

Government: Don't Just Stand There, Undo Something

Speech, November 8, 1997

The article below is the transcript of the 38th Alex G. McKenna Economic Education Series which was delivered by Dr. Henderson at Saint Vincent College on November 8, 1997. Dr. Henderson is a professor of economics at the Naval Postgraduate School and a Research Fellow at the Hoover Institution.

"Dear Abby, I am about to get married next week. My fiancée knows nothing about my family. I have two brothers and two sisters. One brother is an economist; the other is in prison for murder. My two sisters are in prison for burglary. My wife-to-be is an axe murderer. Abby, here's my question. Should I tell my wife-to-be about my brother, the economist?"

Economics is known as the dismal science. Economists can find the cloud in every silver lining. Economists have predicted eight of the last five recessions. If an economist were present when Jesus Christ was walking on water, I swear the next issue of the American Economic Review would of have had an article titled, "Jesus Can't Swim." Actually that wouldn't have been the title. As anyone who has read an economics journal lately knows, it would have been something like, "The Theory of Divinity: Testing a Hypothesis With a Sample of One." Economics, as I say, is often thought of as the dismal science. But for me, economics is the hopeful science. Economics says that you can have freedom and economic progress at the same time; that in fact, freedom is required for economic progress. Freedom is the mainspring of economic progress.

Look at the world ten years ago. Look at two countries; West Germany and East Germany. In West Germany, shops were filled with goods, people were able to buy cars, clothing, houses, chocolates, candy, everything. There was lots of abundance. Walk one hundred yards through Checkpoint Charlie to East Germany, and what do you see? You see drab buildings that have not been reconstructed since the second world war. The only people in cars are high-level government officials. But they are all Germans. They have the same genes, the same culture, the same history. Why the difference? One word - freedom. West Germany had a lot of economic freedom. Starting in 1948 when they ripped away

all the regulations that Hitler had imposed before and during the war, and they left a free economy in its place. East Germany was communist, with complete government control, complete government running of the economy. The difference is freedom, not genes, not culture, not history, not natural resources, the difference is freedom.

In fact, I remember when the Berlin Wall fell. I woke up on a Friday morning and heard the news. I was so excited I could not contain myself. I looked around for my wife. She was in our four year old daughter's bedroom waking her for the day. So I came in and said, "The Berlin Wall fell!" And my wife was about a third as excited as I was, and my daughter did not understand what that meant. I had to go off to work, but later that weekend my daughter asked, "So what, why is that so important?" I tried to put it into words that a four year old could understand. I said, "There were these men who were told to shoot to kill anyone who tried to get from East Germany to West Germany. And some other men had suddenly decided that they were no longer going to shoot to kill people; they were going to let them move. This meant that these people who before were trapped where they lived now were not trapped. They could get out and do things they always wanted to do." And my daughter said, "Like go to Disneyland?" And I said, "Yes, that is right." And do you know when they interviewed people there they found that a lot of people had this desire to go to Disneyland. And I said, "Not only can they go where they want to go, they can buy things they have always wanted to buy." And my daughter said, "Like candy?" And I said, "Yes, like candy." That weekend the candy stores in West Berlin were sold out. My daughter figured this out at four years old. Everything you need to know about freedom, you knew before kindergarten.

It is not just East Germany and West Germany; look at North Korea and South Korea. Again, these countries have the same history, same genetics, same culture. In 1953, both are totally devastated by the Korean War. What happens? South Korea has freedom; South Korea has private property; South Korea lets people keep a lot of what they earn. North Korea is a complete communist society, with complete government control. We see the results now. In the 1950's, when I was growing up my mother would say, "Finish everything on your plate because people are starving in Korea." Now the illogic of that was evident even to an eight year old. I was not going to save those people by cleaning my plate, but I

