

FREEMarket

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THOSE STUDENT LOAN SCANDALS

Robert Murphy

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In response to mounting controversy over the student loan industry, the House passed the Student Loan Sunshine Act by a large margin (414–3). The Act would require lenders to disclose any financial relationships they have with educational institutions, and it would prohibit certain questionable activities, such as lenders giving “gifts” to the employees in a school’s financial aid office.

Straightforward as this act seems, it will fail to address the true causes of corruption in higher education. Stronger proposals, such as to bypass the private lenders altogether and have all students get their loans directly from the federal government, would be disastrous. At root the problem is massive government subsidies and regulations, and more of the same will only make the situation worse.

To understand it all, we need to separate out the various allegations. On the one hand, Democrats are accusing the Bush administration of *very* benign neglect of what has been dubbed “recycling and refunding,” whereby lenders use artful manipulation of their portfolios to qualify for a 1980 provision (when interest rates were far higher than today) that guaranteed lenders a 9.5 percent return on their student loans.

As reported in a critical Salon.com article: “While payments on 9.5 percent loans had held steady at below \$200 million per year since 1990, according to a 2004 report by the Government Accountability Office, the amount of 9.5 percent payments rose from \$209 million in 2001 to over \$630 million in 2004.”

If true, these allegations would be deplorable indeed; hundreds of millions of taxpayer dollars would be funneled into private hands in clear violation of the spirit of the original laws.

However, the solution here would be *to end the subsidies*, not demonize the lenders who can’t resist picking up millions of dollars lying on the table. For an analogy, there are currently plenty of landowners who get paid large sums by the federal government *not* to grow crops. (This dates back to a misguided New Deal-era program designed to prop up farm prices.) The solution here too is to stop making such payments, not to gnash our teeth about greedy landowners or (even worse) suggest the federal government nationalize all food production.

However, the real outrage in the past few months hasn’t been over wasted taxpayer dollars. Instead, the controversy centers on the cozy relationships between private lenders and school officials, whereby colleges steer new students to preferred lenders ⇨

who then reward the compliant staff with gifts and other compensation. For example, in 2005 J.P. Morgan apparently paid \$70,000 for a harbor cruise in New York City for over 200 financial aid officers—and one gets the sense that this wasn't an altruistic effort by the investment bank to promote maritime appreciation. With seemingly outrageous behavior like this, surely the federal government needs to step in, right?

The problem with this knee-jerk reaction is that it is *government involvement* that has led to the corruption in the first place. For example, why don't we read daily newspaper articles about the problem of kickbacks in, say, the retailing industry? After all, the manager of the apparel section in a Wal-Mart could easily take bribes from a vendor in order to stock the shelves with a more expensive sweater.

But we don't need the federal government to police this possibility, because Wal-Mart executives themselves have every reason to stamp it out, since such self-serving behavior by the individual manager hurts Wal-Mart's bottom line. Customers are always free to shop at a different chain that does a better job controlling its employees and thus holding down costs.

(For those younger readers who might wonder whether my analysis is realistic, I merely refer them to the episode of *Friends* when Monica is fired from her prestigious job as a chef when she innocently accepts steaks from a vendor. This is serious stuff!)

These incentives for self-regulation are largely absent in higher education. For one thing, a large volume of student loans is processed through government-run

schools in the first place. There, if the administrators keep a sharp eye out for corruption and thus hold down costs, this doesn't translate into higher profits for shareholders. But even in nominally private colleges and universities, government regulations and massive subsidies effectively blur the distinction between private and public. Very few schools in the United States today are "run like a business," and that's precisely why corruption is so manifest—unlike the vast majority of businesses.

The solution to the crisis in higher education is to take the government out of the equation. The "single payer" Pentagon certainly doesn't hold down costs, and the ranks of politicians are certainly not known for their upstanding morals. The idea that the federal government can be trusted to root out waste and corruption is absurd—those proposing such a "remedy" need to get educated. ■

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A CASE FOR PIRACY

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In marketing the most effective way to introduce new products is the free sample. In 1978 Lever Brothers spent \$15 million (\$47.55 million in today's currency) delivering a free sample of Signal Mouthwash to two-thirds of all US households. The strategy was a success and the product remained on the market well into the 1990s.

The significance of the free sample is product trial; it gets the product into consumers' hands. If consumers use the sample and like it, they may go on to buy the product and buy it again and again, that is, become repeat purchasers; they may even spread the good word to others. When repeat purchasing and favorable word of mouth kick in, the product's sales will experience a shift from slow to rapid growth and management will consider the product a success.

Free sampling is the best method of introducing new products, but it is also the most expensive. Not surprisingly, then, *Forbes ASAP* magazine reports this alternative way to practice free sampling:

“One security manager for a major manufacturer, who asked not to be identified, says she is sure some companies actually view being counterfeited as a boon to their efforts to build brand awareness. After all, she says, if some companies give away merchandise to expand market share, what's not to like about having someone else take on the expense of manufacturing and distributing the goods, as long as they're high-quality copies?”

