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POLEMICS & EXCHANGES

On Bursting Bubbles

Greg Kaza ("Economic Liberty and American Manufacturing," *Views*, January) is to be congratulated for seizing hold of two important realities: that the late 1990's saw a financial bubble of historic proportions, the origins and implications of which are poorly understood; and that incomes for the median- and lower-wage earner, when adjusted for inflation, have seen little progress over the last three decades.

Wage stagnation is something that, frankly, puzzles academic economists. At the risk of appearing obsessed, I suspect that the impact of the extraordinary immigration over the last 30 years, unmentioned by Kaza, will ultimately prove greater than is currently believed. (At the moment, academic economists generally accept only that it has affected the incomes of the unskilled, albeit substantially.) The extraordinary strength of the American dollar, not mentioned directly by Kaza, has also made American exports more expensive and foreign imports cheaper. It is hardly surprising that the auto industry has suffered—and, more generally, manufacturing wages with it.

But why has the U.S. dollar been so strong? Markets do overshoot, sometimes for years. But I have a horrible feeling that Kaza is right to point to the LTCM bailout—coupled, since his article appeared, with the Enron fiasco—as evidence that something is fatally wrong in the system. Conspiracy theorists on Wall Street believe that authorities and key financial actors have colluded to manipulate markets for public ends—and, quite possibly, private gain. Paranoids, as we all know, do have enemies. And, in this case, even if they don't, the economic hiccup which Kaza and I both believe may follow the excesses of the 1990's will make them sound credible. I suspect that we may well see the equivalent of the witch-hunting Nye hearings, advancing government at the expense of free markets, in this decade.

Ironically—and here I suspect I may differ from the official *Chronicles* line—the real culprit is not the market but the authorities. Why do we have a Federal Reserve anyway? But that, of course, was the story of the Depression, the nightmare from which we only awoke in time to repeat as farce.

—*Peter Brimelow*
Connecticut Berkshires

The observations of Greg Kaza concerning the sorry state of blue-collar American workers due to the decline of manufacturing need to be heeded by conservatives. There are now more government workers in the United States than manufacturing workers—and that's not even counting the legion of suppliers to government and those who draw welfare.

This growth in parasites at the expense of productive workers has been financed by borrowing abroad and selling our physical and financial assets to foreigners—a "buy now, pay later" proposition.

Kaza attributes the demise of American manufacturing to the explosive growth of the money supply and the demand abroad for dollars and dollar-denominated assets. While he may be on to something, it is not clear that he has identified the root causes—that *both* the decline of American manufacturing *and* the explosion of the dollar supply may be consequences of more fundamental structural problems.

Why have changes in exchange rates not offset the effect of the excessive supply of dollars in order to balance U.S. exports with U.S. imports? Eliminating the U.S. trade deficit of over a third of a *trillion* dollars per year would be the single most important way to resuscitate the manufacturing sector.

Why do foreigners prefer to buy U.S. assets instead of U.S. manufactured goods? Why do U.S. manufacturers prefer to make goods abroad rather than here? The answers lie in the inefficiencies of our federal tax code, the sorry state of American public education, and the failure of U.S. foreign policy to defend real American interests.

The federal government taxes income saved for investment, then corporate income, then dividends and capital gains from that income—and then taxes the composite upon death. Even though the typical Organization for Economic Cooperation and Development (OECD) country has higher *average rates* on personal incomes, it has lower *composite marginal rates* on investment income. So foreigners have a higher propensity to save and invest, and Americans have a higher propensity to consume. Also, nearly all OECD countries other than the United States abate their principal corporate tax, the VAT (value-added tax) on exports and levy it on imports. These *ad valorem* taxes have, in effect, replaced *ad valorem* tariffs. "Free trade" has been a one-way street to the poorhouse for U.S. manufacturers and their workers.

A recent report by the Federal Reserve Bank of Dallas compared the average literacy rate of U.S. border cities with Mexican border cities. For the United States as a whole, literacy rates average 75 to 77 percent; for Texas, 75 percent; and for Mexican border cities, 95 percent. Do manufacturers move plants to Mexico just for lower labor rates, or to get workers who can read and follow instructions? We cannot even educate an adequate supply of engineers to run our shrunken manufacturing sector.

