BASTIAT PRIZE '09

2009 Bastiat Prize for Journalism

The Bastiat Prize for Journalism was established by International Policy Network in 2002 to encourage, recognize and reward writers around the world whose published works elucidate the institutions of the free society.

In the enduring spirit of the Prize's namesake Frédéric Bastiat, the Prize is given to writers who employ eloquent and witty explanations of complex ideas, combined with a clear understanding of markets and their underlying institutions – including property rights, the rule of law, freedom of contract, free speech and limited government.

2009 marks the eighth Bastiat Prize competition. The winner will be announced during IPN's annual Bastiat Prize dinner on October 26 in New York City. This year, the winner will receive $10,000; the runner-up will receive $4,000; and third place will receive $1,000. The winner of the online prize will receive $3,000. All winners receive an engraved crystal candlestick, reminiscent of Bastiat's essay "A Petition".

For the 2009 competition, IPN received submissions from 292 writers in 51 countries, representing 292 publications, media outlets and websites.

ipn INTERNATIONAL POLICY NETWORK

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IPN is an independent, non-partisan think tank. Our work is guided by a belief that free enterprise and its supporting institutions (especially property rights, markets and the rule of law) are able to harness human potential better than any other arrangement and are the best way to address the poverty and tragedy faced by many people in the world.

IPN seeks to improve public understanding of the role of these institutions, especially in the context of international policy debates relating to the environment, development, health, globalization and trade. We work with partner organizations and individuals around the world, coordinating coalitions, producing policy materials, organizing meetings, liaising with the media, and producing and disseminating opinion editorials.

International Policy Network
Rooms 200–205, Temple Chambers
3–7 Temple Avenue, London EC4Y 0HP
United Kingdom

2009 Bastiat Prize Finalists

Bastiat Prize for Journalism

Nolan Finley
Detroit News

Peter Foster
National Post

Robert Guest
The Economist

John Hasnas
column written in *The Wall Street Journal*

Matthew Kaminski
Wall Street Journal

Robert Robb
Arizona Republic

Bastiat Prize for Online Journalism

Shikha Dalmia
Forbes.com, Reason Foundation

Daniel Hannan
Telegraph.co.uk blog

Rohan Samarajiva
columns written in LankaBusinessOnline

2009 Bastiat Prize Judges

Each member of the panel of judges was chosen for their lifelong commitment to promoting the institutions of the free society. Whether as economists, policymakers, writers or entrepreneurs, each has made an outstanding contribution to the cause of liberty across the world.

Bastiat Prize for Journalism

BRIAN CARNEY
Editorial Board member, *Wall Street Journal*, USA, winner of 2003 Bastiat Prize, author of Freedom, Inc.

CLIVE CROOK
Senior editor, *The Atlantic Monthly*, Chief Washington commentator, *Financial Times*, *National Journal* columnist

BIBEK DEBROY
International Management Institute, India

HON. DOUGLAS GINSBERG
DC Circuit Court of Appeals

AMITY SHLAES
Syndicated Bloomberg columnist; Co-winner of 2002 Bastiat Prize; Chairman of Judging Panel

Bastiat Prize for Online Journalism

SCOTT BANISTER
Entrepreneur and angel investor (Paypal, IronPort, Zivity, Slide)

ESTHER DYSON
Journalist, digital commentator, philanthropist, IT and investor (Flickr, 23andme, Space Adventures)

AMIT VARMA
India Uncut blog, 2007 Bastiat Prize winner

JIMMY WALES
Founder of Wikipedia; owner of Wikia

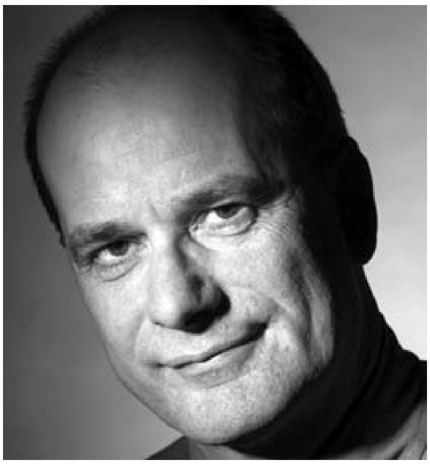
Nolan Finley

The Detroit News

America should follow Little Red Hen | October 19, 2008

Vive le CEO? Not in today's America | December 7, 2008

Hey neighbor, buy you a window? | May 3, 2009



Nolan Finley is Editorial Page Editor of *The Detroit News*, a position he's held since 2000. He directs the expression of the newspaper's editorial position on various national and local issues, and also writes a column in the Sunday newspaper. Prior to that, Finley was the newspaper's Deputy Managing Editor, directing the newsroom. Previously, he served as Business Editor. Finley has been with the newspaper since 1976, starting as a copy boy in the newsroom while a student at Wayne State University. He is a graduate of both Schoolcraft College in Livonia and Wayne State, where he earned a Bachelor's degree in journalism. He is a native of Cumberland County, Kentucky.

AMERICA SHOULD FOLLOW LITTLE RED HEN

October 19, 2008

If America really is structurally broken, as we've been warned with authority from the campaign trail, then it's not because our fundamental principles have failed us, but because we've strayed so far from them.

I'm not talking about the values defined by Jefferson, Adams, Hamilton and crew; though Lord knows we could certainly use a good refresher course in those.

The principles I miss are the ones voiced so eloquently by the Little Red Hen, the Three Pigs and the Little Engine That Could.

Generations of Americans were raised on these fables and in the process were taught lessons that would be considered harsh on "Sesame Street." But they reinforced who we were.

From the feisty Little Red Hen we learned the rewards of hard work. We also learned to savor those rewards guilt-free and to understand that what we create belongs to us.

The hen would have flailed the Rainbow Fish had he come sashaying around with his share-your-crayons silliness.

She planted the wheat and ground the flour and baked the bread and felt no obligation to break off a piece for the shiftless sheep or do-nothing donkey – unless she wanted to. She was my kind of chick.

But she doesn't fit into an America that increasingly questions the fairness of one person having more than another, without weighing sweat or skill.

In the hen's world, if you produced, you ate; if you were able to and didn't, you went hungry.

Why is that too sinister a concept to teach tykes today?

This country will become a very dangerous place if the mindset takes hold that the fruit of individual industriousness is a collective asset.

Those house-building pigs drove home the reality that bad choices carry bad consequences. Build your house out of sticks or straw, and your hams will be steaming on the Wicked Wolf 's table.

Build it out of bricks, and you can safely rest them in a La-Z-Boy in front of your big screen TV.

Compare that lesson to the plea that we have no choice but to open our wallets to the Wall Street tycoons who overplayed their hands or to the homeowners who borrowed too much without reading the fine print.

The Little Engine is my favorite. He huffed and puffed up that hill on his own steam, and kept stubbornly going even when he wasn't sure he could make it to the top.

He didn't pull off the tracks to wait for Dora the Explorer to give him a push.

The Engine's breed of self-reliance and determination to overcome obstacles would serve us well as we enter what promises to be the most challenging economic stretch in decades. Will we turn to the government to pull us up the hill, or will we get up a good head of steam and go for it ourselves?

In a couple of weeks, a large number of voters, likely even a majority, will go to the polls to choose a political Pied Piper to lead them to an America where everyone shares and hugs and plays patty cake in equal-size houses.

I'd rather follow that cranky Red Hen.

VIVE LE CEO? NOT IN TODAY'S AMERICA

December 7, 2008

The building hostility toward the executive class is starting to take on a French Revolution feel.

Expect the mobs at any moment to break through the boardroom doors and carry away to the guillotine all the chairmen, directors and chief executives.

CEOs have been made the scapegoats of America's distress, and politicians are more than willing to deflect the blame for the misery away from themselves.

"It's horrible," says David Brandon, CEO of Domino's Pizza in Ann Arbor and chairman of Detroit Renaissance, the civic group made up of the region's most powerful executives. "The image of the CEO has been thoroughly trashed – it's as if we're subhumans. I don't want anyone to recognize me in the grocery store."

Brandon faults, in part, a political season in which Republicans and Democrats used "CEO" as a pejorative. Then came the Wall Street collapse, and the subsequent bailout at taxpayer expense of financial firms that paid their executives as if they were New York Yankee shortstops.

The pizza chief admits there were compensation abuses, and that CEOs have to shoulder some of the blame for their status. But he says it's wrong to paint all executives as overpaid elitists who would sell their workers' souls for a profit.

He's right. And it's dangerous. Business leaders are the dollar signs behind efforts to rebuild communities like Detroit. They write the checks for symphonies and museums, build the hospitals and bankroll the do-gooder work of the nonprofit world.

They also create the jobs that keep the rest of us in paychecks. It's a 24–7 responsibility. Heads of national companies are on the road much of the time.

When they climb on a corporate jet, it's not for the luxury; it's to save a few precious hours they can pour back into their work.

Most didn't inherit their seat in the corporate suite. Again like Brandon, they worked their way up from the bottom by being better at what they do than everyone else.

The danger of turning them all into Simon LeGrees – or Ken Lays – is that it emboldens the anti-business forces and makes the public less sympathetic to improving the business climate.

In Michigan, that means little support for fixing the suffocating state business tax surcharge, which is driving investment out of the state.

But once you convince Americans that business is the problem and government is the solution, you build a constituency for excessive regulation and punitive taxes.

And you soften them up for accepting that massive government spending programs make more sense than a long-term economic strategy built on encouraging private investment and job creation.

Brandon is already seeing that in California, where Dominos sold off its corporate franchises because it couldn't deliver enough pizzas to cover the regulatory costs.

"It's easier to do business in France than in California," he says.

Perhaps easier to be a business executive in France, too, even with the guillotines.

HEY NEIGHBOR, BUY YOU A WINDOW?

May 3, 2009

You may be surprised when the insulation truck pulls up to your neighbor's house and starts stuffing his attic. Or when his high-tech new windows arrive.

You'll be even more shocked to learn you're paying the bill. Most of the Obama stimulus money coming to Michigan counties is in the form of weatherization and neighborhood stabilization funds – $248 million to plug drafty houses and $134 million to pretty up foreclosed homes.

Michigan expects 40,000 homes to get attic insulation, weatherstripping and window and roof repairs at a cost of up to $6,500. The lucky recipients will save about $400 annually on their heating bills.

As the taxpayer picking up the tab, you might have a few questions. I know I do.

First, I wonder who did the math. At $400 a year, it will take 16 years to recoup the investment. The White House claims the greater good is the impact on global warming, but I doubt it'll cut enough carbon to keep a single ice cube from melting in the Arctic.

My bigger question, though, is: What about my house? While my tax dollars are going to make someone else's home cozy, I've got drafts blowing through that would take a chihuahua airborne.

Likewise, my castle could use a good sprucing to make it more marketable.

But the money I might have used for new siding went for taxes to fund a federal Neighborhood Stabilization stimulus program, which gives buyers of foreclosed homes cash to fix them up. Never mind that they bought the houses at a 40 percent discount and should have plenty of cash leftover for repairs. Obama is making sure they can flip them at a tidy profit.

The counties, starved for operating cash, have no choice but to use the money to pay for Obama's Robin Hood schemes. Paul Gieleghem, chairman of the Macomb County Commission, said he would have rather used the $8 million his county is getting for weatherization to improve Macomb's higher education options.

That would be legitimate economic stimulus in a county that needs a more highly skilled work force. And it would have been a more direct benefit to a broader group of residents.

Weatherization? That's welfare wrapped in itchy pink fiberglass.

It expands the idea of a safety net well beyond making sure everyone is secure, fed and healthy to guaranteeing everyone has the same stuff, even the same R value in the attic.

It reflects the driving mission of Obamanomics to equalize wealth and flatten the standard of living.

It makes charity compulsory and takes away the discretion of the individual giver about how his or her charitable dollars should be used. .

You'd likely dig into your pockets to make sure your neighbor has enough to eat and a roof over his head. But patching that roof and caulking his doors?

Bet you didn't realize you were so generous.

Peter Foster

National Post

Saving Earth, one noodle at a time | July 11, 2008
Nobel savages | August 20, 2008
The Mugabe solution | December 5, 2008

Peter Foster studied economics at Cambridge and worked for the *Financial Times* of London before emigrating to Canada. He has written eight books including *Self Serve: How Petro-Canada Pumped Canadians Dry*, which won Canada's National Business Book Award. He has also written books on the Reichmann real estate empire and the Bacardi rum family. His magazine journalism has won awards for topics as diverse as Moscow McDonald's and oil exploration in the Beaufort Sea. Since 1998, he has been writing a twice-weekly editorial column for the *National Post*. He is finishing a book provisionally titled *Why We Bite the Invisible Hand*.

SAVING EARTH, ONE NOODLE AT A TIME

July 11, 2008

According to a story in this week's Financial Post Business magazine, Lee Scott, CEO of retailing behemoth Wal-Mart, deemed the noodles in Hamburger Helper guilty of "unnecessary curliness," so he browbeat their producer, General Mills, into straightening them out.

As with so much corporate lunacy these days, this vignette is rooted in the alleged need for corporations to take a conspicuous lead in forestalling catastrophic climate change. You see, curly noodles take up more space than straight noodles and thus require larger packages. So, due to Mr. Scott's intervention, the Hamburger Helper box is now 20% smaller, with – according to General Mills – an annual saving equivalent to taking 500 trucks off the road.

One assumes that Mr. Scott's crusade will now bring him into conflict more broadly with the pasta industry, whose products display a shameful array of shapes that require redundant packaging. He will no doubt be seeking the eradication of the spirals, bow ties and tubes of fusilli, farfalle and penne in favour of more compact spaghetti and tagliatelle. Otherwise we might be forced to conclude that Mr. Scott has something against consumers of Hamburger Helper, whom he seems to think can make do with utility pasta. When will he start editing alphabet soup?

I always regarded tales of Wal-Mart's terrifying "power" as nonsensical, based on confusing economic heft with political clout. Now I'm not sure. For Wal-Mart to squeeze its suppliers in the name of customer value and profitability is sound business; to twist suppliers' arms to save the planet drifts into dangerous politics, and potentially lousy economics.

In my Wednesday column, I noted that the otherwise delightful animated film Wall-E portrayed a world depopulated by crass materialism, of which the main pusher was a monolithic and environmentally feckless nightmare version of Wal-Mart named "Buy n Large." The irony is that Wal-Mart is now determined to portray itself as greener than green. Indeed, its new, Orwellian, motto is: "For the Greener Good." And I do mean Orwellian, because Wal-Mart seems to want to play Big Brother to its suppliers.

Straightening out Hamburger Helper is just one example of the use of Wal-Mart's green muscle (perhaps its new symbol should be The In-credible Hulk). Procter & Gamble, too, has apparently been pressured to produce only concentrated detergent.

The problem is that the Hamburger Helper intervention might burnish Wal-Mart's CSR credentials, but it makes General Mills look stupid, and undermines the free market more generally.

General Mills was either inefficient in providing its Hamburger Helper in a form that consumers didn't want, and which involved waste packaging, thus damaging its own profitability, or, if its consumers really did like their curly pasta, it has sacrificed them to environmental bullying.

I sent an e-mail to General Mills asking – among other things – about the role of Mr. Scott, why Hamburger Helper was curly in the first place and whether any market study had been done on how consumers felt about the shape shift. The company claimed that consumers were happy with the changes, and ignored the questions about Mr. Scott and the pasta's shape. It also asserted that General Mills had been "focused on efficiency and minimizing our impact on the environment for decades." But that's the point. Economizing on packaging and raw materials is a critical aspect of any business, as is responding to, and anticipating, consumer wants.

