

THE FreeMarket

LUDWIG VON MISES INSTITUTE

VOLUME 8, NUMBER 2

FEBRUARY 1990

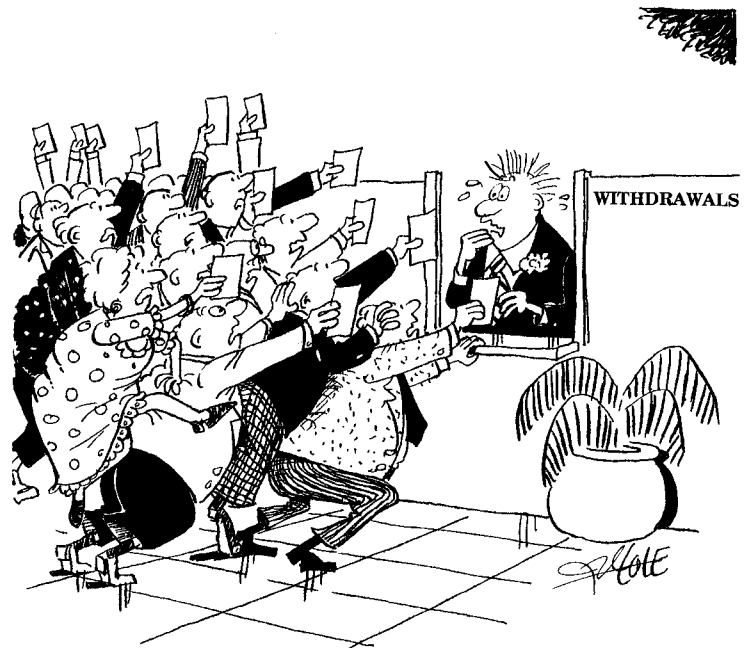
Bring Back the Bank Run

BY JAMES GRANT

The banking dilemma seems eternal, like the monetary dilemma, the tax dilemma, and the marital dilemma. The essence of the banking dilemma, however, is that the depositors' money is not in the vault awaiting the depositors' decision to withdraw it. Instead it is out on loan or invested in the money market or in mortgage-backed securities.

Some of the money is in the vault or on deposit with the Federal Reserve—these funds are called bank reserves—but only a few cents of every dollar. Depending on the specific management, depositors, and financial markets, the average bank may be prepared to accommodate a sudden demand for repayment by a sizable minority of its depositors. Almost no bank in modern times, however, has been able to accommodate a sudden demand for repayment by a majority of its depositors.

Murray N. Rothbard, Mises



Institute economist and libertarian philosopher, has a forcible view on the institutions of fractional-reserve banking: It is "a giant Ponzi scheme in which a few people can redeem their deposits *only* because most depositors do not follow suit."

Some features of the 1989

banking dilemma are new, notably the socialization of credit risk during the Reagan years. It was decided that no money-center bank would be allowed to fail and that no depositor, even a sophisticated one, would be allowed to lose his money in a failure, if it

CONTINUED ON PAGE FIVE

Time for an American Perestroika

BY ROBERT HIGGS

The recent astonishing developments in the Soviet Union and Eastern Europe suggest that after more than 40 years, the Cold War may be about to end or at least to enter a less menacing phase. But not everyone is rejoicing at the turn of events. Many people have a strong vested interest in the continuation of a high level of military spending. The prospect of a more reliable peace scares them to death.

The reaction is described as "panic" as headlines proclaim "Arms Companies Fear Guns

Will Turn to Butter." Said one investment strategist, "we were all joyous at the scenes of people climbing on the Wall, but the problem is, how do you make money on this?" Is it gauche to suggest that superfluous military firms try to make money by producing goods consumers are willing to buy?

Of course, one should not expect to collect the peace dividend. The widely discussed "cuts" of \$180 billion in military spending, which Defense Secretary Dick Cheney recently asked the armed services to consider,

are not actually cuts from the present level of spending but cuts in the Pentagon's desired spending increases over the next five years.

At present military spending is about \$300 billion per year. So the U.S. military economy is roughly the same size as the entire economy of East Germany. And like that economy, it is centrally planned. Long ago Ludwig von Mises showed that the authorities in a planned economy cannot calculate to achieve an economically rational allocation of resources. Without prices

CONTINUED ON PAGE SIX

Government Garbage

From the President



BY LLEWELLYN H. ROCKWELL, JR.

Writers IN THIS ISSUE

James Grant, a media fellow of the Ludwig von Mises Institute, publishes *Grant's Interest Rate Observer* in New York City.

