good, then why did FDR adopt Hoover's major policies? If Hoover's policies were a reason that high unemployment dragged on for three years of his presidency, then why weren't FDR's policies a reason that high unemployment dragged on for seven years of his presidency? If Hoover is viewed as having failed to get America out of the Great Depression, why shouldn't FDR similarly be viewed as having failed to get America out of it? The main difference between Hoover and FDR might be that FDR went on to win World War II, and probably many people ignore or forgive his depression-era bungling because of that.

The key to Hoover's and FDR's failures during the Great Depression was their "progressive" ideas. Both men grew up on those ideas and took them to heart when they served in Woodrow Wilson's wartime administration. The depressing thing about this book is that instead of debunking the myth that Hoover and FDR were philosophical opponents, it attempts to keep it alive. FEE

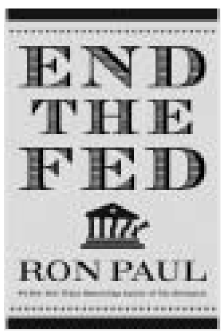
Jim Powell (powellj@optonline.net), a senior fellow at the Cato Institute, is the author of FDR's Folly, Bully Boy, Wilson's War, Greatest Emancipations, The Triumph of Liberty, *and other books.*

End the Fed

by Ron Paul

Grand Central Publishing • 2009 • 224 pages • $21.99

Reviewed by George Leef



Of all the blunders in American history, perhaps the greatest was the decision to put control of money and banking in the hands of a cabal of big bankers operating under the highfalutin title "Federal Reserve System." Unfortunately, few among us know anything about the Fed, much less have any inkling of how badly it has damaged the nation. Without it we'd have a smaller government and economic stability.

And yet the Fed enjoys almost sacred-cow status. Most Americans have been led to believe that modern nations absolutely must have some government institution to "manage" the economy, provide money and credit, and control interest rates. Blinded by that notion, they assume that if we didn't have the Fed, we'd be stuck in the horse-and-buggy age, plagued by terrible boom-and-bust cycles.

Over the near-century since Congress established the Fed (in 1913), it has had many critics, but never one with the moral and political stature of Representative Ron Paul. The congressman from Texas is not a political hack who takes positions just to please constituents and get reelected. He has made a lengthy, serious study of economics, especially our monetary institutions, and his book *End the Fed* puts his knowledge on display. But it's more than just a display of knowledge. The book shows Paul's passionate commitment to the cause of establishing the honest, dependable monetary system the United States was supposed to have.

That's why Paul wants to end the Fed. It gives us a dishonest and easily manipulated monetary system that we can only depend on for constant inflation. Abolishing the Fed, he writes, "would be the single greatest step we could take to restore American prosperity and freedom and guarantee that they have a future."

The financial turmoil and prodigious deficits of recent years have people wondering about the future. For them, this book will be like finding an oasis when you're desperate for water in the desert.

Paul begins by explaining how the Fed came to be. The United States survived without it for more than a century, although the nation suffered from periodic recessions and "panics." Those episodes, Paul makes clear, weren't due to any flaw in the free market, but were caused by bad government monetary policy and banking regulation. The Panic of 1907, however, was seized on by banking interests to push for the cartel they had long desired. Congress obligingly created the National Monetary Commission in 1908. It was dominated by big bankers who said that the country needed an "elastic" currency and a "lender of last resort" to backstop banks that got themselves into deep trouble. The legislation was drafted in 1910 at a secret meeting on Jekyll Island, Georgia, at a resort owned by the biggest banker of all, J. Pierpont Morgan. Congress passed it in 1913.

One thing most people have heard is that it is the Fed's job to give us price stability. Paul shatters the idea that it does so by noting that goods costing one dollar in 1913 now cost $21. Nor does the Fed give us economic stability. Paul points to the numerous recessions we've had since it was established.

Drawing on his study of Austrian economic theory, Paul demonstrates that the boom-and-bust cycle is generated by the Fed's penchant for tampering with interest rates. When it drives them artificially low, it stimulates a temporary boom that must eventually end in recession or depression, with high unemployment and many bankruptcies among overstretched firms.

Furthermore, the Fed makes it easy for the federal government to finance its extravagant (and usually unconstitutional) spending. It can purchase government bonds through "open market operations" and magically turn federal debt into new money. What a scam. Politicians get to spend without explicitly raising taxes and then blame the resulting depreciation of money on others.

So the Fed is a bad institution, but what alternative is there? We can't go back to some antiquated system like gold, can we? Paul shows that a monetary system based on precious metal is both feasible and much to be desired, precisely because, unlike paper, government can't manipulate gold.