Imitation is a universal trait of human behavior, ranging from the use of phrases and mannerisms of admired others to the reuse of hummable themes in music, recognizable images in paintings and well-known plots in literature and Disney movies. Imitation is a normal part of the competitive process in growth markets. As the sales of an innovative new product take off, competitors enter the market with their own, often cheaper, versions.

If the innovative product is patented, competitors make minor design or functional changes to secure their own patents. Knock-offs are unauthorized, usually cheaper copies. And, of course, the innovative marketer often produces its own cheap version, sometimes called a fighting brand, to fend off the competition. Over time real prices in the product category decline and quality improves.

Knock-offs are pirated products. Because they are usually cheaper than the original, knock-offs tend to appeal to a more price-conscious segment of the market; that is, the buyers of pirated products are probably not legitimate prospects for the innovative new product, either because they cannot afford, or do not want to pay, the higher price. Message to the innovative marketer? Either drop the price of the new product or produce a cheaper version—or be the first to exploit a new technology, something the movie and recording industries chose not to do. Many, including these two industries, would rather sue than practice good marketing.

One study found that users of pirated software sufficiently influenced—by word-of-mouth communication—80 percent of the software’s prospects to buy the legal product and another described several scenarios in which piracy can help increase the sales of legal products. The pirated product functions as a free sample that the innovator does not have to fund.

So what about free copies? How do you compete with free, to state the battle cry of the new Luddites who fear digital technology? It’s done all the time. One of the most dramatic recent instances of this was the strategy of science fiction writer Cory Doctorow who, over the course of three years, gave away 700,000 electronic copies of *Down and Out in the Magic Kingdom*. Sales of the hard copy went through six printings

and surpassed his publisher’s expectations. Many of the downloaders, Doctorow said, did not buy the hard copy and probably would not have regardless, but the giveaway created considerable buzz and a significant minority did buy the hard copy as well.

Compare this to the experience of the Mises Institute with *Omnipotent Government*, *Human Action*, and a hundred plus other titles. The goal of all the free books on Mises.org (and new ones seem to appear every day) is first to get the word out, but they have also generated new attention to free-market economics, which has in turn assisted in bringing people to conferences, selling books, and inspiring donors to support the overall work of the Mises Institute.

Free—no matter where it comes from—can help sell. ■

TIMELESS IDEAS, TIMELESS BOOKS

Jeffrey Tucker

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We have several criteria for books published by the Mises Institute and carried in our store. They should advance the Austrian School of economics, of course. And this is true even if the topic is history, philosophy, or law. They must explain and promote liberty. And they must not be merely news commentary or bound up with contemporary issues only. The hope is that whatever book we publish or distribute, it will hold up after decades. This is another way of saying that we want to use our resources to back timeless ideas. After all, the science of economics and the concern for human liberty advance truths independent of time and place.

Does this seem like a small niche? Perhaps, but once you look at the vast amount of material published since the founding of the Austrian School, you are overwhelmed at how much important material has been tragically left to languish in obscurity.

To address the problem, we have seriously stepped up our publication program. A recent example is Rothbard’s *The Panic of 1819*. It was his doctoral dissertation, and remains the definitive study on how government should handle economic instability: do nothing and it fixes itself.

Our new book program will include not only the biography of Mises but many wonderful surprises besides. In

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News from the Institute

Summer Seminars

It's a summer of learning at the Mises Institute, with back-to-back seminars all season long. It's wonderful that so many people have come to attend them. But for those who can't make it, donors have made it possible for them to be broadcast on the web in super high quality, both in audio and video. All lectures are then permanently available on webcast and packaged for distribution through our online store. This way, the ideas of freedom can achieve maximum exposure. See mises.org/store. ■

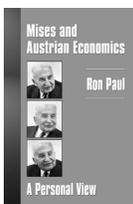
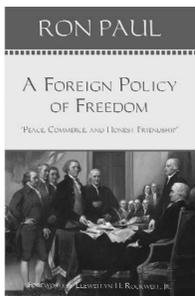
Mises Circle Seminars

An innovation of the past year has been regional seminars conducted by staff and senior scholars of the Mises Institute. The attendance at these events has far surpassed our expectations. Members of the Institute are bringing friends, who then join. If you are interested in holding one of these sponsored seminars in your area, contact James Fogal at James@mises.org. ■

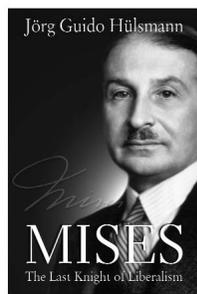
Mises Institute Books

Ron Paul's run for the Republican nomination has brought new attention to the Austrian School and free-market ideas. Ron is, of course, the distinguished counselor to the Mises Institute. He has been a great supporter over the years. Indeed, he credits the work of Mises with providing his intellectual foundation and also giving him the inspiration to enter public life. He will be joining us at our 25th anniversary celebration in New York, October 12–13, 2007.

