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# BANKNOTES

NELSON NASH MONTHLY NEWSLETTER

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## SOMETHING TO PONDER

by R. Nelson Nash

There is a great video named *Banking With Life*, produced by James Neathery of Alvarado, TX. It's less than sixty minutes long and features a dozen or more personalities who are economists or financial people, including yours truly.

Early in the video is Dr. Paul Cleveland, an economist at Birmingham Southern University. Paul explains that money is not wealth. Wealth is goods and services. Money is the medium of exchange whereby we acquire wealth.

You sell someone something or provide valuable services to someone and you are given a token of agreed upon value that we call money. It's the way we keep score of our exchange of goods and services. Therefore, we can accurately refer to this as "real money." The money is a symbol of something you did.

Unfortunately, there is something else circulating in our economy that looks like the same thing — but it is not. We might accurately refer to it as "funny money" — a product of the fractional reserve banking system.

Jesus Huerta deSoto describes this fact very succinctly on page 118 of his book, *Money, Bank Credit, and Economic Cycles*. ....*that the nationalization of money and the the central bank's regulation of the banking system and its laws governing it have been incapable of maintaining a stable financial system that avoids economic cycles and averts bank crises. Thus, we may conclude that the fractional banking system has failed as well, even though it is backed by a central bank.*

Perhaps a simpler explanation is the fact that the fractional reserve banking system is all a *lie* and the whole scheme is backed up by *an even bigger lie* — *the central bank*. It is amazing that this sort of stuff has been going on for a long time.

Maybe this example will help people see the light. Let's say that you are Mr. Smith and you have come upon a business idea that will highly benefit mankind. It is going to require an initial investment of \$50,000.00 to get started on this project — but you don't have \$50,000.00 lying around your

office in a desk drawer.

You decide to go to a local commercial bank and get a loan. If you don't already have an account there, then you will have to open one with them. You have to deposit some "real" money into the account. You describe your project to one of their loan officers who finally responds, "Yes, Mr. Smith, we will lend you \$50,000.00 for this proposed project of yours. It sounds pretty exciting — but we will require that you put up collateral of \$50,000.00 to secure this loan.

(That collateral you assign to the bank is "real wealth" —something for which you have previously provided goods and/or services). You and the loan officer agree on what is appropriate collateral.

Pay close attention to what happens next (don't let this "go over your head"). The loan officer secures your signature on a document that assigns your collateral (real money) to the bank. He also has you sign another document that authorizes him to *credit your account with the bank with \$50,000.00 (funny money)*.

**He did not loan you \$50,000.00. He simply entered digits into your account as if he lent you that money.** It's called bank credit. A more accurate description is "thin air." You have assigned collateral (real money) in exchange for bank credit (thin air). Do you understand?

And then the loan officer tells you that you must repay the loan — "let's say we amortize this loan over ten years — maybe like \$5,000.00 per year plus interest on the unpaid balance." (You are paying "real money" back for a loan of money that never existed.) Got that?

So, how does one explain how this phenomenon has been going on for many, many years? How could this possibly happen? Do you expect the banking community to tell these facts? If any other business did this sort of thing the perpetrators would be jailed!

Surely this activity can be described as a "hostile financial environment."

You can secede from this situation by studying

the Infinite Banking Concept — and adopting its teachings. A follow-up article explaining the basic fundamentals will be forthcoming.

## Economists and the Emergence of Antitrust

02/23/2018 Thomas J. DiLorenzo

Although most economists today favor stricter antitrust regulation, from the 1880s until the 1920s the economics profession expressed nearly unanimous opposition to antitrust. When Sanford Gordon surveyed professional journals in the social sciences and articles and books written by economists before 1890, he found, "A big majority of the economists conceded that the combination movement was to be expected, that high fixed costs made large-scale enterprises economical, that competition under these new circumstances frequently resulted in cut-throat competition, that agreements among producers was a natural consequence, and the stability of prices usually brought more benefit than harm to the society. They seemed to reject the idea that competition was declining, or showed no fear of decline." <sup>1</sup>

George Stigler has also noted economists' initial disapproval of antitrust: "For much too long a time students of the history of antitrust policy have been at least mildly perplexed by the coolness with which American economists greeted the Sherman Act. Was not the nineteenth century the period in which the benevolent effects of competition were most widely extolled? Should not a profession praise a Congress which seeks to legislate its textbook assumptions into practice?" Stigler offered three possible explanations. First, economists did not appreciate the importance of tacit collusion. Second, they had too much confidence in other forms of regulation as a means of dealing with monopoly. Third, they underestimated the income they would receive as antitrust consultants.

These explanations are plausible, but there may be an even more important reason for the transformation of economists' attitudes toward

antitrust. In the late nineteenth century most economists viewed competition as a dynamic, rivalrous process, similar to the theory of competition embodied in the work of Adam Smith and today's Austrian economists. Consequently, they tended to regard mergers as a natural consequence of the competitive struggle and not something that should be interfered with by antitrust legislation.<sup>3</sup> Although some industries were becoming more concentrated in the late nineteenth century, rivalry was still as strong as ever, as the rapid expansion of output and the decline in prices attest. Thus, the economists of the time saw no reason to interfere in market processes with antitrust regulation.