Green marketing is hardly a new phenomenon. Almost twenty years ago, Dave Nichol, the marketing genius who spearheaded Loblaw's President's Choice brand, said, "I think in the future we're going to look back at this point in time as the start of what is going to be the most important revolution in our society – the politicization of the consumption process."

It was an astonishingly prescient choice of words, although what Mr. Nichol was in fact talking about was the power of consumers "to vote for the environment at the cash register." Things have turned out somewhat differently, significantly due to climate change hysteria. Corporations now seem to imagine that it is their role to be out in front of consumers – indeed, that they should force consumers into the paths dictated by radical NGOs. They also pressure their suppliers as a means of taking the heat off themselves. This thrust is inevitably pushed farther by a growing army of environmental consultants and "licensers" who earn fat fees for nagging their clients, and/or providing them with a "Cloak of Green".

Corporations, by subscribing to vague sustainability, are unwittingly leaving themselves open to an almost infinite range of further demands and interference. Whether they realize it or not, they are subscribing to the blanket condemnation that markets do not work and that the whole capitalist system represents one giant "market failure" that requires fretting and tinkering at every level, from noodle shapes through carbon labeling to the calculation of "food miles." That way lies madness, but that's where we're heading.

NOBEL SAVAGES

August 20, 2008

Joseph Stiglitz is a Nobel Prize winner in economics who doesn't like capitalism or markets very much. This does not make him that unusual. The very first economics Nobel, Jan Tinbergen, admitted without embarrassment that he had always seen his academic task as making the case for socialism. The roster of laureates is filled with skeptics about Adam Smith's invisible hand. Mr. Stiglitz has claimed, for example, that the hand "is invisible, at least in part, because it is not there."

Throughout the twentieth century, much of the economics profession drifted towards "Welfare Economics," which emphasized not how markets worked, but how they "failed." Their creed was that governments, guided by smart economists like themselves, might – nay, had to – prevent, or compensate for, market shortcomings.

One of the founding members of the school was Arthur C. Pigou, whose hatching of market-correcting "Pigovian taxes" is bemoaned in the Post's Nopigou Club. In an age when it is claimed that markets have to be "greened," and that all that this requires is a little judicious fiddling with taxes and prices, Mr. Pigou is much in fashion. After all, catastrophic man-made climate change is "the greatest market failure the world has ever seen," even if the world hasn't actually seen it yet.

Welfare economists suffer from twin delusions. One – as pointed out by the "Public Choice" school championed by another Nobel laureate, James Buchanan – is that politicians are selflessly interested in making effective policy rather than winning elections. The second delusion is that the market actually can be "fine tuned." Traditionally, welfare-oriented interventions – from minimum wage laws through rent controls to the promotion of biofuels – have ended both in taxpayer tears and damage to those who are meant to be "helped."

The very fact that Messrs. Stiglitz and Buchanan are Nobel economics laureates with diametrically opposed views was one of the reasons Alfred Nobel never set up a prize for economics in the first place (it was added later by Swedish bankers). Economics is not a science in which there is a broad body of knowledge on which all economists agree. Rather – when it is not mathematically abstruse and irrelevant – it is a field of ideological conflict which many economists enter intent on "improving" markets without understanding them in the first place.

Many such economists, including Messrs. Tinbergen and Stiglitz, not to mention the late John Kenneth Galbraith, are primarily moralists, who reject the market as a messy affair based on greed and exploitation, and swell with pride at their role in "redistributing" other peoples' money. They are always on the lookout for evidence of market failure or government success. Since this coincides with naive public perceptions, they are often "popular economists," (which is thus a contradiction in terms).

They are also inclined – as does Joseph Stiglitz – to write off promoters of markets as "fundamentalists," as if their conclusions were based not on studying the counterintuitive workings of the economic order, but on some form of wacky religious faith-cum-mental disorder. To the extent that such blinkered fundamentalists might exist, as opposed to being merely straw men, they certainly have little or no voice in current policy-making.

In a recent piece in the Globe and Mail, Mr. Stiglitz suggested that free-market "rhetoric" is only ever used selectively; "embraced when it serves special interests, discarded when it does not." While this may certainly be true, it is no argument against markets any more than the Nazi doctor Joseph Mengele invalidated the case for medical science. No sensible economist suggests that markets are perfect, but those on the supposed "right" point out that they are much more efficient than most people imagine, while government meddling seldom if ever has the intended results.

The Invisible Hand may not be perfect, but it beats governments' Visible Bull in the China Shop every time.

Certainly, governments are needed to maintain property and contract rights, and to protect us against the threats posed by other governments, but expansive government tends to be both ineffective and oppressive. For men such as Mr. Stiglitz, however, it is sufficient to point out the theoretical shortcomings of the market and leave the question of the practical shortcomings of politics unaddressed. Thus, he is quick to point to the current financial crisis as "market failure," but to downplay the role of inflationary government policies, or de facto government-backed institutions such as Fannie Mae and Freddie Mac, in the debacle.

Mr. Stiglitz points out that, among their other failures, free markets produce "too much" pollution and "too little" research and development. Both these claims are dubious. The problems of pollution spring from inadequate property rights, and sometimes need correcting by governments, but it is surely worth reflecting that pollution laws tend to be much stricter in mature capitalist democracies. That's because capitalism gives rise to demands for democracy, and democratic governments derive much of their power from exploiting exaggerated fears of market failure!

As for markets promoting "too little" R&D, fans of governments claim that they have the responsibility, and ability, to promote society-wide innovation and investment. According to Professor Stiglitz, for example, the U. S. government "invented" the Internet. I plan to examine that claim, and its broader implications, in my next column.

THE MUGABE SOLUTION

December 5, 2008

The 2008 Oscar for best foreign language film went to "The Counterfeiters," which was based on the true story of a Nazi plot to subvert the British and American economies by flooding them with forged paper currency. It is worth reflecting that the potential economic destruction would have been exactly the same if the increased currency had been "genuine."

Monetary corruption does not require forgery. John Maynard Keynes famously attributed to Lenin the statement that "There is no subtler, no surer means of overturning the existing basis of society than to debauch the currency." In our own time, one of the essential features of the economic disaster created by Robert Mugabe in Zimbabwe is the promotion of hyperinflation, which is simply achieved by running printing presses and adding zeros to banknote denominations.

Inflation has been a government-manipulated wrecking ball throughout history, but it is now being promoted as a potential economic saviour. According to a piece in Wednesday's Globe and Mail by Kenneth Rogoff, a former chief economist with the International Monetary Fund and now professor of economics and public policy at Harvard, "It's time for the world's major central banks to acknowledge that a sudden burst of moderate inflation would be extremely helpful in unwinding today's epic debt morass."

There are many good reasons for being suspicious about recommendations that money creation be accelerated to ward off the allegedly greater evil of price deflation, although the rate of money creation inevitably becomes a public policy issue under all systems of fiat money (that is, where the value of money depends on the prudence, or otherwise, of governments). That was one of the main reasons for the universal trend in the 1990s to make central banks independent of possibly feckless democratically-elected governments.

Despite his quotation of Lenin, Keynes in fact later invoked deliberate inflation as an economic and political tool, suggesting that the "euthanasia of the rentier" – that is, anybody who lives on a fixed investment or retirement income – was preferable to mass unemployment. This confirmed, however, that such a policy involves effectively robbing the minority for the sake of the majority.

Keynes' analysis could be considered to have been borne out by the Great Depression, where government-promoted deflation, as noted by Milton Friedman, was a central factor. Nevertheless, when the chairman of the U. S. Federal Reserve, Ben Bernanke, invoked Professor Friedman's insight that a deflation problem could be theoretically "solved" by dropping cash from helicopters, he acquired the pejorative nickname "Helicopter Ben." That reflected that inflation is always to be feared.

The question is now said to be one of the degree of inflationary stimulus, which will be prudently managed, according to Professor Rogoff, to be "moderate." But the events of the past 18 months have surely left all pretensions of prudent macro-management in tatters. Professor Rogoff's rationale is that the Gordian knot of "modern finance" means that it is impossible to "restructure one financial institution at a time." Hence "System-wide solutions are needed." The unquestioned assumption is that top-down "system-wide solutions" are possible. Indeed, how could the wonkish class be expected to work at any less exalted a level?

"Unless governments get ahead of the problem," writes Professor Rogoff, "we risk a severe worldwide downturn unlike anything we've seen since the 1930s." All we need, he claims, is a couple of years of currency debasement to the tune of 6% annually. But what's all this about governments "getting ahead" of a problem they have so far been way behind? Did Professor Rogoff, during his tenure at the IMF, never bump into any of the clueless, populist, power-hungry blunderers who often get to run governments?

Like the aspiring (but at least temporarily delayed) Canadian governmental triumvirate of Stephane Dion, Jack Layton and Gilles Duceppe, Professor Rogoff wants "aggressive macroeconomic stimulus," but this reminds us that wonks may propose but it is politicians who dispose. More fundamentally, how can governments possibly rescue "us" – collectively – with our own money?

Professor Rogoff now finds himself compelled to address this problem and admit that the only solution is redistributional robbery. "[I]t's clear," he writes, "[that] the hole in the financial system is too big to be filled entirely by taxpayer money." (A statement hardly likely to comfort taxpayers).

And so we come to the "inflation option." According to Professor Rogoff, "a short burst of moderate inflation would reduce the real (inflation-adjusted) value of residential real estate, making it easier for that market to stabilize." So in order to stabilize the housing market, all other markets must be destabilized!

"Fortunately," he continues, "creating inflation is not rocket science. All central banks need to do is to keep printing money to buy up government debt." He admits a risk "that inflation could overshoot, landing at 20% or 30% instead of 5% or 6%." But this problem, he claims, is "easily negotiated." All you need is a good "communication policy" to contain inflation expectations.

Professor Rogoff's all-too-typical macro-economic hubris is as frightening as any fictionalized Nazi plot or sub-Saharan central bank policy. In the real world, investors and pensioners might not react so well to being so flagrantly manipulated and expropriated. After all, we're all rentiers now.

Robert Guest

The Economist

Creative destruction | 28 May, 2009

Red tape and scissors | 28 May, 2009

Robert Guest has been a Washington correspondent for *The Economist* since 2005. He covers American news and politics and writes a column under the byline "Lexington". Before that, he was *The Economist*'s Africa editor. Before joining *The Economist*, he was the Tokyo correspondent for *The Daily Telegraph*, and before that he was a freelance based in South Korea. He is the author of *The Shackled Continent*, a book that tries to explain why Africa is poor and how it could become less so. He won the Bastiat Prize in 2004.

CREATIVE DESTRUCTION

28 May, 2009

On a quiet street in Romulus, a suburb of Detroit, is an empty house. Even if there were not a foreclosure sign outside, the rotting newspapers and broken toys on the lawn make it obvious that no one lives here. The owner lost his job and left last year, according to neighbours.

But the house itself is solid and spacious, with four bedrooms and an ample yard. Someone should buy it and fix it up, reckon the neighbours. So long as it is empty, it drags down the value of the surrounding properties, grumbles one, a retired car worker. "Homes round here used to sell for $120,000, but if you can get it for $25,000, that would be a good deal," he suggests.

The house was sold that same day by an auction firm, Real Estate Disposition Corporation (REDC). The bidding started at a mere $500, but soon grew heated. "We're approaching the bottom of the market! This is a great time to buy!" buzzed the auctioneer. As his sales patter rattled through the amplifiers, tuxedo-clad "spotters" dashed back and forth among the crowd spotting bidders and shouting out their bids.

The house in Romulus was one of dozens REDC auctioned on March 30th at a hotel in nearby Dearborn. It went for $32,000, to a local entrepreneur who plans to turn it into a home for the mentally ill. Perhaps not what the neighbours most wanted, but at least it will be occupied.

Such auctions are now common in America. They are a conspicuous sign of misery but they serve a purpose. If banks could not seize and sell homes with mortgages in default they would not lend in the first place. And though it may be heartbreaking for former owners to see their homes offloaded cheaply, low prices are good for first-time buyers.

The auction in Dearborn was packed with young couples who until recently could not afford to own a house. There were throngs of landlords, too, looking for bargains to buy, clean up and rent out. Someone has to do this. A mobile population needs rentable homes.

Some think the housing market is about to recover. Optimists took heart when sales of single-family homes rose in February but March's weak figures undermined their hopes. Pessimists note that one home in nine is still empty. Between 2002 and 2007, at least 1m more homes were built than new households were formed. It will take a while for this surplus to be cleared. In much of the Midwest and north-east demand is unlikely to catch up with supply until 2012, by some estimates.

Bankruptcies are soaring. In the first quarter of this year, 20,251 companies filed for bankruptcy, a 52% jump from the same period last year, according to AACER, a firm that monitors such things. Including individuals as well as firms, AACER expects to see 1.5m bankruptcies this year, twice as many as in 2007.

Bankruptcy lawyers are busy. Douglas Bernstein of Plunkett Cooney, a Michigan law firm, says he could work 14 hours a day, 7 days a week and not keep up with the demand for his services. "Unfortunately, when the economy is bad, they don't add hours to the day," he grumbles in an e-mail from his office at 6am.

Companies that recycle the valuable parts of bankrupt companies are doing well, too. Distressed firms typically shed assets to raise cash so they can restructure and continue operating. If that does not work, they may go into liquidation. Everything must then be sold – the goods on the shelves, the shelves themselves, the leases on the shops, the websites, the trademarks, you name it. Firms such as Hilco, a privately held Illinois firm, can help, either by broking the sales or by buying assets themselves and selling them later. Richard Kaye, a vice-president of Hilco, says there has been a "significant uptick" in its bankruptcy business. In April, for example, the firm agreed to buy the remnants of Polaroid, a once-iconic instant-photo firm whose only significant asset now is its name.

Firms that prey on dead or dying firms are not popular. When someone calls you a "vulture", it is not a compliment. But vultures have their place. The easier it is for lenders to collect what they are owed, the easier firms will find it to borrow. An efficient bankruptcy process is an essential part of capitalism red in tooth and claw. The weak die. The strong feast on their carcasses. Little is wasted.

In January Circuit City, an electronics retailer, went into liquidation, shutting more than 500 stores and selling its entire inventory. Shoppers snapped up bargains at its closing-down sales. Other retailers pounced on some of its properties. And its rivals in the iPod-and-toaster-hawking trade are fighting to woo its former customers. "We think there's six to eight billion dollars of business up for grabs," says Brad Anderson, the outgoing boss of Best Buy, Circuit City's closest competitor.

An ideal bankruptcy system would transfer resources efficiently from less productive to more productive uses. How close does America come to this ideal? It is less ruthless than Britain, which is quick to force firms into liquidation, but less indulgent than France, which has a "huge bias" towards propping up zombie firms on the assumption that this will save jobs, says Michelle White, a bankruptcy expert at the University of California, San Diego. Overall, she thinks the American bankruptcy system does a "very valuable" job.

But Jack Williams of the American Bankruptcy Institute, a think-tank, adds a caveat. Firms are now finding it hard to use bankruptcy as a temporary shield to allow them to reorganise, because that usually requires a bridging loan of some kind, and at the moment no one is lending. That has given the system an unfortunate bias towards liquidation, he fears.

When times are hard, American firms find it easy to lay off workers. When times are good, however, they are quick to hire new hands. A ruthless labour market and a miserly welfare state have historically meant that Americans are more likely to have jobs (albeit often low-paid ones) than Europeans, and far less likely to be unemployed for a long time. In 2007 America's jobless rate was 4.6%, compared with an average of 7.9% for the OECD's European member countries. And whereas the average jobless American was out of work for less than four months, the average jobless European spent nearly 15 months involuntarily idle.