Robert Higgs, an adjunct scholar of the Ludwig von Mises Institute, is Thomas F. Gleed Professor in the Albers Business School at Seattle University and editor of *Arms, Politics, and the Economy* (Holmes & Meier, 1990).

Lawrence W. Reed is president of the Mackinac Center for Public Policy in Midland, Michigan, and an adjunct scholar of the Ludwig von Mises Institute.

Llewellyn H. Rockwell, Jr., is founder and president of the Ludwig von Mises Institute.

Murray N. Rothbard is academic vice president of the Ludwig von Mises Institute and S.J. Hall distinguished professor of economics at the University of Nevada, Las Vegas.

In the loony leftist town where I live, we're ordered to separate our trash into seven neatly packaged piles: newspapers, tin cans (flattened with labels removed), aluminum cans (flattened), glass bottles (with labels removed), plastic soda pop bottles, lawn sweepings, and regular rubbish. And to pay high taxes to have it all taken away.

Because of my aversion to government orders, my distrust of government justifications, and my dislike of ecomania, I have always mixed all my trash together. If recycling made economic sense—and this is an economic question, not a dogma of the mythical earth goddess Gaia—we would be paid to do it.

For the same reason, I love to use plastic fast-food containers and non-returnable bottles. The whole recycling commotion, like the broader environmental movement, has always seemed to have a large malarkey component. So I have never felt guilty—just the opposite—nor have I yet been arrested by the garbage gendarmes. But I was glad to get some scientific support for my position in the December 1989 issue of *The Atlantic Monthly*.

Professor William L. Rathje, an urban archaeologist at the University of Arizona and head of its Garbage Project, has been studying rubbish for almost 20 years, and what he's discovered contradicts almost everything we're told.

When seen in perspective, our garbage problems are no worse than they have always been. The only difference is that today we have safe methods to deal with them, if the environmentalists will let us.

The environmentalists warn of a country covered by garbage because the average American generates 8 lbs. a day. In fact, we create less than 3 lbs. each, which is a good deal less than people in

Mexico City today or Americans 100 years ago. Gone, for example, are the 1,200 lbs. of coal ash each American home used to generate, and our modern packaged foods mean less rubbish, not more.

But most landfills will be full in ten years or less, we're told, and that's true. But most landfills are designed to last ten years. The problem is not that they are filling up, but that we're not allowed to create new ones, thanks to the environmental movement. Texas, for example, handed out 250 landfill permits a year in the mid-1970s, but fewer than 50 in 1988.

The environmentalists claim that disposable diapers and fast-food containers are the worst problems. To me, this has always

for example, degraded rapidly, tons of ink would leach into the groundwater. And we should be glad that plastic doesn't biodegrade. Being inert, it doesn't introduce toxic chemicals into the environment.

We're told we have a moral obligation to recycle, and most of us *say* we do so, but empirical studies show it isn't so. In surveys, 78% of the respondents say they separate their garbage, but only 26% said they thought their neighbors separate theirs. To test that, for seven years the Garbage Project examined 9,000 loads of refuse in Tucson, Arizona, from a variety of neighborhoods. The results: most people do what they say their neighbors do: they don't separate. No matter how high or low the income, or how liberal

Because of my aversion to government orders, my distrust of government justifications, and my dislike of ecomania, I have always mixed my trash together.

revealed the anti-family and pro-elite biases common in any left-wing movement. But the left, as usual, has the facts wrong as well.

In two years of digging in seven landfills all across America, in which they sorted and weighed every item in 16,000 pounds of garbage, Rathje discovered that fast-food containers take up less than 1/10th of one percent of the space; less than 1% was disposable diapers. All plastics totalled less than 5%. The real culprit is paper—especially telephone books and newspapers. And there is little biodegradation. He found 1952 newspapers still fresh and readable.

Rather than biodegrade, most garbage mummifies. And this may be a blessing. If newspapers,

the neighborhood, or how much the respondents said they cared about the environment, only 26% actually separated their trash.

The only reliable predictor of when people separate and when they don't is exactly the one an economist would predict: the price paid for the trash. When the prices of old newspaper rose, people carefully separated their newspapers. When the price of newspapers fell, people threw them out with the other garbage.

