A Closer Look At Businesses Part I

By L. Carlos Lara

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According To The Kauffman Index of Startup Activity1 the share of new entrepreneurs who started businesses to pursue opportunity rather than from necessity is now up more than 12 percentage points higher than in 2009 at the height of the Great Recession. This of course is a very encouraging nationwide trend and I extend my admiration to all those individuals who have ventured out into an endeavor where only about half survives the first five years in operation. Obviously, by any measure, these are certainly not great odds so I also applaud their courage and their desire to start their very own enterprise.

It’s difficult to know exactly why half of these new business startups will eventually not make it and will be forced out of business before their fifth anniversary, if not sooner. What could it be? We will explore some of those reasons in this article. Yet even when I look back at the history of my own business, I am not sure that I can pinpoint exactly what has made the difference in my company’s longevity. All I know is that my business today looks nothing like the business I started 42 years ago, but then again neither does the economy of 2018 resemble the economy of 1976. I suspect that similar and brand new economic challenges await this new group of budding entrepreneurs.

Going into business is an intimidating big step for anybody and if you are considering it for yourself this article may actually be helpful in drawing your attention to some of the more indispensable elements of a business enterprise. My intention for this first part of my summary is to merely present an overview of some of the more core components of going into business for oneself, the things you often hear about, but perhaps just pass over entirely too quickly without giving them enough serious thought. Who knows, one or two points expressed in a particular way in this article could potentially make the vital difference in your success, or even perhaps dissuade you from going through with the venture altogether.

What I will be pointing out are the important basics of a business combined with some significant historical facts in order to provide a frame of reference.
One such example would be simply answering the question: “What is a business?” With a 50% failure rate by the fifth year I am not going to take it for granted that all those going into business for the very first time know exactly what they are getting into.

WHAT IS A BUSINESS?

Untold manuscripts in book form and otherwise have been written on this particular subject so there are countless ways to define a business. But certainly one main important component of a business is that it is an economic activity involving a continuous production and distribution of goods or services for the express purpose of satisfying human wants. The main objective of these pursuits is a monetary reward, commonly known as a profit.

For all these undertakings to occur as described a business must have enough satisfied customers buying its products and services on a continuous and consistent basis, otherwise the business has no reason for being and its lifespan will be short lived. Consequently, another central feature of a business is that they are inherently predisposed to many different kinds of risks and uncertainties that will endanger the life of the business beginning very soon after it is born. To counteract these life-threatening obstacles a business must have a sound business plan from the very start to carry it forward as a profitable going concern.

While hundreds of thousands of businesses fail each year it’s noteworthy that the oldest and still operating non-farm business in the United States is 395 years old! This is the Avedis Zildjian Company, a cymbal and drumsticks manufacturer based in Norwell, Massachusetts.

The Seaside Inn in Kennebunkport, Maine is another business that has been in continuous operation under the same family since 1667. Before the arrival of motorized vehicles, inns such as this one not only provided lodging for travelers, but they also provided an assortment of other goods and services like food, drinks, and even accommodations for horses.

While these are only two examples of the oldest businesses in the United States there is actually a list of 80 to 100 such companies engaged in commercial, industrial, and professional activities that were established over 200 years ago and yet are still in operation to this day. All to say that a business, despite the many headwinds it faces just to keep itself alive, has the potential to grow and prosper for a very long time into the future.

Of course behind and at the helm of these businesses are individuals. A founder of a business is an individual that is often referred to as an entrepreneur and it is he or she who first conceives of the business concept (the idea), gives the business its name, and establishes its primary business strategy. Business founders (entrepreneurs) are also known as businessmen or businesswomen. At the same time they can also be referred to as capitalists because their businesses own their capital and are capable of producing goods and services, which they sell, trade, or convey to others. Capitalists, by the very nature of their economic activities, must constantly compete with other capitalists for the purchasing power of the consumer who is the ultimate source of the sought after profit. The primary means for getting the attention of the consumer is through marketing.

COMPETITION AND BUSINESS

Like it or not, competition is also an essential component of businesses. Every consumer market gives rise to many businesses seeking to serve it. Additionally, the demand for a certain product or service can be here today and gone tomorrow because the wants and the needs of consumers are constantly changing. This in turn gives rise to newer forms of businesses eager to fulfill the new demand and that adds to the existing competition within the same consumer market. For this reason, how a product or service is to be marketed to consumers is vitally important to the welfare of the newly formed business and why it is part of the overall business plan at conception.

Even though a business plan is laid out at the outset, marketing problems do develop quite quickly in the

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life of a new business when competition from other similar businesses and new start-ups enter the field and begin to run away with revenue. Depending on the type of business and its market share this can lead to marketing wars as businesses ramp up their advertising in an effort to lure back the consumer. This is why entrepreneurs must fully understand the buying habits of their customer and they must know how to market to them as their desires change over the course of time.

Mises, the great defender of capitalism and entrepreneurship, has a poignant observation about businessmen stating that “...as a rule capitalists and entrepreneurs are not saints excelling in the virtues of self denial,” which in a sense implies that competition among businesses in trying to woo consumers can become fierce (cutthroat) at times often pushing the “self-interest” envelope into the area of selfishness. Who among us has not witnessed that form of human behavior in action to know exactly what Mises meant? In fact those who oppose the market system that capitalists operate in often say that it pits men against one another in a quest for material gain and draws from them baser human motives, such as greed.

