

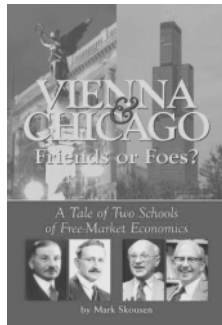
Book Reviews

Vienna and Chicago: Friends or Foes? A Tale of Two Schools of Free-Market Economics

by Mark Skousen

Capital Press • 2005 • 304 pages • \$24.95 paperback

Reviewed by Richard M. Ebeling



In the post-World War II era, two of the leading voices for a return to a competitive free-market economy have been the Austrian and Chicago schools of economics. Both schools have influenced many people about how markets work and how government affects economic affairs.

To many, the Austrian and Chicago economists seem to be saying the same thing: markets are an efficient way of using scarce resources to best serve consumers; individuals know their own interests and circumstances better than government regulators and planners; political controls tend to distort supply and demand and the price system through which markets are kept in balance. In addition, members of both schools of thought have long warned that inflation and its negative consequences stem from government monetary mismanagement.

As a result, on the surface there seems not to be much difference between the two schools. Yet anyone fairly familiar with the Austrian and Chicago approaches knows that in fact they not only look at the world through significantly different conceptual lenses, they often are extremely critical of each other.

In his recent book, *Vienna and Chicago: Friends or Foes?*, Mark Skousen tries to explain the history of the Austrian and Chicago approaches, and critically evaluate their strengths and weaknesses. Skousen explains the beginnings of the Austrian school in the last decades of the nineteenth century, during which Carl Menger, Eugen von Böhm-Bawerk, and Friedrich von Wieser developed the theory of marginal utility and opportunity cost; formulated a theory of capital, investment, and interest; and undermined the foundations of Marxian

economics. He then traces the contributions of such leading twentieth-century Austrians as Ludwig von Mises and F.A. Hayek in the areas of monetary and business-cycle theory, their insightful criticisms on socialist central planning, and their conception of the market as a dynamic competitive process.

The Chicago school developed later, in the 1920s and 1930s, out of the writings of Frank Knight, Jacob Viner, and Henry Simons, who were early critics of some aspects of Keynesian economics and of government planning. But the Chicago school only really flowered in the postwar era out of the contributions of Milton Friedman and George Stigler, who challenged, respectively, some of the rationales for macroeconomic and regulatory management of market activities.

For the remainder of the book, Skousen contrasts the two schools on a variety of topics, including methodology; inflation, business cycles and the monetary system; and government regulation and intervention. Somewhat irritatingly, Skousen concludes each section by declaring which school “wins the debate,” using the language of tennis: “advantage” Vienna or Chicago. While seeming to be a cute way to evaluate the two schools, it comes across as rather sophomoric. Also, it often seems that Skousen’s decision reflects his judgment about which school has been more influential among economists or in the policy arena. But the correctness of an idea is not measured, per se, by the number of its adherents. Alchemy and astrology have had wide followings, after all.

The core of the differences between the Austrian and Chicago schools is the question of how one tries to understand the world, including the market. Imagine that two objects are observed moving toward each other at a certain velocity. What can we predict about what will happen? Well, we can attempt to estimate their respective speeds and calculate when they are likely to collide, given the measured space between them.

There is nothing wrong with doing this. But if the two objects happen to be human beings, limiting the “facts” or “evidence” to these quantitative dimensions will leave out crucial features of the situation. For example, do these individuals view each other as friend or foe? The answer to that question alone will greatly influence what we predict as the likely sequence of events as they come closer to each other. (If foe, one of them

might suddenly stop dead in his tracks and run in the opposite direction from fear.)

To analyze this situation requires the social scientist or economist to look beneath the quantitative surface to try to determine how the actors define the situation, including the meanings they see in their own actions and those of others with whom they may interact. A voluntary exchange and a coerced transfer may look the same to an observer. But they are certainly not the same when understood from the perspectives of the actors.