We're all told to save our newspapers for recycling, and the idea seems to make sense. Old newspapers can be made into boxes, wallboard, and insulation, but the market is flooded with news-

CONTINUED ON PAGE EIGHT

Welcoming the Vietnamese



BY MURRAY N. ROTHBARD

From its inception America was largely the land of the free, but there were a few exceptions. One was the blatant subsidies to the politically powerful maritime industry, trying to protect what has long been a chronically inefficient industry from international competition. One of the initial actions of the first American Congress in 1789 was to pass the Jones Act, which protected both maritime owners and top employees. The Jones Act provided that vessels of five or more tons in American waters had to be owned by U.S. citizens, and that only citizens could serve as masters or pilots of such vessels.

Times have passed, and whatever national security considerations that might have required a fleet of private boats ready to assist the U.S. Navy have long since disappeared. The Jones Act had long become a dead letter. But let a law remain on the books, and it can always be trotted out to be used as a club for protectionism. And that is what has happened with the Jones Act.

Unfortunately, the latest victims of the Jones Act are Vietnamese immigrants who were welcomed as refugees from communism, and who have proved to be thrifty, hard-working, and productive residents of the U.S., working toward their citizenship.

Unfortunately, too productive as fishermen for some of their inefficient Anglo competitors. In the early 1980s, Texas shrimpers attempted, by use of violence, to put Vietnamese-American competitors out of business.

The latest outrage against Vietnamese-American fishermen has occurred in California, mainly in San Francisco, where Vietnamese-Americans, legal residents of the United States, have pooled their resources to purchase boats, and have been engaged in successful fishing of kingfish and hagfish for the past decade. In recent months, in response to complaints by Anglo competitors, the Coast Guard has been cracking down on the Vietnamese, citing the long-forgotten and long-unenforced

allegiance to America there is an implication that they are untrustworthy."

In the best tradition of Marie Antoinette's "let them eat cake," the government replies that the Vietnamese are free to work on boats under five tons which would be fishing closer to shore. The problem is that the Vietnamese concentrate on fish that cater to Asian restaurants and fish shops, and that such kingfish and hagfish have to be caught in gill nets. So why not use gill nets in small boats closer to shore? Because here, in a classic governmental Catch-22 situation, our old friends the environmentalists have already been at work. Seven years ago the environmentalists persuaded California to outlaw the use of gill netting in less than

Once again, the environmentalists, speaking for the interests of all conceivable species as *against* man, have won out against their proclaimed enemies, human beings.

provisions of the Jones Act. While the Vietnamese-Americans have been willing to pay the \$500 fine per citation to keep earning their livelihood, the Coast Guard now threatens to confiscate their boat-registration documents and thereby put them out of business. The fact that these are peaceful, legal, permanent residents makes all the more ridiculous the U.S. government's contention that they "present a clear and present threat to the national security."

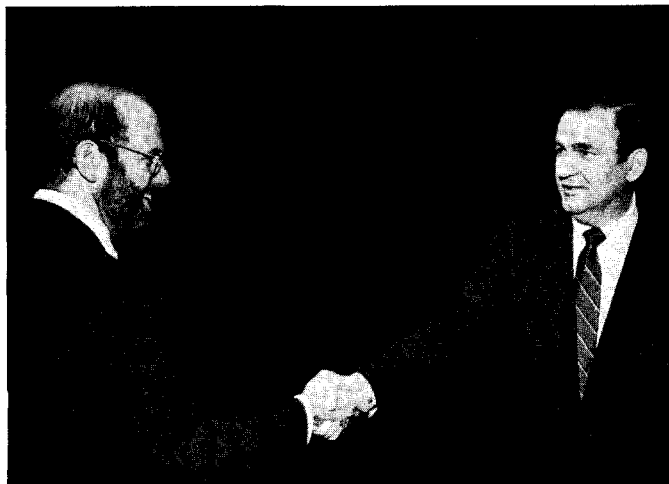
Dennis W. Hayashi of the Asian Law Caucus, who is an attorney for the Vietnamese fishermen, notes that all of them "are working toward citizenship. They were welcomed as political refugees. It is noxious to me that because they have not yet sworn

60 feet of water. Why? Because these nets were, willy-nilly, ensnaring migratory birds and marine mammals in their meshes. So, once again, the environmentalists, speaking for the interests of all conceivable species as *against* man, have won out against their proclaimed enemies, human beings.

And so, seeking freedom and freedom of enterprise as victims of collectivism, the Vietnamese have been trapped by the U.S. government as pawns of inefficient competitors on the one hand and anti-human environmentalists on the other. The Vietnamese-Americans are seeking justice in American courts, however, and perhaps they will obtain it. ◀

Pat Buchanan (right), leader of the American conservative movement, recently named Mises president Lew Rockwell (left) to the board of editors of his new monthly, *On the Right*.