The book ends with an excellent list of suggested readings. I predict that *End the Fed* will lead to quite a few knowledgeable and zealous opponents of government economic intervention, and not just regarding money.

Ron Paul's book is a timely cry of the heart. With our economy in tatters, opportunistic scoundrels in Washington are calling for vast, freedom-killing expansions of government power. Paul stands athwart their plans. This brave book is a rallying point for Americans who know that we're on a path to ruin. FEE

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Books for People Who Think

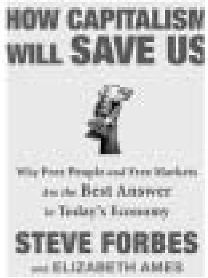
Capitalism Unbound: The Incontestable Moral Case for Individual Rights

Andrew Bernstein's book is a concise explanation of capitalism's moral and economic superiority to all forms of socialism, including America's current mixed-economy welfare state. Bernstein shows that the current crisis is essentially similar to the Great Depression in its causation and in the steps necessary to resolve it. The book's concluding section applies moral and economic principles to the current economic crisis, showing that government intervention is its cause and a policy of laissez-faire its necessary solution. Furthermore, socialist/statist policies are universally the cause of social calamities and that the answer lies in individual rights and laissez-faire capitalism. The principles that the book clearly articulates are timeless; in diverse forms, the conflicts these principles explain will recur repeatedly throughout history. As a result, this book is relevant not merely today, but will be forever.

Bernstein accomplishes all of this in a concise, lively, impassioned volume that is fully accessible to potentially countless readers.

Paperback, 133 pages, list price $19.95; Amazon price, $14.35; Laissez Faire price, $12.95.

Free with every order!
The House that Uncle Sam Built
by Steve Horwitz & Peter Boettke.
Also a free copy of *Laissez Faire* magazine.



How Capitalism Will Save Us

Is it fundamentally greedy and immoral, enabling the rich to get richer? Are free markets Darwinian places where the most ruthless crush smaller competitors, where vital products and services are priced beyond the ability of many people to afford them?

Capitalism is the world's greatest economic success story. It is the most effective way to provide for the needs of people and foster the democratic and moral values of a free society. Yet the worst recession in decades has widely—and understandably—shaken people's faith in our system. Even before the current crisis, capitalism received a "bad rap" from a culture ambivalent about free markets and wealth creation. This crisis of confidence is preventing a full recognition of how we got into the mess we're in today—and why capitalism continues to be the best route to prosperity.

How Capitalism Will Save Us by Steve Forbes and Elizabeth Ames, transcends labels such as "conservative" and "liberal" by showing how the economy really works. When free people in free markets have energy to solve problems and meet the needs and wants of others, they turn scarcity into abundance and develop the innovations that are the foremost drivers of economic growth. The freedom of democratic capitalism is, for example, what enabled Henry Ford to take a plaything of the rich—the car—and transform it into something affordable to working people.

In the capitalist system, economic growth doesn't mean more of the same—grinding out a few more widgets every year. It's about change to increase overall wealth and give more people the chance for a better life. Hardback, 368 pages, list price, $25.00; Laissez Faire price, $16.50.

The War on Kids

The *New York Times* calls this documentary "a shocking chronicle of institutional dysfunction. *The War on Kids* likens our public school system to prison and its disciplinary methods to fascism. At least now you know why little Johnny won't get out of bed in the morning.

Arranged in sections that range from merely interesting to downright horrifying, this provocative documentary suggests a system regulated by fear and motivated by the desire to control. Tracing the evolution and application of zero-tolerance policies on drugs and violence, the director, Cevin Soling, amasses overwhelming evidence of institutional overreaction. When an 8-year-old can be suspended for pointing a chicken finger and saying "Pow," we know that common sense has officially left the building. DVD, 95 minutes. $19.95.

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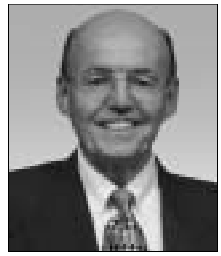

ObamaCare and Unions

BY CHARLES W. BAIRD

Last November 7, the House of Representatives passed H.R. 3962, crafted by Speaker Nancy Pelosi and whimsically titled the Affordable Health Care for America Act (AHCAA). It was the House's version of ObamaCare. American labor unions, whether representing government- or private-sector workers, enthusiastically endorsed the measure. Yet most unions have been effective at securing good health care benefits for their members, and they frequently cite this as a reason for workers to unionize. So why are they so eager for government to expand its role in American health care? The short answer, as illustrated by several provisions of the AHCAA, is that government-run health care would enable union bosses to capture large numbers of hitherto union-free workers into forced-dues subservience.