Unfortunately, this incorrect view of business competition by those who oppose the free enterprise system has been one of the main drivers of government intervention in the market economy, which has spawned all kinds of regulatory measures that result in hindrances to the economic activity of businesses. These advocates claim that without government regulation in the marketplace, businesses will take advantage of the consumer by forcing them to buy inferior products and services while charging them whatever the market will bear. In reality this is far from the truth, yet government intrusion in the markets is continually on the rise and it is a force that the new entrepreneurs will have to contend with in their quest to survive as a business.

It’s also very important for entrepreneurs to realize that in any market economy, unhampered by government or not, the consumer always has the upper hand in the buying and selling negotiation. Businesses should know this without a shadow of a doubt. The consumer, by their buying or not buying, determines the future of any business. There is a reason for the age-old adage that says, “the customer is always right.” In effect, the customers are the real bosses in the market economy and by their buying habits force businesses to obey their orders.

The point being that in order to be profitable businesses must never lose sight of their customer’s wishes and manage their affairs in such a way that will satisfy them. These few business traits that I have mentioned thus far are some of the more intrinsic, but there is still a lot more to consider in growing a business. In addition to having to anticipate the needs of the fickle consumer, constantly competing with other businesses in the marketplace, and dealing with excessive government regulations, there is still business taxation and financing that must be dealt with. These last two in particular also pose significant problems for a young business startup, as we shall see.

**BUSINESS STRUCTURES**

If you are going to start a business you must understand up front that “Uncle Sam” is going to be your partner in the venture. This is why businesses are sometimes referred to as taxing entities and when entrepreneurs start out they have different accounting structures to choose from for the new enterprise. The main U.S. business structures as of 2018 are the Sole Proprietorship, Partnerships, S-Corporations, C-Corporations, and the Limited Liability Company (LLC). The Limited Liability Company (LLC) and the similar PLLC (which is specially designed for professional services) are the newest business structures that only became available in all states in 1996.

Selecting the appropriate business structure for a new enterprise is a very important decision with two main considerations—the tax rate and the creditor liability exposure. Most newly formed businesses pay the most attention to the taxing rate aspect of the business structure and not enough attention to
the creditor liability exposure. This is evident in
the latest SBA national statistics (2016), which
show that 86.4% of small businesses are sole
proprietorships, or as the name implies, a business
owned and operated by a single natural person. In
a sole proprietorship the tax passes directly to the
individual at the individual’s tax rate, but there
is no legal separation between the individual and
the liabilities of the business. Consequently, a
lawsuit from an angry creditor of the business can
potentially shut down the entire company and seize
the individual’s personal assets. This may be one
explanation for the high mortality rate of so many
business startups since the majority of them are
sole-proprietorships, hence immensely vulnerable.

A partnership is a business relationship between two
or more individuals who come together to operate a
business. Each partner contributes assets (or startup
capital) and share in the profits and losses of the
business, which are recorded on each partner’s
individual tax returns. Partnerships are also tax flow-
through business entities.

Incorporating a business releases its owners from
financial responsibility of business obligations.
Depending on the nature of the business this
may ultimately be the most important factor in
deciding what business structure to use. But tax
considerations require extra scrutiny when selecting
either an S-Corporation or a C-Corporation. Once
again, the nature of the business or the business’s
primary strategy may be the deciding factor on
which business structure to select.

For example, businesses that have intentions on
selling shares of stock as part of their business plan
will generally select a C- corporation. This is why
you find that most large businesses, which engage
heavily in selling stock shares, are C-corporations.

The popularity of the LLC in recent years came
about from the fact that this business structure
combines the pass-through taxation benefits of a
sole-proprietorship or a partnership with the limited-
liability benefits of a corporation. In effect the LLC
is a hybrid business structure.

Nevertheless, individuals considering a startup
should investigate all aspects of each of these
business structures in consultations with
professionals that can properly weigh the selection of
the business structure in relationship to the primary
strategy of the business. Some startups will grow
into very large complex companies very quickly and
changing business structures in midstream can be
difficult and expensive, so it pays to start off on the
right foot from the beginning.

**BUSINESS SIZE AND OTHER IMPORTANT DEMOGRAPHICS**

We come now to one of the most fascinating aspects
of businesses and that is the matter of business
**size.** It’s important because it provides perspective.
When we think of a startup we naturally think in
terms of a very small business consisting of one
or a few people. After all, it’s a startup. But we are
taken aback when we first learn that there are 28.8
million businesses in the United States of which 23
million of them are owned and operated by only one
individual with **no** employees. These are the statistics
put out by the Office of Advocacy of the SBA as of
June 2016. In fact, this government agency goes on
to define a small business as any business with less
than 500 employees, but at least one. This represents
5.8 million small businesses.

According to the SBA numbers there were only
large businesses with more than 500 employees.
The United States Census Bureau also provides
statistics that vary slightly from those of the SBA,
but not by much. They actually go further and
breakdown the number of employees of these 18,600
larger companies and show that there are only 981
businesses in the United States that have 10,000
employees or more. Other sources list Walmart as
the largest employer in the US with 2.3 million
employees followed by Amazon with 566,000.
Even so, out of the total 118 million employees
currently working in the US, 57 million (or 48%)
are employed by small private businesses. This is an
impressive number we should not forget.