Beginning in the 1920s, mathematical economists developed the so-called perfect competition model, and it replaced the older theory. To economists competition no longer meant rivalry and enterprise. Instead, it meant the equation of price and marginal cost. Most important, it meant that there must be "many" firms in "unconcentrated" industries. Once economists began to define competition in terms of market structure, they became more and more enamored with antitrust regulation as a way of forcing the business world to conform to their admittedly unrealistic theory of competition.

Economist Paul McNulty has noted: "The two concepts [of competition] are not only different; they are fundamentally incompatible. Competition came to mean, with the mathematical economists, a hypothetically realized situation in which business rivalry ... was ruled out by definition."<sup>4</sup> F. A. Hayek has made an even stronger statement: "What the theory of perfect competition discusses has little claim to be called competition at all and ... its conclusions are of little use as guides to policy."<sup>5</sup> Moreover, wrote Hayek, "If the state of affairs assumed by the theory of perfect competition ever existed, it would not only deprive of their scope all the activities which the verb 'to compete' describes but would make them virtually impossible." Advertising, product differentiation, and price undercutting, for example, are all excluded by definition from a state of "perfect" competition

which, according to Hayek, "means indeed the absence of all competitive activities."

Those economists who use market structure to measure competition are likely to have a favorable attitude toward antitrust regulation. Stigler asserted more than 30 years ago, "One of the assumptions of perfect competition is the existence of a Sherman Act."<sup>6</sup> To the nineteenth-century economists, however, an antitrust law was incompatible with rivalry and free enterprise. The perfect competition model and its corollary, the structure-conduct-performance paradigm of industrial organization theory, have seriously misled the economics profession, at least as far as antitrust policy is concerned.

The two principal reasons for the "antitrust economists' paradox," then, are the lack of historical knowledge—particularly about actual economic events in the late nineteenth century—and the failure to appreciate that competition is best viewed as a dynamic discovery procedure, as Hayek contends. Economists who believe that there was once a "golden age of antitrust" have never produced any evidence of such an age. As this paper has shown, the Sherman Act was a tool used to regulate some of the most competitive industries in America, which were rapidly expanding their output and *reducing* their prices, much to the dismay of their less efficient (but politically influential) competitors. The Sherman Act, moreover, was used as a political fig leaf to shield the real cause of monopoly in the late 1880s—protectionism. The chief sponsor of the 1890 tariff bill, passed just three months after the Sherman Act, was none other than Sen. Sherman himself.

In the late nineteenth century most economists viewed competition as a dynamic, rivalrous process, much like the contemporary Austrian theory. Accordingly, they nearly unanimously opposed antitrust on the grounds that such a law would be inherently incompatible with rivalry. Once the economics profession embraced the "perfect" competition theory which, as Hayek has said, means "the absence of all competitive activities,"

it also embraced antitrust regulation. For once competition came to mean "many" firms and the equation of price to marginal costs, rather than dynamic rivalry, most economists became convinced that antitrust laws were needed to force markets in the direction of their idealized model of "perfect" competition. Consequently, antitrust has for over a century been a tremendous drag on competition, rendering American industry less productive and less competitive in world markets. Robert Bork might not have been exaggerating when, writing in his book, *The Antitrust Paradox*, he remarked that if government were to somehow force the economy into "competitive equilibrium," it would have approximately the same effect on personal wealth as several strategically placed nuclear explosions.

Excerpted from *The Truth About Sherman*

1. Sanford Gordon, "Attitudes Toward the Trusts," p. 158.
2. George Stigler, "The Economists and the Problem of Monopoly," *American Economic Review* (May 1982): 1
3. The following discussion is based on T.J. DiLorenzo and Jack C. High, "Antitrust and Competition," Historically Considered," *Economic Inquiry* (Summer 1988).
4. Paul McNulty, "A Note on the History of Perfect Competition," *Journal of Political Economy* (August 1967): 398
5. F.A. Hayek, "The Meaning of Competition," in F.A. Hayek, *Individualism and Economic Order* (Chicago: University of Chicago Press, 1948), p. 92.
6. George Stigler, "Perfect Competition, Historically Contemplated," *Journal of Political Economy* (February 1957): 1.

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## Bastiat Knew the Proper Limits of Government Force

by Frank Hollenbeck

High school students in the United States are usually required to take a course in government. They learn about the structure of government but rarely discover the appropriate role of government or the justifiable limits for the use of force in our society. If they did, one of their required readings would be Frédéric Bastiat's treatise *The Law*, a seminal mid-Nineteenth-century work that describes eternal truths about life and how we pursue justice. These truths are just as valid today as they were then.

### Natural Rights and the Role of Government

Bastiat states that individuals are born with the natural rights of life, liberty, and property. From this notion, the only proper function of the use of force or the law is the collective organization of the natural right to self-defense of these rights.