Rockwell has also been named a columnist for the 920,000-circulation *Orange County Register* in Los Angeles, to which he has been a frequent contributor.



Would Legalization Increase Drug Use?

BY LAWRENCE W.
REED

If drugs were legalized, says drug czar William Bennett, drug use “would skyrocket.” George Will echoes him. They offer no evidence for this claim, of course. Judging from America’s last experience with Prohibition, they are probably wrong. If we ended the War on Drugs, drug use might even decline.

In his 1963 book *How Dry We Were: Prohibition Revisited*, Henry Lee gives us a fascinating and instructive account of what happened when alcohol was prohibited from 1919 to 1933.

When Prohibition was enacted, everyone predicted the dawn of a New Moral Era. Dr. Billy Sunday said: “The slums will soon be only a memory. We will turn our prisons into factories and our jails into storehouses and corncribs. Men will walk upright now, women will smile and the children will laugh. Hell will be forever for rent.”

And George Will agrees: “The fact is that Prohibition worked. Alcohol consumption during the twenties declined.” The reality is otherwise.

Lee’s facts and figures show, as we might expect, that prohibiting alcohol simply drove its production and consumption “under-

ground” and even had the perverse effect of increasing both. Many people drank more than ever, or for the very first time, just because the stuff was illegal. “Men were drinking defiantly,” writes Lee, “with a sense of high purpose, a kind of dedicated drinking that you don’t see much of today.”

One place where they drank was the “speakeasy.” In Rochester, NY, for instance, 500 licensed saloons in the days before Prohibition gave way to twice as many speakeasies when booze was outlawed. On Eagle Street in Albany, there were 18 speakeasies; before Prohibition there were only three saloons.

Public drunkenness was illegal both before and during Prohibition, but in Detroit, drunkenness arrests increased steadily from 6,590 in 1920 to 28,804 in 1928. Drinking even increased among members of Congress during the Prohibition!

During daylight, “Prohibition did cut down the amount of drinking,” says Lee. “Probably because it was illegal, people preferred to do their imbibing at night, more than making up for their daytime abstinence.”

Another indication of all the booze sloshing around in the 1920s was “the most spectacular agricultural event” of the decade—the 470% increase in corn sugar production. The stills were operating at full tilt; neither the revenuers nor Elliott Ness’s “Untouchables” put much of a dent in their growth. In 1929, one state alone confiscated more stills than the nationwide total in 1913, while the grand total of all state and federal seizures was a dozen times higher.

America’s total national “drunk tab” during Prohibition was in the neighborhood of \$2.9 billion (in 1929 dollars), putting the bootleg liquor business “right up in the category of steel, autos,

and gasoline.” Millions of first-time drinkers were brought into the underground.

Lee is backed up by the most respected analyst in the field, economist Clark Warburton, whose data in his *The Economic Results of Prohibition* (1932) come from law enforcement officials, consumers, and producers. He shows that alcohol use increased dramatically during Prohibition: liquor, from .3 gallons per capita to 1.86 (520%); wine from .44 to .87 gallons per capita (97%); and beer from 1.26 to 6.9 gallons per capita (447%). During Prohibition, America went on a drinking binge, and, says Warburton, the data for spirits may be underestimated.

Prohibition also made the liquor much more potent (as with drugs today) and alcoholism much more common. After 11 years of Prohibition, wrote British author G.K. Chesterton, “Alcoholism has never threatened disaster as it is threatening America today. It isn’t normal that girls at 16 should go to dances and drink raw alcohol.” Alcohol-induced deaths appeared and increased. Of the 480 gallons of liquor confiscated in one Prohibition year, 98% contained poisons.

Bennett and Will are wrong. Prohibition didn’t work, and meanwhile, taxpayers were picking up the bill for the massive enforcement effort. And though decent people might have used alcohol, they didn’t manufacture or distribute the illegal stuff, leaving those lines of work to some of the sleaziest and most violent crooks in our history. Crime rates soared in the “Roaring ‘20s,” most of it Prohibition related.