One of the saddest statistics is the one that shows
that startups by the millennial age group (individuals age 15-34) have been steadily declining since 1990. In other words entrepreneurship is lower among millennials than among prior generations with predictions that it will remain relatively low for decades into the future, according to a recent U.S. Small Business Administration Advocacy Research. In effect millennial entrepreneurs are prominently missing and they represent a population size greater than baby boomers. The trend is sad because new businesses are the creators of both jobs and innovation (new ideas), which translates into economic growth for the nation. Although entrepreneurship has been rare among millennials nevertheless some, like Mark Zuckerburg, have achieved recent remarkable success. For others, success may be just around the corner and that may help change future attitudes.

CONCLUSION

Small businesses are the core of the U.S. economy, yet in examining what entrepreneurs must go through in order bring their business ideas to fruition it’s a wonder the mortality rate is not higher than it is. The task is daunting and filled with all manner of risks and uncertainties.

This article, by merely exposing some of a business’s fundamental elements, introduces non-business owners or those possibly considering starting up a business to a brief summary of some of the key areas and pressure points that can spell success or failure for a brand new business startup.

Besides the management skills and talent required to guide a business from inception to maturity, there is a maze of legal structures and government bureaucracy that can make success nearly impossible. Federal policy, especially when it fails to consider the smallness of initial startups, can easily overburden small businesses with so much excessive regulation that just the mere cost of compliance harms the viability of small businesses before they have a chance to get off the ground. This of course can have a negative influence on the attractiveness of starting a new business for others that are possibly considering it. Next month in Part II of this article we will examine Financing. Financing is essential for business survival and growth and in this next section we will examine all of the financing options available to businesses as well as creative alternatives that will make this story have a happier ending, plus encourage many of you, our readers, to launch out and become entrepreneurs—champions of the free enterprise system.

References

Want to Improve the World?

First Improve Yourself It sounds insignificant, but don’t underestimate the power that self-improvement can bring.

By Tyler Brandt

The world is an imperfect place, full of suffering and tragedy. The humanitarian in each of us longs to change the world. For example, maybe you would like to alleviate crippling poverty, disease, or mental illness. Maybe you wish people would stop killing each other, be it by homicide, war, or even genocide. Maybe you wish every human being could have a roof over her head, a stable income, and something decent to eat.

But doubts may creep in. Who are you to make these things happen? Isn’t it true that you are just a small pawn in an intricate game, subject to the arbitrary power of ruthless politicians and corrupt capitalists? Maybe the only way to make a change is through the political process: by supporting some political savior (like Alexandria-Ocasio Cortez or Donald Trump) or by becoming one yourself. Or maybe you become deeply nihilistic, give up all hope of changing anything, and distract yourself from the awful tragedy of the world by pursuing a life of shallow pleasures. After all, you are just one individual in the face of billions of others.

The question becomes: what are you to do in this imperfect world?

Maybe what you need is a change in perspective.

First Change Yourself

Before you can get to the level of solving such gargantuan, globe-spanning problems, you must first change yourself. It sounds insignificant, but don’t underestimate the power that self-improvement can bring.

Ask yourself what things you can do today to make the world a better place. What bad habits are you clinging to? What behaviors do you wish to change? Are you following a path that brings you fulfillment? Are you taking adequate time to recognize the importance of the others around you? Could your room use a little cleaning? Could the rest of your home use some work, too?

This is the central message of Jordan B. Peterson, a psychologist whose perspective has taken the world of public discourse by storm and has transformed the lives of many.

When many consider the flawed nature of existence, they think that change must happen at the highest level possible. Perhaps they wish for sweeping global legislation regarding climate change or poverty alleviation. Perhaps they blame politicians for the world’s woes and seek to elect “better” politicians or wish to overturn the entire system.

While the motivation is understandable, not only is it difficult to design perfect systems, it is also near impossible to actually implement them.

As Peterson says:

You want to be very careful about doing large-scale experimentation with large-scale systems because the probability that if you implement a scheme in a large-scale social system that the scheme will have the result you intended is negligible. What will happen will be something that you don’t intend and, even worse, something that works at counter-purposes to your original intent.

If we accept this premise, what can we do if we still want to achieve good in the world? To that, Peterson says:

You try not to step outside the boundaries of your competence and you start small and you start with the things that you actually could adjust, that you actually do understand, that you actually could fix.

You should restrict your attempts to fix things to what’s at hand. So there’s probably things about you that you could fix, things that you know that aren’t right.

After starting small and realizing how difficult it is to even change things at the individual level, we might develop some humility and rescind our grandiose plans for the world. As Peterson says:
It's hard to put yourself together, it’s really hard to put your family together, why the hell do you think you can put the world together? Because obviously the world is more complicated than you and your family. So if you’re stymied in your attempts even to set your own house in order, which of course you are, then you would think that what that would do would be to make you very very leery about announcing your broadscale plans for social revolution.

As soon as you start improving, others around will take notice. Hopefully, your growth inspires people in your immediate sphere to grow alongside you. But, if some want to bring you down out of jealousy, don’t let that distract you. All you can do is offer a shining example for those ready to follow it.

If every individual would dedicate themselves towards first bettering their own corner of the world—the part where they have the most interest and the best incentives—imagine how much better the whole world would be.

This Is What FEE Is Here For

So, if you’re up to the task, I ask that you consider joining FEE on a journey of self-improvement. I was once an existential-angst-ridden nihilist with no hope for the world. I started reading FEE articles and gained a more hopeful perspective on the world and a more responsible and engaged attitude toward my own life and career. I attended my first FEEcon three years ago at the age of 20, and my life has been on a better path ever since.