During previous downturns, unemployment in America has risen more sharply than elsewhere but then fallen more quickly, too. This time round, it has certainly followed the painful first part of that script. Joblessness is already almost 9%, and the OECD predicts that it will hit 10.3% next year. The question is: will the labour market rebound as robustly as it has in the past? No one knows the answer. This recession has been particularly severe. More than 2% of American workers have been out of work for six months or more, which is close to a post-war record. And firms are cutting back on hours, too. The average working week fell by half an hour in 2008 to 33.2 hours, the shortest since records began in 1964.

Now for the creative part

Despite the gloom, there are several reasons for believing that American business retains its underlying dynamism. First, one can listen to what businesspeople say. They may be feeling wretched this year, but few doubt that things will get better. Bill Green, the boss of Accenture, a consultancy, predicts that America will come out of the recession "much earlier" than other parts of the world. He talks constantly to other chief executives around the world, he says, and their consensus is that America will begin to recover later this year or in early 2010. They give three reasons. The recession started earlier in America than elsewhere. The government's stimulus package is likely to work. And "they believe that we have a natural competitive streak – that people are going to want to get back in the game."

Second, one can look at America's admirable record of dealing with turmoil. A study by the Ewing Marion Kauffman Foundation, a think-tank that studies entrepreneurialism, found that America's high rate of economic "churning" boosts productivity and hence material well-being. Between 1977 and 2005 some 15% of all American jobs were destroyed each year as firms closed or cut back. Thanks to the expansion of successful firms and the entry of new ones, however, many more jobs were created than destroyed. Start-ups (ie, firms less than five years old) provided a third of the new jobs during this period.

Start-ups that went bust were on average 32% less productive than mature incumbents. Mature firms that went out of business were 27% less productive than mature survivors. Start-ups that survived, however, were 3% more productive than mature incumbents; five years later they were 5% more productive. This was true of all industries but especially retailing, in which stores the size of football fields have given way to even larger ones.

The credit crunch is making it harder for new firms to find capital. That matters: not all entrepreneurs start up in their garages with money from "family, friends and fools". In a survey for the Kauffman Foundation of 4,163 companies started in 2004, Alicia Robb and David Robinson concluded that 80–90% of start-up capital for a typical firm came from two sources. One was the entrepreneur's savings. The other was external debt: either a bank loan or a credit-card balance.

Most start-ups do not require huge amounts of capital. The average in the Kauffman sample was $78,000. Some need far less. Saudia Davis, for example, founded Greenhouse Eco-Cleaning, a green apartment-cleaning firm in New York, with $800 she earned from mopping floors herself. She now has between seven and ten cleaners working for her and would like to expand, but banks are not lending, she says. She is looking for an "angel" investor but this is tough when you have no intellectual property, so she may have to grow organically.

The recession itself sometimes generates start-up capital, in the form of severance payments. Adrienne and Kelly Lumpkin got their start with the help of a redundancy package Mr Lumpkin received from IBM in the early 1990s when Big Blue was in trouble. Alternate Access, their Raleigh, North Carolina-based firm, helps florists, doctors and other small enterprises do clever things with internet telephony. It offers call-centre services, for example, and sells software that helps employees see, on their computer screens, whether the person calling them is an important customer or a deadbeat.

Despite the recession, Americans started 530,000 businesses a month last year. And firms founded during tough times have to be tough. Although more firms typically start up in fat years, Paul Kedrosky of the Kauffman Foundation found that each bad year in America since the second world war produced just as many firms that have subsequently grown large enough to list their shares. He concludes that firms that begin in bad times are more likely to turn out to become economically important: think of Microsoft, Apple and Krispy Kreme doughnuts.

During good times, any idiot can get his ideas funded, says William Barnett, a professor at Stanford University's business school. During bad times, only the most impressive and persistent entrepreneurs can. Mr Barnett has discovered that firms which are set up shortly after a successful IPO (initial public offering of shares) by another firm that does roughly the same thing tend to do very badly. By contrast, firms founded shortly after news of the bankruptcies of firms doing roughly the same thing tend to do well. Google, for example, got started just after a clutch of other search-engine firms crashed.

During a crisis, says Mr Barnett, the market's signals are clearer. During a boom, people buy stuff without much thought. During bad times, they are much choosier. So only firms with genuinely superior products or services will thrive.

RED TAPE AND SCISSORS

28 May, 2009

America is supposed to be the land of laissez-faire, but it doesn't seem that way to Erroll Tyler. He wants to run tours of Cambridge and Boston, cities that nestle on opposite banks of the Charles river. He would pick up punters in an amphibious vehicle, show them the sights and give them a pleasant cruise. But Boston will not let him. Officials say he needs a sightseeing licence. Alas, there is a moratorium on such licences. It was imposed for fear that Boston would get congested during the Big Dig, a construction project. But the Big Dig ended three years ago. Mr Tyler thinks the real reason he cannot get a licence is that someone is protecting a cartel of local tour operators. He is suing the city authorities.

Mr Tyler is not the only American who feels that red tape is garrotting his business. Senseless rules that benefit cartels are common. Oklahoma protects consumers from the perils of unlicensed interior decorators. Marylanders are barred from massaging animals without a vet's licence. Wisconsin until recently banned the sale of excessively cheap petrol (gasoline).

Not all rules are pointless. Under George Bush, the White House Office of Management and Budget reckoned the total yearly cost of federal regulations between 1997 and 2007 was $46 billion to $54 billion. The benefits, in terms of pollution averted, lives saved and so on, were far higher: $122 billion to $656 billion a year. But businessfolk still have plenty of gripes.

First there is the tax code. Overall, American taxes are light and the tax code is highly progressive. But corporate taxes are steep. Federal and state taxes on profits together average 39.3%, the second-highest rate in the rich world. And the system is repulsively complex. Federal, state and local rules accumulate each year in a vast and impenetrable heap. No one understands it. Some 82% of individual filers pay for professional help or tax software.

Big business can cope – clever accountants find all manner of lucrative loopholes. But small businesses "face a particularly bewildering array of laws, including a patchwork set of rules that governs the depreciation of equipment, numerous and overlapping filing requirements for employment taxes, and a vague set of factors that govern the classification of workers as either employees or independent contractors and that can keep businesses and the IRS battling each other for years with no obvious 'correct' answer." Those are not the words of an anti-tax zealot but of the Internal Revenue Service itself, in its annual plea to Congress to simplify the tax code.

A second gripe is America's lottery of a legal system. Litigation cost the country $252 billion in 2007, according to Towers Perrin, a consultancy. At nearly 2% of GDP, that is about twice the burden that lawsuits impose on other rich countries. Yet the Pacific Research Institute (PRI), a conservative think-tank, thinks it a gross underestimate. By including indirect costs, such as products never launched for fear of litigation, PRI arrives at a total of $865 billion a year. Of this, it reckons two-thirds is wasted; that is, it neither compensates the injured nor deters the reckless.

Whatever the size of the "tort tax" – and this is hotly disputed – nearly every business grumbles about the system's unpredictability. Most juries are reasonable, but many misunderstand complex disputes and some impose penalties that bear no relation to any harm suffered. Trial lawyers are adept at crafting suits aimed at whoever has deep pockets. Judges sometimes fail to apply common sense.

In a recent case, a patient lost an arm because a health assistant injected a drug into an artery. She sued the hospital. Fair enough. But she also sued the drugmaker, Wyeth, although the drug was approved by the Food and Drug Administration and came with six warnings not to inject it into arteries. She won $7m in damages. "The simple lesson businesspeople took was that the drugmaker could not have done anything to avoid being sued," observed Gordon Crovitz, a columnist.

"Patent trolls" pose another problem. These are firms that buy up patents, not to turn them into products but solely to sue other firms that may have infringed them. Since the United States Patent Office grants patents freely and courts enforce them zealously, every inventive company lives in fear of trolls. If one can convince a court that a billion-dollar product incorporating hundreds of patents infringes only one of his, he can get an injunction to stop it being sold. The victim typically settles. Michael Heller, author of "The Gridlock Economy", argues that such vaguely defined and aggressively asserted property rights stifle innovation and cost lives.

Another common complaint, especially among medium-sized firms, is that it costs so much to list on an American stock exchange. After the Enron scandal of 2001, in which auditors failed to notice a vast fraud at a publicly traded energy firm, disclosure requirements were tightened drastically. A hastily passed law known as Sarbanes-Oxley includes provisions for financial reporting that can cost millions of dollars to obey. Mark Friedman of Accruent says he cannot take his firm public because compliance costs might erase his profits. Founders of high-tech firms, who once hoped to make their fortunes with an IPO, now pray that a big firm such as Google will buy them.

Finally, businesspeople are worried about how the new administration might rewrite the rules. For the most part they are not reflexively hostile to Barack Obama. But since he has such a short record in office, they don't know much about him; and they don't like uncertainty. The government has taken control of large chunks of the financial and carmaking industries. Is this a temporary response to the crisis, as the White House insists? Or will the Democratic Congress, some of whose members would love to harness private firms to pursue policy goals, find ways to prolong it? No one knows.

A more immediate worry is a bill that would in effect abolish workers' rights to a secret ballot before being unionised. The measure, misleadingly named the Employee Free Choice Act, would let a union win automatic recognition simply by cajoling a majority of employees to sign cards. The firm would then have to reach a deal with the union or accept one brokered by a government-appointed arbitrator.

If the bill passes – and it faces a struggle and possible revision in the Senate – unions hope it will revive their shrivelling membership. Businesses fear it will let unions do to them what they have already done to Detroit. Arne Sorenson of Marriott predicts that his typical employee, a diminutive Hispanic housekeeper with shaky English, will find it hard to say no to the tall, articulate union man who turns up and asks her to sign a card. Some Marriott hotels are already unionised – typically in cities that insist on it. Its non-union ones are 10% more profitable, says Mr Sorenson, mostly because of more flexible work rules. At one unionised hotel, he recalls, the pool attendant was not allowed to take the deck chairs out of the pool when the wind blew them in. It was not his job.

Bigger is better

Despite such grumbles, nearly every entrepreneur and executive interviewed for this report judged the United States the best place in the world to make money – or at least, one of the best. Impartial observers tend to agree. "Doing Business in 2009", a World Bank report on regulation, finds that America is the third easiest place to do business, beaten only by Singapore and New Zealand. Its labour market is the world's most flexible. Starting a business involves few bureaucratic hassles: America ranks sixth out of 181 countries on this score. Enforcing contracts is straightforward (also sixth), as are registering property (12th) and trading across borders (15th).

Using a broader range of more subjective measures, the World Economic Forum puts America first out of 134 countries in its annual "competitiveness" rankings. It scores only adequately for macroeconomic stability (66th) and health and primary education (34th). But it ranks near the top for infrastructure and the efficiency of its market for goods. And it comes top for labour-market efficiency, absolute market size and innovation.

Amar Bhidé, a business professor at Columbia University, thinks these last two points are connected. Because America's market is so huge, it is the best place to test new products. American consumers not only spend more than those of other nations; they are also more "venturesome", says Mr Bhidé. That is, unusually willing to try new things. Their purchases reward innovators. And their feedback helps those innovators fine-tune their products.

Innovation tends to come incrementally, says Mr Bhidé. "Eureka!" moments are rare. More often, inventors incorporate at every stage what their customers teach them about what works, what doesn't and why. Apple's iPod, for example, was not based on truly original technology. Rather, it skilfully integrated technology from multiple sources and countries. Millions of Americans bought the clunky, expensive first version; it was much more popular in the United States than in other rich countries. Apple used the cash and feedback from the first iPod to develop smarter and more user-friendly versions. The product is now a global hit. A similar tale could be told of Amazon's electronic book-reader, the Kindle.

American customers know what they want, and they want it now. They are not always reasonable, but as far as businesses are concerned, they are always right. Saudia Davis of Greenhouse Eco-Cleaning recalls a client who demanded that she replace a cleaner who was ruining her apartment's *feng shui* by being too thin. Ms Davis says she "yessed her to death" and sent someone else.

The only time customers do not know what they want is when they do not realise what is technically feasible. For that reason, Intel, a microchip-maker, hires ethnographers to watch people in their homes and search for unmet desires that might be fulfilled. They discovered that Americans still love television but would like to combine it with the internet in an undemanding way. With Yahoo!, an internet firm, Intel took a step towards this last year by unveiling the Widget Channel, which lets viewers look up such things as the name of the actress in the soap they are watching.

Despite the downturn, American firms continue to spend copiously on research and development (R&D). Software firms, which used to keep offering more and fancier features, are now concentrating on doing things more quickly and cheaply. In February Intel said it would plough $7 billion into factories in New Mexico, Arizona and Oregon to make chips with transistors so small that 60m could fit on the head of a pin. If something is technologically possible and you don't do it, someone else will, says Paul Otellini, Intel's boss.

Since 1970 industrial spending on R&D in America has never fallen significantly from one year to the next, though it dipped a bit after the dotcom crash of 2000–02 (see chart 3). This recession may be different, of course. Jules Duga of the Battelle Memorial Institute, a think-tank, predicts that R&D spending from all sources (government, business and universities) will rise by 3% in 2009 but contract slightly in 2010. As American firms outsource more technical work to cheaper countries such as India, however, they will find that each research dollar goes further.

Some observers worry that America is growing complacent about its technological prowess. In a report for the Information Technology & Innovation Foundation, Robert Atkinson and Scott Andes rank America 6th out of 40 countries for innovation and competitiveness, but contend that it has improved the least in the past decade. They liken America to "an ageing sports dynasty that has won the Super Bowl for many years but blithely ignores the rising performance of younger teams".

But these rankings include measures that have little to do with innovation, such as the size of a country's trade deficit. Also, they fail to give corporate America due credit for its knack of turning raw science into marketable products. Nearly all the best universities are American – 17 of the top 20 by one recent ranking – and they all work arm in arm with industry. Firms that exploit advances in cloud computing or genomics tend to cluster around the top colleges. Start-ups are fed and nurtured by venture capitalists. Big firms snap up small ones with marketable ideas. That said, many of the best students and academics at America's universities, and indeed many of the entrepreneurs they turn out, are foreign – which means that the country's success in turning ideas into dollars would be imperilled if the recession prompted Congress to tighten immigration laws still further.

American firms such as Google, Microsoft and Cisco have changed the way almost everybody handles information. As yet unheard-of American biotech firms are working on drugs tailored to individual patients' genomes. But one of the glories of American capitalism is the way firms apply complex technology to the most basic businesses. Hollywood uses awesome computer power to tell fairy stories. Burger King has invested oodles of money to develop restaurant layouts that let workers put sandwiches swiftly in customers' hands. A study by Diana Farrell and other McKinsey researchers found that of the five sectors that contributed most to American productivity growth between 2000 and 2003, three were refreshingly unglamorous: retailing, wholesaling and administrative and support services.

John Hasnas

The 'Unseen' Deserve Empathy, Too | May 29, 2009 | *The Wall Street Journal*

John Hasnas is an associate professor of business ethics at the McDonough School of Business at Georgetown University in Washington, DC, and a visiting associate professor of law at the Georgetown Law Center, where he teaches courses in ethics and law. He received his B.A. in Philosophy from Lafayette College, his J.D. and Ph.D. in Legal Philosophy from Duke University, and his LL.M. in Legal Education from Temple Law School. Between 1997 and 1999, Professor Hasnas served as assistant general counsel to Koch Industries, Inc. in Wichita, Kansas. His scholarship concerns ethics and white collar crime, jurisprudence, and legal history.