Unlike the Chicago-school economists, the Austrians have always insisted on emphasizing this “subjectivist” approach. This is partly due to the Chicagoans’ continuing belief (a subjective state of mind, for sure!) that “science” should be defined narrowly as the quantitatively measurable and predictable.


Skousen tries to reduce and ridicule the Austrian view by making it into a caricature of an “a priori-deductive” approach that is both incorrect and unjust to the actual arguments that Austrians like Mises developed in great detail. Nor does Skousen do justice to the fact that Austrians, too, believe in “applied” economics, historical studies, and factual evidence. They just do “empirical” work differently from the Chicago economists—the Austrian approach tries not to forget that it is the course of *human* events that is being investigated.

He therefore too easily gives “advantage” to the Chicago school when comparing their contributions, for instance, in the area of government regulation. The Austrians focus on the entrepreneurial element of innovation and market coordination; they think of competition as a creative discovery procedure; and they view markets as processes of change and adjustment through time. To appreciate the power of the unregulated market, none of these aspects of the real “empirical” world can simply be reduced to econometric coefficients of correlation without losing essential qualities of the subject. It would be like trying to study man by looking only at the skeleton and ignoring the flesh, blood, muscles, nerve endings, and most especially, the *mind* that guides what the body does.

Skousen finds the most important Austrian contributions in the areas of money, inflation, the business cycle, and monetary institutions. This should not be surprising since these are the areas in which he has written the

most over the years from an Austrian-oriented perspective. Friedman’s monetary contributions have basically followed in the Keynesian footsteps. While rejecting most of Keynes’s assumptions about the power of fiscal policy for stimulating the economy, Friedman accepted his “aggregate” approach of looking almost purely at money’s impact on prices, wages, and output in general.

The Austrians, on the other hand, have always focused on the more insidious effects of monetary expansion on relative prices and wages, and on demand, effects that can give a wrong twist to the entire economy.

Unfortunately, while an easy read and even entertaining in places, *Vienna and Chicago* fails to give the reader a fully balanced understanding of the Austrians or a sufficiently critical appreciation of the limits of the Chicago school. 

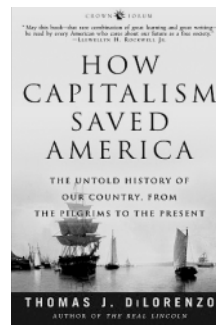
Richard Ebeling (rebeling@fee.org) is the president of FEE.

How Capitalism Saved America: The Untold History of Our Country, from the Pilgrims to the Present

by Thomas J. DiLorenzo

Crown Publishing • 2004/2005 • 295 pages • \$25.95
hardcover; \$14.95 paperback

Reviewed by Robert Batemarco



Professor Thomas DiLorenzo of Loyola College, Maryland, has managed to pack two books into the volume titled *How Capitalism Saved America*. The first is the work promised in the title, the inspiring story about the creative power of that nexus of voluntary exchanges known as capitalism. The second, more sobering, book inhabiting these same pages tells the tawdry tale of those who through venality, envy, or simple ignorance have acted to stifle capitalism and deprive us of its benefits. Unfortunately, this second is as necessary as the first.

The “first book” is replete with unsung heroes, such as industrialist Thomas Weston and nobleman Thomas Dale. These two Englishmen observed, diagnosed, and treated the free-rider problem that subjected the

Jamestown and Plymouth Bay colonies to impoverishment, famine, and death. Their prescription was not, as today's conventional economic wisdom would have it, enlisting the government to provide food, but rather replacing communal property rights with private property rights. Within a year, poverty was succeeded by plenty, initiating a process that would make America the wealthiest country the world had ever known.

The "second book" shows that identity theft has been a problem since long before the Internet, credit cards, and Social Security numbers. The culprit here is mercantilism and the victim capitalism. Few who have not studied the history of economic thought even know what mercantilism is, a problem that wide readership of this book would remedy. Yet this system, in which the state extracts large amounts of resources from the populace to subsidize favored corporate interests, is what most people think capitalism is. This deception has led to a double injustice: the vilification of market entrepreneurs whose wealth came from solving the problems of millions within the capitalist system and the hailing as the "saviors of capitalism" politicians who conjure up phony problems or phony solutions to real problems.