had to. Now we know what is happening. People are not starving in South Korea, but people are starving in North Korea. They are facing one of the worst famines ever. And it is not just North and South Korea, look around the world, look at the Pacific Rim. Hong Kong is a rock at the edge of the ocean and not even a large rock. But Hong Kong has economic freedom and 8% to 10% economic growth for thirty years. Taiwan is the same, Singapore is the same. China is starting to get some economic freedom, and it has had 8% to 10% economic growth rates for about the last twenty years. Latin America, perpetually full of sick economies twenty to thirty years ago, is turning around. Why? More economic freedom. And of course there is eastern Europe. Eastern Europe is throwing off the shackles of communism, allowing private property, privatization, cutting tax rates, and cutting government spending. With economic freedom, they are starting to see economic growth even in Russia. And consider Africa, the traditional sick puppy of economies in the world. Africa, where development economists in the 1960's coined the term "cleptocrat" to describe the dictators of some of those countries. Clepto- from Latin, meaning thief, and crat, meaning autocrat or dictator. Consider the former of Zaire who just died, Mobutu. Mobutu was one of the wealthiest men in the world. He was the ultimate cleptocrat, he stole it. Even Africa is starting to change. We have gone from three democracies in Africa to over fifteen. And places like Botswana are cutting tax rates and the government down to size, and they are getting 6% annual economic growth. So the winds of freedom are blowing around the world.

Let us look at Russia for a minute. They have had some rough times, but they are starting to get some economic freedom. What led to that? What led Russians to demand economic freedom? What led to more freedom in Russia? What brought down the communists? One word - information. Some young entrepreneurial Russians in the mid-1980's started wiring apartment buildings with cables so that people could watch television. People started watching, and the stations needed to have content every night, so they started showing American movies. American movies like Diehard, and Harry and the Hendersons (no relation); radical movies, incredible revolutionary movies. "What! Diehard, Harry and the Hendersons revolutionary? You have to be kidding." I am not kidding, because what did those people see? Those people saw in the background that Americans owned refrigerators! (Trouble, trouble, trouble.) Cars! (Trouble, trouble, trouble.)

Fresh oranges! (Trouble, trouble, trouble.) Folks, the bureaucrats in Russia had trouble right there in Moscow. And they said when they saw refrigerators, cars, and oranges, "I want." And they started demanding reforms that could let them have those things. In fact, there is an old Soviet joke that used to be told in the seventies. A Soviet teacher pulls down a map of the world and says, "Children, here is America where there is mass poverty, mass unemployment, racism, rich getting richer and poor getting poorer. And here is the Soviet Union where everyone is employed, everyone has all that they want, and children get ice cream to eat every day. Natasha in the back of the room starts to cry uncontrollably. And the teacher says, "Natasha, what's wrong?" Natasha says, "I want to live in the Soviet Union."

Harry Truman said it best. Harry Truman said that if we could put a Sears catalog in every Russian's mailbox on Friday, communism would be dead by Monday morning. It happened slower than that, but that is what happened. So the winds of freedom are blowing around the world, and there are actually some economists who would not have been surprised if they were alive today. I have two people in mind, Ludwig von Mises and Frederic Hayek. Ludwig von Mises in the 1920's said, "Communism can't work." Why? Because you have to have prices to guide resources. You have to have prices so buyers know what to buy and producers know what to produce. And you cannot have a price system with centralized planning; you cannot have a price system with government running things. Frederic Hayek came along in the 1930's and added the point that you cannot even have a social society create artificial prices, because the amount of information that central planners would have to have cannot exist in one mind. No small body of people can have all the information that is needed, so he said that communism would not work. Guess what? They were right. Communism never worked, and we all know that now.

These economists did not say that therefore government has to set up markets; they did not say that because central planning does not work government has to set up markets. What they understood is that markets happen. Markets are. The market is. Leaves are green; the market is. Gravity is; the market is. The market happens. Someone selling blue jeans from a kiosk on the streets of Moscow today does not have to be told by any five year plan to do so. They see a demand, they see a need, and they fill it. The market is. It is one of the most natural things in

the world. Put any two people together, and if they don't end up fighting, they will end up trading.

Suppose that I could choose any time in the whole of history up to today to be alive. You know what I would choose? Today. With one little difference; I would choose to be your age rather than mine. (Most of your ages.) Why? Because I think it is going to get better and better and better and better. I think we are on the verge of about a twenty-five year boom. We may have little recessions, but we will have economic growth and economic progress such as we have never seen before. By the way, that is why I think the stock market is high. I think the market is already anticipating that.