My guess is that if we outlawed soda pop, we could produce a similar effect. Bootleg cola-from-a-still would flow like water; people would pay a high price for illegal root beer; criminal gangs would supply it; and the feds would spend billions fighting the

Mark Skousen held a dinner-dance in honor of the Hard-Money Pioneers: (back row, l-r) Jim Dines, Richard Band, Ian McAvity, Jim Davidson, Ed Gunther, Doug Casey, James McKeever, Harry Browne, Walter Porschke, Adrian Day, Vern Myers, Clark Aylsworth; (middle row, l-r) Lew Rockwell, Joe Bradley, Gary North, Larry Abraham, Jim Blanchard; (front row, l-r) Mark Skousen, Jack Pugsley, Howard Ruff.



soda-pop cartel.

Making drugs illegal only increases their lure, and with the profits available in the drug trade, there is more incentive to advertise and get others hooked.

Experience strongly suggests that drug abuse, like alcohol abuse, is a demand problem. Attacking it from the supply side is inherently futile and even counterproductive.

Lower prices, which legalization would bring, always increases the quantity demanded. But probably just about everybody who wants to use drugs is using them now. People can get them easily, even in federal prisons. There simply is no pent-up demand. And legalization would end the "forbidden-fruit phenomenon," in

which some young people are attracted to drugs precisely because they are illegal.

Bush and Bennett want people to stop abusing drugs. I couldn't agree more. What they haven't explained, however, is just exactly why this latest stepped-up attempt at Prohibition will work any better than the last time we tried it. ◀

Bring Back the Bank Run

CONTINUED FROM PAGE ONE

could possibly be helped. But other problems are cyclical and still others are chronic. Reading up on the subject, one becomes fatalistic about it.

In gaslight days, before the "Too-Big-To-Fail" doctrine and other modern banking improvements, national banks were bound to hold reserves amounting to 25% of demand deposits. By our standards, this was a lavish margin of safety, even if, as Rothbard notes, capital reserves were often tied up in government bonds ("...banks were induced to monetize the public debt," he has written, "state governments were encouraged to go into debt and government and bank inflation were intimately linked").

Reserve requirements were reduced to 18% with the advent of the Federal Reserve System in 1913 and stand at 12% today. Loans as a percentage of assets are higher today than they used to be, however. And off-balance sheet liabilities—such as standby letters of credit, interest-rate swap commitments, and futures-markets trading—are higher, too.

The rise in the risks attached to banking prompts numerous questions about the nature of lending and the credit cycle. How has the regulatory and monetary climate of the 1980s affected bank lending? If, as seems obvious, it has inflated it, what will be the consequences of this?

If anything is new about bank-

ing in the 1980s, it is the substitution of federal guarantees for the liquidity of individual banks. It is the policy that, in the case of the 11 or so largest banks, failure will not be allowed and that, even in smaller institutions, depositors will be protected. It is this regulatory sea change that distinguishes the current debt expansion from so many earlier ones.

Years ago, when weak banks suffered runs by public depositors, instead of seizure by the Federal Deposit Insurance Corporation, a liquid balance sheet constituted a competitive advantage. When James ("Sunshine Jim") Stillman, National City's dour chairman, correctly forewarned his associates in early 1907 to prepare for a panic that Fall, he was able to anticipate a competitive silver lining: "What impresses me as most important is to go into next Autumn ridiculously strong and liquid, and now is the time to begin and shape for it. If by able and judicious management we have money to help our dealers when trust companies have suspended, we will have all the business we want for many years."

If, however, one's institution is beyond failure, it hardly makes business sense to build reserves against an unpredictable day of reckoning. What it makes sense to do is lend, and so banks have lent.

Economist Rothbard has written a brief ode in prose to the

bank run: "It is a marvelously effective weapon because (a) it is irresistible, since once it gets going it cannot be stopped, and (b) it serves as a dramatic device for calling everyone's attention to the inherent unsoundness and insolvency of fractional reserve banking."

The Federal Reserve Act of 1913 was hailed as a gift to the nation, in part because it seemed to promise a run-free future. Because the reserve banks would lend in times of crisis, commercial banks could afford to become a little less liquid—a little more expansive—in good times.

Things did not work out exactly that way, and the 1930s saw a marathon of bank runs. Rejecting conservative counsel, the Roosevelt administration created the Federal Deposit Insurance Corporation to furnish still more federal assurances to bankers and depositors. Over the next several decades, the conviction took root that enlightened legislation had eliminated the possibility of another national banking crisis.

The strategy has worked, and it hasn't worked. There has been no great deflation, no national bank holiday, and no prairie-fire run on the members of the New York City Clearing House Association. On the other hand, there has been the thrift snafu and the Third World crisis. Each is an emblematic event, as each has lingered for years, not months, and

CONTINUED ON NEXT PAGE

Trusts and Taxes—The Institute now has the ability to offer all manner of Charitable Trusts and Continuities to Members who want to help the Institute in its work, and reap significant tax benefits in the bargain.

