IDEAS ON LIBERTY

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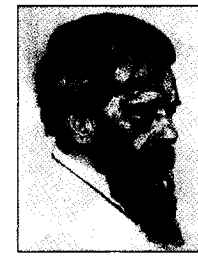

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PERSPECTIVE

Is Socialism Good in Theory?

Socialism has been mortally discredited on economic grounds, thanks to Ludwig von Mises, F. A. Hayek, and history. But for many people it has not been discredited on moral grounds. You can tell this by how often people say that while socialism doesn't work in practice, it is good in theory.

Strange notion—that a theory which doesn't work in the world can somehow still be good. Where else is it to be judged? One would think that a theory whose consistent realization requires gulags and secret police would be morally disqualified even if it "worked."

I guess the people who say socialism is good in theory really mean they *regret* that it doesn't work without the attendant unpleasantness. Why should that be regrettable? The typical answer is that in socialist theory people are not acquisitive or self-regarding; they are more concerned about others. The regret about socialism turns out to be a regret about human nature.

Leaving aside the facts that the taint on self-interest is assumed not established and that one prospers under capitalism by competitively attending to others, is this a valid statement about socialism? Originally socialism promised a superabundance of goods—so much of everything that no one would have to do without anything. Sharing would be unnecessary because scarcity would be abolished. Wasn't that an appeal to acquisitiveness, even gluttony? To be sure, socialism's miserable record has compelled its advocates lately to discover the "age of limits," but that is only to make a virtue of necessity.

Socialism of course did promise to reconstruct humanity, but the message was always mixed. It promised to subordinate the individual to society while liberating him to be fully himself—free of the necessity to make a living. Leon Trotsky wrote that "Communist man . . . will become immeasurably stronger, wiser and subtler; his body will become more harmonized, his movements more rhythmic, his voice more musical. The forms of life will become dynamically dramatic. The average

human type will rise to the heights of an Aristotle, a Goethe, or a Marx." But the *nice* Bolshevik also said, "In a country where the sole employer is the State, opposition means death by slow starvation. The old principle: who does not work shall not eat, has been replaced by a new one: who does not obey shall not eat."

Was the new Socialist Man to be a self-centered achiever or group-centered worker bee? It was never clear how both could be accomplished.

Maybe all that people mean when they lament socialism's impracticality is that the theory held out hope for an end to material inequality. As intellectual historian Ralph Raico reminds us, it didn't exactly do that. Marx promised only "to each according to his *needs*." He never said we all have the *same* needs. Besides, it is capitalism not socialism that has achieved essential material equality. (See Donald Boudreaux, "Equality and Capitalism," September 2002, www.fee.org/vnews.php?nid=5201.)

The ugliness of socialist theory now comes into focus. Under individualist and capitalist theory (and practice) each person is free to determine his own needs and, through the division of labor and voluntary exchange, to produce what's required to satisfy them. (As the old Spanish proverb puts it, "Take what you want and pay for it.") Under socialist theory the individual's needs are determined and satisfied collectively. Dissent and venturing out on one's own are not options. As Trotsky acknowledged, everyone is an employee and tenant of the collective—that is, the state.

It's a mystery why anyone would find that theory beautiful or regret that it doesn't work in practice.

* * *

The antitrust folks at the Federal Trade Commission are at it again, this time trying to stop a merger in the "superpremium" ice-cream market. George Leef debunks the government's latest anticompetitive mischief.

All around the country imaginative businessmen are turning now-useless landfills into useful golf courses. Why, Scott McPherson asks, didn't the bureaucrats think of that?

Owners of businesses everywhere are victimized by ruinous state regulations and taxes. Steven Greenhut reports that in California they are doing something about it.

To hear the American Lung Association tell it, the air we breathe is killing us. But Roy Cordato demonstrates that those reports are flawed.

Governments throughout the West are on a collision course with reality, thanks to their politicized pension systems. Norman Barry describes the wreck in our future.

For nearly 70 years, saving has been regarded in some quarters as socially destructive. Arthur Foulkes shows how wrong that view is.

The term "Austrian economics" often is found in this magazine. We thought it was a good time to reprint Henry Hazlitt's classic essay on exactly what it is. Part one appears this month.

If a collectivist cannot refute individualism, he may try to build a straw man in order to knock it down. According to Tibor Machan, that summarizes much of contemporary political theory.