THE 'UNSEEN' DESERVE EMPATHY, TOO

May 29, 2009

While announcing Sonia Sotomayor as his nominee to the Supreme Court, President Barack Obama praised her as a judge who combined a mastery of the law with "a common touch, a sense of compassion, and an understanding of how the world works and how ordinary people live." This is in keeping with his earlier statement that he wanted to appoint a justice who possessed the "quality of empathy, of understanding and identifying with people's hopes and struggles."

Without casting aspersions on Judge Sotomayor, we may ask whether these are really the characteristics we want in a judge.

Clearly, a good judge must have "an understanding of how the world works and how ordinary people live." Judicial decision-making involves the application of abstract rules to concrete facts; it is impossible to render a proper judicial decision without understanding its practical effect on both the litigants and the wider community.

But what about compassion and empathy? Compassion is defined as a feeling of deep sympathy for those stricken by misfortune, accompanied by a strong desire to alleviate the suffering; empathy is the ability to share in another's emotions, thoughts and feelings. Hence, a compassionate judge would tend to base his or her decisions on sympathy for the unfortunate; an empathetic judge on how the people directly affected by the decision would think and feel. What could be wrong with that?

Frederic Bastiat answered that question in his famous 1850 essay, "What is Seen and What is Not Seen." There the economist and member of the French parliament pointed out that law "produces not only one effect, but a series of effects. Of these effects, the first alone is immediate; it appears simultaneously with its cause; it is seen. The other effects emerge only subsequently; they are not seen; we are fortunate if we foresee them." Bastiat further noted that "[t]here is only one difference between a bad economist and a good one: The bad economist confines himself to the visible effect; the good economist takes into account both the effect that can be seen and those effects that must be foreseen."

This observation is just as true for judges as it is for economists. As important as compassion and empathy are, one can have these feelings only for people that exist and that one knows about – that is, for those who are "seen."

One can have compassion for workers who lose their jobs when a plant closes. They can be seen. One cannot have compassion for unknown persons in other industries who do not receive job offers when a compassionate government subsidizes an unprofitable plant. The potential employees not hired are unseen.

One can empathize with innocent children born with birth defects. Such children and the adversity they face can be seen. One cannot empathize with as-yet-unborn children in rural communities who may not have access to pediatricians if a judicial decision based on compassion raises the cost of medical malpractice insurance. These children are unseen.

One can feel for unfortunate homeowners about to lose their homes through foreclosure. One cannot feel for unknown individuals who may not be able to afford a home in the future if the compassionate and empathetic protection of current homeowners increases the cost of a mortgage.

In general, one can feel compassion for and empathize with individual plaintiffs in a lawsuit who are facing hardship. They are visible. One cannot feel compassion for or empathize with impersonal corporate defendants, who, should they incur liability, will pass the costs on to consumers, reduce their output, or cut employment. Those who must pay more for products, or are unable to obtain needed goods or services, or cannot find a job are invisible.

The law consists of abstract rules because we know that, as human beings, judges are unable to foresee all of the long-term consequences of their decisions and may be unduly influenced by the immediate, visible effects of these decisions. The rules of law are designed in part to strike the proper balance between the interests of those who are seen and those who are not seen. The purpose of the rules is to enable judges to resist the emotionally engaging temptation to relieve the plight of those they can see and empathize with, even when doing so would be unfair to those they cannot see.

Calling on judges to be compassionate or empathetic is in effect to ask them to undo this balance and favor the seen over the unseen. Paraphrasing Bastiat, if the difference between the bad judge and the good judge is that the bad judge focuses on the visible effects of his or her decisions while the good judge takes into account both the effects that can be seen and those that are unseen, then the compassionate, empathetic judge is very likely to be a bad judge. For this reason, let us hope that Judge Sotomayor proves to be a disappointment to her sponsor.

Matthew Kaminski

The Wall Street Journal

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Labor's European Model | March 16, 2009

Matthew Kaminski is a member of *The Wall Street Journal*'s editorial board in New York, a post he took up in July 2008. For the previous three years, Mr. Kaminski was the editorial page editor of *The Wall Street Journal Europe*, based in Paris. He joined the Journal in 1997 as a reporter in Brussels and specialized in security issues, Central Europe and the Balkans. Before joining the Journal, Mr. Kaminski was the Kiev-based correspondent for the *Financial Times* and *The Economist*, reporting on the former Soviet Union in 1993–97.

AMERICA'S OTHER AUTO INDUSTRY

December 1, 2008

The men from Detroit will jet into Washington tomorrow – presumably going commercial this time – to make another pitch for a taxpayer rescue. Meanwhile, in the other American auto industry you rarely read about, car makers are gaining market share and adjusting amid the sales slump, without seeking a cent from the government.

These are the 12 "foreign," or so-called transplant, producers making cars across America's South and Midwest. Toyota, BMW, Kia and others now make 54% of the cars Americans buy. The internationals also employ some 113,000 Americans, compared with 239,000 at U.S.-owned carmakers, and several times that number indirectly.

The international car makers aren't cheering for Detroit's collapse. Their own production would be hit if such large suppliers as the automotive interior maker Lear were to go down with a GM or Chrysler. They fear, as well, a protectionist backlash. But by the same token, a government lifeline for Detroit punishes these other companies and their American employees for making better business decisions.

The root of this other industry's success is no secret. In fact, Detroit has already adopted some of its efficiency and employment strategies, though not yet enough. To put it concisely, the transplants operate under conditions imposed by the free market. Detroit lives on Fantasy Island.

Consider labor costs. Take-home wages at the U.S. car makers average $28.42 an hour, according to the Center for Automotive Research. That's on par with $26 at Toyota, $24 at Honda and $21 at Hyundai. But include benefits, and the picture changes. Hourly labor costs are $44.20 on average for the non-Detroit producers, in line with most manufacturing jobs, but are $73.21 for Detroit.

This $29 cost gap reflects the way Big Three management and unions have conspired to make themselves uncompetitive – increasingly so as their market share has collapsed (see the nearby chart). Over the decades the United Auto Workers won pension and health-care benefits far more generous than in almost any other American industry. As a result, for every UAW member working at a U.S. car maker today, three retirees collect benefits; at GM, the ratio is 4.6 to one.

The international producers' relatively recent arrival has spared them these legacy burdens. But they also made sure not to get saddled with them in the first place. One way was to locate in investment-friendly states. The South proved especially attractive, offering tax breaks and a low-cost, nonunion labor pool. Mississippi, Alabama, Tennessee and South Carolina – which accounted for a quarter of U.S. car production last year – are "right-to-work" states where employees can't be forced to join a union.

The absence of the UAW also gives car producers the flexibility to deploy employees as needed. Work rules vary across company and plant, but foreign rules are generally less restrictive. At Detroit's plants, electricians or mechanics tend to perform certain narrow tasks and often sit idle. That rarely happens outside Michigan. In the nonunionized plants, temporary workers can also be hired, and let go, as market conditions dictate.

All the same, Mitsubishi Eclipses and Toyota Corollas are made by UAW workers at plants in Illinois and California. In each case, unions have made concessions to ensure the jobs stay put. Honda makes the Civic and Accord in two plants in Ohio, which isn't a right-to-work state. But attempts to unionize foreign-owned factories have generally been unsuccessful, most recently at Nissan; their workers know too well what that has meant for their UAW peers. Since 1992, the Big Three's labor force declined 4.5% on average every year; the international grew 4.3%. According to the

Center for Automotive Research, for every job created by the transplant producers, Detroit shed 6.1 jobs in the U.S., 2.8 of them in Michigan.

Another transplant advantage: Their factories are newer and production process simpler. As a result, they can switch their assembly lines to different models in minutes. In response to the economic downturn, Hyundai decided to make more fuel-efficient Sonata sedans and fewer of the larger Santa Fe model at its Montgomery, Alabama plant, sparing steeper production cuts. Such a change would take weeks at UAW plants.

It's true that at the foreign companies, strategic decisions are taken and much of the value-added design and engineering is done back home. But both U.S. and the Japanese and European companies have tended to move operations closer to large markets. The expansion of manufacturing in the U.S. has brought research and development. Honda stands out for designing some cars from the ground up in the U.S. The foreigners account for a small but growing chunk of the $18 billion in yearly development spending. And while headquartered overseas, the companies have millions of American shareholders – either directly or through pension funds. Is Honda a Japanese or an American company nowadays? It really is both.

As GM CEO Rick Wagoner recently wrote on these pages, the Detroit companies have finally begun to adapt to this real economic world. Last year Detroit struck a deal with the unions to unload retiree health obligations by 2010 to a trust fund set up by the UAW. The trio's productivity has improved as well. In 1995, a GM car took 46 hours to make, Chrysler 43 and Toyota 29.4. By 2006, according to Harbour Consulting, GM had moved it to 32.4 hours per vehicle and Chrysler 32.9. Toyota stayed at 29.9.

Yet these moves born of desperation have come so late that the companies are still in jeopardy. Both management and unions chose to sign contracts that let them live better and work less efficiently in the short-term while condemning the companies to their current pass over time. It is deeply unfair for government now to ask taxpayers who have never earned such wages or benefits to shield the UAW and Detroit from the consequences of those contracts.

There's no natural law that America must have a Detroit automotive industry, any more than steel had to be made for all time in Bethlehem, Pennsylvania or textiles in New England. Britain sold off all its car plants to foreigners and was no less an advanced economy as a result, though it was a healthier one. Detroit may yet adjust to avoid destruction in the best spirit of American capitalism. The other American car industry is a model for how to do it.

HOW CALIFORNIA BECAME FRANCE

February 21, 2009

As California goes, says an old cliché, so goes the nation. Oh my.

These days, the Golden State leads the nation on economic and fiscal dysfunction, from the empty homes spread across the Central Valley to the highest state budget shortfall in the nation's history. Meanwhile, its political class pioneers denial in the face of catastrophe.

The spark for the immediate political crisis was a familiar Californian discovery, a fiscal hole of $41 billion. Gov. Arnold Schwarzenegger declared an "emergency" in November and took legislative leaders behind closed doors to hammer out a compromise. The budget adopted in a marathon session this week splits the baby, closing the deficit with spending cuts (hated by the left) and tax hikes (ditto the right), all the while largely failing to tackle the state's built-in structural defects.

Some parts of the deal, such as borrowing from future lottery receipts, may yet collapse at the ballot in May, and California could soon be back in line to mark another first – state bankruptcy. In anticipation, Standard & Poor's this month downgraded its bond rating a notch below Louisiana's.

Even discounting for the impact of global recession, the most populous state's ills are unique and self-inflicted – and avoidable. In the last three decades, California expanded the public sector and regulation to Europe-like dimensions. Schools, state employees, health care, even dog kennels, benefited from largesse in flush times. Government workers got 16 official holidays, everyone else six. The state dabbled with universal health care and adopted strict environmental standards. In short, California went where our new president and Nancy Pelosi of San Francisco want America to go.

Now there's much to recommend the Old World. California brings to mind my last home, France – God's country blessed with fertile soil for wines, sun-blanched beaches, and a well-educated populace. Amusingly, both states are led by bling-bling immigrants married to glamorous women and elected to shake up the status quo. In both departments, the governator got a head start on Nicolas Sarkozy in Paris.

The parallels are also disquieting. The French have long experienced the unintended consequences of a large public sector. Ask them about it. As the number of people who get money from government grows, so does the power of constituencies dedicated to keep this honey dripping. Even when voters recognize the model carries drawbacks, such as subpar growth, high taxes, an uncompetitive business climate and above-average unemployment, their elected leaders find it near impossible to tweak the system. This has been the story of France for decades, and lately of California.

Six years ago, Mr. Schwarzenegger arrived in Sacramento to "cut up the credit card" and give the girlie men at the State Capitol a testosterone shot. California languished then in a fiscal crisis whose causes were pretty much the same as today. The hapless Gray Davis had been recalled, and the Austrian-born actor made a promising start to break the pattern.

In 2005, banking on his popularity, the governor pushed an ambitious ballot initiative to impose a hard state spending cap, limit the unions' political buying power, tighten requirements for teacher tenure, and overhaul a gerrymandered state political map. Arnold lost.

After that setback, Mr. Schwarzenegger shifted his attention to green jobs and energy, winning fans in Europe and among Democrats. "He's recognized that California's a pretty moderate place," says Darrell Steinberg, the Democratic president pro tem of the Senate. "You've got to govern from the middle."

People closer to the governor offer a different take. "Once he got beat, he reverted back to, 'I want to be liked,'" says a former Schwarzenegger aide. "It's classic narcissism." (The governor declined requests for an interview, but I did walk away with three custom-made Daniel Marshall cigars from his office.)

In the Arnold era, the overall cost base has stayed the same as in the Davis era. That isn't entirely his fault. California's constitution locks in higher spending in good years, paving the way for huge deficits in the down. A dependence on a highly progressive tax code leaves it particularly vulnerable to boom and bust cycles. Democrats run the legislature. Across the street from the Capitol, the offices of unions and lobbyists are arguably the real locus of power in Sacramento.

In this budget debacle, Mr. Schwarzenegger found himself back where his remarkable political journey began in 2003. Only now with him in the Davis role. The pill is bitterer still since the budget he signed yesterday will raise the vehicle tax – the same Davis tax increase he campaigned against and terminated in his first act in office.

Neither side won with this deal, to which the one good alternative would be a time machine to take Sacramento's political class back five years and do it right then. In the event, Republicans split, and signed off on $14.5 billion in new taxes and a less than airtight spending cap. State personnel reductions are minimal, as well, further infuriating their base. The Democrats swallowed $15 billion in spending cuts, which unions vow to fight.

California is in a French-like bind: unable to afford a welfare-type state, and unable to overhaul it. "The people say they want all these programs, then there's nothing they want to pay for," says Hector De La Torre, a Democratic assemblyman. "The schizophrenia in the legislature reflects the peoples'."

This week's deal likely won't keep the state in balance beyond 18 months, perhaps even fewer. "This budget will take us through 2010," says Karen Bass, the Assembly speaker, a Democrat from Los Angeles. "I don't know if it will hold."

Some Democrats and Republicans privately say the best option may be failure. The rough scenario is fiscal insolvency, followed perhaps by federal receivership. No precedent or legal avenue exists for a state to reorganize its affairs under a form of Chapter 11 protection, but that striking suggestion sounds better by the day.

The expectations for Mr. Schwarzenegger's two remaining years in office are low, leaving many of his supporters to ponder the might-have-been. "No one has the political incentives to cut government," says a Republican strategist. "It takes tremendous political capital, which Arnold had. It's a tragedy to have this rare moment when you can try to change and waste it."

For the nation, California is the what-might-be.

LABOR'S EUROPEAN MODEL

March 16, 2009

First came the huge stimulus, then the huger budget, then the Obama universal health-care plan. But Big Labor, cheering each, was really waiting for this: The "card check" bill introduced last week and considered the missing link in the revival of unions in America.

The so-called Employee Free Choice Act would let unions organize a worksite once 50% of employees sign a card saying they support a union. No secret-ballot election would be needed. Supporters claim this is necessary because workers are intimidated by companies to cast a vote against the union in secret, but are only too happy to express their true feelings to a union steward. Right.

The bill also gives the government power to influence wages and benefits under its binding arbitration provision. The exact terms of a first contract between an employer and a new union would be set by a state-appointed mediator if parties fail to reach a deal by a state-appointed deadline. Unions would have every incentive to make maximum demands, knowing that an arbitrator would more often than not split the difference.

We think workers have every right to form a union, and companies that get them often deserve their fate. (See: auto and steel makers, failure of.) But the goal of "card check" is to use federal power to tilt the playing field in favor of union organizers. Union rolls hit a peak of 32.5% of the labor force in 1952, then fell fast. As of last year, 12.4% of American workers belonged to a union. The share of unionized government employees has held steady for decades, but a mere 7.6% of the private workforce chooses to join a union. Unable to reverse the trend in the marketplace, unions have focused on electing Democrats who will rewrite national labor law.