“Every individual has the right to use force for lawful self-defense. It is for this reason that the collective force — which is only the organized combination of the individual forces — may lawfully be used for the same purpose; and it cannot be used legitimately for any other purpose.”

He then defines any illegitimate use of force or of the law as legal plunder. This is an all-encompassing term which includes any unjustified violation of the life, liberty, or property of others. Many examples abound today with regulations on labor (e.g. minimum wage laws), products (e.g. subsidies and tariffs), health care, education, or even the use of marijuana or any other drugs.

Legal plunder has two primary motivations:

1. The first is stupid greed. For example, you would never think of robbing your neighbor, but are complacent if the government uses legal plunder to rob him on your behalf.
2. The second is misplaced philanthropy. Many socialist concepts fall into this category. For

example, they constantly talk about fraternity, not one that is voluntary but rather forced by the law onto everyone. This is just another example of legal plunder.

Because legal plunder is so pervasive in society today, we often fail to distinguish the difference between justice and injustice. Just because something is legal, we assume it must be just, which is simply not true.

## **Legal Plunder and Social Unrest**

The Democrats will shortly spend billions of U.S. dollars to try to take control of Congress in the 2018 Midterm elections and will spend billions more on the next presidential campaign in 2020. You only need to watch a few minutes of CNN or even part of an episode of *Saturday Night Live* to see the vitriolic hatred of the President by the left-wing media.

A similar hatred was shown by the right-wing towards Obama. Why such animosity between the opposing political positions? The answer is simple: they are trying to protect themselves from legal plunder, or are actively participating in the plundering.

The problem with legal plunder is that it creates hatred and discord and eats at the very fabric of society. The US Civil War was fought primarily for two reasons: slavery and tariffs. The first was a violation of liberty, the second was a violation of property.

According to Bastiat:

“It is not true that the function of law is to regulate our consciences, our ideas, our wills, our education, our opinions, our work, our trade, our talents, or our pleasures. The function of law is to protect the free exercise of these rights, and to prevent any person from interfering with the free exercise of these same rights by any other person.”

## **The Government Should Matter Less**

The law should be viewed as a negation; if you don't violate the life, liberty, or property of someone else, you should not see the arm of the law or care

much about the role of government. You should be somewhat indifferent as to who is elected president just as you should be indifferent as to who is elected dog-catcher if it does not affect you.

If the law were properly defined, you would not blame the government for your misfortunes nor would you credit it with your successes. There would be greater harmony and less reason to revolt since the government's jurisprudence would be well defined. You would not see, as in France today, different sectors of the economy constantly going on strike, paralyzing the country, and often demanding concessions from the government that are difficult or impossible to meet.

Bastiat wrote:

“[I]f you attempt to make the law religious, fraternal, equalizing, philanthropic, industrial, literary, or artistic — you will then be lost in an uncharted territory, in vagueness and uncertainty, in a forced utopia or, even worse, in a multitude of utopias, each striving to seize the law and impose it upon you. This is true because fraternity and philanthropy, unlike justice, do not have precise limits. Once started, where will you stop? And where will the law stop itself?”

More important than left or right is the concept of liberty. The solution to the problem of human relationships is freedom, and it thrives most when the role of government is limited, the use of force is constrained, and the law is confined to the administration of universal justice, or, more precisely, the law is exclusively used as a roadblock to injustice.

Today, a person in the U.S. will watch either CNN or Fox News but will probably never watch both. On Facebook, if a friend disagrees with you, you just unfriend him so that you are left with a group of people who hold similar opinions. We no longer have political discourse at the dinner table because of often-opposite viewpoints. Everyone tries to avoid disharmony.

This polarization can only ultimately lead to a form

of civil war, very different, though, from the one fought over 150 years ago. We must recognize that we have a ticking social time bomb in our midst, and we must begin a serious discussion on the appropriate role of government or the just limits to the use of force by government. A good place to start would be to study Bastiat's eternal truths found in *The Law*.

Frank Hollenbeck is a financial consultant who worked for the State Department as senior economist, Caterpillar overseas as chief economist, and Director of Research at the Banque Eduard Constant in Geneva.

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## Fake Women and Phony Interest Rates

02/15/2018 Doug French

While the world stresses about #metoo, Trump's tweets, and other cultural nonsense, the latest *Grant's Interest Rate Observer* is blunt about "the most consequential prices in capitalism — interest rates..." Rates are "stuck under the bureaucratic thumb." There is no mystery or debate, "It's as plain as meatloaf that something is wrong with credit."

Mario Draghi has pushed rates in Europe into the never-never land of zero and below, attempting to prove Murray Rothbard wrong when he wrote in *Man, Economy and State*, "the interest rate can never disappear." Financial basket case Greece, has 10-year bonds yielding 3.69%, 69 basis points is all Germany is paying and France's bonds are yielding 96 basis points.