Let us look at some of the technologies that are out there, some that you are already familiar with. Look at computer technology. Between 1951 and today, the cost of a unit of computer power has fallen over 20% a year. Let us put that in perspective. That means that you can get the amount of computer power today for \$3.00 that would have cost you \$100,000.00 in 1951. To put this in perspective another way, if we had the same kind of economic progress with medical care, you would be able to choose whether to get a liver transplant or spend the money instead taking your family to a movie. When Thomas Watson ran IBM, guess how many computers he predicted there would ever be a worldwide demand for? Not five million, not five thousand, but five. I would bet there are people in this room who have five computers in their home, even in the narrow sense of PCS. I guarantee most people in this room have more than five computers in your home in the wider sense, because you have computers in your car. The average American car has more computer power in it than the lunar landing module when we landed on the moon. So computers are a big part of the story. Computers are a big part of why things are getting better.

In fact, computers have helped to revolutionize the production process. I was visiting a friend in Detroit this weekend who is a consultant in something called, lean thinking. Leaning thinking looks at how everything in a production process works and how you can make everything efficient. He pointed to an example in Detroit. When Ford starts to build a truck, it starts at the start of the assembly line. An hour and a half later, they need a seat to put in the truck. At the start of that hour and a half, Ford calls the order to Lear, which produces seats. The seat

is produced and delivered in that hour and a half. That is the kind of production process we are moving towards today - lean thinking. And we can apply lean thinking all over the place. In fact, my friend is applying it to lots of different industries in his consulting.

Now, there is a whole tradition of economics that says we are going to run out everything. The first big advocate of this was Malthus. Have the students here heard of Malthus? He was kind of the prophet of doom and gloom two hundred years ago. I do not know what he sounded like, but when I picture Malthus, I picture Ben Stein. Has anyone seen Ben Stein, the guy who does the clear eyes commercial? He is also the science teacher in *The Wonder Years*. Here is Malthus: "Population grows geometrically. Capacity to produce food grows arithmetically. Result, mass starvation. Ouch." Guess what? Malthus was wrong, spectacularly wrong! He thought the only way you could increase agricultural production was to increase the amount of land in production. He did not take into account fertilizer. He did not take into account pesticides. He did not take into account new hybrids. He did not take into account any of those things. And of course if you look at food production, it has gone up faster than population growth. We currently have less starvation than at any other time in our history. In fact, this is an area where the computer revolution is just beginning, and it is going to have a dramatic impact. In the United States, there are farmers who have sub-surface soil sensors that detect the amount of water in the root zone at various points in the field. Using little computers, they communicate how much should be irrigated in that particular square yard so it does not get any more or any less water than is needed. There is no wastage of water. We have a new term in farming, precision farming. Every piece of harvesting equipment sold in the last two years has a yield monitor that monitors the yield square yard by square yard produced on a farm. They also use the global positioning satellites to figure out square yard by square yard how much fertilizer, pesticide, and water should be applied. When they put this information together, they are able to have virtually no run-off of pesticides, and it is incredibly efficient, with incredibly little damage to the environment compared to farming a little while ago. Case International Harvester, the second largest farm machinery company in the United States, now does not call itself in that business. Instead, it says that it is in the business of consulting on precision farming. They sell software, for example, to farmers on how to do this.

Information is replacing materials. Matter does not matter much anymore. Here are a few examples. When I was a teenager, we had aluminum soda cans, and it was a big deal for a real macho guy (I was not one of them) to take his aluminum can and with one hand crush it. Some of the more macho people would put it against their forehead and go like that. I couldn't do it, I tried, but I just got a hurt forehead. Well you all know that now a two year old could do that. Do you know why? Because they figured out how to get a thousand cans out of 35 pounds of aluminum versus a thousand cans out of 164 pounds of aluminum thirty years ago.

Information is replacing materials. Matter doesn't matter much anymore. In the phone company, they used to have five tons of phone books for ninety million names. Now they have one CD-rom, which costs under a hundred dollars to produce, with those ninety million names on it. They used to produce with a thousand pounds of copper an amount of wire that would carry a certain amount of messages. Now they can carry one thousand times the messages with fiber optics produced from twenty-five pounds of sand. Information is replacing materials. That is another reason Malthus was wrong.