The federal government years ago set out to equalize funding for male and female sports in schools. It created a textbook case of the Law of Unintended Consequences, Larry Schweikart writes.

Here's what our columnists have cooked up: Richard Ebeling honors Ludwig von Mises, who died 30 years ago this month. Lawrence Reed eulogizes a man of character. Thomas Szasz says beware of drug "reformers." Stephen Davies solves the mystery of China. Russell Roberts examines the claim that medical care cannot be left to the marketplace. And Richard Gordon, hearing claims that deregulation caused the August blackout, objects, "It Just Ain't So!"

The book reviewers grapple with World War I, the bloody twentieth century, capitalism, and the globalization of culture.

—SHELDON RICHMAN

From the President

by Richard M. Ebeling

IDEAS ON LIBERTY
OCTOBER 2003

Ludwig von Mises: A Voice for Freedom and Principle

October 10 marks 30 years since the death of Austrian economist Ludwig von Mises. (He passed away at age 92.) For more than six decades in the twentieth century Mises was one of the leading voices for individual freedom and the market economy. During a time when socialist and interventionist ideas and policies seemed to be the almost inescapable wave of the future, he consistently and uncompromisingly defended human liberty, private property, the free market, and limited government.

Ludwig von Mises was an original scholar, an insightful policy analyst, and an influential teacher in both Europe and the United States. Without exaggeration, his books, essays, lectures, and personal impact on others were crucial in stemming the intellectual trends toward various forms of collectivism during the last 100 years. Mises's most famous protégé, the Austrian economist and Nobel laureate F. A. Hayek, once said, "There is no single man to whom I owe more intellectually. . . . He certainly had more influence on my outlook of economics than any other man."

Mises was born in Lemberg (now Lvov) in the old Austro-Hungarian Empire on September 29, 1881. He attended the University of Vienna and earned a doctoral degree in jurisprudence in 1906, with an emphasis on economics. He made his living, however, not in academia but in the world of public policy, in the role of economic analyst for the Vienna Chamber of Commerce, Crafts, and Industry, a position he held from 1909 until 1934.

In the Austria between the two world wars he was a leading figure in bringing the Great Austrian Inflation to a halt and assisted in reorganizing the Austrian National Bank on a non-inflationary, gold-backed basis. He was an influential voice in preventing the Austrian socialists from nationalizing commerce and industry and was in charge of a department of the League of Nations' Reparations Commission in Austria. During these years Mises also founded the Austrian Institute for Business Cycle Research, taught a highly acclaimed seminar each term at the University of Vienna, was the Austrian representative of the European Free Trade Association, and led a world-renowned private seminar for Austrian and visiting scholars at his office at the Chamber of Commerce.

But his international recognition during these years and the remainder of his life was the result of his profoundly important contributions to economics and social philosophy. Even before World War I he developed what became known as the Austrian theory of money and the business cycle in *The Theory of Money and Credit* (1912); he showed that inflations and depressions had their origin in government mismanagement of the monetary and banking systems.

Richard Ebeling (rebeling@fee.org) is the president of FEE. His latest book is Austrian Economics and the Political Economy of Freedom *(Elgar).*

But Mises's most famous contribution in the period immediately following World War I was his demonstration, in his 1920 article "Economic Calculation in the Socialist Commonwealth" and in his treatise *Socialism: An Economic and Sociological Analysis* (1922), that socialist central planning was inherently unworkable for any rational use and allocation of the goods and resources in society. The abolition of private property, the elimination of monetary transactions, and the end of market-based competition meant the loss of the price system. But market-generated prices were the essential social tools by which all the goods and services, resources, and capital could be reduced to a relatively simple and useable common denominator for purposes of economic calculation by consumers, producers, and resources owners.

In his 1927 work, *Liberalism*, Mises defended the institutions and workings of the free-market economy. He warned of the inherent contradictions and inevitable distortions resulting from various types of government regulation in *Critique of Interventionism* (1929). And he defended the logic and essential value of economic theory for sound thinking about economic policy in *Epistemological Problems of Economics* (1933).

Magnum Opus

But his greatest contribution, in which he synthesized all these earlier works into a comprehensive vision and logic of freedom and the market economy, was *Human Action: A Treatise on Economics* (1949). Here the reader finds a detailed and well-grounded conception of man, human nature, and society. Mises formulates a theory of social cooperation arising from the benefits from division of labor. He explains the institutional prerequisites for freedom and prosperity, and the workings of the market process, competition, the price system, and the role of the creative entrepreneur. He also restates in a refined exposition his criticisms of socialism, interventionism, and government monetary and fiscal policies.