DiLorenzo sets this out clearly and provides many historical examples. For instance, he contrasts the private road systems that sprang up throughout the United States in the early 1800s with the "public improvements" subsidized by state governments that were so corrupt and inefficient that by 1860 most states had banned such boondoggles. Unfortunately, after the Civil War the newly empowered central government picked up where the states left off by subsidizing railroads. While most historians paint all railroad owners as "Robber Barons," this book makes the crucial distinction between market entrepreneur and political entrepreneur to separate the Vanderbilts and the Hills from politically connected railroad magnates such as Jay Cooke and Thomas Durant, who were truly deserving of that ignominious title.

This book elucidates many other examples of capitalism delivering the goods while its opponents fraudulently take the credit. For one, it demonstrates how capitalism enriched the working class through that most capitalist practice, capital accumulation, while union leaders and politicians claimed their beloved income-

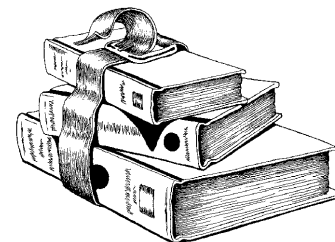
redistribution policies had done the trick—and some trick it would have been, since you cannot redistribute what has not been produced. For another, it illustrates how capitalism, in the person of the entrepreneur John D. Rockefeller solved the problem of providing cheap energy, enabling supply to grow and price to fall year after year. Simultaneously, nearly every measure promulgated by the government to tame the "excesses" of capitalist production of oil, including antitrust prosecutions, worked against the interests of consumers. Especially worthwhile is the discussion of the antitrust bait-and-switch scam, which promises to promote competition while actually seeking to rein in those who compete too successfully.

Finally, no discussion of how government problem-solving makes matters worse would be complete without surveying its sorry record of ameliorating the business cycle. DiLorenzo's detailed analysis of the policies adopted from the onset of the Great Depression obliterate any justification for believing that Herbert Hoover was a practitioner of capitalism and Franklin Roosevelt was its savior.

The author writes with a clarity and passion rare for economists. *How Capitalism Saved America* is scholarly yet accessible. While not theoretical, it uses theory to help us understand the facts. I did note a couple of inaccuracies, however. For example, the author says a worker must generate at least as much *profit* as the wage he is paid, when he means *revenue*. He also confounds the First and Second Banks of the United States. While neither of these undermines the main themes of this powerful work, they are the kind of errors that will be pounced on by those who cannot counter his arguments on the merits.



Robert Batemarco (rbate@verizon.net) is a vice president at a market research firm in New York City and an adjunct professor of economics at Pace University.

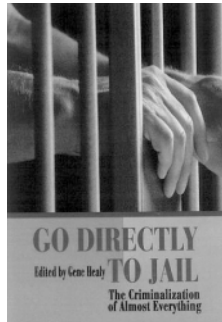


Go Directly to Jail: The Criminalization of Almost Everything

Edited by Gene Healy

Cato Institute • 2004 • 151 pages • \$17.95

Reviewed by George C. Leef



In the gigantic theater that is American politics, one of the favorite roles for politicians to play is that of the tough guy who is determined to “crack down” on something or other. Such actions are predictably cheered by whatever voting groups the politician wants to curry favor with. An

often-heard campaign line is, “Vote for me and I’ll push legislation to make it a crime to . . .” We already have an enormous criminal code, but adding one more thing to it serves to show the voters that the pol really means business.

Like most features of our politics this mania for the criminalization of behavior is harmful. As is usual with government, the unseen problems dwarf the seen benefits. The more we criminalize conduct that voters dislike, the more we put people who never intended any wrongdoing into the quicksand of criminal prosecution. With legions of prosecutors who are more interested in making names for themselves than in doing justice, Americans are living in an increasingly dangerous country.