And now they see their big chance. The House is almost certain to pass "card check," so the real battle is in the Senate. Six Senators who previously backed the measure, including Democrats from right-to-work states like Arkansas and Louisiana, are expressing new skepticism. But Big Labor's lobbying has only begun, and business needs to be wary of false compromises.

The larger union economic model here is Europe, where organized labor first led the charge to build welfare states. Then it concentrated on fighting back attempts to roll back costly entitlements and regulations once the bill of chronic debt, stagnant growth and stubbornly high unemployment came due. Margaret Thatcher defeated them in Britain, but successive German, Italian and French leaders have failed.

American political traditions are different, and Ronald Reagan stopped an earlier slide toward Europe. But complacency is misplaced. The Democratic Party sketched out plans for a Continental-like welfare model before Barack Obama burst into the White House.

In the last session of Congress, Democrats tried to: Raise the notice period required for certain layoffs at private companies to 90 days, extend health benefits for laid-off workers for up to a decade, and increase penalties for noncompliance (the expanded WARN Act); reclassify certain managers as employees who can be unionized, forcibly in non-right-to-work states (the Respect Act); facilitate class action suits for alleged gender-based pay discrimination (Paycheck Fairness Act); and much more. None passed, but now they might.

In the Obama revolution, unions are the vanguard force. Contrary to promises of moderation, the Administration has so far sided firmly with the union left. On the day after the Inauguration, the Department of Labor stopped the implementation of new union financial disclosure rules that provide greater transparency about union finances. A fortnight on the job, President Obama issued four executive orders, on federal contracting and political spending, demanded by Big Labor. Mr. Obama this month endorsed card check and vowed that it "will pass."

In Euro-terms, a "social market economy" offers state-provided health care, generous unemployment benefits, long holidays, various job protections and a prominent role for unions. Sounds good, you might say. But consider that the Europeans have spent the past two decades struggling to wean themselves off entitlements that are a huge drain on the overall economy. These welfare states leech off the productive parts of the economy through onerous taxes, debt and regulations.

Everyone ends up paying. Consider just one measure: the tax wedge, the share of labor costs that never reaches an employee's wallet but goes straight to state coffers. In Belgium, Germany and France, the tax wedge is around 50%; in America, it was 30% in 2007. (See the nearby table.) Not coincidentally, salaries and job opportunities are better here, especially for the least-skilled. The Obama budget, universal health care and now the union-revival effort known as the Employee Free Choice Act would steer America toward the Continent. That's good for the unions, but not for the public good.

The late economist Mancur Olson explained the phenomenon. Starting with "The Logic of Collective Action" (1965), he showed how democracies are vulnerable to proliferating parochial interests that use government to claim an ever larger share of private wealth. Slow but clear decline follows once narrow interests take the wider polity hostage. Look at France – or California.

"[Economic] success doesn't depend on natural resources and location as much as on the degree of stupidity of the policies and institutions of the country," Olson wrote. The 2009 debate over Big Labor's agenda is about whether we want to continue to be a dynamic, entrepreneurial nation, or slip into unionized decline.

Robert Robb

The Arizona Republic

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Robert Robb is an editorial columnist for the *Arizona Republic*, writing three columns a week on public policy and politics as well as for his blog, robbblog.azcentral.com. He is also a contributor to RealClearPolitics.com. Prior to joining the Republic in 1999, he had a public affairs firm, served on the staffs of the Arizona and Phoenix Chambers of Commerce, and was a founding director of the Goldwater Institute. He was general chairman of Jon Kyl's first campaign for the U.S. Senate in 1994. He graduated with a degree in political science from Occidental College in 1976. His writings can be found at robertrobb.com.

GREENSPAN'S "FLAW" AND OTHER NONSENSE

October 30, 2008

In his testimony before Congress last week, Alan Greenspan supposedly spilled the beans.

The "credit tsunami," as Greenspan put it, had revealed a "flaw" in his beliefs about how markets work. The flaw, Greenspan explained, was that he assumed that financial firms would not imprudently borrow or lend to protect their shareholders.

The sound of thousands of tongues clucking could be heard. That proves it, the left contended. Markets don't work without significant government regulation. Greenspan admitted as much.

This is all utter nonsense. There is no theory of markets that holds that business managers and investors won't take excessive or imprudent risks. That's a Greenspan fiction.

Instead, the theory of markets holds that those who take excessive or imprudent risks will pay the price for them. They will lose money. And if their risk-taking is excessive enough, they will go out of business.

In the credit crunch, markets did not fail to work. They were not permitted to work. Government stepped in to prevent those who took excessive and imprudent risks from failing.

What would have happened if government hadn't stepped in and instead allowed the markets to work out the overleveraging and imprudent risk-taking on their own is unknown and, at this point, unknowable.

However, this much is known: the government intervention to prevent failure isn't working out too hot.

The federal government has spent a ton of money. A $168 billion stimulus package. A $700 billion bank bailout. A $300 billion mortgage refinancing guarantee program.

And yet the economy has continued to slide.

Originally, the $700 billion bailout was going to be used to buy distressed mortgage-backed securities to help improve the balance sheets of financial institutions.

This was a bad idea, but at least it was a passive investment. The federal government would own the MBSs, take their income, and try to sell them at a profit in a more stable market. The banks would be free to make their own decisions and operate with repaired balance sheets.

Instead, the Bush administration decided to take the money and buy preferred shares in banks, even banks that didn't want the federal government as an investor.

For its money, wanted or unwanted, the federal government demanded the right to determine executive pay and the payment of dividends to other shareholders.

The idea was to increase the banks' capital so they would lend more. But they don't want to lend. Some of them want to buy other banks. So, now the federal government is muscling the banks to lend and making vague threats about reprisals if they don't.

Meanwhile, the Fed has cut its funds rate to 1 percent. Let's see, easy money and government lending pressure. Isn't that a significant part of what started this mess to begin with?

Much is being made of the spread between short-term treasuries and the inter-bank lending rate. Investors have been willing to buy short-term treasuries for an interest rate of around 1 percent or less. Banks are charging each other closer to 4 percent for short-term loans.

This spread is cited as evidence of irrationality in the private credit markets and the need for government action to restore "confidence."

Now, inter-bank lending isn't as important economically as the fretting assumes. Such loans are a way of tiding up accounts. Banks are neither consistently borrowers nor lenders with each other. These loans aren't part of bank capital used to make lending commitments to others.

Nevertheless, inflation is still running north of 4 percent. So, which is the irrational act, banks charging each other close to the rate of inflation, or investors lending to the federal government at a considerable real loss?

The economy is undergoing two large corrections: from overinvestment in housing and from overborrowing in general.

There is a price at which the supply and demand for homes will reach equilibrium. There is a price at which banks will lend to each other. And there is a price at which they and investors will lend to others.

When those prices are discovered and reached, recovery will begin.

Government efforts to change the prices at which those equilibriums are reached, or to ease the severity of the necessary corrections, are probably futile.

They certainly have been so far.

GEITHNER'S RADICAL TAKEOVER PROPOSAL

March 31, 2009

During the campaign, I wrote a column saying that Barack Obama was not a socialist, when the accusation that he was became pervasive in certain conservative haunts.

To me, some distinctions are valuable to maintain. And there is a very important difference between even a heavily regulated and taxed system of democratic capitalism and socialism. Obama was proposing the former, not the latter.

Nevertheless, there are some highly critical lines that should not be crossed if the essential character of our system of democratic capitalism is to be maintained. Treasury Secretary Timothy Geithner has proposed to cross one of them.

Geithner has proposed that the federal government be given the authority to take over financial institutions that, in its judgment, pose a systemic risk.

After taking over the company, the federal government would have unlimited power to do whatever it wants. It could override the rights of shareholders and abrogate obligations to and contracts with employees, creditors and customers. All the normal legal rights of these other parties would be extinguished.

This is basically the confiscation of private property without compensation or due process. Companies which the federal government fingered for takeover could appeal to the courts for review. But since there are no normative standards to restrict such takeovers, it's a subjective judgment of the regulators, there's no real basis for appeal.

Moreover, there's no point. A company so designated by the federal government is toast. There's nothing a court can give it of any value at that point – except compensation, which isn't a remedy permitted under the Geithner proposal.

Geithner says that his proposal is patterned after the resolution authority of the Federal Deposit Insurance Corporation over banks. But there is a critical difference. The FDIC insures deposits at such banks. Such banks receive a competitive advantage in attracting capital in exchange for subjecting themselves to the FDIC's resolution authority.

Geithner's proposal is at least arguably unconstitutional. It would certainly be found to be so if we had judges who placed as much importance on protecting property rights as did the founders.

Regardless, the proposal puts too much power in the hands of fallible regulators. The handling of all the various bailouts to date hardly inspires much confidence.

Regulators have handed out hundreds of billions of dollars and shredded shareholder equity in several companies to stem a systemic risk they've never been able to coherently or cogently define. Moreover, what has been disclosed, for instance about AIG's counterparties, severely undercuts some of the claims of systemic risk.

The proposal is also fundamentally unfair. Fannie Mae and Freddie Mac didn't want to be taken over by the federal government. They thought they could still make it. Then Treasury Secretary Henry Paulson made the decision to take them over anyway, even though it wasn't legally his decision to make.

Fannie and Freddie may have been wrong. But their shareholders and management should have had the chance to try.

My solution is to let big boys fail. The Lehman Brothers bankruptcy is claimed to be evidence against that approach. But in his recent book, "Getting Off Track," Stanford economist John Taylor makes a convincing case that the Lehman bankruptcy did not, in fact, add significant stress to the credit markets.

If additional regulation is to be the response, then regulating behavior is in keeping with our system of democratic capitalism. If leverage is thought to pose excessive systemic risk, then limit leverage. If opaqueness is a risk, then increase disclosure requirements.

But allowing the federal government to preemptively confiscate private property and abrogate contracts without due process or compensation is a radical departure.

It may not be socialism, per se. But it's a giant and dangerous stride away from being a civil society dedicated, in part, to the protection of private property rights.

THE CHRYSLER POWER GRAB

May 5, 2009

The proposed end games for General Motors and particularly Chrysler illustrate why government shouldn't have gotten involved in the first place.

It's worthwhile to begin with the broader picture. Americans used to buy about 17 million new cars and trucks a year. Now, we're buying less than 10 million. That, of course, puts considerable stress on manufacturers with weaker products or financial structures.

How many new cars Americans will want to purchase in the future is unknown. But there can be a high degree of confidence in this: however many it is, someone will sell them to us.

Moreover, they are likely to be produced in the United States. A majority of cars sold by foreign manufacturers in the U.S. are actually built here.

So, why should the federal government care who it is that sells us our cars? There are two rationales offered. First, to preserve an "American" auto industry. Second, to preserve "American" jobs.

The proposed Chrysler restructuring gives the lie to both rationales.

Under the Obama administration's proposal, Chrysler would, in essence, be given to Fiat, an Italian company, to operate.

So, how is an Italian car manufacturer operating in Michigan any more "American" than a Japanese manufacturer operating in Kentucky?

And why should the federal government give a market preference – through taxpayer financing and warrantee guarantees – to Italian cars produced by American workers in Michigan over Japanese cars produced by American workers in Kentucky?

The Obama administration's proposed restructuring is more than just unjustified, however. It dangerously undermines the rule of law, as explicated so beneficially by Friedrich Hayek in his classic, "The Road to Serfdom."

The essence of the rule of law, according to Hayek, is that what the government will do is known to all economic actors in advance. That government will not act arbitrarily in specific circumstances to favor some economic actors over others.

Chrysler has $6.9 billion in secured debt. Under the law, secured lenders have the first claim on the assets of the debtor in the event of non-payment.

The Obama administration is attempting to muscle past this law. Under its proposal, the health care trust of the auto workers' union, an unsecured creditor, would forgive 57 percent of what Chrysler owes it, and receive 55 percent of the company's equity in exchange. The federal government would forgive about a third of what it would loan Chrysler and receive 8 percent of the company's equity. Fiat would pay nothing for its 20 percent initial ownership.

The secured creditors, with the first claim on Chrysler's assets, were asked to forgive 70 percent of what they are owed and receive nothing in equity. When they refused and forced the company into bankruptcy, they were excoriated by Obama – a shameful act by a president who pledged to uphold the law, not make it up as he went along.

The purposed GM restructuring is equally lopsided. The union trust would forgive half of what it is owed and receive 39 percent of the company. The government would forgive half of what it is owed and receive 50 percent of the company. The other private lenders, in this case unsecured, would forgive 100 percent of what they are owed and receive just 10 percent of the company.

In his recent press conference, Obama said he had no interest in owning or operating car companies. Until this point, I was willing to accept Obama at his word, while fundamentally disagreeing with his economic policies.

Given his actions, however, it's hard to credit his disclaimer in this instance.

These proposed restructurings are power grabs, pure and simple. The positions of lenders are eviscerated to give control to the union trust and the government. The emergent companies are given market preference through taxpayer financing and government warrantee guarantees. All to serve no true national purpose.

Shikha Dalmia

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Obama's Health Care Reform Tactics | Forbes.com | May 5, 2009
Dear GOP: Please Choose Liberty | Forbes.com | May 20, 2009

Shikha Dalmia is a senior policy analyst at Reason Foundation, a nonprofit think tank advancing free minds and free markets. She is also a columnist at *Forbes*. She is a frequent contributor to the op-ed pages of *The Wall Street Journal* and publications such as the *Los Angeles Times*, *New York Post*, *San Francisco Chronicle*, and *the Chicago Tribune*. She is also a frequent guest on Fox Business and other media outlets. From 1996 to 2004, Dalmia was an award-winning editorial writer at the *Detroit News*. She also worked as a reporter for the *Patriot*, a national daily newspaper based in New Delhi, India, where she grew up. She now lives in the Detroit area.

GOVERNMENT INTERVENTION MIGHT DELAY THE ECONOMIC RECOVERY

February 4, 2009

There is one thing that's giving political momentum to the Bush-Obama multi-trillion bailout/stimulus spending spree, and it is not a superior understanding of how to fix the ailing economy. It is fear. "Nameless, unreasoning, unjustified terror," as FDR once said.

The economy is in terrible shape. Financial markets are in a deep freeze. The stock market has lost over 40 percent of its value from the Dow's peak last year and 401(k) portfolios are shrinking. Unemployment is rising to levels not seen in 25 years. Companies – big and small – are downsizing or, worse, shuttering their doors completely. And home foreclosure rates are reaching record highs.

Under such circumstances, the fear is that we might well reach the point of no return – or, as a CNN anchor recently put it, face permanent "economic catastrophe."

But it's as likely that government intervention might well delay the recovery process, just as it did in the 1930s when a combination of spending and regulations unleashed by FDR's New Deal turned a recession into a prolonged depression.

Rather than a time for panicked reactions, this is the time to fully understand a lesson of history: The rubble of every recession contains the seeds of its own regeneration. Physical and human capital of dying economic sectors don't vanish with them. These assets – equipment, property, workers – are re-released into the economy, where entrepreneurs, unless thwarted by taxes and regulations, scoop them up and inevitably find more productive uses for them. In the process, new companies are born and new jobs created – offering, over time, far better returns and wages than before.

This is not idle, theoretical speculation.