For more information, without any obligation, please check the box on the enclosed form.

Bring Back the Bank Run

CONTINUED FROM PAGE FIVE

the cost of each is measured in the scores of billions of dollars, nothing less. It is hard to imagine a free banking system getting itself into scrapes like those in the first place.

Commenting on some of these trends a few months ago was none other than the Chairman of the Federal Reserve Board. Alan Greenspan delivered an unusual speech at a remarkable time. The date was October 16, the Monday following Friday the 13th, and the audience was the American Bankers Association. Greenspan proceeded to describe the 150-year odyssey by which American banks have become more leveraged and less liquid.

What was notable was the chairman's historical perspective (even if, for professional reasons, he did not share Rothbard's view that fractional-reserve banking is a fraud). In banking and credit terms, Greenspan admitted, the 20th century has been an age of relaxation. While not deploring this trend, he did not ignore it either. "Although leverage was important in the past, as now, the amount of leverage historically was much less than we see today." Despite the addition of \$14 billion in equity capital by national banks in 1988 and the first half of 1989, "capital levels for the industry remain at the low end of their

ratified by consumer demands and without asset values established in open capital markets, a planned system must necessarily misallocate resources. By now everyone, including communists from Gorbachev on down, acknowledges that the planned economies of the Soviet bloc have been failures. The U.S. military economy also has been a failure, for the same reasons.

But if the military economy has been an economic failure, squandering resources right and left, it has been a political success—at least for those who com-

broad historical range."

In other words, by historical standards, the banks are loaned up. More than that, they are stuffed (many of them) with loans that were once considered inappropriate for the balance sheet of a commercial lending institution. The most prevalent specimen of this class of dubious assets is loans against speculative commercial real estate. As banks withdrew from business lending, they turned to property.

Rothbard's theory holds that a run-resistant, semi-socialized, fractional-reserve banking system is a house of cards.

Like Greenspan, Robert L. Clarke, Comptroller of the Currency, adopts a non-Rothbardian world view. He recently testified that "the national banking system is fundamentally sound. That conclusion is based on a substantial increase in capital levels, especially equity capital levels, relatively strong earnings, and an improvement in overall credit quality among the majority of national banks during the past 18 months."

He evidently rejects Professor

Rothbard's theory that a run-resistant, semi-socialized, fractional-reserve banking system is a house of cards.

What has been lacking in American banking in recent years is the run. And when it has not been lacking—as in the rescue of Continental Illinois in 1984—it has been frightening. With the wholesale substitution of federal promises, actual or implied, for conservative banking practices, the caliber of lending has inevita-

bly suffered. Sunshine Jim Stillman, were he to return to Wall Street for a day, would very probably wish that he hadn't.

Is the banking dilemma eternal? It doesn't have to be. We could desocialize credit risk and let the bank runs take their toll. Absent federal meddling, the bottom line would be simplicity itself. The proof that banks have created excess credit would be found in the action of markets. It would be a fascinating picture if not a pretty one. ◀

Time for an American Perestroika

CONTINUED FROM PAGE ONE

mand its heights or feed at its troughs.

Defense, of course, is often taken to be the classic "public good," and it is true that virtually all Americans want the government to do whatever is necessary to deter attacks from abroad. But no one knows with any certainty what the relation is between military spending and national security. Obviously, vast sums can be, and have been, spent for worthless weapons. Other weapons work well enough but trigger offsetting reactions by adversaries, leaving the nation no more

secure or even less secure, but assuredly poorer.

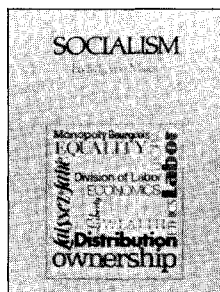
Further, no one knows how much of the military effort goes toward protecting the lives and property of U.S. citizens and how much goes toward advancing the interests of the U.S. government, which are by no means synonymous with the interest of the general public. But however problematic true national security may be, military spending undoubtedly generates private benefits in the form of jobs, incomes, votes, and power. For these prizes, there has been no

secure or even less secure, but assuredly poorer.