For this year’s FEEcon, our theme is “Set Your Path, Change The World.” I can promise you, you will do yourself a whole lot of good by attending. We will inspire you to change your immediate sphere for the better and help you realize how much good can come from those small actions. It starts with the individual; never underestimate the power of that.

I hope to see you at FEEcon 2019. If you wish to discuss bettering yourself and figuring out your life’s path, don’t hesitate to find me and talk with me. I’ll conclude with a short and sweet Peterson quote:

The proper way to fix the world isn’t to fix the world; there’s no reason to assume that you’re even up to such a task, but you can fix yourself. You’ll do no one any harm by doing so. And in that manner, at least, you will make the world a better place.

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No, You Don’t Need A $200K College Degree

By Ryan McMaken

A female supporter of Bernie Sanders is advertising on Twitter the fact that she went 226,000 in debt to get a college degree in speech pathology. Those who posted the video apparently believe that this ought to be interpreted as a convincing example of how hard it is to pay for college these days.

There is no doubt that a college education is not free. But publicly admitting that one owes nearly a quarter of a million dollars for (apparently) just a four year degree will hardly be convincing for anyone familiar with the actual cost of attaining a college degree.

After all, according to the US Department of Education, "annual current dollar prices for undergraduate tuition, fees, room, and board were estimated to be $16,757 at public institutions."

That's an annual amount. So, rounding up to $17,000 and multiplying by four, we get $68,000. This, mind you, includes tuition, fees, room, and board. It's an all inclusive package. So, assuming a student does virtually no outside wage work at all during his or her college career, the student would still get fed, and still have a place to live, while attending school full time.

But, let's say that this amount is low for many areas. Let's look at a higher-cost region of the country.
Indeed, the private school option appears to be the only way one might end up with $226,000 in student loans. Either that, or a student transfers around to various schools, starting from scratch each time.

But why should those people be taken seriously when they complain about their tuition and debt? People who attend private school already have countless tax-subsidized options available to them. Instead, they choose to attend a private school, and want the taxpayers to subsidize their debt instead. (Most private schools are also subsidized with a variety of grants, but that's another issue.) And then we're supposed to feel sorry for them when they end up with a lot of debt.

This is especially unconvincing when we consider that the data on college degrees and earnings shows that where one attains a degree has little effect on earnings. In other words, the extra expense incurred to attend Picturesque University in some charming Midwest town does nothing to actually increase earning potential.

The educational benefits of taking on these additional costs, however, are negligible.

Meanwhile, of course, more responsible consumers attend what the Europeans call a "polytechnic" where students attend to get degrees and quickly and painlessly as possible. The publicly subsidized versions of these schools exist to allow students with real responsibilities to get degrees and get on with their lives at a manageable cost. In other words, taxpayers are already paying for the college educations of students at public universities. They don't need to be lectured on how they ought to pay even more so little Johnny or little Susie can also get a designer education at a private school as well.

There are real reasons to be concerned about the cost of higher education. Student loans have actually been a significant part of the problem by making students less price sensitive, thus pushing up prices for everyone.

It might also be helpful to weigh the costs and benefits of cost-saving measures used by Europeans,
such as larger class sizes, longer wait times, and fewer amenities at colleges.

But it's not at all convincing when we're told that we ought to be subsidizing higher education even more for those students who choose to spend far and above what the average cost of what is an already-subsidized higher education.

How Government-Guaranteed Student Loans Killed the American Dream for Millions

When government-guaranteed checks keep rolling in, there’s no incentive for colleges and universities to lower their prices. In fact, they do the opposite.

By Daniel Kowalski

(Comment by R. Nelson Nash ) This problem began many years before the advent of student loans. It began with the GI Bill after WWII. Millions of GI’s were getting off active duty. The Socialist thinkers who dominated our government said, “Oh, this is going to ruin our economy. We need to give them something to do so that it won’t be such a shock to the economy. Something to let them meld into civilian jobs over several years. So, let’s send them to college. That will do the job — and we will be increasing the intellectual capital of our nation at the same time. Two worthy goals accomplished with one action!”

What were the real results of this Socialist action? Colleges became “diploma mills” and tuition and administrative expenses have become ridiculous and debs have become unbearable. And we now have college graduates that can’t even read their diplomas!

When I was in college there were more GI’s in college than any other time (1948 - 1952). GI’s had no college costs. They had a stipend to live on. It wasn’t something which on which they could enjoy a lavish lifestyle. They even had automobiles. Peasants like myself had bicycles or walked.

I paid my own way through college with two part-time jobs plus ROTC — not the ROTC scholarships that exist now — It was very limited.

This GI Bill idea morphed into the unbelievable mess that exists with academia today and the belief that “everyone needs a college education.” Do yourself a favor and find articles on this subject written by Walter E. Williams and Tom DiLorenzo.

Perhaps, even worse, is the Socialist propaganda that has been firmly planted in the “heads full of mush” that predominates today. How can they get that nonsense out of their brains? Read — or listen to — what Jordan Peterson has to offer on this subject.

In Basic Economics, Thomas Sowell wrote that prices are what tie together the vast network of economic activity among people who are too vastly scattered to know each other. Prices are the regulators of the free market. An object’s value in the free market is not how much it costs to produce, but rather how much a consumer is willing to pay for it.

Loans are a crucial component of the free market because they allow consumers to borrow large sums of money they normally would not have access to, which are later paid back in installments with interest. If the borrower fails to pay back the loan, the lender can repossess the physical item the loan purchased, such as a house or car.