These rates are as fabricated and detached from reality as the silicon sex-doll brothels now opening throughout Europe. "Since it was reported in the summer of 2017 that sex doll Fanny was attracting more customers than real-life prostitutes at the Kontakthof brothel in the Austrian capital, Vienna, the sex doll craze has taken Europe by storm," writes Gemma Mullin. An additional analogy can be found in the fact that many bond

investors surely suspect there's something phony going on. But that doesn't stop many from making the sale.

*Moreover*, Grant's highlights the work of Claudio Borio, who says persistent low rates are adverse to productivity, in humans that is.

Low rates lead to malinvestments as illustrated aptly by Matt Wirz's excellent reporting for the Wall Street Journal. Wirz leads his piece with,

Last fall, a hydroelectric dam in Tajikistan, the government of Portugal and a cruise-ship operator all issued debt at unusually low interest rates. The seemingly unconnected deals are part of a proliferation of aggressive bond sales influenced by a decade of loose monetary policy and a demographic shift in global investing.

Investors held \$1.5 trillion in US Bond mutual funds 10 years ago, now it's \$4.6 trillion.

Portugal required a financial bailout in 2011. However, this past November all that was forgotten as the country with junk rated debt borrowed at its lowest rate ever, 1.94% for 10-year paper. That's lower than what Uncle Sam is paying on its higher-rated bonds.

Sounding like a member of the Austrian school, Borio says monetary policy boosts "credit, asset prices and risk-taking." Grant's reminds us that Ben Bernanke, himself, wrote that easy money was needed to "boost consumer wealth and help increase confidence."

And you thought the current ebullience was ginned up by Donald J. Trump?

Borio believes "ultra-low rates delay balance sheet adjustment and sustain the lives of corporate living dead." Wirz provides examples from corruption-plagued Tajikistan, where bond investors funded \$500 million to kick-start construction of a hydroelectric dam project first started under the Soviet Union, and "the American Dream Mall in East Rutherford, N.J., also got a jump-start from bond markets in 2017. The project, previously known as Xanadu, broke ground in 2003 but ran out

of money to finish construction. The mall's current owner — its third — is betting that it can buck the trend of retail extinction spreading across the country.”

Hope springs eternal and low interest rates turn hope into a strategy. But, not a good one.

Rothbard explained, “The interest rate regulates the temporal order of choice of projects in accordance with their urgency. A lower rate of interest on the market is a signal that more projects can be undertaken profitably. Increased saving on the free market leads to a stable equilibrium of production at a lower rate of interest.”

Clearly, investors and business men and women have been fooled by Draghi, Yellen, and soon enough, Powell. In the end, it will be as Rothbard saw it in *America's Great Depression*,

inflation is not the only unfortunate consequence of governmental expansion of the supply of money and credit. For this expansion distorts the structure of investment and production, causing excessive investment in unsound projects in the capital goods industries. This distortion is reflected in the well-known fact that, in every boom period, capital goods prices rise further than the prices of consumer goods. The recession periods of the business cycle then become inevitable, for the recession is the necessary corrective process by which the market liquidates the unsound investments of the boom and redirects resources from the capital goods to the consumer goods industries. The longer the inflationary distortions continue, the more severe the recession-adjustment must become.

The reader is urged to review the last sentence carefully a second time. This latest distortion is very long in the tooth.

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from UNLV, studying under both Professor Murray Rothbard and Professor Hans-Hermann Hoppe.

## Be Prolific. And Don't Agonize Over Things Outside Your Control.

by Zachary Slayback

Indefatigable.

Adjective.

Of a person or their efforts. Persisting tirelessly.

### Life Can Weigh You Down

You can't control much in your life. You can't control how others will react to your work. You can't control the weather. You can't control economic downturns. You can't control the price of bitcoin. You can't control what your loved ones think of you.

Most of life is learning how to properly understand how to react to these facts and to plan for them.

The well-lived life is one where you aren't constantly acting in reaction to these facts. The well-lived life is one where you plan well for these facts and anticipate them when possible.

But a life that is built around preparing to shoulder the burdens of the facts of the universe is, at best, a decent life. It is not the life worth writing about. It is not the life worth admiring (except in comparison to the poor schlub who thinks he can control most of the universe). And it is most certainly not the life worth living if you had the choice.

Even those who prepare well for the realities of life become fatigued in time. The stress of work, the manager, the wife, the husband, the kids, the neighbors, the commute, the weather, the President, the Congress, the economy, the car, the dog, the schools, the potholes, the litter, the deadlines, and the passed-by dreams appear on their faces and in their eyes as wrinkles on a once-energized canvas. The cracks you see in old art that is poorly preserved, broken down by the sun, the wind, the elements, and oil from others touching it, appear on the faces of those fatigued by the realities of life.

They become fatigued.

## Act, Don't React

Life is more than mere reaction. The individual, worn down through the minutiae of life and work, is more than merely a victim of Chinese water torture. We are more than the metal orbs of a Newton's Cradle, transferring energy from one place to another as others slam into us, not of their own choosing.

There are elements we can control.

You can control your ability to create.

You can control your ability to deliver.

You can control your ability to meld something new out of the landscape.

You can control whether or not you become prolific.