Further, no one knows how much of the military effort goes toward protecting the lives and property of U.S. citizens and how much goes toward advancing the interests of the U.S. government, which are by no means synonymous with the interest of the general public. But however problematic true national security may be, military spending undoubtedly generates private benefits in the form of jobs, incomes, votes, and power. For these prizes, there has been no

Time for an American Perestroika

CONTINUED FROM PAGE SIX



Fighting for the Free Market

When you help the Ludwig von Mises Institute, you support internationally recognized educational programs dedicated to the free market, sound money, individual liberty, and private property.

Since the Institute refuses to solicit or accept government funds, and is considered—like Ludwig von Mises himself—“too uncompromising and intransigent” by establishment sources, we depend entirely on those people who share our principles.

shortage of seekers.

The military-industrial-congressional complex (hereafter the MICC) includes all those who have found a way to turn a bad public situation, the Cold War, into a good personal deal. Members of Congress, especially those who belong to the key military committees, milk the system to gain reelection. Arms contracting firms, many of which lack the ability to compete successfully in commercial markets, rake in large profits, often with little or no risk. The military services, with their bloated officer corps and labyrinthine bureaucracies, gain positions, income, and prerequisites, not to mention one of the cushiest retirement plans in the land. On the periphery of the MICC thrives congeries of military-oriented lobbyists, consultants, research institutions, academicians, and labor unions.

The companies that supply the Pentagon talk a good private-enterprise game, but in practice they are at best mutant and twisted actors in the market. They are subject to no genuine market discipline; the government is the sole buyer of the arms they produce. But the government purchasers are using other people's money and have no bottom line of their own.

Small wonder if the big military companies all form political action committees to channel millions into the campaign coffers and personal accounts of many members of Congress. Hardly surprising if the firms hire thousands of retired military officers, former congressmen, and congressional staffers to help them acquire additional arms contracts. Big arms companies in trouble can confidently apply for a government bailout.

The whole business reeks of corruption, some of it illegal but much of it, like the blatant bribes (“honoraria”) paid to members of Congress, perfectly legal. The FBI, eavesdropping on a tele-

phone conversation between two men engaged in a Pentagon procurement fraud, recorded one of them saying, “If the farmers in Indiana knew what you sons of bitches were doing with their money, they would come up there and kill you with their pitchforks.”

But despite the scandals that flare up every few years, the public either doesn't know or feels powerless to do anything about the conduct of the MICC. Like the East Germans who toiled in poverty while their masters lived in luxury, the average citizen surrenders the funds to feed the gargantuan military economy year after year.

The companies that supply the Pentagon are at best mutant and twisted actors in the market.

As William J. Stern recently wrote, the political insiders who flourish when the government maintains a vast military economy are “our version of the East bloc's Nomenklatura and they have absolutely no wish to see anything change.” For a perfect example, read the history of Wedtech—it doesn't get any sleazier.

Over the years, numerous real or pretended efforts to reform the system have been made. Three major studies by presidential blue-ribbon commissions, the latest being the Packard Commission of 1986; many acts passed by Congress; various in-house efforts at the Pentagon; scores of investigations by the General

Accounting Office; countless proposals by scholars and private groups—all have come to naught.

Secretary Cheney took office pledging to carry out effective fundamental changes. But his actual plan, announced late in 1989, was correctly described as leaving “intact the structure and authority of the entrenched Pentagon procurement bureaucracy.” Cheney sought to avoid alienating the top civilian and military leadership of the armed services. The result: no substantive change.

Now, as the public sees less and less justification for the maintenance of an enormous military establishment, especially one designed for another world war in Central Europe, the MICC will surely come under attack. But its political resources are enormous. Even if military spending is cut, it is unlikely to be cut very much very fast. Regardless of events in Eastern Europe and the Soviet Union, those whose positions and incomes derive from high levels of military spending will continue to resist the spending cuts.

They may also be tempted to stir up fears of new threats or to revive the Cold War—after all, the past 40 years are littered with weapons “gaps” and other forms of scare-mongering. The public would be well advised to anticipate such tactics.

As the welfare state has matured, people have come to appreciate better that groups seeking to redistribute income to themselves always present their plans wrapped in a claim to promote the public interest. Those who seek to feather their nests in the warfare state use the same tactic even more effectively.

Perhaps, if the Cold War really does end, the basis for this far-reaching redistributive activity will erode. Then *perestroika* may become possible in the United States, too. ◀

Government Garbage

CONTINUED FROM PAGE TWO

print thanks to government programs. In New Jersey, for example, the price of used newspapers has plummeted from \$40 a ton to *minus* \$25 a ton. Trash entrepreneurs used to buy old newspaper. Now you have to pay someone to take it away.