There are those who say we are going to have a collapse. In fact, if I wanted to make easy money and I did not have any scruples, I would write a book titled, "The Coming Collapse: Bankruptcy 1995," although I would have to change the title to a later date. I would talk about all these collapses we are going to see, because people love to read that stuff. Well, the news is that it is good news, not bad news. It just is not going to happen.

My talk is titled, "Government: Don't Just Stand There, Undo Something." Here is why. Because all these things are happening because we have pared down government. Look around the world. We have had privatization, with Maggie Thatcher privatizing the telephone company and public housing, two million units of public housing sold. We have had Mexico privatizing the banks after they previously nationalized them. We have had privatization in Chile starting from the mid-1970's to now. Taking things out of the hands of government, putting them into the hands of individuals. Why is that so good? Because when government owns it, it is as if no one owns it. No one has the incentive to take

care of it, whereas if you own it, you have incentive to take care of it. It is yours. So privatization is part of why this boom has happened. Also around the world in the late seventies until now, tax rates have fallen. Governments around the world have slashed tax rates. Again, Maggie Thatcher and Ronald Reagan started it, but other countries had to keep up in order to not lose capital, in order to not lose their highest skilled labor. That is a big part of why this boom has happened.

Let me point to a few cases where government is in the way and if they got more out of the way things would be a lot better. First, consider health care. If a drug company in the United States wants to introduce a drug, it cannot just introduce it. It must get the Food and Drug Administration to approve it. What does it have to do to get the approval? It has to do two things. It has to show safety, and it has to show efficacy. It has to show that it is safe and that it works. You know what it typically costs to do all of the tests to show this? Over \$250 million per drug. And it typically takes eight to twelve years to go through this process. You might say, "Wait a minute, that makes sense. Why not have the government do that? They have the expertise." Well, they have some of the expertise. But consider this, suppose you have AIDS and you are near the end. Do you really care if the drug is going to cause some side effect twenty years down the road? What if you have cancer and you are near the end, do you really care whether the drug is going to have that side effect down the road? The government might have some people who are experts on that drug, but they are not expert on you. They are not expert on your tolerance for risk. You know what you are willing to risk.

There is a very simple solution that would dramatically increase the rate of production and introduction of new drugs. If the FDA wants to certify a drug, let them certify it. However, if they want to say this drug is not certified, then they could require the drug company to put on the box in big letters the FDA has not certified this drug. You know what would happen. We would start to see private certification agencies that would certify drugs, and they would do it faster than the government. Look at the electrical equipment in this auditorium, and look at what it says on virtually on all of the electrical equipment. There are two letters, UL. What's it stand for? Underwriters Laboratory. Government agency? No. This is a certification agency. We have this type of certification already with other things; I am saying we should have it with drugs.

Let me talk about another area. This is where the government should stand there and do nothing. Yet the government is about to do something. I am talking about encryption. I will start by talking about something else that does not even sound like encryption. Suppose someone invents a really neat lock, a lock that you can put on your door. You live in a high crime area, and the lock is a fairly low price. Do you think you might want to buy the lock? This sounds like a reasonable thing to do, so you go out and buy the lock. Do you think you should have to give the government the key so that they can get into your house whenever they want? Well, it is the same with encryption. There are now encryption technologies that people can use that are so effective that no one can break it. But guess what President Clinton wants; he wants the key. He wants you to have to register with him and tell the government how it can break in and get into your house when it needs to. This is an area that President Clinton and Vice-President Gore have been talking about recently, in which the government should just stand there.