In his review Hayek said the book "ranges from the most general philosophical problems raised by all scientific study of human action to the major problems of economic policy of our own time."

Mises elaborated further on many of these themes in a number of other books, including *Planning for Freedom* (1952), *Theory and History* (1957), and *The Ultimate Foundation of Economic Science* (1962).

All these works were written at a time when freedom and the free society appeared destined for defeat, reduced to a soon-to-be-forgotten chapter of human history. Especially after Mises moved to the United States in 1940 during World War II, socialism, interventionism, and Keynesian economics all seemed to be heading for triumph throughout the world. Voices like Mises's were increasingly marginalized and often ignored.

But while many chose to remain silent or compromised their classical-liberal views for acceptance or recognition in academic and public-policy circles, Ludwig von Mises did not. He did not consider logic, truth, and right to be matters of mere "opinion." These were invariant elements in the world and for man. Illogic, deceptions, and error all finally led to outcomes quite different from what had been hoped for or promised. And many policies emanating from such misguided thinking resulted in disasters for millions of people. Each of us as members of a common humanity, he argued, were called on to speak up and work to stop the tide of socialist and interventionist destruction.

Now that the twentieth century has ended, it is clearer than ever before that Ludwig von Mises, during those darkest decades of collectivism, understood and explained far better than most the dangers that humanity faced and the path to human freedom and economic progress. Our task in the 21st century is to take his legacy of ideas and see that the next hundred years is better than the last. □

IDEAS ON LIBERTY
OCTOBER 2003

Deregulation Caused the Great Blackout of 2003?

It Just Ain't So!

As I sat in New York during the blackout, I wondered who would succeed at producing the first predictable polemics blaming "deregulation." Every crisis unsurprisingly is used to further the agendas of anyone remotely concerned. Every interest group claimed that had its agenda been accepted the crisis could have been avoided. The Northeast power outage followed true to form. Blaming deregulation apparently began while my power was still out.

Blaming anything may be totally wrong. However electricity is generated and transmitted, a complex system must exist. Nothing can be made foolproof, and it will be unclear, at least until the investigations cease, whether the causes were readily predictable and easily corrected, according to a cost criterion. The possibility remains that the blackout could not have been prevented.

Even if a prevention strategy were available, the failure to adopt it is not clearly due to neglect of the many alternatives that might have been adopted. What is involved is a long-standing crisis in electric power that the so-called deregulation process sought to remedy. To the extent the effort failed, it was precisely because deregulation was a fraudulent description.

The situation has a long history. In the early decades of the twentieth century, the electric-power industry urged the states to institute regulation. The system worked to the satisfaction of companies, customers, and the regulators until the early 1970s. Stable fuel prices and improved technology allowed selling prices to fall (from 2.71 cents per kilowatt hour in 1926 to 1.59 cents in 1970) despite inflation.

The 1970s brought the unhappy combination of rising fuel costs, soaring construction costs, lessened technical progress, and increased environmental requirements. Suddenly, the regulators had the new task of adjusting to upward pressures on rates. They acted with, at best, equivocation and, at worst, with disastrous expedients. Several states, notably New York and California, saw non-utility generation as a miracle cure and pressured utilities to sign long-term contracts based on the expectation of continued energy price rises. A further problem was that the utilities had embarked on expensive expansion programs, much but not all nuclear. A growth slowdown produced by rising rates and the spurt in construction costs made these expansions expensive and premature. These plants and the contracts for non-utility generation became severe burdens when energy prices softened.

Utilities naturally sought reversal. Some proclaimed that they had lived under a regulatory compact that could and should be restored. Others sought whatever relief they could find. In several states, major initiatives were undertaken. The details differed greatly. The main common feature was that generation of electricity was freed from wholesale price regulation. Generally, a further step was a phased removal of regulated rates to final consumers. A third step in some states was to require divestiture of generating capacity. New York required total divesting; California confined the sell-off to fossil-fuel plants within the state.