When foreign debts and the loss of American values yield their inevitable consequences, will we still be able to claim that "United We Stand"? The financial bubble that Mr. Kaza observes distorts values, and the creation of values is, at its root, a manifestation of America's loss of *fundamental* values.

—*David Hartman*
Austin, TX

Greg Kaza correctly reveals how the "traumatic changes" in the U.S. auto and steel industries have been ignored by media pundits and neoconservatives, despite huge job losses. Unfortunately, instead of addressing the cause of those tragedies, Kaza played a "trivia game," asking how often Clinton and Reagan mentioned those industries while in office. He concludes by painting Reagan as more concerned with those industries.

Neither former president deserves credit in this regard, least of all Reagan, who took his marching orders from globalists in his "Kitchen Cabinet" and from Trade Representative William Brock and Commerce Secretary Malcolm Baldridge.

In the 34 years from 1946 to 1980, the U.S. trade deficit averaged less than one billion dollars per year. During Reagan's eight years, the trade deficit ballooned to nearly $100 billion a year. Nearly half of that deficit was with Japan, and over half was in autos and steel. Eight months after leaving office, Reagan went to Japan to collect his two-million-dollar fee for services rendered and had the gall to say that it was for two 20-minute speeches.

When Reagan took office, the federal debt was $909.1 billion. When he left office, that debt had soared to $2.6 trillion, an increase of $1.7 trillion, or 186 percent. In just eight years, Reagan piled up more debt than was accumulated in the previous 192-year history of our nation.

Every credible economist knows that production (i.e., the labor of real people) is the origin of all income, wealth, real-capital formation, tax revenue, and the ripple multiplier effect. Based on a conservative 5-to-1 multiplier effect ratio and a 40-percent marginal tax rate, had the goods represented by Reagan's trade deficits been produced in America, they would have generated over four trillion dollars in added national income (equal to $40,000 per household) and $1.6 trillion in added tax revenue to offset 94 percent of the federal debt increase during the Reagan years.

This makes no allowance for lower welfare and unemployment-benefit costs, had the growth rate of GDP under Reagan (a mere 3.13 percent) been comparable to the 4.56 percent growth rate in the preceding 21 years, nor for a 1.2 percent drop in hourly wages compared with rising wages in the preceding 21 years.

The failure of the media to expose destructive U.S. trade policies and deficits stems from an apparent delusion that the U.S. government has nothing to do with U.S. product costs. So U.S. industries and their executives, particularly in auto and steel, have been unfairly criticized for alleged shortcomings.

The truth is that, as a result of millions of federal, state, and local tax and regulatory laws, government is responsible for over 80 percent of U.S. product costs. Since all domestic taxes and the cost of regulatory laws wind up in the costs of production, they are essentially tariffs on our own products.

An honest government would protect every American company against any competitor, including foreign producers, not burdened with the same, or comparable, mandated costs. Even Adam Smith proposed tariffs on imports to equalize costs imposed by domestic governments. But that is not the guiding principle of U.S. trade policies.

Instead, U.S. companies have been the victims of outrageously immoral and unconstitutional trade policies that encourage imports made under conditions that violate our own laws by levying tariffs of just two percent—hardly a level playing field.

Kaza remarks that Fed Chairman Paul Volcker "cleaned up" the double-digit inflation of the 1970's. Volcker opted for interest rates as high as 20 percent on mortgages and a "high dollar." But that is not what brought inflation down. Rising inflation in the 1970's was largely due to oil prices that soared from about $1.75 a barrel to nearly $40. Inflation rates came down as prices fell under $20 a barrel as a result of a global oversupply and major conservation programs, including better automobile efficiency.

Volcker's tight-money policies exacerbated trade deficits, especially with Japan, as his "high dollar" caused imports to rise sharply while exports fell. By the time Reagan left office, both the auto and steel industries were on the brink of bankruptcy. In just two years, General Motors alone lost over $20 billion.

The trade and monetary policies of the Reagan years resulted in another two trillion dollars in trade deficits during the Bush and Clinton years, culminating in a $425-billion deficit in 2000, sending total trade deficits since Reagan took office to over three trillion dollars. Concurrently, the federal debt soared to $5.95 trillion, forcing the current Bush administration to request raising the debt ceiling to $6.7 trillion, making a mockery of the silly notion that we would enjoy trillions of dollars in surpluses over the next decade.