Student loans are different. Education is abstract; if they’re not paid back, then there is little recourse for the lender. There is no physical object that can be seized. Student loans did not exist in their present form until the federal government passed the Higher Education Act of 1965, which had taxpayers guaranteeing loans made by private lenders to students. While the program might have had good intentions, it has had unforeseen harmful consequences.

The Problem with Government-Backed Student Loans

Millennials are the most educated generation in American history, but many college graduates have tens of thousands of dollars in debt to go along with their diplomas.
Young Americans had it drilled into their heads during high school (if not earlier) that their best shot—perhaps their only shot—at achieving success in life was to have a college diploma.

This fueled demand for the higher education business, where existing universities and colleges expanded their academic programs in the arts and humanities to suit students not interested in math and sciences, and it also led to many private universities popping up to meet the demands of students who either could not afford the tuition or could not meet the admission criteria of the existing colleges. In 1980, there were 3,231 higher education institutions in the United States. By 2016, that number increased by more than one-third to 4,360.

Secured financing of student loans resulted in a surge of students applying for college. This increase in demand was, in turn, met with an increase in price because university administrators would charge more if people were willing to pay it, just as any other business would (though to be fair, student loans do require more administration staff for processing). According to Forbes, the average price of tuition has increased eight times faster than wages since the 1980s. In 2018, the Federal Reserve estimated that there is currently $1.5 trillion in unpaid student debt. The Institute for College Access and Success estimates that in 2017, 65 percent of recent bachelor’s degree graduates have student loans, and the average is $28,650 per borrower.

The government’s backing of student loans has caused the price of higher education to artificially rise; the demand would not be so high if college were not a financially viable option for some. Young people have been led to believe that a diploma is the ticket to the American dream, but that’s not the case for many Americans.

Financially, it makes no sense to take out a $165,000 loan for a master’s degree that leads to a job where the average annual salary is $38,000—yet thousands of young people are making this choice. Only when they graduate do they understand the reality of their situation as they live paycheck-to-paycheck and find it next-to-impossible to save for a home, retirement, or even a rainy-day fund.

Nor can student loans be discharged by filing for bankruptcy. Prior to 1976, student loans were treated like any other kind of debt with regard to bankruptcy laws, but as defaults increased, the federal government changed the laws. So student debt will hang above the borrower’s head until the debt is repaid.

**How to Fix the Problem**

There are two key steps to addressing the student loan crisis. First, there needs to be a major cultural shift away from the belief that college is a one-size-fits-all requirement for success. We are beginning to see this as many young Americans start to realize they can attend a trade school for a fraction of what it would cost for a four-year college and that they can get in-demand jobs with high salaries.

Second, parents and school systems should stress economic literacy so that young people better understand the concepts of resources, scarcity, and prices. We also need to teach our youth about personal finances, interest, and budgeting so they understand that borrowing a large amount of money that only generates a small level of income is not a sound investment.

Finally, the current system of student loan financing needs to be reformed. Schools should not be given a blank check, and the government-guaranteed loans should only cover a partial amount of tuition. Schools should also be responsible for directly lending a portion of student loans so that it’s in their financial interest to make sure graduates enter the job market with the skills and requirements needed to get a well-paying job. If a student fails to pay back their loan, then the college or university should also share in the taxpayer’s loss. Only when the demand for higher education decreases will we witness a decrease in its cost.

Daniel Kowalski is an American businessman with interests in the USA and developing markets of Africa.
Why Bastiat Deserves to Be in the Pantheon of Great Economic Theorists

His work should be more widely known; it deserves much greater professional respect.

By Donald J. Boudreaux

Frédéric Bastiat (1801-50) is known today among economists—if he is known at all—as at best a brilliant polemicist. An economic theorist he most certainly was not—such is the common opinion.

I believe this common opinion to be mistaken. To explain why first requires a discussion of the nature of a theory.

A Theory Is a Story

As I tell students in my Principles of Microeconomics courses, a theory is a story that assists us in making better sense of reality. And a theorist is a storyteller who offers this assistance.

Stories, of course, differ in their believability. A story that explains, say, the Industrial Revolution as being the result of new knowledge imparted to us by aliens from another galaxy is completely unbelievable. Some other, more believable story is called for—one, say, that features a change in people’s attitudes toward commerce and innovation.

But for a story to deserve to be called a theory requires that it also be generalizable.

In economics, supply-and-demand analysis is a general account of how prices are formed and change. It’s not a story about the formation of the price of only one item, such as bread. It’s an outline for telling believable stories about the formation of all prices—from the prices of toy planes to those of jumbo jetliners, from the wages earned by motel maids to those earned by Tom Hanks. A story that explains the price only of bread is not a proper theory of prices, even if it is highly believable.

To be generalizable, a story whose creator wishes it to be regarded as a serious theory must make that story abstract. Being abstract, however, makes the story—standing alone—barren. As such, it engenders no understanding of the physical or social world. But it proves itself to be a good theory if, when relevant details of reality are added to it, those of us who encounter this story go, “Aha! Now I understand reality better than I did before!”

The core purpose of all theories is the creation of improved understanding. A theory that does not cause those who hear or read it to go, “Aha!” is worthless.

Bastiat the Theorist

And so we return to Bastiat. He’s one of history’s most brilliant tellers of economic stories. This fact, I’m convinced, justifies calling Bastiat a great economic theorist.