Several critical points emerge. First, not all states instituted such changes. Second, those imposing restructuring each adopted a unique approach. Third and most critically, the liberation was limited. The guts of the California crisis, for example, was simply that uncontrolled wholesale prices soared in response to rising natural gas prices, and retail prices were not allowed to rise in response. (The charges of manipulation will

probably prove wildly exaggerated.) More critically, the transmission system was not included in the restructuring process. The only initiative was the Federal Energy Regulatory Commission's (FERC) ultimate decision that independent regional transmission companies were the proper response.

Central Plan versus Market

The debate on what to do involves both the classic question of plan versus market and how the market should be organized. Thus Robert Kuttner's fanciful discussion in the *New York Times* of August 16 postulates that what is needed is formal energy plans submitted to the states and ratified by appropriate rate settings. This is incorrect as both diagnosis of need and description of history.

Kuttner's article begins correctly but irrelevantly, noting that planning, coordination, and incentives are needed to ensure efficient supply of electricity. However, this is true of *every* commodity. The world economy nevertheless produces most commodities without any *central* plans, and somehow enough investment occurs to preclude significant shifts in supply-demand balances. Contrary to common statements about electricity, nothing about it inherently prevents adequate investment as long as prices are set in the market. The amounts are no vaster than in other heavy industry, and uncontrolled prices would be adequate to recoup costs.

It also is utter fiction that, as Kuttner alleges, plan ratification by regulators was the method used to ensure adequate electric-power investment in the face of price control. As it happens, the states that employed systematic state energy plans were California and New York. The California approach was for a massive state agency to formulate extensive reports notorious for their enthusiasm at discouraging expansion. The New York state utilities submitted annual plans to the state, and similar inaction prevailed. Kuttner's basic error is to blame deregulation for the failure to remove price controls that eliminated the incentives for investment in transmission.

Kuttner precedes this claim with another whopper and irrelevance. He spins a fanciful tale that the new un-integrated industry is prone to massive price manipulation. Elementary economics makes clear that a well-structured market cannot be manipulated. To the extent that the opportunistic charges against California generating and natural-gas pipeline companies are substantiated, the manipulation was possible only because of flaws in the government-imposed restructuring.

Kuttner's second criticism of deregulation was that economic transmission of electricity is limited by physics. This is true but does not preclude the systematic maintenance of massive flows over the distances in which exchange is economic. Moreover, the move to an almost national grid long antedates the regulatory initiatives of the past few years.

However, the issue of the optimal organization of private electric-power companies remains. In a classic 1937 article, Nobel laureate Ronald Coase noted that vertical integration (the combination of successive steps in the supply process) improved coordination, but might strain the capabilities of top management. Specialists on the subject long raised questions about the optimum in electric power. At one extreme, the concept of "superpower" has had proponents since at least the 1920s. The idea is for power companies to continue the traditionally standard practice of simultaneously generating, transmitting, and distributing electricity, but to merge companies so that they supplied much larger regions. At the other extreme, it was suggested that integration, if ever needed, was no longer required. The truth remains to be proven, and one of the defects of imposed restructuring is that it establishes a new structure on the basis of regulatory judgment rather than market tests.

In short, once again the interventionists blame limited changes in regulation for the impacts of continued regulation.

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IDEAS ON LIBERTY
OCTOBER 2003

The FTC Gets in Its Licks

by George C. Leef

The freedom of Americans to peacefully manage their own affairs has been shrinking for many decades, as government officials find more and more reasons to tell us what things we must do and what things we may not do. The pettiness of it all is wonderfully demonstrated in a recent decision by the agency that supposedly acts as a protector of the consumer: the Federal Trade Commission (FTC).

The FTC has legal power to block business mergers that it decides might "lessen competition." Recently, the management of Dreyer's Inc., a firm that makes ice cream, concluded a deal with the international food giant Nestlé, under which Nestlé would purchase Dreyer's stock and wind up with majority control of the firm. Dreyer's shareholders approved the transaction, only 0.1 percent of the shares being voted against. But it isn't enough just to have a willing buyer and a willing seller in modern America. You also have to play "Captain, may I?" with government officialdom. In March, the FTC announced its opposition to the merger. If Nestlé and Dreyer's want to merge, they will have to fight it out with the FTC in court.