On a micro level, consider the Pony Express, which was the UPS of 1860. The company cut down delivery time for coast-to-coast mail from six weeks to 10 days by using horse riders instead of ships going around South America. It was wildly successful, but only for about a year. Then commercial telegraph came along, and the company went belly up. Hundreds of workers lost their jobs at a time when civil war was starting, a major recession was brewing after a European bubble in railroads burst, and unemployment was soaring as immigrants from Ireland and elsewhere were coming in droves. But according to *Saddles and Spurs*, a rare group biography that traces the fortunes of the laid-off riders, all of them found equal or better jobs, in the burgeoning telegraph industry, rodeos and other shows, and as scouts in the Union Army.

On the macro level, consider the experience of the U.S. steel industry in the 20th century and the tech sector at the start of the 21st century. Both went through brutal downsizings that eventually strengthened the American economy and led to generally higher living standards.

Until about 1945, Big Steel – consisting of companies such as U.S. Steel that produced steel from iron ore in large mills – dominated the world market, producing about half of the global steel output. This hegemony, notes University of Dayton economic historian Larry Schweikart, led the industry to precisely the same vices that are responsible for torpedoing the Detroit-based car makers today: bloated corporate bureaucracies; a pampered, unionized workforce with unsustainable legacy costs; and inefficient production methods.

By the 1960s, Big Steel was facing stiff competition from overseas producers, first from Japan and Europe and then from Third World countries such as Brazil. About a quarter of American steel producers went bankrupt between 1974 and 1987. The industry's global market share shrank to 11 percent and employment dropped from 2.5 million in 1974 to 1 million in 1997. But this fight for survival, spanning decades and several recessions, eventually restored the overall industry to profitability. Led by companies such as Nucor, domestic steel makers discovered new ways to turn scrap into steel in sleeker, smaller factories called "mini-mills," using non-unionized workers and a leaner management team.

The physical and human resources that the steel industry squeezed out in its quest for more efficiency didn't simply go up in smoke. They were utilized by other sectors of the economy. For example, employment in the plastics industry, which replaced steel for some uses, grew over 18 percent between 1980 and 2006.

If American-owned automakers were among the loudest voices demanding a bailout from the Bush administration, American steel makers are among the loudest voices demanding massive stimulus spending (on schools, roads, bridges, rapid transit, and other steel-intensive projects) from the Obama administration right now. But if the industry emerged stronger without artificial measures to boost demand for steel once, there is no reason to believe that it won't do so now.

An arguably more stunning comeback involves the dot-com industry. After the 2000 stock market crash, hundreds of Silicon Valley startups collapsed, throwing thousands of highly paid computer professionals out of work. However, within a few short years the industry began to recover, reabsorbing many of the laid-off workers.

One reason for the industry's quick recovery, according to Todd Zywicki, an economist at the George Mason University, was that it was able to rapidly redeploy its resources away from failing enterprises toward more promising ones. Unlike traditional industries, much of the dot-com sector was financed not by debt from bond holders but venture capitalists with equity stakes. This meant that when these companies started showing signs of trouble, their financiers were able to cut their losses and seed other ventures without getting bogged down in time-consuming bankruptcy proceedings.

What's more, they did so at a time when there was a glut of computer talent, not to mention cheap office space, equipment, and other physical assets – all of which positioned them for future success. "If Washington had appointed itself in charge of saving the industry, it would have declared AOL too big to fail," comments Zywicki. "The net effect would have been to retard the advance of broadband and we would all still be using slow-speed dial up to access the Internet."

These are tough economic times and it is impossible to know in advance where the next telegraphic or broadband revolution will come from to drive us out of recession. But the American economy has demonstrated awesome powers of self-correction when its entrepreneurs are left alone to blaze new trails – without a panicked Washington pushing them off course.

FDR famously proclaimed that we have nothing to fear but fear itself. That, and a government that will get in the way of an economic recovery.

OBAMA'S HYPOCRISY

April 17, 2009

Perhaps hard-bitten cynics aren't surprised by the quiet ruthlessness with which this administration has deep-sixed a popular D.C. school voucher program. But for everyone else – or, rather, everyone else not in bed with teachers' unions – its conduct has to come as a total shock.

D.C. public schools are violent, chaotic places that have among the highest dropout – and the lowest graduation – rates in the country. In 2007, D.C.'s fourth- and eighth-grade students scored lower than children from all 50 states on the National Assessment of Educational Progress (NAEP), the nation's most reliable standardized test. Less than half of its children are "proficient" – meaning they perform at grade-level – in reading and math.

Against this grim reality, one would have thought an administration that ran on the theme of hope would do anything to nurture a program that offers a way out of D.C.'s hope-killing factories and into other schools.

Instead, the Obama administration has done everything in its power to strangle it. Obama cheerfully signed a spending bill that gratuitously included a provision phasing out the program next year unless Congress expressly reauthorizes it. Of course, making water flow uphill will be easier than winning approval from a Democrat-controlled Congress with strong ties to the teachers' unions who contributed $50 million to Obama's campaign.

As if that wasn't a big enough obstacle, no sooner had the ink dried on the law than Education Secretary Arne Duncan rescinded the scholarship offer to children admitted for next year, making the program's shuttering a fait accompli.

And now it turns out that, while the program's fate was being sealed in Congress, the administration deliberately sat on a study its own Department of Education completed weeks earlier. Why? Because the study found not that the program was failing, but that it was succeeding.

In fact, the program, with per-pupil costs that are a third of what D.C. public schools spend, is producing solid gains for the 1,700 predominantly poor and minority children it serves. Indeed, the first batch of children who received vouchers from the program for private schools is now 19 months ahead of its public school peers in reading – which is why there are four applicants for every available slot.

But transparency is not the only principle the administration has sacrificed in this matter. In fact, the layers of hypocrisy underlying its conduct would make even Machiavelli blush.

First: This administration has proudly boasted that it would make a decisive break with its predecessor's habit of ignoring science when it clashed with policy objectives. And concerning the D.C. program in particular, President Obama had assured that he would let evidence settle its fate. "Let's see if it [the voucher program] works," he said during the campaign. "And if it does, whatever my preconceptions, you do what's best for the kids." Yet far from being led by the scientific evidence, he concealed it.

Second: The administration has been airdropping money across the country in an alleged attempt to stimulate the economy. Indeed, it increased education spending 10-fold for two years in its $750 billion stimulus package that includes, among other things, money to weather-proof school buildings. It has also been pouring trillions of dollars into failed banks and auto companies. Yet it didn't think it fit to spend an infinitesimal $14 million on a thriving program that makes a palpable difference in the lives of children desperately in need of help.

Third: President Obama has promised to lead the most ethical administration, one immune from the corruption of special-interest politics. Yet he offered not even a pretense of resistance to the biggest Democratic interest group: teachers unions – even though it is evident that what's driving their opposition to this program is not principle but naked self-interest.

To be sure, unions have long pretended to oppose vouchers not because they are afraid of competition but because vouchers drain resources from public school children. But the D.C. program didn't do that. In fact, precisely to address this objection, the program was structured to keep D.C. public schools financially stable, meaning they lose no funding when their students transfer elsewhere. If anything, they have more money to spend on the remaining children. Obama would have done all D.C. children a service by pointing out this inconvenient truth – but he chose to remain silent.

Four: The most blatant hypocrisy involves Obama's personal parental decisions. He chose to send his own daughters to Sidwell Friends, a private school among D.C.'s most exclusive institutions whose annual tuition runs around $30,000. If he felt so strongly that offering children an exit route would stymie the reform of public schools, then why not put his own daughters in one? Jimmy Carter did. This would not only please unions – prompting them to open up their war chest even more in the next elections – but also signal his resolve about reform. If he didn't, that's presumably because his daughters' futures are too precious to be sacrificed on the altar of politics. But, evidently, the futures of other children are not.

Incidentally, among the children who will have to return to public school once this program is scrapped are two of his daughter's schoolmates, who were using their vouchers to attend Sidwell. It's sad that Obama's message of hope and change doesn't include children like them.

OBAMA'S HEALTH CARE REFORM TACTICS

May 5, 2009

True to the advice of his chief of staff to never let a good crisis go to waste, President Barack Obama is using the current economic crisis to sell a top item on the liberal wish-list: universal health care. "You can't fix the economy," he has repeatedly said, "without fixing health care."

But the president needs to take a chill pill before committing America to a huge new entitlement: One is hard pressed to find any evidence from abroad showing that universal coverage has grown the major industrialized economies more than ours in the past – or shielded them more than us from the global slump now.

At the president's behest, Democrats are exploring ways to ramrod a health care reform bill through Congress this fall by using procedural shenanigans to avoid a Republican filibuster. In his budget, Obama has already proposed an additional $634 billion – nearly three-quarters of a trillion dollars – in health care spending over the next few years. If he gets his way, this money will be the first installment toward a government insurance plan that will compete with private plans to allegedly put affordable coverage within everyone's grasp.

But whatever else universal coverage might bring, there is no evidence that it will bring economic nirvana. If anything, contrary to what the president suggests, the correlation runs the other way for countries with universal coverage such as Canada, England, France, Germany and Japan. On nearly every economic front, their performance has been worse than America's – even, surprisingly, in controlling health care costs.

Contrary to popular perception, even though America is at the epicenter of the financial crisis, it has suffered less than its industrialized peers in terms of economic growth. According to the latest International Monetary Fund figures two weeks ago, the U.S. economy actually grew 1.1% last year even as Japan's shrank by 0.6%. France and England's both grew 0.7%, and Canada's only 0.5% – or less than half of America's. Only Germany did slightly better at 1.3%.

What's more, despite all the gloom and doom about the American economy, IMF expects its gross domestic product to shrink 2.8% this year compared to anywhere between 3% (France) to 6.2% (Japan) for these other economies. (Figures from the U.S. since the IMF projections suggest that the U.S. economy contracted more than expected in the first quarter of this year but it is not yet clear how the other countries performed.)

Not only is America hurting relatively less now, its economic performance in the prior 18 years – from 1990 to 2007 – has also been visibly better than everybody else's. Calculations based on Department of Agriculture data show that America's GDP grew at an average annual rate of 3% during this period. By contrast, Canada's grew 2.88%; England's 2.3%; France's 1.92%; Japan's 1.74% and Germany's 1.59%.

Besides experiencing lower growth rates than America in the past, with the exception of Japan, these countries have also experienced chronically higher unemployment rates. Setting aside last year, between 1997–2007 America's peak unemployment rate was below its peers by anywhere from 1% (Canada) to 5.7% (France). Japan has always had an unusually low unemployment rate, never hitting over 5.3% partly because of its policy of guaranteed employment in urban areas that forces workers to share jobs to keep more people employed.

All of this has made Americans much wealthier than all these countries, given that Americans' per capita income in 2006, adjusted for purchasing parity, was about $6,000 more than the next country, England.

But are these countries fiscally stronger? Not by a mile. European countries started reining in their soaring deficits in the years prior to the downturn, thanks to the European Union's requirement that these levels not rise above 3% of GDP. But that meant that they had to either dismantle their social spending programs – including universal health insurance – a politically difficult task, or maintain their sky-high taxes. For the most part, they have chosen the latter.

The upshot is that whereas America's 2007 taxation rate was 28.3% of GDP, Canada's was 33.3%; Germany's 36.2%; England's 36.6% and France's 43.6%. Japan's taxation level of about 28% is at par with the United States' – but only at the price of a government debt that totaled a jaw-dropping 170% of GDP last year, nearly three times that of America's. Such taxation rates have left these countries limited room to respond to crises, which is why European countries roundly dismissed Obama's calls to increase stimulus spending right now.

The trillions of dollars that this administration is spending to stimulate the economy might be a complete waste of money. But such wastage is a luxury that America can afford because of its relatively lower tax-and-spend burden.

The one remaining economic argument for universal health insurance in the United States is that it will help rein in medical costs. The rap against America is that it spends over 15% of its GDP on health care – more than any other industrialized country – and yet leaves upwards of 45 million people uninsured. If it had universal coverage, the theory goes, uninsured folks would get care sooner – not wait till they have a medical emergency – saving the system a ton of money.

It is a nice theory, but there is no evidence that it is true. Although America's per capita health care spending soared in the 1980s, a 2007 study by Kaiser Family Foundation found that it slowed considerably in subsequent years. Indeed, between 1990 and 2003, the rate of growth of America's per capita spending was 3.6%, only a little bit higher than France, Germany and Japan's – but significantly lower than England's 4.2%. That's striking given that England engages in the most aggressive rationing known to the free world, routinely delaying care to patients unless they are critically ill.

However, Canada, which too indirectly rations care for many specialized treatments by putting patients in queues, has succeeded in limiting per capita spending to 2.4%. At best, then, universal coverage has a mixed record in controlling health care spending increases, even after resorting to rationing.

All in all, there is no major industrialized economy with universal coverage that has performed as well – let alone better – than the United States in the last decade. Universal coverage might not be the cause of their inferior performance. But the crucial point is that there is zero evidence that it has put them on a more solid footing. Before applying this exotic therapy to America, Obama needs to offer more than mere hunches that it will work. He needs to offer actual evidence.

Over to you, Mr. President.

DEAR GOP: PLEASE CHOOSE LIBERTY

May 20, 2009

If Pennsylvania Senator Arlen Specter's defection to the Democratic side of the aisle affected only the fortunes of the Republican Party, it would be no cause for concern for non-Republicans like me. But America's democratic scheme depends on a robust opposition to check the government's tendency to grow – especially now that the White House is occupied by Barack Lyndon Roosevelt. Yet Republicans are as far from serving that role as the Detroit Lions are from winning the Super Bowl.

So what should the Grand Old Party do to resurrect itself enough to mount some semblance of resistance to the advancing Democratic juggernaut? The answer is that it needs intellectual coherence around a powerful idea, and that idea should be liberty. This is a principle that is both strong enough to intellectually moor the party in the way that those who want a "purer" GOP desire – and grand enough to appeal to a broad swath of the population, as those who advocate a more Big Tent approach recommend.

This would be the exact opposite of what Bush did. He, remarkably enough, managed to combine every anti-individual liberty idea from the right with every pro-big government policy from the left. From the right, Bush acquired: a super-hawkish foreign policy; contempt for civil liberties; and religiously informed positions on gay marriage, abortion and end-of-life issues. And from the left he got: high-spending ways, including the massive drug entitlement for seniors; expansive ideas about the federal government's role in education policy; and the chutzpah, just before leaving, to engineer a massive government bailout of banks and auto companies.

Since the utter rout of the Bush agenda last November, the only Republican who has made the case for liberty is Sen. Jim DeMint of South Carolina. In a recent *Wall Street Journal* op-ed, he argued that the GOP should concentrate on returning the federal government to its core functions, not imposing its moral views on everyone. But this is hard to take seriously from a man who voted not once but twice for a constitutional amendment overriding the power of states to issue marriage licenses to same-sex couples, demonstrating that for all his brave talk about freedom and federalism, he is not completely serious about either.

But what should Republicans do to reclaim the mantle of freedom?

They could begin, first and foremost, by showing some embarrassment with the label "conservative." Democrats have been embarrassed with the term "liberal" ever since it became synonymous with tax-and-spend in the public mind. Interestingly, even Obama, who is nothing if not a tax-and-spend liberal and then some, has shunned the label.

In fact, F. A. Hayek, the Nobel Prize-winning economist who did more than anyone in the 20th Century to fight socialism and revive the cause of liberty, urged conservatives nearly half a century ago in his essay, "Why I Am Not a Conservative," to find another name – one that emphasizes liberty – to describe themselves. There is an inherent tension between conservatism and liberty, he pointed out, which in a "conservative" party can't reliably be resolved in favor of liberty.