Ron's books have become top sellers in our store. His *Foreign Policy of Freedom* maps out a military policy consistent with a free society. His *Case for Gold* still holds up as a great history of money and banking and a blueprint for the future. His *Gold, Peace, and Prosperity* is an excellent primer on money and inflation. His personal story is told in *Mises and Austrian Economics: A Personal View*. All are available from Mises.org/store.



We can hardly wait for the book of the season (year, decade, more?), which is Jörg Guido Hülsmann's *Mises: The Last Knight of Liberalism*. Its release date is October 12th, at the 25th anniversary celebration. The Mises Institute is very pleased to be the publisher. We had other offers for the manuscript from prestigious university presses but the price would have been higher, the release date further into the future, and the question of reprinting rights were uncertain. With the Mises Institute as the publisher, the book receives the broadest possible exposure, and the highest quality production values! A special thank you to all donors who have made it possible. ■



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addition, there are many excellent books that have appeared in the past that need not new editions but reprints that make them available for students. That is why we initiated our Student Series. Of the sixty books we've reprinted in this series, it is difficult to isolate the best. So I'll just stick with the ones that stand out in my own mind.

Frank Chodorov was a champion of liberty at a time when liberty needed it most: between the wars and after the second world war. He was unbelievably sound, and he had a gift for exposition. There is his wonderful treatise on the bane of everyone's existence: *The Income Tax: The Root of All Evil*. Yes, there is rhetoric in that title, but you know what? By the time you finish the book, the reader is convinced! His collection, *Out of Step*, includes his plea to not buy government bonds. And there is his inexplicably overlooked treatise called *The Rise and Fall of Society*. If I were to pick one book to give to undergraduates, to form in them a sound view of society, government, and economics, it would be this one.

John T. Flynn came from the same generation of thinkers. His riveting book on the rise of fascism in the United States is called *As We Go Marching*. How this could have ever gone out of print is beyond me, but at least it is back. But there is also his astonishing work *Men of Wealth*, which is as fine a history of American entrepreneurship from the Gilded Age forward that I've ever seen. If business students haven't read it, they probably don't understand American business. Then there is his biography of Rockefeller: *God's Gold*. Two other books also appear in this Flynn series. At last he speaks again!

Henry Hazlitt too wrote between the wars and after, and now all his books are available again, including *The Failure of the "New Economics"* (in our main imprint) as well as: *Anatomy of Criticism; What You Should Know about Inflation;*

The Conquest of Poverty; Time Will Run Back (a novel!); *Will Dollars Save the World?* (the Marshall Plan was a bad idea), and *Man vs. The Welfare State*.

Wilhelm Röpke and Joseph Schumpeter can't be called Austrians with a capital A but they both offer excellent insights on international affairs that you can't get elsewhere. And both were influenced by the Misesian tradition in the course of their writing. From Röpke, there is *International Economic Order and Economic Integration; International Economic Disintegration; and Crises and Cycles*. Before our reprints, you had to take out a second mortgage to buy these books. And from Schumpeter, there is his work *Imperialism*, in which he describes Rome in a portrait very familiar to contemporary America.

Some purely economic works, great and important books, had mysteriously disappeared from human consciousness. Here I mention *Economics of Inflation* by Costantino Bresciani-Turroni (the story of the German hyperinflation); *The Economics of Illusion* by L. Albert Hahn (an early opponent of Keynes); *Economic Principles* by Frank Fetter (an American Austrian who influenced Rothbard); *Essentials of Economic Theory* by John Bates Clark; and three forgotten books by Knut Wicksell, who had a mighty role in the formation of Austrian business cycle theory.

And I've saved the most exciting for last. Back in the 1960s, Murray Rothbard put out a tiny journal with a revolutionary impact. It was called *Left and Right*. Until recently, it was impossible to find. Now all the issues are collected in a single volume—reprinted exactly in the format in which they first appeared.

These books don't just put ideas back into circulation. They give the whole movement for liberty a massive boost, almost as if our glorious intellectual tradition has come back in full force. Thank you to all who have made this possible! ■

The Life, Times, and Work of Ludwig von Mises

A George and Joele Eddy Seminar

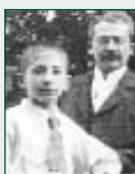


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A George and Joele Eddy Seminar with Guido Hülsmann
July 23–27, 2007 • Auburn, Alabama
- MISES UNIVERSITY
July 29–August 4, 2007 • Auburn, Alabama
- MISES INSTITUTE SUPPORTERS SUMMIT AND 25TH ANNIVERSARY
October 12–13, 2007 • New York, New York
- THE MISES CIRCLE IN HOUSTON (Sponsored by Jeremy Davis)
January 26, 2008 • Houston, Texas
- AUSTRIAN SCHOLARS CONFERENCE 2008
March 13–15, 2008 • Auburn, Alabama



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