Being prolific is a function of your ability to take the world, process it, and put your own spin on it, no matter how small or how different. Everything before you is a remix. Everything after you is a remix.

You may not be able to control how people react to your work, but you can control whether or not they have work of your own against which they can react. There is no central committee stopping you from writing, creating, painting, or thinking. There are no longer any gatekeepers that say whether you are worthy of having your work published to the fora or whether you have to keep your thoughts to yourself.

The only thing stopping you is yourself and your own fears and worries.

## Make Something, Do Something

Take the example of writing. You are reading this on the greatest tool for writing democratization the world has ever seen. You can, by the end of this piece, start your own blog, your own article, or your own site in reaction to this piece. You can put your spin on it and start your path towards being prolific.

As you write and publish, writing a new piece and publishing again becomes easier. As you show up every day, you build efficacy and momentum. Soon, you are acting *on the world* as much as you are being

acted upon by the world.

Your act of creation is a rebellion against the acted-upon life. You may still have to sit in morning traffic, listen to your colleagues complain about the weather, the economy, and the President, have your kids ignore your phone calls, and walk past the neighbors' yippie dogs, but you take a moment out of the day to reject being acted upon to become prolific.

Do this enough — create enough, write enough, speak enough — and out of your prolificness comes indefatigability. It becomes so easy to create and to reject the minutiae of the day that creation comes to you like showering or making a meal.

There's little you can control about your life.

You can control whether or not you become prolific.

You can control whether or not you choose to create.

You can control whether you will become fatigued by the slow march of time or if you will make yourself indefatigable.

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Zak is a communicator focusing on issues of education, innovation, and social change. He's the author of the 2016 Amazon best-seller, *The End of School: Reclaiming Education from the Classroom* and is currently finalizing *The Little Guide to Learning Anything*. He regularly speaks on issues of learning, social change, innovation, and the changing jobs landscape. He is a founding team member at Praxis.

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## Nelson's Favorite Quotes

*If a man has the right to self-ownership, to the control of his life, then in the real world he must also have the right to sustain his life.* - Murray Rothbard

*There can be no truly moral choice unless that choice is made in freedom.* - Murray Rothbard



## New Book's "Case Against Education" Is a Persuasive One

by Logan Albright

It's common to hear politicians wish aloud that everyone should have access to a quality college education. As rhetoric, it sounds lovely, but as in many a fairy tale, there's good reason to be careful what we wish for.

Bryan Caplan's new book, unflinchingly titled *The Case Against Education*, is an important contribution to the growing body of literature challenging one of society's most cherished sacred cows. Unlike most writers on the subject, Caplan doesn't just target the Department of Education, the public school system, or liberal arts universities. He goes after all of it — the education system as a whole. And it's about time someone did.

### The College For All Fallacy

We know that more educated people tend to make more money, and it's easy to use that statistic as a defense of the education system, but Caplan's thesis is that a significant portion of the salary bonus for graduates comes not from increased ability. Instead, it is the result of what he calls "signaling." In other words, having a degree demonstrates to employers that you know how to follow orders, work hard, and finish what you've started, all valuable skills in the workplace. People with lower levels of education may well have these skills too, but a degree provides a convenient way for employers to separate the wheat from the chaff in a competitive labor market.

Viewed in this light, the idle musings of politicians for universal college enrollment actually constitute a nightmare scenario. In a world where everyone has a bachelor's degree, employers will look for graduate degrees to determine who is really willing to go the extra mile and work the hardest. Everyone will have to put in more time, money, and effort towards obtaining more educational credentials, only to end up exactly where they were before the well-intentioned degree inflation took place.

It's an arms race where everybody loses, and there's no reason it will stop at college degrees. The same do-gooders who made it possible for everyone to have a bachelor's degree will soon want to give everyone a Ph.D. Children used to start school at six years old. Then kindergarten kicked in at five. Then pre-K at four. Pretty soon, babies just out of the womb could be shuttled into formal education programs in the hope of getting a leg up on the increasingly stiff competition. And remember that this competition is not about who knows the most or can do the best job, it's simply about who has the most impressive credentials.

What are the implications of this observation? Caplan argues that the education system fails to actually teach anything very useful and that we, therefore, shouldn't pour billions of taxpayer dollars into it. As a society, it's a waste of money. It's also a huge waste of time to have children spend so many years in school when they could be doing something more productive.

The apparent paradox is this: while education may pay for an individual student, if everyone consumed less education, society would be no worse off either in terms of useful skills or premium wages. This resembles the old economists' critique of advertising. When an individual firm advertises, it gains an advantage over its rivals, but when everybody advertises, they cancel each other out, resulting in a collective waste of money. The major difference is that the money advertisers are wasting is their own, whereas the education system wastes the money of every American taxpayer.

### Not Perfect

As an economist writing about education, it's not surprising that in doing so, Bryan Caplan focuses heavily on the monetary rewards from schooling. Educators like John Holt and John Taylor Gatto have argued against the school system on the grounds that it robs children of their natural curiosity through a fundamental misunderstanding of how learning happens. Caplan, on the other hand, eschews these lofty arguments in favor of a deep focus on the

statistics.