Let me talk about another area in which the government should undo something. I talked about the Soviet Union, and I said that information is what brought down the Soviet Union. Well, we are doing just the opposite with Cuba. We have had an embargo against Cuba since the early 1960's, and what does that do? It means Cubans are not getting access as much to American culture and American things. And it is the awareness of those things that would make them want to bring Castro down. Our policy really is to try to squeeze Cubans whom Castro has impoverished; to squeeze them so hard that they will rise up and overthrow him. Besides being profoundly immoral, it does not work. The latest step we have taken on that is the Helms-Burton Law. The Helms-Burton Law says that anyone, anywhere in the world, who trades with Cuba, trading an expropriated property, will not be admitted into the United States. And right now they are using it against some Mexican and Canadian executives with mining companies in Canada who trade with Castro. They are not being allowed into the United States, and neither are their spouses or their children. Think about why we object to Castro; why do we object to a totalitarian government? What distinguishes a totalitarian government from a free government? One distinguishing feature is that people are responsible for their own actions in a free society. A totalitarian society often makes other family members responsible for what particular family members do. That is what distinguished Nazi Germany and the Soviet Union for

example. If your brother was involved in something, the Nazis would come after you. So in the name of defeating totalitarianism, the U.S. government is adopting its techniques. The purpose is to defeat Castro, but Helms-Burton with that law has let Castro defeat them and us.

I would say three quarters of the people in this room are looking ahead to what you are going to do with your lives. What are you going to do once you leave college? I heard some people talking about it before the program, and I want to give some thoughts based on what I have said about where the economy is going. If you are thinking about trying some venture, some entrepreneurial activity, trying to grow your own business, remember this. If you take the risk now, you are taking it when there is the least to lose. It gets only harder once you get married and have kids. That does not mean you should not have three parachutes when you jump off the cliff, but it is still worthwhile to take the risk now when the cliff is not that high. I think there are going to be only mild recessions in the next twenty-five years, and it is a lot safer now. I run into students who say, "I don't know what I am going to do, so I am going to go to law school." Or, "I don't know what I am going to do, so I am going to go to graduate school." I do not think this is a good idea, because then you get doing what you did not want to do and turn around at age twenty-six and want to have a family and you are kind of stuck. I also run into people who say, "I got my degree at a good college. I have paid my dues. The world should open the doors for me." Well, guess what. It is not that you have not paid your dues, but it is not about dues paying. As Adam Smith recognized two hundred years ago, it is about figuring out what you do well that other people are willing to pay for. Both of these things are important; you do something well and other people are willing to pay for it. Hopefully, not a lot of other people do this well or you will have a lot of competition. I am not saying that this is obvious when you are twenty-one. But if you are spending time, spend your time thinking about what is your thing rather than spending your time doing something else you do not want to do. Everything that I just said is important: things you do well, other people are willing to pay for, and that there are not many people who do that well. Let me give a counter example. Let us say you are the best person on the assembly line at turning a bolt hanging upside down whistling "Dixie." You are not suddenly going to get paid a higher wage for that skill, because people are not willing to pay for you whistling "Dixie." On the other hand, you can take it

on the road and maybe you would make money that way.

I want to tell you how this affected my own thinking about my career. I used to be tempted when watching TV by these infomercials touting no money down, how to buy houses and make all kinds of money. You know, "I have \$662,999.00, and I started nine months ago." I used to be tempted, but fortunately I never acted on it. But I was reading an article in Fortune magazine in 1987 entitled, "The Working Rich." What they meant by the working rich was people making \$250,000.00 or more per year in 1987 dollars that did not inherit it. I think most of us would agree that is doing pretty well. I noticed something that all seven of those people profiled had in common. They all had in common that none of them had set out to be rich, but all of them had gotten good at something they really liked doing and had gotten better and better at it. And when I read that at age 36, this gong went off in my head, and I was never again tempted to try and get rich quick. I settled for getting rich slow. And it made me think, "Okay, what do I do well? I write well." So I started focusing on writing better and getting higher and higher paying publishers, and I am in that process right now. I will get back to you in a few years.

You are a bunch of students, and I usually like to leave my students with an assignment. So here is my assignment. The way we can mess this up, the way we can mess up this twenty-five year boom, is by having government take over, by having government eat away at the edges with higher tax rates, with enforcing these restrictions on encryption and so on. So my assignment is for you to write a letter to your senators and your congressperson saying, "Please tell President Clinton to back off. Please tell President Clinton that he is going to destroy this incredible boom that we have going." He is not going to destroy it, but he is going to hurt it to the extent that he hampers our encryption technology. I know I am a little under budget, but I am done. Thank you.