The relationship of trade deficits to the federal debt can no longer be ignored. Nor can the fact that over 20 million Americans have lost their jobs, their homes, their families, their health, and even their lives while the social fabric of our nation was being torn apart, creating the widest gap between "rich and poor" in our nation's history.

Therein lies the tragic legacy of free-trade policies. When President Bush and his aides tell us that free trade creates jobs, they are doing more than blowing smoke: They are lying.

—*Gus Stelzer*
Mill Creek, WA

Mr. Kaza Replies:

Mr. Hartman is correct in raising the issue of "more fundamental structural problems" in the credit structure. Mainstream economists focus on the growth of the money supply as the source of the financial bubble. Consider the frequently cited Money of Zero Maturity (MZM), which grew at a 13-percent annual rate between 1995 and 2001, and at 14 percent post-LTCM. But they overlook the full ramifications of non-commercial bank entities, including government-sponsored enterprises (GSEs), creating money and credit.

Consider one example among many: hedge-fund speculation through repurchase agreements (or offshore "spread" and "carry trade" derivative plays) that expand institutional fund deposits and the money supply (beyond MZM growth). This credit is recycled into U.S. financial markets. Credit growth, in response to the demand for dollar-denominated financial instruments, is the key causal factor. Foreign and domestic speculators prefer these instruments because they often deliver a greater rate of return.

The credit structure's demand for an artificially strong dollar is in conflict with the manufacturing sector's desire for a currency in equilibrium.

Much of this credit structure is centered, as Mr. Brimelow notes, in the government sector (Federal Reserve, GSEs such as Fannie Mae, Freddie Mac, and the Federal Home Loan Bank system) or among private banks whose insurance is backed by the full faith and credit of the U.S. government—i.e., the taxpayer.

Deflation has also undoubtedly contributed to the climate facing manufacturers. Japan, the world's second-largest economy, is exporting its bad deflation (and cheaper exports), and domestic manufacturers, for only the third time since World War II, face a rare "rolling deflation" that appears, disappears, and reappears. The Producer Price Index (PPI) has been negative for three of the last five years (1997, 1998, and 2001), and Consumer Price components such as "new cars" are negative while the index itself is slightly positive. General Motors and U.S. Steel could raise prices in earlier periods of rolling deflation (1948-1954, 1959-1963) but have little pricing power today.

The current manufacturing decline began almost a year before the current recession; it is also more severe, according to the National Bureau of Economic Research, which reported on February 11: "Industrial Production. A peak occurred in June 2000 and the index declined over the next 17 months by 7.1 percent, far surpassing the average decline in the earlier recessions of 4.6 percent." Consider the Eighth Federal Reserve District (St. Louis), which includes Illinois, Arkansas, and five other Midwestern and Southern states. Manufacturing employment in all seven states has contracted during this recession (Arkansas' decline, spurred by high tax rates on capital investment, is the greatest on a percentage basis), while government and service-sector employment has grown in every state except Missouri and Mississippi.

Mr. Stelzer misses my main point: My essay was meant not only to illustrate that President Clinton neglected manufacturing but to warn Republicans that Ronald Reagan was their last presidential nominee to win the industrial states of Michigan, Indiana, Wisconsin, Ohio, and Pennsylvania.

On Ludwig von Mises

Thomas Fleming's criticism of Ludwig von Mises and his student, Friedrich von Hayek ("Abuse Your Illusions," *Perspective*, January), overlooks or misinterprets major contributions of both. In *Socialism* (1922), Mises was the first economist to show the unworkability of socialist systems. He based his analysis on the impossibility of establishing a price structure for the various means of production and thus the absence of a mechanism for allocating resources in a reasonably efficient manner. In other words, he demonstrated the essential character of information—information that no central planner can possibly accumulate because most of it is subjective and fleeting. This brings up his other important contribution: the subjective nature of value. The value of something (material, of course) is what someone is willing to pay for it, not, for example, the quantity of labor that went into it.

Hayek carried the analysis of information dependence further and then began the application of "self-ordering" to any economic system. Self-ordering or "spontaneous organization" was first proposed during the Scottish Enlightenment (e.g., Adam Smith's "invisible hand") but had been forgotten. Hayek's revival of the concept was an important contribution, although he regrettably failed to pursue it. Hence, putting down Hayek with respect to this concept, as Fleming seems to have done, is completely unjustified.