Here are the pertinent facts. There is a huge market for ice cream and similar frozen desserts (like Eskimo Pies). A small part of that market consists of what the FTC calls "superpremium" ice cream—very rich and costly brands such as Häagen-Dazs, Ben & Jerry's, and Godiva. The FTC contends that 98 percent of the "superpremium market" is "controlled" by three large manufacturers: Nestlé, Dreyer's, and Unilever. If two of those three were allowed to merge, the result would be "greater concentration" in the industry, which the FTC invariably assumes to mean less competition and therefore harm to consumers. The director of the FTC's Bureau of Competition, Joe Simons, said, "This merger, as structured, would likely raise prices and reduce choice for consumers. The market for superpremium ice cream is already highly concentrated and this deal will reduce the number of significant competitors from three to two."

This is the classic approach of antitrusters: define markets with absurd narrowness and then assume that any reduction in the number of competitors is an "injury to competition" necessitating their intervention. It's all done to help those of us who can't resist an occasional bowl of ice cream. I cheerfully admit to being one of those people, and would be quite pleased to see the FTC stop pretending to do me favors.

First, the "superpremium ice cream market" is nonsense. There is nothing unique about Häagen-Dazs, Dreamery, Ben & Jerry's, or any of the other brands. They cost more per ounce and have a higher butterfat content, but still it's just ice cream. Dreyer's

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superpremium ice creams compete for consumer favor with their premium labels, as well as with many other ice creams, like Sealtest and Texas Gold. If the three or two makers of superpremium ice cream should start to raise their prices, they will find their sales falling as consumers switch to other ice creams or other luxury desserts that now seem to be a better value.

Second, the FTC treats as of no consequence the sellers of that small slice of the "superpremium market" not accounted for by the big makers. But they exist and offer real competition. I grew up in a city known for its custard stands (Milwaukee) and consumers can and do purchase terrific ice cream there. (Maybe the FTC wizards don't think that "custard" belongs in the same market as "superpremium ice cream," but I do.) If the Dreyer's-Nestlé merger takes place and prices go up for superpremium ice cream sold in stores, many consumers will stock up on pints or quarts of custard. Also, most cities have specialty ice-cream shops such as Baskin-Robbins that sell scrumptious products that I'd bet the regulators at the FTC couldn't tell from "superpremium" in a blind taste test. If prices for products like Häagen-Dazs go up, those shops will find themselves serving more customers.

Number of Competitors Doesn't Matter

Third, the FTC makes far too much of the reduction in the number of major competitors from three to two. It's an economic old wives' tale that the intensity of competition is a function of the number of firms. Fewer firms do not necessarily mean less competition. Unilever's Ben & Jerry's brand will still struggle just as hard to win purchasers away from other labels, no matter the ownership arrangement of Dreyer's and Nestlé facilities. That's because they are also struggling to win customers from other ice creams and luxury desserts.

Finally, even if all the competitors in the "superpremium" market were to raise their prices, that would simply invite new competition from ice-cream makers who don't currently produce superpremium brands but could readily do so.

It looks awfully silly for a government agency to flex its muscles over a proposed merger involving a small part of the market for one kind of dessert. Even if the FTC's fears were realized, all that would happen is that a container of Cherry Garcia or Black Raspberry Avalanche might go up in price from perhaps $3.29 to $3.49. Why should that be any concern of the federal (or state or local) government? Anyone who doesn't like the price increase can buy something else, or have "superpremium" ice cream less often. Government is supposed to protect our rights to life, liberty, and property, not fret over whether we're getting the lowest possible price for ice cream.

So why go through this exercise, either forbidding a harmless merger or forcing the firms to spend huge sums on legal fees to fight an FTC injunction in court? In a column in the March 12 *Wall Street Journal*, writer Holman Jenkins put his finger on the reason: "Now the agency has manufactured an enemy monopolist that it can be seen vanquishing in a fabulous war of regulatory coercion. . . . It's obvious why the FTC engages in such intellectual sleight of hand. It wouldn't have anything to do otherwise. Were they obliged to wait until presented with a case raising genuine antitrust concerns, its lawyers might spend the whole of their government service twiddling their thumbs."

That's exactly it. Government agencies want to be perceived as beehives of activity. If they weren't, taxpayers might start asking impertinent questions like, "Why are we paying high salaries to all these people?"

Jenkins's column hit a raw nerve at the FTC. It drew an indignant reply letter from Bureau of Competition Director Simons, who harrumphed that Jenkins was displaying his "indifference to consumer welfare."

But free markets are the best maximizers of consumer welfare, and they don't stop working just because the owners of two competitors want to merge their operations. We no more need a federal agency to oversee competition than we need one to make sure that gravity keeps working. □