That’s the point of *Go Directly to Jail*, edited by lawyer and Cato Institute writer Gene Healy. “At one time,” he writes, “the common law doctrines of *mens rea* (“guilty mind”) and *actus reus* (“guilty act”) cabined the reach of criminal sanctions, but those protections have eroded dramatically over the past 50 years. Today it’s possible to send a person to prison without showing criminal intent or even a culpable act. . . .”

Consider this case. Edward Hanousek worked for a railroad in Alaska. One day, a backhoe operator working under his supervision accidentally ruptured an oil pipeline while removing some boulders from the tracks. Hanousek, who wasn’t even at the site of the accident, was nevertheless prosecuted for having violated the Clean Water Act, which makes it a crime if a “negligent failure to supervise” leads to any discharge that might

pollute water. Hanousek was convicted for someone else’s accident. His case was appealed to the Supreme Court, which declined to review this legal abomination. Americans must now worry about criminal prosecution for all sorts of conduct that a few decades ago hardly anyone would have thought should be illegal.

The book has six chapters by different authors. Erik Luna’s “Overextending the Criminal Law” explores the unfortunate tendency for politicians to use criminal sanctions as an all-purpose tool of social control. It’s impossible to disagree with Luna’s assessment that “When the criminal sanction is used for conduct that is widely viewed as harmless . . . the moral force of the penal code is diminished, possibly to the point of near irrelevance. . . .”


In the second essay, “The New Criminal Classes: Legal Sanctions and Business Managers,” James V. DeLong observes that the spread of criminalization means that nearly anyone can fall victim to prosecution for some regulatory crime, and often the defendant finds that the law accords him a lower degree of protection for his rights than do old-fashioned criminals who rob and murder. The Fourth and Fifth Amendments have been subverted in the crusade to send people like Ed Hanousek to jail.

Legal scholar Timothy Lynch, in “Polluting Our Principles: Environmental Protection and the Bill of Rights,” shows that the incentives for environmental regulators to produce “results” (that is, convictions to prove how dedicated they are to safeguarding the environment) lead to terrible travesties of justice. The vagueness of many environmental regulations gives the enforcers almost unfettered discretion to prosecute businesspeople. Lynch notes that individuals accused of environmental crimes are often subjected to procedures that the courts would not tolerate for normal criminal defendants. He calls it the “environmental exception to the Bill of Rights.”

Galen Institute president Grace-Marie Turner discusses criminalization in medical care, specifically, the dangerous trend toward criminal prosecution in the futile crusade against Medicare and Medicaid fraud. An especially frightening feature of the law here is that the enforcers get to keep a percentage of the fines they impose.

Editor Healy contributes a chapter on the rampant federalization of crime. To provide just one example, President Bush's Project Safe Neighborhoods has led to a surge in federal prosecutions for illegal firearms possession. Healy writes that this law "violates the Tenth Amendment, clogs the federal courts, encourages a mindless zero tolerance policy and opens the door for every special interest group in Washington to politicize criminal justice policy."

The book's final chapter, again by Erik Luna, examines the nation's sorry experience with federal sentencing guidelines, which he argues "saps moral judgment from the process of punishment."

The U.S. is off track in many, many ways. *Go Directly to Jail* leaves no doubt that our legal system is careening out of control and poses a grave threat to our liberty. 

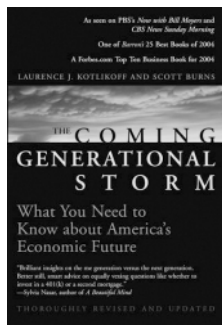
George Leef (georgeleef@aol.com) is the book review editor of *The Freeman*.

The Coming Generational Storm: What You Need to Know about America's Economic Future

by Laurence J. Kotlikoff and Scott Burns

MIT Press • 2004/2005 • 274 pages • \$22.00 hardcover; \$16.95 paperback

Reviewed by Christopher Westley



Boston University's Laurence Kotlikoff is a serious scholar who has devoted much of his professional life to examining Social Security. What he writes on this issue it's wise to read. *The Coming Generational Storm*, co-authored with Dallas-based financial columnist Scott Burns, is a worthwhile

book.