The resuscitation of the economic ideas of Mises and Hayek is laying to rest the whole Keynesian enterprise. Older economists and a few younger ones with political agendas still push Keynes' ideas, but an increasing number of younger ones are abandoning them for Mises and Hayek. Admittedly (but not surprisingly), the approach of Mises and Hayek is incomplete, as are the approaches of even the very wisest economists. This lack should not obscure their very significant contributions.

—*Robert C. Whitten*
Cupertino, CA

I enjoyed Thomas Fleming's analysis of the shortcomings of economists Ludwig von Mises and Friedrich von Hayek in developing a corresponding theory of morality and human values. Although Hayek often criticized modern materialists and socialists, he lent solid support to much of their ideology and method. He attributed his education in the methodology of science to Bertrand Russell, the chief spokesman for logical positivism.

Like Karl Marx, Hayek writes that Christianity is a curious jumble of myths that allowed mankind to assimilate the values of capitalism and facilitated the development of free markets and industrial society. In *Science and Socialism*, Hayek remarks, "We do not owe our morals to our intelligence: we owe them to the fact that some groups uncomprehendingly accepted certain rules of conduct—the rules of private property, of honesty, and of the family—that enabled the groups to prosper, multiply, and gradually replace others . . . But the fact that our morals are not the result of man's supreme intelligence explains why we all so much dislike them."

Hayek also wrote that Christianity, having served its appointed task, is an historical relic. "There can," he writes, "be no doubt that moral and religious beliefs can destroy a civilization and that when such doctrines prevail not only the most cherished beliefs but also the most revered moral leaders may become a grave danger . . . we can protect ourselves only by subjecting our dearest desires to ruthless rational dissection."

Hayek was very suspicious of the power of nation-states, their tendency to make war, and their ability to disrupt the magical perfection and scientific efficiency of the invisible hand. This explains why, in *The Road to Serfdom*, Hayek calls for a world superstate similar to the one promoted by the Fabian society and the World Federalists. Anticipating the appearance of today's Blue Helmets—the United Nation's world police force—by almost half a century, Hayek, in 1944, outlined his "true system of law which guarantees both that the certain rules are invariably enforced and that the authority to enforce those [rules] cannot use it for any other purpose, for its task of enforcing the common law the supernational authority must be very powerful." It might have been best if Hayek had limited himself to elaborating on the intricacies of the free market.

—*David J. Peterson*
Chicago, IL

Dr. Fleming Replies:

I neither overlooked nor misinterpreted the contributions of Mises and Hayek to economic theory. Since I was writing an article about political theory and social ethics, I cannot imagine why anyone would expect any interpretation of economic theory. The absurdity of Marxist political and economic theory was noted in Marx's lifetime and after his death by many sane people (e.g., W.H. Mallock).

Bad economic systems crumble under the weight of their own contradictions of human nature, and although poverty is a great misfortune, it is not the inefficiencies of Marxism that are so terrible but the inhuman coercion practiced by communist countries against the basic tendencies and institutions of human life: marriage, the family, competition, loyalty, patriotism, ambition, etc. Communists replaced the traditional view of human nature—rooted in nature, revelation, and history—with a materialist theory that deprives human beings of their freedom and dignity. Unfortunately, Mises is no less a materialist than Marx and no less a moral relativist than any of the other self-appointed gurus who have promised to liberate us from our traditions and superstitions.

I have no quarrel with atheists and moral relativists proclaiming their blind allegiance to Ludwig von Mises; indeed, I admire more than a few of them. What I do object to is the palpable fraud that one can be a Christian Misesian or a "Catholic libertarian." Yes, Mises and Hayek did yeoman service in pointing out the absurdity of economic planning, and if I ever need someone to tell me to ask the federal government to surrender some of its power, I'll be sure to call on the Misesians. For the rest of life, Mises is of no use. Render under Mises the things that are Mises . . .

On Agrarianism and Freedom

I enjoyed Mark Winchell's "Tracts Against Capitalism" (*Vital Signs*, January) when it presented facts regarding the Agrarians, but I must take issue with a number of his opinions.