If it is economically efficient to recycle—and we can't know that so long as government is involved—trash will have a market price. It is only through a free price system, as Ludwig von Mises demonstrated 70 years ago, that we can know the value of goods and services.

Environmentalists don't seem to understand this. They ask their followers to ignore price signals and cut their consumption of everything from gasoline to paper towels. This one plank in the environmental platform I agree with, since it will make these goods cheaper for the rest of us. I'm happy to have my standard of living raised by voluntary pov-

erty from what Ronald Reagan once called "the tree huggers."

Some liberal economists claim prices can't solve the garbage problem because of "external diseconomies." Since greedy capitalists are out to make a fast buck, the theory goes, they produce goods that impose costs external to their businesses, i.e., trash. But all businesses have spill-over effects, good and bad, and in a free market, this creates opportunities for other entrepreneurs. The donut industry may help make people fat (an external diseconomy). Should it be forced to sponsor Weight Watchers? Or, more to the point, should the public be taxed for a new federal Department of Corpulent Affairs?

The cave men had garbage problems, and so will our progeny, probably for as long as human civilization exists. But government is no answer. A socialized garbage system works

no better than the Bulgarian economy. Only the free market will solve the garbage problem, and that means abolishing not only socialism, but the somewhat more efficient municipal fascist systems where one politically favored contractor gets the job.

The answer is to privatize and deregulate everything, from trash pickup to landfills. That way, everyone pays an appropriate part of the costs. Some types of trash would be picked up for a fee, others would be picked up free, and still others might command a price. Recycling would be based on economic calculation, not bureaucratic fiat.

The choice is always the same, from Eastern Europe to my town: put consumers in charge through private property and a free price system, or create a fiasco through government. Under the right kind of system, even I might start separating my trash. ◀

Still the Best

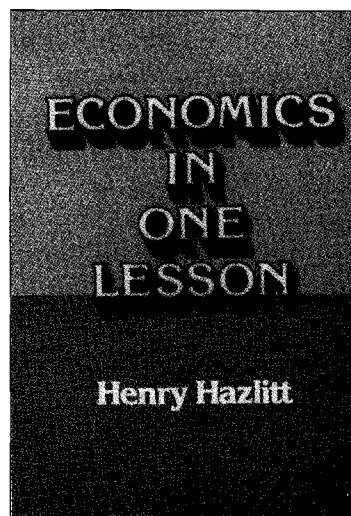
A large stone sails through your front window. Does this help the economy? The answer is, of course, no, and government intervention is the stone writ large. From taxes, regulation, inflation, welfare, and price-fixing to protectionism and group privileges, virtually everything the government does is destructive to prosperity. *Economics in One Lesson* by Henry Hazlitt explains why.

This book is more than a classic. It is a treasure. It first appeared in 1946 and caused a sensation. And the economic establishment was scandalized. The economics profession is still

catching up with Hazlitt, and the blurb on the first edition still rings true: "An introduction to economics based on the conviction that the shortest and surest way to an understanding of this

science is through analysis of the economic fallacies most popular today, and particularly of the central error from which they stem." Even today, there is still no better introduction to the economics of freedom.

Hazlitt—economist, journalist, and student and friend of Ludwig von Mises (and the Institute)—gave the "freedom philosophy" real meaning. He believed that ideas have consequences only when individuals apply and advocate them, especially by battling the government. Hazlitt was a fierce opponent of the leviathan state, and this helped inspire the founding of the Mises Institute. *Economics in One Lesson* will show you why. ◀



Henry Hazlitt's classic *Economics in One Lesson* is available this month for \$9, which includes U.S. postage and handling. Please see the enclosed form.

LUDWIG
VON
MISES
INSTITUTE

Copyright ©1990 by the Ludwig von Mises Institute, 851 Burlway Road, Burlingame, California 94010, (415) 579-2500, Fax: (415) 579-0612, and Auburn University; the O. P. Alford III Center for Advanced Studies in Austrian Economics; the University of Nevada, Las Vegas; the Lawrence Fertig Student Center; and the *Review of Austrian Economics*. Permission to reprint articles is hereby granted provided full credit and address are given. Editor: Llewellyn H. Rockwell, Jr.; Contributing Editor: Murray N. Rothbard; Managing Editor: Jeffrey A. Tucker; Scholarly Publications Editor: Judith F. Thommesen; Production by MacDonald-Morris Creative Services; Publisher: Patricia O. Heckman; Associate Publisher: Norma A. Marchman.