Consider Bastiat’s famous 1843 “Petition of the Manufacturers of Candles.” In this short essay, Bastiat radiantly conveyed economists’ understanding that artificially contrived scarcities make the general population worse off even if they increase the wealth of a small handful of individuals. Who other than the most benighted protectionist can read Bastiat’s satirical portrayal of sunlight as an unfairly low-priced import and not go, “Aha! Of course inexpensive imports that ‘flood’ into a country no more impoverish that country than does the light sent to us free by the sun!”

Another example is Bastiat’s even-shorter essay “A Negative Railway.” Here Bastiat revealed the flaw in the argument of a gentleman who insisted that if a railroad connecting Paris to Bayonne were forced to have a stop at Bordeaux, the wealth of the French people would be enhanced. The hapless target of Bastiat’s brilliance based his conclusion on the correct observation that forcing trains to stop at Bordeaux would increase the incomes of porters, restaurateurs, and some other people in Bordeaux.

Yet Bastiat didn’t settle for drily noting that, after paying these higher incomes, railways and their passengers would have less money to spend on goods and services offered by suppliers in locations...
other than Bordeaux. Instead, Bastiat followed the proposal’s logic in a way uniquely revealing: If forcing trains to stop at Bordeaux will increase the total wealth of the people of France, so too will the total wealth of the people of France be increased if trains are obliged to stop also at Angoulême. And if also at Angoulême, then the French will be enriched even further if a third stop is required at Poitiers. And if at Poitiers, then at each and every location between Paris and Bayonne.

Bastiat revealed the proposal to be flawed by showing that, if its logic were sound, the railway that would do the most good for the French people is one that is nothing but a series of stops—a negative railway!

A final example of Bastiat’s brilliance is his illustration, in his 1850 paper “What Is Seen and What Is Not Seen,” of the nature of protectionism—protectionism as personified by a fictional French ironmonger, Mr. Prohibant. Mr. Prohibant feels abused by his fellow citizens who purchase iron from his Belgian competitors.

“I will take my rifle,” he [Mr. Prohibant] said to himself, “I will put four pistols in my belt, I will fill my cartridge pouch, I will buckle on my sword and, thus equipped, I will go to the border. There, I will kill the first blacksmith, nail-maker, farrier, mechanic or locksmith who comes to do business with them and not with me. That will teach him how to conduct himself properly.”

When he was about to leave, Mr. Prohibant had second thoughts, which mellowed his bellicose ardor somewhat. He said to himself:

“First of all, it is not totally out of the question that my fellow-citizens and enemies, the purchasers of iron, will take this action badly, and instead of letting themselves be killed they will kill me first. Next, even if I marshal all my servants, we cannot guard all the border posts. Finally, this action will cost me a great deal, more than the result is worth.”

Mr. Prohibant was about to resign himself sadly to being merely as free as anyone else when a flash of inspiration shone in his brain.

He remembered that in Paris there was a great law factory. “What is a law?” he asked himself. “It is a measure to which everyone is required to comply once it has been decreed, whether it is good or bad.”

Bastiat explains that Mr. Prohibant then went to Paris to lobby the state to inflict violence upon all French blacksmiths, nail makers, farriers, mechanics, and locksmiths who insist on buying iron from Belgium. In this brilliant example, Bastiat—with his signature sense of humor—revealed the true essence of protectionism.

**Applied Theorists Are Theorists Too**

Some people will object to my calling Bastiat an economic theorist. They’ll point out that he did not devise any theories that are new—that the truths that Bastiat so clearly revealed were already known to professional economists.

Let’s grant here that Bastiat invented no original theories. (This concession is likely contrary to fact. David Hart of Liberty Fund and, separately, GMU econ student Jon Murphy are each working on projects that will show that Bastiat did indeed have original theoretical insights.) Even if Bastiat has to his credit no original theories, we economists have long, and rightly, celebrated the work of those whom we call applied theorists.

Applied theorists apply existing abstract theories to real-world situations. In doing so, these theorists enhance our understanding of reality. The stories they tell cause us to go, “Aha!”

I submit that Bastiat ranks, at the very least, among the greatest of all applied economic theorists. His work should be more widely known; it deserves much greater professional respect.

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**Garet Garrett: The Journalist Who Predicted Americans Would Sacrifice Liberty to a Government Leviathan**

"Unless people can reconquer government its bigness will swallow them up."

By Gary M. Galles

February 19 marks the birth of a great American individualist, called “one of the most eloquent defenders of freedom in America”—Garet Garrett, who offered what Jeffrey Tucker called “a sparkling vision of peace under free markets.”

Of particular relevance is *The People’s Pottage*, of which Ludwig von Mises wrote, “His keen penetration and his forceful, direct language are…unsurpassed by an author.” Written during an earlier episode of metastasizing government, they still apply today after we have compounded those abuses.

"About 1900 began the flowering of…the intellectual…a social theorist who knew…all about nothing, except how to subvert the traditions and invert the laws."

"The first great turning…was the amendment of the Constitution in 1913, giving the Federal government power to impose a progressive tax on all incomes…one of the cardinal points of the Communist Manifesto."

"Then the Federal government seized control of money, credit, and banking…After that it was merely nostalgic to talk any more of controlling government or limiting its powers of self-aggrandizement."

"No one can imagine that [people] would have said yes…to accept the coils of octopean government, the dim-out of the individual…They voted against it…they elected Mr. Roosevelt on a platform that promised less government, a balanced Federal budget, and sound money."

"They never voted for the Welfare State, with…its endless vista of confiscatory taxation, its compulsions and its police-like meddling with their private lives…Yet step by step they accepted it and liked it."

