State after state—Illinois, Indiana, Ohio, Michigan, among others—tried to build transportation networks only to watch them collapse ignominiously through mismanagement, poor planning, miscalculated funding, and partisan politics. Pennsylvania tried to copy the Erie Canal only to run up such catastrophic debt that the state had to declare bankruptcy. Even New York ran into debt because it built other canals that were all unprofitable and soaked up the capital gained by the success of the Erie Canal.

Governor Stevens T. Mason, who presided over the failed canals and railroads in Michigan, eventually called the fever to build at taxpayer expense the "false spirit of the age." Upstate New York, with its excellent and atypical geography, topography, and river system, was a natural choice and the Erie Canal would have been profitable whether built by state or private funds. States that followed the Erie Canal example were later eager to privatize their failed transportation system. Larson is simply wrong when he says that in Michigan (and, by implication, elsewhere), "it was with great reluctance that voters embraced the privatization of their transportation networks." In fact, Michigan voters went to the polls with gusto in 1851 to amend the state constitution to say "the [s]tate shall not be a party to or interested in any work of internal improvement."

After the canal era, national planning and federal subsidies in transportation continued to fail. Private enterprise consistently worked better in the steamship business, in the building of the transcontinental railroads, and in developing the airplane. *Internal Improvement* contains useful information on early transportation, but its interpretation is unsupportable. □

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Time and Money: The Macroeconomics of Capital Structure

by Roger W. Garrison

Routledge • 2001 • 272 pages • $99.00

Reviewed by Robert Batemarco

Although it was Tolstoy who said that "the highest wisdom has but one science—the science of the whole," these words express with uncanny accuracy the practice of the Austrian school of economics. One of the hallmarks of that school is that it sees economics as an integrated whole, with a few initial principles underpinning every theory. It is in this spirit that Roger Garrison of Auburn University has written *Time and Money*, an in-depth exploration of Austrian, Keynesian, and monetarist macroeconomic theory. The three principles Garrison deploys as the launching pad for his excursion into these issues are scarcity, the market for loanable funds, and the time structure of production. Each is represented throughout this work by a simple diagram—production possibilities frontiers, supply and demand curves, and Hayekian triangles, respectively. Tying these together enables Garrison not only to furnish a standard account of the Austrian (that is, Mises-Hayek) theory of business cycles, but also to draw other implications of Austrian macroeconomics as well as to obtain penetrating insights regarding the nature of Keynesian and monetarist alternatives.

Another comparison of various macroeconomic paradigms may sound to many economists like flagellation of an expired equine. Yet Garrison rises above such potential ugliness and draws a number of fresh insights. One of these may be a triumph of style over substance—but in a good way. His coining of the term "capital-based economics" not only captures one of the most important distinctions between the Austrian approach to macroeconomic theorizing and its rivals, but may also be a public relations coup as well. Just as the "supply-side" designation effectively pointed out a fundamental deficiency of the Keynesian approach and re-popularized

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a basic truth that had gone out of fashion, Garrison's use of the term "capital based" points to another shortcoming of conventional analysis and has the potential to lend new appeal to bygone verities.

Garrison uses his graphical tools judiciously. He takes them as far as they are applicable, but no further. Yet the graphics employed in *Time and Money* are not mere window-dressing. Their role is twofold: demonstrating the coherence of the Austrian vision and exposing the limited scope of its Keynesian and monetarist rivals. They permit us to see that those two paradigms are really special cases of the Austrian theory, obtained by disabling or ignoring the market mechanisms that, when functioning properly, align the capital structure with consumer desires.

It is a tribute to his powers of analysis that Garrison can do this without resorting to caricatures of those theories. Rather, he treats the theories of Keynes and Friedman fairly, frequently using their own words by way of exposition, and examining several versions of each of their models. One of the more interesting lessons to emerge from this procedure is that Keynes's theory of unemployment had both cyclical and secular components, with the latter having even more statist implications than the former. His critique of monetarism is less severe, finding that framework to be more incomplete than erroneous; indeed, he sees Austrian economics and monetarism as complementary approaches, each useful in helping us to understand different situations.

A major strength of this book is its avoidance of one-dimensional analyses. The author incorporates into many parts of this work the recognition that "how" may be at least as important as "how much." This is obvious in Austrian business-cycle theory, which posits that *where* new money is injected affects the ultimate impact of the injection. Garrison uses this same notion to advance our understanding of fiscal policy. He sees the variety of ways in which a deficit can be financed (borrowing domestically, borrowing abroad, and monetizing debt) as the potential source of much of its economic damage, in that it creates uncertainty, which dissuades many entrepreneurs from lengthening the structure of production, thus hampering economic growth. Another implication of this is that each method is used only as long as it meets little political resistance. Once experience reveals the true costs of the method, policymakers switch to another. Garrison uses this fact to explain a good deal of U.S. fiscal history in the '80s and '90s.

The book's target audience is professional economists, but with only a few dozen graphs, a handful of equations and a clear style, it is more accessible to the educated layman than most of what's being written about economics nowadays. Still, it will be the reaction of professional economists that will make or break this book. *Time and Money* has the potential not merely to improve the way economists look at macroeconomics, but to take it to the next level. It sends out a message of utmost importance: that economists cannot adequately understand macroeconomic phenomena if they neglect the role of capital. □

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IDEAS ON LIBERTY
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Enron Lessons

The Enron soap opera continues to unfold. And as it unfolds, lessons are being learned. Some people are learning lessons about the energy business. Some are learning lessons about the securities business. Some are learning lessons about the accounting business.

But some are not content to learn such narrow lessons. They want to look at the big picture. And so when studying Enron, they have learned the lesson that the invisible hand doesn't work. Or it doesn't apply any more. Here is Marjorie Kelly, cofounder and editor of the journal *Business Ethics*, on the Enron affair: "The ideal of the unregulated free market is flawed, and it's time we said goodbye to Adam Smith's 'invisible hand.'"

Numerous other writers have invoked the failure of the invisible hand to protect us from Enron.

When Adam Smith wrote about the invisible hand, he was referring to the effect of investors' putting capital into domestic industries in search of the highest profit. He argued that the desire to find the highest return on their money led to beneficial effects for society as a whole.

But what most critics have in mind when they invoke the invisible hand is something more complex. They are referring to the worldview that says that markets are self-regulating, that there are natural restraints on greed and dishonesty built into the market system.

I agree with that worldview. Let me flesh it out a little further. Those of us who are sympathetic to this view believe that human nature is self-interested. There are greed and even malice along with altruism and kindness. What is the best way to restrain that self-interest from being harmful? In the Smithian worldview, competition and market forces impose costs on dishonesty.

But that does not eliminate greed. It does not eliminate dishonesty. Even in a free-market system, there are con men and scams and products that are poorly made and even sometimes unnecessarily dangerous. The claim of the Smithian worldview is that such behaviors are hard to sustain. The market punishes dishonesty. The market drives out products that are mediocre or unnecessarily dangerous.

If the maker of a first-rate product decides to cut corners and live off its reputation, it may get away with it for a while. Lexus and Southwest Airlines could continue to thrive for a while if they lowered their quality. But they will pay a price as information spreads and consumers acting in their own self-interest choose alternatives. The threat of those alternatives is an incentive for market leaders to try to maintain their high quality.

The critics of the Smithian worldview seem to be arguing that the Enron disaster is, in and of itself, evidence of the failure of the Smithian worldview. On one level, this is a

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