Their description of the fiscal nightmare known as Social Security is a must-read for both academics and interested laymen. It's a credit to Kotlikoff and Burns that they can produce a page-turner for both groups, despite some technical sections on general equilibrium, intergenerational accounting, and actuarial science.

The picture they paint isn't pretty. Social Security is

in crisis because it's organized as an intergenerational wealth-transferring scheme in which the assets of workers are turned over to current retirees. It's a welfare program, pure and simple, but a unique one in that it gets its own special tax—a tax on labor.

It is also unique because since the late 1960s Social Security *expenditures*—though not its revenues—have been off-budget, an accounting rule that would never be tolerated in the private sector where investors would punish such deceit. But it is one that serves the government's needs because it understates budget deficits year to year. For decades Social Security has allowed the feds to appear less fiscally irresponsible than they really are.

The authors note that at Social Security's creation, 16 workers supported each retiree. That ratio was achieved because the labor force was so young and because old-timers just didn't get that old. (The late John Attarian pointed out that the New Dealers' purpose in Social Security was no higher-minded than to get older workers to leave the workforce. Their presence was blamed for the failure of New Deal programs to reduce unemployment.) Those were Social Security's glory days.

But life expectancy has been rising and the worker-to-retiree ratio has been falling. Result: The ratio now stands at 3:1, and over the next 30 years, the figure is expected to fall to 2:1. The longer reforms are put off, the greater the burden placed on future generations to pay for current spending, and it is here that Kotlikoff and Burns make their most compelling case. We have long been told that the national debt represents spending to be paid for by future generations, but we are rarely told that the special accounting rules applied to Social Security (and Medicare/Medicaid) mask the debt's actual size. In truth, the fiscal gap—defined as the present value difference between the government's expected expenditures and receipts—is \$45.5 trillion. This is six times higher than the official national debt figure.


Kotlikoff and Burns note that this is the government's number—well-hidden in the fine print of Treasury documents—and that it's probably a low-ball estimate. What's more, it was computed before passage of the new Medicare drug benefit. That massive expansion promises to increase the fiscal gap to over \$51 trillion. Each year that these programs or the tax system that funds them are not reformed, the fiscal gap grows by \$1 trillion.

The book's chief shortcomings are two. The first is in Kotlikoff and Burns's personal saving system. While their approach improves on the various proposals currently being discussed in Washington, it still maintains the form of a compulsory saving program with the inherent assumption that individuals are incapable of planning for their own retirement.

Why not simply abolish Social Security outright, cut everyone's taxes, slash spending, and allow the market to work? There would be more jobs available for workers in short order, resulting in increased wealth creation and greater self-sufficiency across society. (Provision for current retirees does not require continuation of this failed system.)

A second problem with the authors' approach is that their description of the future and proposed solution

assume that the size and continuing growth of the state won't change. But it seems likely that as Social Security inflicts more costs on the economy, some of the burden of big government will become harder to hide from the masses. The result will be a crisis for politicians, who will find it harder to redistribute wealth. For the majority of Americans, who are net taxpayers (as opposed to net tax consumers), the crisis may actually be an opportunity to highlight the bankruptcy of the state, in both theory and in real life.

While their book is flawed, Kotlikoff and Burns should be applauded for calling attention to Social Security's moral and financial bankruptcy. 

Christopher Westley (cawestley@email.msn.com) is an assistant professor of economics at Jacksonville State University.

**Coming in the December issue
of *The Freeman***

**Paying High Gas Prices and Abolishing FEMA
Would Help Disaster Victims**

Dwight R. Lee

Repeal Davis-Bacon

George C. Leef

**From Kleenex to Zippers:
The Unpredictable Results of Entrepreneurs**

Burton Folsom, Jr.

U.S.-China Relations after CNOOC

James A. Dorn