Conservatives of course dismiss this tension. America's institutions are built on principles of liberty, they claim, therefore defending them means defending liberty. But labels shape self-understanding – and the term conservatism shifts the emphasis from defending America because it is the land of liberty to defending liberty because it is American.

This has profound consequences for the conservative psyche, putting it fundamentally at odds with liberty whenever it threatens the conservative conception of America. It is not a coincidence that nativists who hyperventilate about immigration's effect on American language and attitudes, isolationists who fear that trade agreements will dissolve American sovereignty, culture warriors who regard gay marriage and evolution as a mortal threat to American values, and technological Luddites who rail against advances in bioengineering because they tamper with their idea of nature have all found a comfortable home within the conservative party. It is hard to imagine, say, the Freedom Party becoming a ready forum for such ideas.

But to truly become the party of liberty, conservatives have to accept liberty not just in name but also in attitude. They can't be the party of liberty if they reject the consequences of liberty. This means they have to internalize the notion that leaving individuals free to incrementally revise existing institutions in response to shifting human needs adds to – not subtracts from – the overall social well-being. To put it in economics terms, liberty produces positive – not negative – externalities. It doesn't destroy existing culture, community and country, but rather produces what Hayek called "spontaneous order," which, without bloodshed, allows the old and decrepit ways to be replaced by new and better ones. In short, they have to unabashedly welcome progress and finally purge the ghost of William F. Buckley, who keeps telling them to "stand athwart history and cry stop."

Admittedly, adopting a posture of liberty won't resolve every internal disagreement within the GOP. But it will cause it to rethink its policy agenda – abandoning many existing issues and adopting new ones. It will certainly mean that Republicans will have to stiffen their resolve to fight the frightening advance of the nanny and regulatory state under one-party rule in Washington.

But the recognition that a free people can't be constrained in whom they hire, marry or engage in commerce with (barring of course some security or public health issue) will also give them ammunition to become passionate defenders of open trade and immigration, and thereby distinguish themselves from Democrats. A commitment to liberty won't settle the abortion debate because even people who are pro-choice (like me) have to acknowledge that there is no easy answer as to when individuals become entitled to rights. But it will settle many end-of-life and other social issues where only an individual's own life is at stake. Nor will committing to liberty yield clear principles to gauge the best course of action on the various foreign policy challenges of our times – but it will make the loss of civil liberties that inevitably follows overseas adventurism a central part of the discussion.

The 19th century French philosopher Alexis de Tocqueville pointed out that there are essentially two grand themes around which political life can be organized in America: equality and liberty. Democrats already have a lock on the first and so, unless Republicans want to once again become tax collectors for the welfare state, as they were from 1933 to 1980, they will have to offer something radically different.

Dan Hannan

Telegraph.co.uk blog

In which Pooh meets the Eurocrats | July 22, 2008
Congressmen will now be blamed for the recession | October 4, 2008
Why I wouldn't emigrate to America | April 5, 2009

Daniel Hannan is a writer and journalist, and has been a British Conservative Member of the European Parliament since 1999. He campaigns against European integration, and for the dispersal of power to the lowest level. He speaks French and Spanish, watches lots of Shakespeare and is married with two young children.

IN WHICH POOH MEETS THE EUROCRATS

July 22, 2008

"Oh, Pooh," squeaked Piglet in alarm, "look what they've done to our sign!"

Pooh peered at the old signpost. Someone had crossed out "Hundred Acre Wood" and written letters underneath it. And there, in the bottom corner, was a little blue flag with yellow stars.

"Hmm," said Pooh. And then, "Ah!" He walked around the sign twice, rubbed his nose, and said, "Well, well."

"But Pooh," protested Piglet, his nose twitching, "I don't want to live in 40.469 Hectare Wood. It just doesn't feel right"

"Gaiety," said Eeyore glumly. "Song and dance," he said. "A very merry time to be had by all", he added. "Except me."

"Stop being such a bunch of xenophobes," said Rabbit briskly. "The EU Values the Diversity of its Member States. It Respects the Principles of Subsidiarity and Proportionality. Standardising its units of measurement is no more than Customary Procedure…"

"What does crustimoney proseedcake mean?" asked Pooh humbly.

"It means the Thing To Do. Talking of which, Pooh, I can't help noticing that that jar of honey in your paw violates Regulation 92/102 on the Packaging and Labelling of Apian Produce. Hand it over, will you? We Value Diversity…"

CONGRESSMEN WILL NOW BE BLAMED FOR THE RECESSION

October 4, 2008

Congressmen have been bullied into voting for a series of tax-rises for no very good reason except that they are reluctant to be seen to be opposing the experts. The same experts, of course, who caused the mess in the first place.

Will it work? So far, things don't look good. The Dow Jones reacted to the vote by falling: the blue-chip index closed down 157.47 points, or 1.5 per cent, at 10,325.38; the Standard & Poor's stock index fell 1.4 per cent; the Nasdaq composite index slumped dropped 1.5 per cent.

Perhaps traders are less willing than Congressmen to take things on trust. Perhaps they understood that the $700 billion figure had been more or less plucked from the air. (Actually, the number had risen by the second vote to $850 billion, increasing the size of the federal government by nearly a third: like the Sybil offering her books to Tarquinius, Bush kept putting his price up.) Perhaps the traders remembered that the injection of $600 billion by central banks on Monday had made no difference: the markets had fallen anyway.

Politicians hate to acknowledge their impotence. Rather than accepting that a recession is coming, and focusing on trying to help people through it, they cling to the fantasy that they can make the weather. (Quite literally in the case of carbon emissions, but that's another story.) Something Must Be Done. Alright, we're not sure what that Something is, or how it's supposed to work, but it's Something, so let's Do It.

I hope that the experts are right and that I'm wrong. But I fear that the downturn is coming anyway – only now with an additional tax bill that could go as high as $2,300 per family. If it does, the Congressmen who voted for those tax rises will have some explaining to do. They won't be able to blame Bush or Paulson. Like the Ancient Mariner's crewmates, they have made themselves accomplices:

Then all averred I had killed the bird
That brought the fog and mist.

'Twas right, said they, such birds to slay,
That brought the fog and mist.

Well, guys, I hope the ship makes it safely back. But, if it doesn't, don't try to fob off your constituents with the idea that everyone else was making the same mistake. You will find them less credulous than their representatives.

WHY I WOULDN'T EMIGRATE TO AMERICA

April 5, 2009

Larry Elder wants Barack Obama to sign an executive order granting me immediate US citizenship. Many Britons, of course, have gratefully made the journey. Even that great patriot Oliver Cromwell toyed constantly with the idea of emigration. Thomas Jefferson confidently boasted that, while many Europeans would take themselves across the Atlantic, few Americans would return – a prediction that came spectacularly true.

Believe me, Larry, when I say that I'm flattered. Your founders were men of matchless vision. The constitution they agreed was the most sublime political accord ever drafted. Its precepts made you happy, prosperous and free. Its promise drove your fathers to bring liberty to other continents.

Like many Brits, I have American relatives: a troop of kind, warm, generous (if mainly Democrat-leaning) cousins in Philadelphia. But I have no plans to join them, Larry, and to explain why, let me tell you about the weekend I've just had.

My old and dear friends, James and Rowena, had asked my family to their cottage in Shropshire. Now Shropshire, by English standards, is a sprawling, untamed county. But, like all English counties, it has been sculpted tenderly for centuries. This was the landscape that inspired A E Housman, and the situation of my friends' cottage, beneath the Wrekin's forest fleece, has to be seen to be believed. (Go and see it. Seriously. You can rent the cottage on very fair terms.)

Yesterday, under my wife's direction, we plucked nettles and wild garlic for the kitchen, the children splashing in a brook while their mothers combed the bank like Palaeolithic gatherers. I kept thinking, not of Housman, but of the greatest poet of all, and of mad Lear "crowned with rank fumiter, and furrow weeds, with hardocks, hemlock, nettles, cuckoo-flowers, darnel, and all the idle weeds that grow in our sustaining corn."

This morning, for Palm Sunday, we went to the tiny church attached to the estate, its walls hung with the crests of once powerful local dynasties, its congregation so sparse that it holds a service only every fourth week. On our way home, we paused at the site of the battlefield at Shrewsbury ("How bloodily the sun begins to peer above yon busky hill. The day looks pale at his distemperature…") The point I'm trying to make, Larry, is that it's difficult to be in the English countryside in April and seriously want to be somewhere else.

Heaven knows my country has its problems. Our Parliament has been vitiated, our local councils scorned. Our public services are increasingly run by and for their employees. Britain is almost the last place in the Western world where you'd want to fall ill. (Labour politicians are trying to fabricate a row about the fact that I made this point on Sean Hannity's programme, but everyone knows it to be true.) Our people are governed, not by their elected representatives, but by quangoes, human rights judges and Eurocrats.

Then again, each of these problems has its solution. Indeed, several solutions could usefully be imported from your country: dispersed jurisdiction, states' rights, the separation of power, open primaries, regionalised welfare, elected sheriffs, a local sales tax. I've even co-written a book showing how all this could be done in just one 12-month parliamentary session: it's called The Plan.

And where did the ideology that actuated the American Revolution originate? Who first came up with the idea that laws should be passed only by elected legislators? We did. That idea was Britain's greatest export, our supreme contribution to the happiness of mankind.

Forget subsequent flag-waving histories of the War of Independence, and go back to what the colonist leaders were arguing at the time. They saw themselves, not as revolutionaries, but as conservatives. In their eyes, they were standing up for what they had assumed to be their birthright as freeborn Englishmen. It was Great Britain, they believed, that was abandoning its ancient liberties.

And here, my friends, is Britain's tragedy. The things those colonists feared – the levying of illegal taxes, the passing of laws without popular consent, the sidelining of Parliament – have indeed come about. They have come about, not as the result of Hanoverian tyranny, but in our own age, driven by rise of the quangocracy and the EU.

To put it another way, British freedoms thrive best in America, and British patriots should be campaigning to bring them home. I'll be staying here, Larry, working to repatriate our revolution.

Other entries submitted, but not reproduced in this booklet, include:

The International Criminal Court is a threat to democracy | July 16, 2008

EU aid to Palestine is funding the conflict | August 22, 2008

As Rome fell, so will Europe | February 7, 2009

Charities want a bail-out: they shouldn't get a penny | February 9, 2009

Lefties feel threatened by the internet | April 3, 2009

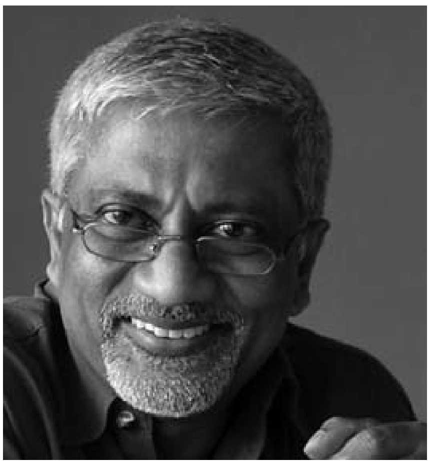
Stop giving us aid, say Africans | May 19, 2009

Father Christmas is a Euro-enthusiast | June 17, 2009

Rohan Samarajiva

LankaBusinessOnline, Sri Lanka

India Sri Lanka economic links de-railed by protectionism | July 28, 2008
Should Sri Lanka have lower taxes or more government? | August 19, 2008
Bottomless | September 29, 2008



Rohan Samarajiva has written an online column entitled "Choices" for *Lanka Business Online* since February 2005 (also published in Sinhala in the weekly newspaper, *Ravaya)*. He also writes for other South Asian publications on topics at the intersection of economics, new technology and law/policy. He is a resource for electronic media as well. He is Chair and CEO of LIRNE*asia* [pronounced "Learn Asia"], an Information and Communication Technology (ICT) policy think tank active across South and Southeast Asia. He served on faculty at the Ohio State University and at the Delft University of Technology in the Netherlands and has worked in government in Sri Lanka, implementing infrastructure reforms.

INDIA SRI LANKA ECONOMIC LINKS DE-RAILED BY PROTECTIONISM

July 28, 2008

The developing discourse on a trade agreement with India is disturbing. The proponents of the manjokka economy, led by experts on plug removal and tooth extraction, are framing the debate.

The level of naiveté displayed by those who should know better, including those who write newspaper columns and the quick surrender by the Minister of International Trade, a man whose intelligence and eloquence cannot be questioned, bodes ill for the future of this little island.

Missing the bus?

Little island. About the size of Greater Mumbai. Not of great consequence to India.

These are the central points that are missed by the commenters (with the honorable exception of Saman Kelegama of the IPS).

Figure 1 [not included here] gives the data for 2003; by now, the Metro Mumbai economy may have overtaken Sri Lanka's.

In the big picture, India can let Sri Lanka be. They have done this once, after the IPKF pulled back due to the stupidity of our leaders. Were lives saved? Was there peace with honor?

Or does Mahinda Rajapaksa who then protested the 13th Amendment that the IPKF was trying to help implement, now see "the Indian solution" (less the North East merger) as THE solution?

In 1987, there were plenty of reasons for India to intervene. Paramilitary groups coddled by the RAW were running riot in Tamilnadu. Refugees were in their thousands. Sri Lanka was affecting Tamilnadu politics and upsetting the equilibrium in Delhi.

No such conditions exist for the alleged intervention to dominate Sri Lanka economically. India is of paramount importance to Sri Lanka, but not vice versa. India is in the top three of everything with us: imports, exports and investment. We are not in the top 10 in any one of these categories for India. Exceptions are international flights into India (an early result of the CEPA negotiations) and tourists into India.

If our weak-kneed politicians keep postponing the already late agreement (it was originally planned to be signed in 2004), India may lose interest. They have signed with Singapore; CEPAs with Japan, South Korea, ASEAN and the European Union are in progress. With these heavy hitters taking up Indian attention, little Sri Lanka may fall by the wayside.

Fix the problems of FTA first?

This is a favourite refrain of the naysayers. A trade agreement is a complex matter. No one can get it right the first time. CEPA is how we fix the problems of the FTA. As I understand, the CEPA will be phased in, and lots of monitoring activities are built into the implementation schedule. This will allow for fine-tuning.

No need for an agreement?

"We trade with Bangladesh without an agreement. We have an agreement with India but we get hassled by low-level flunkies." That is the second main argument.

Yes, there are well-documented problems of non-compliance with FTA provisions by low-level officials. The FTA was the very first bilateral trade agreement for both countries. It would be totally surprising if there were no teething problems. It would also be surprising if these problems were to continue unabated as familiarity increased.

The real solution to this problem is a robust dispute-settlement procedure. Not having seen the final text, I cannot say whether the dispute-resolution provisions are adequate, but I would be most surprised if the negotiators did not include a chapter. This is standard operating procedure in trade negotiations.

The whole point of trade agreements is to provide frameworks and reduce uncertainty. Things may be fine in Bangladesh today, but what happens when the "good" Customs Chief is transferred? What happens when Sri Lankan exports grow to levels that pose a threat to powerful interests? Economic relations with India are too important to be left to ad hoc arrangements.

Not transparent

Consultations with stakeholders have been ongoing since 2002. The last consultation gave lots of details; had all the main chambers represented and even had a long and full write up in the papers, even now accessible through the web. Even pontificators from London can read online newspapers, one assumes.

Ideally, the text of the agreement to be signed would be public. But both countries share an administrative culture that is excessively secretive. I surmise India would not be happy if Sri Lanka were to release the text unilaterally. India has a Freedom of Information law; Sri Lanka does not. It would be interesting to see if someone uses the Indian FOI Act to extract the final text.

One way out of the impasse would be for the articulate Minister of International Trade to give a couple of speeches in the subject; engage in a TV debate with the plug specialist and/or the retired dentist. We cannot have stealth trade liberalization with our most important economic partner.