Peaceful Valley residents have more than two options regarding Wal-Mart. They could, for example, form a corporation (non-profit or otherwise) to buy the land in question, or they could raise a ruckus with the zoning authority either to block the project outright or to impose costly restrictions that would render it uneconomical. The former course is principled and conservative, the latter is just another way for government to steal the landowner's rights without paying just compensation.

Setting up mean old Wal-Mart as a foil to introduce a conservative "counter-tradition" to bigness is highly unenlightening, to put it mildly. Whether it is Wal-Mart or a neighbor who wants to build on any particular lot, the property in question is going to be developed someday. For Peaceful Valley residents to declare that they have got their little bit of heaven—and to hell with the rest—is not admirable; it is typical Malibu I've-got-mine liberalism. Is that what the Agrarians stood for?

People have loved to hate big business for 200 years, and look at the result: The big railroads of the 19th century are anemic behemoths struggling for life; big steel of the early 20th century went bust; big auto manufacturers of the 1950's face stiff competition and are losing money; and the big computer companies of the 1970's have been swamped by innovation.

The problem with bigness is that it does not adjust well to change, and that is the point: No matter how big, no corporate entity is a match for the forces of the market. To suggest that we need to cede more power to big government to battle today's corporate giants seems manifestly wrong. Rather than worry about Wal-Mart coming through the trees, the residents of every Peaceful Valley in America should worry about big government bashing down the door and looting the cupboard.

I agree with Mr. Winchell that bigness is bad and devolution is good. The solution to bigness, however, is not any sort of government action; it is more freedom. While freedom may disrupt Kathleen Dickel's breakfast, it is the only sure way we can achieve and keep meaningful devolution. At least that's what Thomas Jefferson thought.

—*Theodore B. Hannon*
Kailua, Hawaii

Mr. Winchell Replies:

I fear that Mr. Hannon's reading of my article is filled with enough straw men to populate Kansas. As a card-carrying, dues-paying member of the Libertarian Party, I share his concern about "big government bashing down the door and looting the cupboard." In fact, I clearly stated that the biggest mistake made by the Agrarians and Distributists was to think that they could trust the federal government to fight their battles without paying an unacceptable price in personal freedom and local sovereignty.

What is at issue in Clemson is not whether property rights should be respected but *whose property rights* should prevail. Why should the right of a single property owner to turn a profit by selling his land to Wal-Mart take precedence over the right of his neighbors to use their property in accordance with existing zoning laws? Chicago attorney Richard Kuntz has called my attention to the common law of nuisance. This principle prohibits an offensive land use that would interfere with the "quiet enjoyment" of an established landowner. Although this principle has been considerably eroded since the Industrial Revolution, it is one that conservatives can and should defend.

One need not harbor an irrational prejudice against big business to realize that capitalists are not gods but fallen human beings capable of bad behavior. When they do act badly, it is incumbent upon defenders of the market to call them to task.

While I agree that federal regulation has gotten out of hand, the right of local communities to preserve an established way of life is a principle worth defending. On this point, the Agrarians and Distributists are more reliably conservative than the Business Round Table.

SUPER BOWL XXXVI, proclaimed by the National Football League to be a tribute to September 11 (themed "Heroes, Hope, and Homeland") underscored the fact that there is something inauthentic about a spectacle that allows sports-bar patrons to experience masculinity vicariously by watching well-padded millionaires smash into one another for control of a leather ball.

The Fox Television Network, which had exclusive rights to broadcast the game, had promised "the most stirring, patriotic and emotionally charged Super Bowl ever." Indeed, it proved to be a wartime pep rally, with spots made by players saluting the troops, satellite images from Afghanistan, and delegations representing police and fire departments as well as the Armed Forces. And while Irish rock band U2 won the prize for most testosterone-filled act—notwithstanding the irreverent spectacle of fans wildly cheering lead singer Bono, leather jacket lined with Old Glory, preening beneath the names of those killed by the terrorist attacks projected onto a giant bedsheet—the pregame show won the prize for most patriotic.

The pregame show was a film in two parts, with ex-NFL stars reciting excerpts from the Declaration of Independence, and the former living presidents (Nancy Reagan filled in for her ailing husband) celebrating Abraham Lincoln in his own words.