"They never voted for whittling away the restraints imposed by the Constitution on the power of executive government…the sanctity of the Constitution was so strong that when Mr. Roosevelt proposed to…pack it with New Deal minds he was defeated by a spontaneous protest of extraordinary intensity."

"Nevertheless…By a series of reinterpretations of the Constitution, the reformed Supreme Court has so relaxed the austerities of the supreme law as to give government a new freedom…Thus law is made subordinate to the discretions and judgments of men, whereas the cornerstone of freedom was that the government should be a government of law, not of men."

"A momentous change has taken place in the relationship between government and people…people have lost control of government. It is a thing too vast, too complex, too pervasive…to be comprehended by the individual citizen. Indeed…the government no longer comprehends itself."

"The power of the individual to resist the advance of its authority…has diminished. Even organized pressure groups…no longer resist. They ride it and use their influence to gain freer access to the illusory benefits that now flow in all directions from Washington."

"The taxpayer…does not tell the bureaucrat; the bureaucrat tells him…a vast impersonal power…may legally take away his entire income."

"Various administrative agencies…make and execute their own laws, thereby exercising legislative, executive, and judicial functions, all
three at once."

"The founders of the American government knew...all governments...had certain features in common, such as a natural appetite for power...What they did was to create a government that could not obey such a law."

"When [government] goes into debt for what it calls the public welfare...it extends its authority over the lives and liberties of the people. It suborns them...corrupting the people for their own good."

"As the government expands explosively the people...become dependent on government...first enticed by the benefits and then obliged by authority to exchange freedom for status...The moral debacle is cancerous and possibly incurable."

"Unless people can reconquer government its bigness will swallow them up."

Garet Garrett spoke boldly and consistently against "the dim-out of the individual" represented by the political centralization and bureaucratization of American life under FDR. As his Facebook page described it, "he believed that Americans were signing away their birthright of freedom, through trading in their responsibilities of self-governance and self-responsibility, in return for...expansion of government."

Having now moved much farther away from what Garrett defended as "limited constitutional government in the republican form," we could profit greatly from revisiting his insights.

Gary M. Galles is a professor of economics at Pepperdine University. His recent books include Faulty Premises, Faulty Policies (2014) and Apostle of Peace (2013). He is a member of the FEE Faculty Network.

Why Stress Is One of the Best Predictors of High Life Satisfaction

Embracing and adapting to stress can provide important opportunities for personal growth.

By Barry Brownstein

My life is messed up, why can’t I get my act together?

Most of us have heard a variation of this talk track in our heads, or we’ve heard it from others. If only, we think, I didn’t have this problem, then everything would be all right.

We feel burdened by what seems to be our unique sticky problems. Immersed in such a mindset, our actions may not demonstrate our highest values and purpose. What if, Ryan Holiday asks, the adverse circumstances we face offer “a formula for thriving not just in spite of whatever happens but because of it?”

Holiday, in his book The Obstacle Is the Way, draws on the wisdom of Marcus Aurelius and other Stoic philosophers. He points out that Aurelius saw every obstacle, every adverse circumstance, “as an opportunity to practice some virtue: patience, courage, humility, resourcefulness, reason, justice, and creativity.” The more virtues we practice, the more meaning we create in our lives. Resisting our problems means we are forgoing opportunities to become the best version of ourselves.

The beauty in our lives often coexists with our burdens. The beauty remains long after the problem is gone.

“Obstacles,” instructs Holiday, “are not only to be expected but embraced. Embraced? Yes, because these obstacles are actually opportunities to test ourselves, to try new things, and, ultimately, to triumph.”

Adversity Creates Meaning in Our Lives

In her book The Upside of Stress, Stanford University psychologist Kelly McGonigal invites her readers to “Take a moment to identify a time in
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your life that was a period of significant personal growth—a turning point that led to positive changes or a newly found purpose.” Now consider this: “Would you also describe this time as stressful?”

Most answer “yes.” Echoing Aurelius, McGonigal observes, “Adversity can create resilience, and trauma often inspires personal growth.” Persisting, she explains, “is about maintaining the optimism needed to pursue meaning, even in the face of adversity.”

McGonigal asks us to notice how often we see the negative side of adverse circumstances, saying This is so stressful or I’m so stressed. Our mindset matters. Reporting on experiments by Stanford psychology professor Alia Crum, McGonigal explains, when we view stress as harmful we “try to escape or reduce the stress.”

Attempts to escape can be worse than the problem. If we have a stress-is-harmful mindset, instead of addressing root causes, we try to get rid of our feelings by turning to smoking, alcohol, drugs, binge-watching television, checking our smartphones thousands of times a day, and other distractions.

There is a better way. Crum’s research shows that those with a stress-is-helpful mindset view “stressful situations as a challenge, not an overwhelming problem.” The result of that mindset shift is more productivity at work, more satisfaction with life, “more energy and fewer health problems.” Perhaps most importantly, those with a stress-is-helpful mindset “are better able to find meaning in difficult circumstances.”

With a stress-is-helpful mindset, one taps into “a natural capacity to find hope, exert choice, and make meaning.” Challenges in life are opportunities to experience “strength, growth, and resilience.”

Research shows the happiest people are not without adversity. McGonigal offers:

Happy lives are not stress-free, nor does a stress-free life guarantee happiness. Even though most people view stress as harmful, higher levels of stress seem to go along with things we want: love, health, and satisfaction with our lives.