In Canada, Brian Mulroney fought and won a general election to get the free trade agreement with the United States approved. We need that kind of political courage now. Technocrats cannot be the sole defenders of CEPA.

Benefits

We have already seen the benefits of CEPA. For a long time, air travel between Sri Lanka and India was a festering sore. You had to reserve, confirm, reconfirm and you would still get offloaded. Once I was told that I was 77th on the wait list. When I asked Air Lanka why they didn't put in an extra plane, they said they were not allowed, under the rules.

Now, SriLankan runs more flights into India than any other carrier. Jet provides competition. Pretty much no one gets offloaded. At one point, over 40 percent of SriLankan's passengers through Colombo were transit passengers.

All these were a result of a policy change announced by then Prime Minister Vajpayee upon accepting the Joint Study Group's report along with then Prime Minister Wickremesinghe, whose idea it was to open the routes to the Indian private airlines.

The Joint Study Group report makes multiple references to Sri Lanka becoming a services and logistics hub for South Asia. This was a sea change from the previous position which had Indian bureaucrats writing lengthy internal memos on the need to avoid trans-shipment through foreign ports. Guess what that kind of thinking would have done to Colombo (where 70 percent of containers are being trans-shipped from/to India)?

It is also worth emphasising that the Indian negotiators have not insisted on symmetry at any point. Under the FTA, 1,180 tariff lines remained on the Sri Lankan negative list (excluded from the provisions of the FTA) in 2007. On the Indian side the number was 429. Among the items on Sri Lanka's negative list were agricultural and livestock items; rubber products; iron and steel; machinery and electrical goods. India's negative list included garments, plastic goods and rubber products.

But even with garments and tea, India allowed capped trade. The most important thing to remember is that agriculture was kept out of the CEPA (and was out of the FTA) despite the fact that India sells a lot of agricultural products to Sri Lanka. Exclusion of agriculture was a central element of the Sri Lankan strategy because it was felt that tariff-free agricultural imports from India could wipe out higher-cost Sri Lankan producers.

These are the stories Professor Pieris must tell, if he is not to be held responsible for making Sri Lanka miss the bus again.

India is the most dynamic economic engine in the region. It is on everyone's radar screens. It is an emerging world power. We are fortunate in our location and our historical good relations with India. We must nurture and develop this central relationship.

The way to do it is by engaging with India, not by getting pushed off track by fear-mongering plug specialists and knee jerk protectionists.

SHOULD SRI LANKA HAVE LOWER TAXES OR MORE GOVERNMENT?

August 19, 2008

"One out of five people between 18 and 60 works for the government. One out of 20 Sri Lankans works for the government. To serve 20 people we have one government servant. We have increased their salaries and strengthened government in order to serve you."

This is a translated excerpt of a speech by President Mahinda Rajapaksa as reported in the Lankadeepa, Jan 22, 2008, p. 5 (The speech was made before the Provincial Council Elections, so actual numbers may be higher now)

Newspaper columns are required to contain references to conversations with taxi drivers. I mentioned a Hawai'ian taxi driver in my very first column in February 2005, but have since been neglectful of this long-standing journalistic tradition. This makes amends.

So, a taxi driver told me that the JHU had slapped another tax on mobile charges. I said yes, for every 100 rupees you spend on the phone, you'll now be giving the government a little over 31 rupees on top as taxes from now.

He said, this is to make the President happy and to pay for SAARC expenses. I said, maybe, but the government has lots of continuing expenses; SAARC was just a one-time deal.

But this is crazy, he said, why are they taxing my mobile which I need to make a living (I had just called him to arrange the airport drop)? I said, but the government needs money to meet its expenses.

I said the people of this country deserve these taxes, because they oppose the shrinking of government. Somebody has to pay the bills. Government must get money from somewhere. You can't have both your ravula and your kanda, I said.

Ah, he agreed, the UNP didn't give one government job and see what happened to them, they got booted out in 2004.

I said, yes, the mobile taxes at that time were quite a bit lower. The 15 percent value added tax plus the social responsibility levy of 1.5 percent. In 2003 they started this nasty habit of mobile-specific taxes with a 2.5 percent levy (thinking it would get too complicated, I didn't tell him that this levy was placed in lieu of an importation tax that was leading to a lot of smuggling of handsets). That amounted to 20.40 rupees, roughly two thirds of the present tax burden. With 8 million mobile customers paying 10 rupees more for every hundred rupees of use, that's quite a bit of loose change, I said.

Ah, he said, this Professor Pieris was the man responsible for the VAT and all this, wasn't he? Again, I said but the government has lots of expenses like maintaining this road we're on and paying compensation to contractors for the highway on the left that wasn't completed.

The VAT contributes 33 per cent of total government revenues, I said. I personally think it is very good compared to what existed before, if only we can prevent leakage. And Professor Pieris didn't work up the mobile subscriber levy; the credit for that has to go to Mr Bandula Gunawardene.

Unhappy with this egregious violation of the principle of collective responsibility of the Cabinet, I tried a distraction. I pointed out that mobile prices had come down considerably since 2004.

I said you can call the US for 10 rupees and there are special packages to call cheaply to the Gulf. A minute of mobile calling at peak used to cost 11 rupees, I said; now it costs about half depending on the package. Calling at peak times now costs even less than calling at off-peak, which is very weird, I said. And all this with a devalued rupee.

The taxi driver was not to be distracted. How much cheaper it would be if not for these silly taxes, he said. I repeated my mantra about the government needing money. By this time we were on the approach road, which used to have all these hoardings about the sky being ours with Mihin Lanka, with the little swirl/wave thing at the bottom to connect it to that fantastic Triad campaign for the 2004 election.

They have to pay the 1.5 rupee billion debt of Mihin Lanka, I said. We need to keep all those people employed in a government-run airline. They cannot lose their jobs, even if the airline never flies again.

But he was fixated on taxes. How come I have to pay 31 rupees plus for every hundred rupees, when the taxes are 15 percent plus 1.5 percent plus 10 percent (I had by this time explained that the 2.5 percent levy had increased to 10 percent because Minister Bandula Gunawardene, now on the other side, had wanted to reduce some onion or lentil import taxes and had to collect some money to make up for the loss)? How come 15+1.5+10 adds up to over 31? Doesn't the tuition master know how to add?

Ah, I said, don't you know about tax-on-tax? We pay tax; then we pay tax-on-tax. This is not tuition-class arithmetic, but special stuff cooked up by the million plus people who work in government, I said.

This is terrible, he said. Their salaries have to be paid, I said, for them to come up with things like tax-on-tax. This advanced arithmetic is not taught in school, not even in tuition class. Ah, this is something like *val poli* (compound interest), he said.

I was now at the checkpoint. Time to end the conversation. The only people who have a right to object to these taxes are people who support the policy of freezing, if not contracting, government employment, I said.

That's true, he agreed.

I got off the taxi and went to check in to my flight. Not on Mihin Lanka, which owns the sky but cannot fly because its plane was repossessed; but the other government airline run by the brother of the guy who ran Mihin Lanka into the ground; which will, in due course, need some infusions of public money too. Especially after they absorb Mihin Lanka, its losses and its employees.

What would the mobile levy be called then, I wondered, and how much would it be? Mihin Conservation Levy (MCL)? Twenty percent, which would take us to 58.20 rupees on top of every 100 rupees we spend on calls, with tax-on-tax? Or just 10 percent, which would take us to 45 rupees? What would it take to pay hundred rupees in tax for every hundred rupees of mobile use? Would the JHU be an endangered species by then, I wondered. Perhaps we could call that tax a JHU Conservation Levy.

What would be the tagline of the next Mihin Lanka advertising campaign, I wondered. When it was flying an ancient leased Airbus, the slogan was "Ahasa Apey" (the sky is ours). Now, when it is paying salaries, but not flying, would it be "Polova Apey" (the ground is ours)? And what would they be advertising? Rides on the baggage handling equipment they imported? May be a ride in an ancient leased Bus?

These were some of the things that went through my mind while waiting in line for 45 minutes to check in. If the government airline that actually flies had faster check-in, you'd be reading a shorter column. But then I have to be thankful to the taxi driver. Without him, there may be no column at all.

BOTTOMLESS

September 29, 2008

"Mihin Air was started with pure intentions. It was active for 13 months. There were shortcomings in management. The CEO was removed. The Board was asked to resign.

"After study, we are taking steps to make the organization profitable... . Over the 13 months, 215,617 passengers have travelled on this airline. There were revenues of 2.4 million rupees.

"But there were unnecessary expenditures. There were losses of 3,200 million rupees... . We wish to purchase six airplanes from China. Eighteen proposals have been received. A technical evaluation committee has been appointed to examine them. We have requested funds for these purchases from the budget."

The above are translated excerpts from the statement made in Parliament by the Minister of Ports and Civil Aviation, Chamal Rajapaksa, M.P., on 23 September 2008, as reported in the Lankadeepa, 24 September 2008, p. 5. The revenue and loss figures are very strange, but that's what the Lankadeepa parliamentary correspondent reported.

The fate of Mihin Lanka was foretold: Risky business (4 January 2007) . But the urgent task is to contribute to the debate on whether more of our money should be spent on reviving Mihin.

Intentions

Minister Rajapaksa does not appear to have spelled out the purity of the intentions. Minister Aluthgamage says it was started because Sri Lanka did not have a national airline and because Emirates which managed SriLankan had stopped flights to Buddha Gaya, a claim repeated by Minister Dinesh Gunawardene. So this seems to be the government line on the pure intention.

There was no talk of pilgrims and Buddha Gaya in late 2006 when Mihin first emerged. Then it was migrant workers needing cheap flights. We can better assist pilgrims wanting to travel to Bodh Gaya by giving them 10,000 rupees each rather than by giving continuing handouts to a fundamentally unviable airline. This can probably fund the shopping and tourism they like to do, in addition to the pilgrimage to Bodh Gaya, the main reason SriLankan could not fill the flights. No one wanted to travel only to Bodh Gaya.

The government can give this targeted subsidy to 215,617 applicants (the total who flew Mihin before it became a landline) at a cost of 2.16 billion rupees. That is still less than the 3.7 billion being asked from the next Budget and much less than the debts that will have to be forgiven (around 4 billion rupees).

It is eminently silly to hand out 10,000 rupees each to over 2 lakhs of pilgrims. But at least that'll be the end of the madness. In the case of Mihin subsidies, there will be no end because it can never make money and it will always be a drain on the tax payer.

According to The Economist ("Shredding money," 18 September 2008), "at least 30 airlines have gone bust this year, and IATA, the industry's trade body, reckons its 230 members will lose about $5.2 billion in total, having made a rare collective profit of $5.6 billion in 2007, following $40 billion of losses since 2001."

It's not that all airlines will necessarily lose money. It is possible that an exceptionally well managed airline can make money in this environment. But what are the chances that Mihin2 will be a well managed airline?

Shortcomings in management

The previous CEO was incompetent and was fired … to become advisor to the President and travel with him to the UN General Assembly.

The same people who appointed the previous CEO and Board are appointing the new CEO and the Board. And what incentives are there for the new CEO to perform? One thing we can be sure of (maybe) is that the new CEO will not be paid as well as the man who converted an airline into a landline. The new CEO, unlike the previous one has actual experience in aviation, though not of budget airline operation.

The new Chairman is described as an engineer and who "also has a background in business management." He was Chairman of the government-owned State Engineering Corporation, an organization not renowned for efficiency and profit making.

Work as a junior engineer in Chino, a small city in California (population less than Colombo) does not seem to constitute relevant experience.

The rest of the Board comprises the Commander of an Air Force, the chairmen of the Banks that were foolish enough to give loans to Mihin and sundry political appointees.

Only surprising omission is Ashantha de Mel. Mihin owes the CPC a lot of money. The least it can do is to invite Mr de Mel for meetings and offer him tea, sandwiches and an opportunity to discuss cricket selections with really intelligent people. There should be equal treatment for people who extended credit to Mihin. Just because CPC does not directly report to the President, it should not be discriminated against.

Does any of this suggest the kind of management that will make Mihin2 buck worldwide trends?

Corruption

Minister Aluthgamage stated in Parliament that "I do not say that the people who were in this [Mihin] did not take commissions. Commissions were taken." (translation of report in the Lankadeepa, 24 September 2008, p. 5). Here's the Sinhala report, in case you doubt the translation: "Meke hitapu minissu komis gahuve ne kiyala mama kiyanne ne. Komis gahuva."

This damning indictment made by a current Minister on the floor of Parliament should be taken up by the Commission to Investigate Allegations of Bribery or Corruption. Who are the people who fall within the scope of the indictment? Those who were in decision making positions at Mihin1 and are no longer in those positions.

One such person is the former CEO, now advisor to the President who accompanied him to the Buddhist Vihara in New York. Another is the Secretary of the Ministry of Defense who was on the founding Board but is no longer there. The Secretary to the President is also within the scope. At least to clear their names, the Bribery Commission should launch an investigation.

If the Opposition cannot capitalize on internal fissures of this scale, does it merit being called an Opposition?

Minister Aluthgamage says commissions were taken on leases. Can he guarantee that commissions will not be taken on new purchases? What safeguards have been instituted to prevent recurrences of the commission-taking incidents that he confirmed in Parliament ("komis gahuva")? What is ten per cent of 3.7 billion rupees? Or have I got the number wrong?

Lessons learned

Nothing has changed in the external environment that I described in January 2007. If anything, it has become even more challenging. Air Deccan, which I used to illustrate the risks of the budget airline business, is no longer in business, having been acquired by Kingfisher after mounting losses. The world over, airlines are bleeding red ink.

No evidence exists that an exceptional and experienced management team that can surmount the considerable external challenges has been assembled. There is no one on the management team with experience in running budget airlines. The Board has experience in running loss making state enterprises and making foolish loans, but little else.

No evidence suggests that the conditions for the non-recurrence of the kind of corruption described on the floor of Parliament by Minister Aluthgamage have been created.

Government should not be in the business of flying people to Bodh Gaya for pilgrimage or hauling expatriate workers to the Middle East. That should be the biggest lesson.

A mistake was made. Now it should be remedied by cutting off this gangrenous limb even if it is called Mihin. But the previous CEO made one good decision. Most of the inputs for the misbegotten enterprise were obtained on lease. Exit costs are therefore much lower than if he bought planes.

Now the Minister wants the tax payers of this country to pay for aircraft purchases, managing to make Sajin Vaas Gunawardene look like a whiz kid in the process. The Mihin2 debacle will be much worse than Mihin1. Then there will no Sajin to beat up on; just the brother of the President of the Democratic Socialist Republic of Sri Lanka.

Is this not a case of throwing good money after bad? Is this not a case of not learning from past mistakes but of compounding the errors?

As I said in another column (SriLankan or Mihin Lanka? 24 December 2007), "Instead of running two airlines to the ground, why not just concentrate on one?"

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INTERNATIONAL POLICY NETWORK

Rooms 200–205, Temple Chambers
3–7 Temple Avenue, London EC4Y 0HP United Kingdom
t: +44 20 3393 8410
e: inquiries@policynetwork.net
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UK
For opinion columns written in the *Financial Times* and *New York Times*

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Jamie Whyte (co-winner)
UK
For opinion columns written in *The Times*

2005

Mary Anastasia O'Grady
For opinion columns written as Latin American Editor of *The Wall Street Journal*

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Brian Carney
For opinion columns written as editorial writer for *The Wall Street Journal Europe*

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Amity Shlaes (co-winner)
For opinion columns written as senior columnist on political economy for the *Financial Times*

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