The announcer began the show with the question, "Just what is the cornerstone of . . . the much-envied American way of life?" The answer, he replied, is "the Declaration of Independence, which guarantees every individual life, liberty, and the pursuit of happiness." Actually, the Declaration—a political act, not a legal charter—does no such thing. It is the Constitution's Bill of Rights that guarantees our rights under the banner of "life, liberty, and property," the "pursuit of happiness" being a flowery phrase that withers under examination: What makes one person happy might constitute a criminal act.

The first part opened in Independence Hall with actors depicting several Founding Fathers reciting famous lines. It then shifted to ex-NFL stars reciting the Declaration's more stirring passages. Included in the roster were ex-Buffalo Bills quarterback Jack Kemp, speaking from the Capitol's rotunda, and ex-Seattle Seahawks quarterback Steve Largent, now a Republican Congressman from Oklahoma, who spoke from a Western art gallery before a bronze of an Indian war chief. All of this was accompanied by a martial score by John Williams, heavy on the horns and drums.

Lest anyone miss the theme of multicultural unity, the line "all men are created equal" was repeated three times, ending with a group shot of people who looked as if they were swept from the waiting room of an INS office, including an Arab Muslim wearing a white head wrap. This theme was reinforced when a stern-looking black soldier recited the line "It is their duty to throw off the old government and provide a new future of security," flanked by four other diverse but unrepresentative soldiers: two men (white and black) and two women (white and Asian).

The first part closed at the Jefferson Memorial, which is inscribed with several quotes, including "I tremble for my country when I reflect that God is just; that His justice cannot sleep forever." But reciting that would have seemed darkly incongruous, so another was chosen in praise of a uniform American identity.

To the grave tune of Aaron Copland's "A Lincoln Portrait," part two celebrated Lincoln, that "gaunt figure striding across the American political and philosophical landscape like a Colossus" whose "patriotic philosophy is especially apt right now."

The former presidents and Mrs. Reagan quoted Lincoln expounding on the virtues of democracy and equality and the need to reject "the dogmas of a quiet past [that are] inadequate to a stormy present." Images of pastoral America bathed in the setting sun—a mountain lake, a windmill in a golden field of corn—clashed with such martial shots as the Vietnam War Memorial, the flag raising on Iwo Jima, and, of course, the crumbling World Trade Center Towers. The message was clear: Retribution against terrorists will help us recover an idyllic America.

While the pregame show lived up to Fox's claim of the most patriotic Super Bowl ever, it should not be forgotten that selectively chosen words divorced from their historical context and glorified with powerful and pleasing images and music are the stuff of propaganda. Details that would have sullied the nationalistic triumphalism were excluded, such as Lincoln's vow to win the Civil War "whether it meant freeing all the slaves or none of them" and his well-documented belief in the inequality of blacks—not to mention his prosecution of a bloody and unconstitutional war that allowed the federal government to become the colossus it is today. But a great nation needs heroes to enshrine in marble temples and worship in time of war, even if their mythic stature ignores their weaker human natures.

No mere words could better illustrate the pregame show's sentimental idealism than what immediately followed: the singing of "America the Beautiful." To continue the Capra-esque theme, I had hoped for a wholesome singer like Kate Smith, of whom Franklin D. Roosevelt declared, "She is America."

Instead, the 180 million viewers worldwide were subjected to the combined caterwauling of a skankily dressed woman (singer Mary J. Blige) with bulging breasts and a bare arm showing a tattoo of a cross, and a slinky girly boy in sunglasses (Latino pop star Marc Anthony). The illusion of Norman Rockwell's America ended with the rude introduction of America the unbeautiful.

—*Matthew Rarey*

AFTER SEPTEMBER 11, several important stories continue to be ignored. Here, to a lay observer, is the shape of the past fall's most overlooked developments.

The two biggest sponsors of terrorism in the Middle East are Saudi Arabia and Pakistan. The intelligence community has known this for years. The recent kidnapping and slaying of a *Wall Street Journal* reporter is only the most recent incident.

Our bombing campaign against Afghanistan was not really a "war on terrorism." Afghanistan ("Pipeline-istan") is basically a big vacant lot, not formally recognized as a nation by the U.S. government, dominated by squabblers with guns; its training camps and similar operations were founded, staffed, and financed by Saudi Arabia and Pakistan,