This is, to my mind, both a positive and a negative. On the plus side, Caplan's treatment of the data is unassailable. He has gone to great lengths to preemptively respond to potential criticisms of his econometrics, and in doing so has produced a more or less airtight document proving that the education system largely fails at effective teaching and is valuable to the individual only insofar as it helps distinguish them from the motley pack of job seekers.

On the other hand, this very statistical rigor means that the book comes across as being written "by economists, for economists." If we are actually going to change the education landscape, we need to win hearts and minds on a massive scale, creating a popular movement that doesn't just include academics and policy wonks. For the layperson, much of Caplan's book is likely to be a slog, and that's likely to prevent it from getting the broader audience it deserves.

Also problematic is that, when it comes to policy recommendations, Caplan appears to have come down with a case of cold feet. He argues that we should cut funding for the "useless" majors like art and music, and only fund classes in reading, writing, and math. But mere pages earlier, he took the trouble to provide a strong case that schools fail dismally at teaching students to read, write, or calculate. So why continue to waste money on those failures?

Similarly, he recommends replacing traditional education with vocational education, training students for specific jobs rather than focusing on general knowledge. Again, he undercuts his thesis that education is ineffective at imparting knowledge to students. The problem is not with the curriculum, but with the methods of the education system. If teachers fail to produce students who know anything about poetry or music, why should we expect them to churn out productive little plumbers and electricians with any more efficiency?

## **The Education System Isn't Working**

Education fails not because it teaches useless subjects. There are no useless subjects. Education fails because it demands students devote their efforts to subjects in which they are not interested, on a schedule that is not of their own choosing, using methods that are inappropriate to their individuality.

Maybe the above is just Caplan's attempt to attenuate his argument to the point that skeptics will be more receptive, but when you have the chutzpah to call your book *The Case Against Education*, it's disappointing to see this lack of follow-through.

In Caplan's defense, I suspect that he actually agrees with this position more than he is willing to admit. A few comments tucked away near the back of the book emphasize the value of free play and unsupervised reading. But he sends mixed signals by devoting some chapters to praising vocational schooling, and others to the condemnation of schooling in general.

The above quibbles aside, *The Case Against Education* brings some much-needed methodological rigor to the argument that so many Americans intuitively already grasp: that the education system isn't working and that to throw good money after bad is folly. In pointing this out, Caplan proves himself an ally to children, parents, and honest educators everywhere.

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## Bye-bye Bismarck

by Antony P. Mueller

Implementing social security systems and providing so-called welfare and social justice as governmental goals have become the outstanding features of the State since the late 19th century.

Germany in particular is a case worth studying. This country was a pioneer in creating a comprehensive system of social policy, and it is now one of the prime examples where a maze of regulations and the fiscal burden that have come with this kind policy is paralyzing the economy. An historical analysis of the German welfare state also reveals the close link between the welfare and the warfare state.

When Germany's Chancellor Otto von Bismarck conceived a system of social security for the industrial workers in the late 19th century he had a very clear objective in mind. Along with consolidating the geo-strategic position of the Reich, he set out to bring the industrial workers under the control of the State. Integrating the masses into the body of the newly formed unified German State was the objective, and a comprehensive social insurance system provided the means for obtaining this aim.

Social policy was foremost national policy<sup>1</sup> and the social security system was primarily an instrument to lure the workers away from private and communitarian systems into the arms of the State. In the eyes of Bismarck it was the State that had created national unity and this agent was also needed in order to maintain the social unity by a system of mutual obligation between the State and its citizens.

Originally, social security was set up to be specific as to its target, limited in depth, and light in terms of the financial burden for the productive sector of the economy. When the first steps were taken towards the establishment of a social security system in 1883 with the establishment of a health insurance system and with its expansion to cover old age, working place accidents and unemployment, the maximum contribution to social security was held to be no more than a total of six per cent of gross wages.

Social security was meant to be restricted to the new class of the industrial workers. Regular old age pensions would be paid only to those of more than 70 years of age, and the pay-out would rarely be more than the subsistence level.

But as foreseen early on by Adolph Wagner—who was one of the intellectual fathers of social policy and the author of the "law of increasing state activity"—the expansion of the state functions into the "social area" would change the character of the State and lead to a massive financial expansion of governmental activity.<sup>2</sup> He clearly foresaw also that the new "social epoch" would be the age of interventionism with governments actively "correcting" the capitalist process of production and distribution.

While the practice and institutional forms vary from country to country, the idea that the State must protect and promote social justice and progress has become the paramount modern ideology around the globe. Following the footsteps of Bismarck, the construction of social policy systems has emerged as the distinctive feature of the modern State.

Periods of war, depression and prosperity alike were the major propellants for the expansion of the system when social policy became the favorite means to offer the carrot along with the stick of more governmental control. Social policy ushered the way into the age of the unfettered growth of taxation, expenditures and bureaucracy making the modern welfare state inherently totalitarian.