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Increased government intervention in health care increases the number of health care workers who are, or who could be classified as, government employees. In a single-payer system all health care workers are government employees. When government increases its subsidies and regulation of nominally private health care facilities, they become much less private. Their employees derive more of their income from government and are subjected to government-dictated workplace rules. They become more and more like government employees. This gives government-employee unions grounds for trying to intrude where they do not belong. Politicians who receive organized pecuniary and in-kind election support from the unions are all too happy to comply.

Similarly, as individual private health care practitioners receive more of their income from taxpayers they become quasigovernment employees. At the behest of Andy Stern and his Service Employees International Union (SEIU), politicians in several states—including California, Illinois, Washington, and Missouri—are trying to classify home health care workers who are paid with taxpayer money as state government employees who may be unionized and forced to pay union dues. Home health care workers tend to disabled and chronically ill people, often senior citizens, in their homes rather than in health care facilities. Section 2589 of the AHCAA creates a "Personal Care Attendants Workforce Advisory Panel" on which labor unions are guaranteed representation. "Personal care attendants" is another name for home health care providers. Union representatives on this panel will inevitably push for forced unionization of such workers.

The conversion of private-sector workers into government workers benefits unions because government workers are easier for unions to capture than private-sector workers. The percent of government workers who are unionized far exceeds the corresponding percent in the private sector.

In 2009 unionization in government was 37.6 percent while in the private sector it was only 7.3 percent. Moreover, government-employee unions now have more members than private-sector unions. In 2009 government-employee union members comprised 51 percent of all union members, although government workers were only 16.9 percent of all workers (www.unionstats.com).

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The principal reason unions are more successful among government workers than private-sector workers is that government-sector employers have no reason to resist unionization. They and the unions with which they "bargain" sit on the same side of the bargaining table. They each seek more and more money from taxpayers. Bureaucrats seek larger budgets for their agencies, and the unions are helpful in organizing support for those larger budgets. Government employees know their paychecks are determined by political clout, and they recognize the value of unions as effective lobbyists against the interests of taxpayers. For example, in Canada, which has a single-payer medical system, almost all registered nurses are government employees. Sixty-two percent of Canadian registered nurses are unionized (www.tinyurl.com/y8alsrf). The corresponding figure in America in 2008 was 19.8 percent (www.unionstats.com). In brief, ObamaCare would create more government employees; and since government employees are receptive to the blandishments of unions, unions support ObamaCare.

Since government employees are receptive to the blandishments of unions, unions support ObamaCare.

AHCAA also helps private-sector unions because it imposes health care costs on union-free employers who otherwise may not offer medical benefits to their employees. It is elementary economics: If your competitor has a cost advantage over you, you can either cut your costs or lobby government to increase your competitor's costs. AHCAA does the latter through employer mandates and tax penalties imposed on employers who do not comply. Compensation includes wages and nonwage benefits such as health insurance. A union-free employer can tailor compensation packages to fit the preferences of individual employees. He thereby obtains the services of his employees at the lowest cost. Unionized employers with union contracts that require uniform health care benefits do not have that ability.

One might think that federal oversight of the myriad details of American health care would make the medical provisions of collective bargaining contracts irrelevant. Not so. Union-owned politicians are loath to do anything to make any of the games unions play irrelevant. Section 254 of the AHCAA provides that "Nothing in this [legislation] shall be construed to alter or supersede any statutory or other obligation to engage in collective bargaining over the terms or conditions of employment related to health care." Section 424 guarantees that any union-negotiated health plan automatically meets "health care participation requirements."

There are other ways that the AHCAA benefits unions. Section 111 creates a $10 billion trust fund to bail out unions and employers that now have unfunded health care liabilities to early retirees between 55 and 64. The United Auto Workers (UAW), General Motors, and Chrysler are among the big beneficiaries of this "reinsurance" scheme. The government and the UAW have already taken over General Motors and Chrysler, but AHCAA would throw even more taxpayer money at them. Section 110 prohibits any postretirement health care benefit reductions in the private sector. Taken seriously, this would make the accumulation of future unfunded health care liabilities illegal. Inasmuch as the federal government itself continues to accumulate trillions of dollars of unfunded liabilities in Social Security and Medicaid, this is shameful hypocrisy.

There are more goodies for unions sprinkled throughout the 2,016 pages of the AHCAA, but the subterfuge is clear. In a 2008 campaign speech before the SEIU, Barack Obama promised Andy Stern and his subjects that "Your agenda is my agenda" (www.tinyurl.com/ygllo6c; note: audio begins immediately at high volume). Whatever else may be said about the president's attempt to take over American health care, it is obvious that he is keeping that promise. FEE