Stress is one of the best predictors of a meaningful life. Why? McGonigal explains: “One reason is that stress seems to be an inevitable consequence of engaging in roles and pursuing goals that feed our sense of purpose.” She adds, “the ability to find meaning in our lives helps us stay motivated in the face of great difficulties.”

How Adversity Created Meaning in My Life

As a young boy, I was unaware I stuttered. Well-meaning speech pathologists turned me into a “professional” stutterer by coaching me in techniques that kept me focused on controlling disfluency. By the time I got to high school, I was afraid to speak in class out of fear of being bullied. A self-concept as a stutterer was fully formed. When a speaking challenge was on the horizon, fretful thoughts consumed my mental bandwidth. If only I didn’t stutter, then my world would be all right, rang true.

Becoming a professor hardly seemed a wise career move, yet I had little doubt that teaching was my path. At 24, while in graduate school, I taught my first principles of economics class. By 32, I had won the first of 10 major awards for teaching excellence.

Stutterers have difficulty with publicly reading; I was never tempted to cut corners and read my notes or PowerPoint slides. Along the way, I found that stuttering receded when I was outwardly focused, completely present in the classroom, responding to what was needed at that time and in that place. In these ways, stuttering improved my teaching.

Those early years as a professor were especially stressful. Yet, I knew there was more to life than my mental suffering, and that realization opened me to a lifelong interest in human development and spirituality. As McGonigal writes:

Human beings have an innate instinct and capacity to make sense out of their suffering. This instinct is even part of the biological stress response, often
experienced as rumination, spiritual inquiry, and soul-searching. Stressful circumstances awaken this process in us. This is one more reason why a stressful life is often a meaningful life; stress challenges us to find the meaning in our lives.

Success in the classroom led to students’ requests for me to teach more courses in the MBA program. As a result, I developed a second area of expertise in leadership development, which led to fulfilling opportunities to deliver workshops.

Fretting about stuttering has not vanished in my life, but it occupies less of my mental bandwidth. I have benefited from working with speech pathologist Barbara Dahm. Dahm has studied the way normal speakers spontaneously transform thinking to audible speech. Instead of fighting disfluency with more controls, her approach helps remove a stutterer’s self-created barriers to the natural speaking process.

Has stuttering helped me make more meaning in my life? Marcus Aurelius would have said yes, adversity pointed me forward: “The impediment to action advances action. What stands in the way becomes the way.”

In the poignant Star Trek: The Next Generation episode “Tapestry,” Captain Picard has an opportunity to relive a past incident in his life; an incident for which he long regretted his actions. A thread in the tapestry of his life is pulled, and Picard’s leadership abilities are diminished. In this alternative life, instead of becoming captain, Picard is an unremarkable junior officer. His lesson learned, the trajectory of Picard’s life is restored.

It might seem that a life without adversity would be an easier path, but would the richness of our life be lost?

**Turn to Your Values**

McGonigal reports on research by psychologists Geoffrey Cohen and David Sherman. A simple mindset intervention of writing about your values leads to a huge payoff in your ability to cope with adversity:

When people are connected to their values, they are more likely to believe that they can improve their situation through effort and the support of others. That makes them more likely to take positive action and less likely to use avoidant coping strategies like procrastination or denial. They also are more likely to view the adversity they are going through as temporary, and less likely to think that the problem reveals something unalterably screwed up about themselves or their lives.

People may spend their lives seeking permanent solutions to ease feelings of stress in their lives. Such solutions may seem tantalizingly close; in reality, they are out of reach. Aurelius advised looking in a different direction: “Objective judgment, now at this very moment. Unselfish action, now at this very moment. Willing acceptance—now at this very moment—of all external events. That’s all you need.”

McGonigal observes that life is “not about being untouched by adversity or unruffled by difficulties.” She writes, “Although many people idealize a life without adversity, those who actually have one are less happy and healthy than those who have faced some hardship.” We can use adversity to find more meaning. Encouragingly, McGonigal writes:

The good that comes from difficult experiences isn’t from the stressful or traumatic event itself; it comes from you—from the strengths that are awakened by adversity and from the natural human capacity to transform suffering into meaning.

In Man’s Search for Meaning, Viktor Frankl taught us how to find hope and meaning amid great adversity. “Each man,” Frankl wrote, “is questioned by life; and he can only answer to life by answering for his own life; to life he can only respond by being responsible.” We all have the capacity to awaken to our strengths.

Barry Brownstein is professor emeritus of economics and leadership at the University of Baltimore. He is the author of The Inner-Work of Leadership. To receive Barry's essays subscribe at Mindset Shifts.
The following financial professionals joined or renewed their membership to our Authorized Infinite Banking Concepts Practitioners team this month:

- Steven Haroldson-Minnich - Newport, Washington
- Justin Bauer - Cannon Falls, Minnesota
- Julie Ann Hepburn - Chicago, Illinois
- Steve Parisi - Allentown, Pennsylvania
- Michiel Laubscher - Newtown, Pennsylvania
- Kevin Dottenwhy - Wausau, Wisconsin
- Donald Zielinski - Austin, Texas
- Thomas Neeser - South Bend, Indiana
- Scott Gannon - Darmouth, Nova Scotia
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- Brian Fleming - Milwaukee, Wisconsin
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Nelson’s Favorite Quotes

For every complex problem there is an answer that is clear, simple, and wrong. - H.L. Mencken

The whole aim of practical politics is to keep the populace alarmed (and hence clamorous to be led to safety) by menacing it with an endless series of hobgoblins, all of them imaginary. - H.L. Mencken