In accordance with its historical roots, social policy up to the present day has maintained its nationalistic aims, its paternalistic schemes, and its authoritarian practice. As such, social policy represents the modern complement to the traditional role of the State as an agency of warfare. Social security has served as a formidable instrument in the hands of governments to obtain popular loyalty and the allegiance of special groups. Under democratically elected governments and dictatorships alike, the temptation has been the same: expanding schemes of social security has been the effective instrument in

search of political power and presumed legitimacy.

In Germany, it was first during World War I and its aftermath and later under the Third Reich in the 1930s when the welfare state experienced its greatest expansions. Under the national-socialist regime, in particular, the appeal to "social justice" and the expansion of the social security and protection systems flourished together with the build up of the warfare state. In the first couple of years of the dictatorship, social policy was one of the major legal projects of codification.<sup>3</sup>

The systematization of social policy was so profound that almost all major bodies of law that rule Germany's current social security system can be traced back to their original formulation in the national-socialist era. While minor adaptations were made to be more adequate to the current needs, the original spirit of the social policy laws lives on with its roots in the class distinctions and the paternalistic-authoritarian schemes of the past.

Under the Third Reich, social policy measures were extended to protect and further ideologically defined standards of reproduction, health and the environment. The carrot of social policy served as the main means to facilitate the application of the stick of repression. It also happened in this period that the labor market came under almost complete control of the totalitarian State making the dismissal and hiring of personnel dependent on governmental permission (issued by the Labor Office or *Arbeitsamt*).

Along with the privileges given to those employed by the State, the restrictions placed upon a free labor market continued to plague post-war Germany as soon as the era of full employment after the reconstruction period had come to an end in the 1970s. In modern democratic Germany, social issues in all their ramifications have dominated the political game bringing the relevant parties and interest groups together under the common ideological consensus of striving towards a fictitious so-called social balance.

After favoring free-market policies during the early

years of post-war reconstruction, it was as early as the late 1950s when the third wave of social policy expansion set in, this time as a result of Germany's prosperity and as a means to compete with the Socialist regimes during the Cold War era. Step by step from then on, social policy grew into a veritable avalanche, particularly in the 1970s. By explicitly adopting the criteria of "social progress" as a state function, almost each and every aspect of human existence became to be regarded as a social problem and a seemingly legitimate reason for state action to do good.

Grown for over a period of more than a hundred years, the various branches of the obligatory social security system have put the entire population under intensive bureaucratic care. Social policy has become a labyrinth formed by laws and regulations, individual judicial decisions and cases of special considerations that make it impossible to determine who are the net payers or who are the net beneficiaries even in a crude way.<sup>4</sup>

The coverage of old age, sickness and unemployment insurance, along with social aid, and disability insurance and with all the numerous special branches of social policy have turned Germany into an Eldorado for those seeking a free ride. Often described as "generous", the German social welfare system actually provides a plethora of incentives for intentionally becoming unemployed, seeking early retirement and fulfilling the necessary requirements in order to become eligible for social aid and disability payments.

Germany's current state of the economy with persistently high unemployment, exorbitant wage costs and a drastically shrinking active population cries for a change, but it amounts to a gargantuan endeavor to reform a social welfare system which has grown into a veritable monster after having been fed and pampered by all political groups that have been in power in this country since the late 19th century.

With the promotion of "social progress", the modern welfare state has dissolved all limits to government.

Together with the traditional goals of protection and social justice, the extension to social progress has opened the way to all kinds of absurdities, abuses and interventions.

With social policy becoming ever more comprehensive, it has turned into a severe and suffocating burden for the economy. The boon—however great or small it may have been in its early stages for a specific group—has turned into a massive plague. Now, the dismantling of the welfare state emerges as the major policy challenge of the 21st century.

1. Heimann, E.: *Soziale Theorie des Kapitalismus. Theorie der Sozialpolitik*, Tübingen 1929.

2. Wagner, A.: Über sociale Finanz- und Steuerpolitik, in: *Archiv für Soziale Gesetzgebung und Statistik*, Vol. 4, Berlin 1891, pp. 1–81.

3. Seidte, F. : *Sozialpolitik im Dritten Reich 1933 bis 1938*, München and Berlin 1938.

4. Mueller, A. P.: *Sozialpolitik und Wirtschaftsordnung*, Frankfurt 1983, p. 141.

## Mercantilism as the Economic Side of Absolutism

Murray N. Rothbard

[This article is excerpted from *An Austrian Perspective on the History of Economic Thought*, vol. 1, *Economic Thought Before Adam Smith*.]

By the beginning of the 17th century, royal absolutism had emerged victorious all over Europe. But a king (or, in the case of the Italian city-states, some lesser prince or ruler) cannot rule all by himself. He must rule through a hierarchical bureaucracy. And so the rule of absolutism was created through a series of alliances between the king, his nobles (who were mainly large feudal or postfeudal landlords), and various segments of large-scale merchants or traders. "Mercantilism" is the name given by late 19th-century historians to the politicoeconomic system of the absolute state from approximately the 16th to the 18th centuries.

