From The President's Desk

by Mark Skousen

IDEAS ON LIBERTY
JUNE 2002

A Painless Way to Triple Your Savings

"The human mind is charming in its unreasonableness, its inveterate prejudices, and its waywardness and unpredictability."

—LIN YUTANG[1]

"Behavioral" finance is the hot new field in the rapidly growing "imperial" science of economics. Consider the titles of recent books on the subject: *Irrational Exuberance* by Robert Shiller of Yale University, who correctly warned investors that the bull market on Wall Street in 2000 was not sustainable, and *Why Smart People Make Big Money Mistakes* by Gary Belsky and Thomas Gilovich.

Essentially, these writers take issue with a fundamental principle of economics—the concept of "rational" predictable behavior. They argue that investors, consumers, and business people don't always act according to the "rational economic man" standard, but instead suffer from overconfidence, overreaction, fear, greed, herding instincts, and other "animal spirits," to use John Maynard Keynes's term.[2]

Their basic thesis is that people make mistakes all the time. Too many individuals overspend and get into trouble with credit; they don't save enough for retirement; they buy stocks at the top and sell at the bottom; they fail to prepare a will. Economic failure, stupidity, and incompetence are common to human nature. As Ludwig von Mises notes, "To make mistakes in pursuing one's ends is a widespread human weakness."[3]

Fortunately, the market has a built-in mechanism to minimize mistakes and entrepreneurial error. The market penalizes mistakes and rewards correct behavior (witness how well business responded to the Y2K threat in the late 1990s). As Israel Kirzner states, "Pure profit opportunities exist whenever error occurs."[4]

But the new behavioral economists go beyond the standard market approach. They argue that new institutional measures can be introduced to minimize error and misjudgments, without involving the government.

At the American Economic Association meetings in Atlanta in January 2002, Richard Thaler of the University of Chicago presented a paper on his "SMART" savings plan, which is being tested by five corporations in the Chicago area. Thaler, author of *The Winner's Curse* and a pioneer in behavioral economics, has developed a new institutional method to increase workers' savings rates. Thaler noted that the average workers' savings rates are painfully low. I blame the low rate on high withholding taxes, but Thaler suggested that part of the problem is the way retirement programs are

---

Mark Skousen (mskousen@fee.org) is president of FEE. His website is www.mskousen.com.

administered. He convinced these corporations to adopt his plan to have their employees enroll in an "automatic" investment 401(k) plan. Most corporations treat 401(k) plans as a voluntary program and, as a result, only half choose to sign up. In Thaler's plan, employees are automatically invested in 401(k) plans unless they choose to opt out.

Result? Instead of 49 percent signing up (as they do in a typical corporate investment plan), 86 percent participate.

Raises Invested

In addition, Thaler has participating employees automatically invest most of any pay increase in higher contributions to their 401(k) plans, so they never see their paychecks decline, even though their 401(k) plans are increasing. Consequently, employees under this SMART plan have seen their average savings rate increase from 3 to 11 percent.

Robert Shiller was a discussant at the session and rightly called Thaler's plan "brilliant." I agree. Having authored several investment books advocating "automatic investing" and dollar-cost-averaging plans,[5] I applaud Professor Thaler for taking the concept of automatic investing to a new level. If companies everywhere adopt his plan, it could indeed revolutionize the world and lead not only to a much more secure retirement for workers but to a higher saving and investment rate. The result could be a higher economic growth and standard of living throughout the world.

Most important, Thaler's plan is a private-sector initiative and does not require government intervention. In short, through innovative management techniques and education, individuals can solve their own financial and business problems without the help of the state. □

1. Lin Yutang, *The Importance of Living* (New York: John Day Company, 1937), p. 57.
2. References to "animal spirits" and "waves of irrational psychology" can be found in John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York: Macmillan, 1973 [1936]), pp. 161–62.
3. Ludwig von Mises, *Theory and History* (New Haven: Yale University Press, 1957), p. 268. However, Mises refuses to call bad decisions "irrational." He states, "Error, inefficiency, and failure must not be confused with irrationality. He who shoots wants, as a rule, to hit the mark. If he misses it, he is not 'irrational' he is a poor marksman."
4. Israel M. Kirzner, "Economics and Error" in *Perception, Opportunity, and Profit* (Chicago: University of Chicago Press, 1979), p. 135.
5. Mark and Jo Ann Skousen, *High Finance on a Low Budget* (Chicago: Dearborn, 1993) and *Mark Skousen's 30-Day Plan for Financial Independence* (Washington, D.C.: Regnery, 1995).

Capital Formation

A society that looks upon thrift and frugality as social virtues, that believes with Benjamin Franklin "if you know how to spend less than you get, you have the philosopher's stone," such a society cannot escape the rich rewards that come from capital formation. On the other hand, a society whose habits are not thrifty will soon be poverty-stricken.

—Hans F. Sennholz

IDEAS ON LIBERTY
JUNE 2002

Capitalism Is a Government Project?

It Just Ain't So!

As readers of *Ideas on Liberty* all know, politics cannot always be analyzed in simple left-right terms. But professional pundits like to choose up sides, with the "liberal" commentators traditionally being critical of capitalism and the "conservative" commentators supporting it.

Lately, though, there's been a disturbing amount of anti-free-market opining from the conservative team. Some writers for *National Review* and *The Weekly Standard* have contributed to this, but the conservative with the highest profile and greatest exposure (and greatest mainstream credibility), George F. Will, now joins this unfortunate chorus. In his January 15 column, he wrote of the Enron affair that "It will remind everyone—some conservatives, painfully—that a mature capitalist economy is a government project." If even the conservatives are now claiming that we need the state to run the economy, then it is clear that some economic education is in order.

Of course, there is one sense in which capitalism is a government project: the Marxist sense. According to Marx, "capitalism" is defined as a system of exploitation that requires the "bourgeois" state to enforce it. What we think of as property rights are merely the legal fictions that perpetuate class conflict and keep all wealth in the hands of the rich. Once we proceed to communism, the central planners of the economy can arrange things so as to eliminate exploitation and ensure the correct distribution of all resources. Although it sounds as if this too would have to be a government project, Marx argues that everyone would then see the exploitation that had previously been obscured and enthusiastically embrace the new order, and so it would no longer require the state. On this theory, planned socialism is the voluntary social order and capitalism is the government project. But one suspects that George Will is not a Marxist.

But if Will is not a Marxist, then his conception of the role of government in creating the free market must reflect an incomplete understanding of both. Will writes that "A properly functioning free market system does not spring spontaneously from society's soil as dandelions spring from suburban lawns." The clever simile notwithstanding, that's precisely what a free market does. No one determines the amount of a good to be produced, or how much it will cost, or who will compete for the buying and selling of it and competing goods.

As Leonard Read pointed out in these pages many years ago, millions of individual decisions come together to create the amounts and prices of goods without any central planning. The free market is just the totality of all these individual decisions, which end up yielding results no planner could determine. The free market is, to use a phrase popularized by a better economist than Marx, a spontaneous order. What that means is that there is an orderliness to the way it works, without that order being the product of conscious design. Supply is coordinated with demand, and prices and wages reflect both in a much more accurate way than any one person could determine.

What would it mean, then, to say that the free market is a government project? Certainly governments can run a market, setting prices and quantities itself. But the very idea of a *free* market is that individuals make choices about their own preferences, and the confluence of the many individual choices is what determines the outcomes. If the government dictates prices and quantities, some individual will necessarily be deprived of his autonomy, which is bad enough in a free society. Moreover, the planned outcomes