Mercantilism has been called by various historians

or observers a "system of Power or State-building" (Eli Heckscher), a system of systematic state privilege, particularly in restricting imports or subsidizing exports (Adam Smith), or a faulty set of economic theories, including protectionism and the alleged necessity for piling up bullion in a country. In fact, mercantilism was all of these things; it was a comprehensive system of state-building, state privilege, and what might be called "state monopoly capitalism."

As the economic aspect of state absolutism, mercantilism was of necessity a system of state-building, of big government, of heavy royal expenditure, of high taxes, of (especially after the late 17th century) inflation and deficit finance, of war, imperialism, and the aggrandizing of the nation-state. In short, a politicoeconomic system very like that of the present day, with the unimportant exception that now large-scale industry rather than mercantile commerce is the main focus of the economy. But state absolutism means that the state must purchase and maintain allies among powerful groups in the economy, and it also provides a cockpit for lobbying for special privilege among such groups.

Jacob Viner put the case well:

The laws and proclamations were not all, as some modern admirers of the virtues of mercantilism would have us believe, the outcome of a noble zeal for a strong and glorious nation, directed against the selfishness of the profit-seeking merchant, but were the product of conflicting interests of varying degrees of respectability. Each group, economic, social, or religious, pressed constantly for legislation in conformity with its special interest. The fiscal needs of the crown were always an important and generally a determining influence on the course of trade legislation. Diplomatic considerations also played their part in influencing legislation, as did the desire of the crown to award special privileges, *con amore*, to its favorites, or to sell them, or to be bribed into giving them, to the highest bidders.<sup>1</sup>

In the area of state absolutism, grants of special

privilege included the creation by grant or sale of privileged "monopolies," i.e., the exclusive right granted by the crown to produce or sell a given product or trade in a certain area. These "patents of monopoly" were either sold or granted to allies of the crown, or to those groups of merchants who would assist the king in the collection of taxes. The grants were either for trade in a certain region, such as the various East India companies, which acquired the monopoly right in each country to trade with the Far East, or were internal — such as the grant of a monopoly to one person to manufacture playing cards in England. The result was to privilege one set of businessmen at the expense of their potential competitors and of the mass of English consumers. Or the state would cartelize craft production and industry and cement alliances by compelling all producers to join and obey the orders of privileged urban guilds.

It should be noted that the most prominent aspects of mercantilist policy — taxing or prohibiting imports or subsidizing exports — were part and parcel of this system of state monopoly privilege. Imports were subject to prohibition or protective tariff in order to confer privilege on domestic merchants or craftsmen; exports were subsidized for similar reasons.

The focus in examining mercantilist thinkers and writers should not be the fallacies of their alleged economic "theories." Theory was the last consideration in their minds. They were, as Schumpeter called them, "consultant administrators and pamphleteers" — to which should be added lobbyists. Their "theories" were any propaganda arguments, however faulty or contradictory, that could win them a slice of boodle from the state apparatus.

As Viner wrote,

The mercantilist literature ... consisted in the main of writings by or on behalf of "merchants" or businessmen, who had the usual capacity for identifying their own with the national welfare.... The great bulk of the mercantilist literature consisted

of tracts which were partly or wholly, frankly or disguisedly, special pleas for special economic interests. Freedom for themselves, restrictions for others, such was the essence of the usual program of legislation of the mercantilist tracts of merchant authorship.<sup>2</sup>

1. Jacob Viner, *Studies in the Theory of International Trade* (New York: Harper & Bros, 1937), pp. 58–9.
2. *Ibid.*, p. 59.

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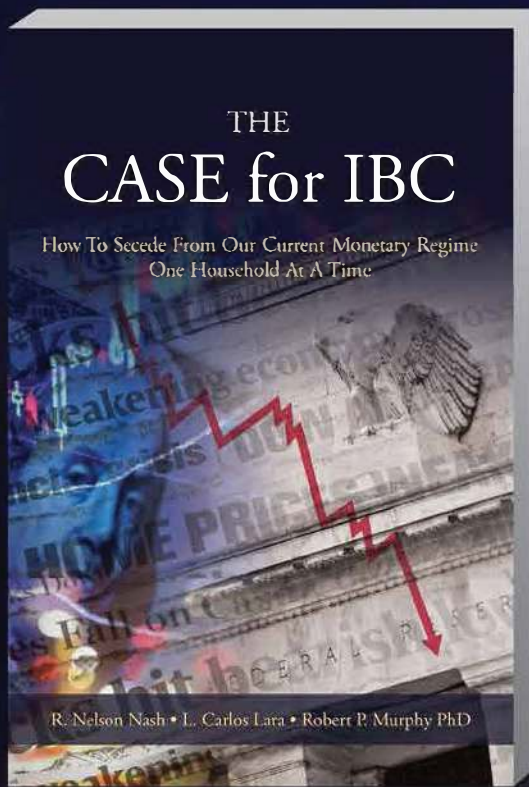
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