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CENTER FOR EDUCATION AND RESEARCH IN FREE ENTERPRISE
TEXAS A&M UNIVERSITY COLLEGE STATION, TEXAS 77843

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NON-CIRCULATING

LIFE IN THE GULAG

One of the most interesting applications of modern economic theory has been the analysis of slavery in the antebellum South of the United States. The analysis of slavery based on the economic theory of property rights, however, can be extended beyond the antebellum South to a more recent institutional phenomenon—the large-scale use of political prisoners as forced labor in modern socialist states. The forced labor camps in various socialist states in this century constitute a well-documented, but poorly understood, modern system of slave labor.

Unlike slavery in the antebellum South, individuals committed to forced labor in the U.S.S.R. are convicted criminals and political prisoners. The forced labor camps, however, also are productive enterprises, generating a nontrivial proportion of the output of the Soviet economy. According to one recent estimate, the total number of *zeks* (inmates in forced labor camps) in the U.S.S.R. at any given time is about five million adults. This forced labor pool is allocated to activities such as mining in remote and inhospitable regions.

The most relevant difference between slavery in the antebellum South and that of the Soviet prison camps is that the forced labor system of the Gulag is an example of slavery where the owners do not have well-defined and enforced property rights in slaves. Inmates in Soviet forced labor camps are not slaves in the strict sense, because they do not represent private property. These inmates are not owned by camp administrators or any other particular individuals. They are not bought and sold, and, hence do not have capital values.

Camp administrators (like factory managers) typically are assigned production quotas in terms of the relevant output. These administrators are evaluated and rewarded on the basis of the degree to which they fulfill planned production. The incentive of camp administrators to maintain the productivity of slave labor tends to be quite limited relative to a system of slavery in which the slave owners have full claim to the value of slave productivity.

Given serious labor shortages in Siberia, where the bulk of the camps are located, the inmate population represents valuable additional labor. A rational (albeit despotic) regime would seek to conserve such resources rather than casually waste them. The puzzling feature of the forced labor system is why the prisoners have been treated in general as if they represented a costless labor resource. Slaves in the antebellum South were, in effect, prisoners for life, and were often treated harshly, but they were in general maintained as valuable, productive assets. Slaves were valuable capital assets, and their value increased steadily following the legal prohibition of the importation of slaves into the U.S. in 1807.

In the U.S.S.R., slaves in the Gulag can be replaced at essentially zero cost by *those managing forced labor camps.* The potential slave population basically includes the entire population. A temporary labor shortage in the gold and coal mines near Omsukchan in Siberia, say, can be remedied by arresting and transporting a sufficiently large group of able-bodied dissidents. The supply of labor for the forced labor camps of the Gulag appears to be nearly perfectly elastic from the perspective of the managers of the camps.

The production incentive structure within which forced labor camp administrators operate, coupled with a high elasticity of supply for replacement slaves, allows administrators to explain the extremely high death rates within the camps as well as

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conditions that tend to hamper the health and productivity of the inmates without presumption of irrational malice by administrators. Gulag administrators do not own the inmates and cannot claim their capital value. Hence, they have a very substantially reduced incentive, relative to slave owners, to invest scarce resources in the care and maintenance of these laborers.

In the U.S.S.R., slaves in the Gulag can be replaced at essentially zero cost by those managing forced labor camps. The potential slave population basically includes the entire population.

Targeted output would be maximized by increasing the intensity of labor supplied by slaves. Such a strategy would be efficient from the perspective of a camp manager, if the marginal cost of replacement slaves is zero (or very low). It is also likely that other resources that are substitutable for slave labor as additions in the production process—equipment and machinery, better management, and more efficient camp administration—are significantly more costly to camp administrators than are new *zeks*. Under these circumstances, resources provided to the camps for operating purposes can be consumed directly by the administrators, while still achieving planned production targets by working the "free" slave labor to death. In other words, this reallocation of resources represents a way by which administrators can spend the lives of slaves in exchange for enhanced welfare for themselves.

It has been common for critics of the Gulag Archipelago to describe it, and similar systems of forced labor in other socialist states, as slavery. This description is inaccurate because *zeks* are not *owned,* but represent free goods from the perspective of their masters. In this context, the high waste rate of inmates of the Gulag by comparison with antebellum slavery is economically understandable. The only thing worse than an economic system based on slave labor is one that treats slave labor as a free good. The consumers outside the Gulag also have suffered as a result of this wasteful system. By the early 1940s, as much as 25 percent of total direct investment in the Soviet Union was in the forced labor sector. The net costs of transferring millions of workers from the ordinary sector to the Gulag have been large to the economy as a whole.

The forced labor system has provided a reliable labor supply at basically zero wage rates under conditions where a volunteer labor force would be available only at high real wage rates. At the same time, the stability of the regime may have been enhanced significantly by the terror the Gulag provides. It *is* clear, however, that the property rights arrangements operative within the system encourage massive waste in terms of slave labor resources, whatever the objective function of the rulers in Moscow.

—Gary M. Anderson and Robert D. Tollison
Center for Study of Public Choice
George Mason University

Dr. Pejovich speaks at a testimonial dinner honoring Richard Ware, president, Earhart Foundation. To the right of Dr. Pejovich are Mrs. G. Warren Nutter; Mr. Baroody, president, American Enterprise Institute in Washington, D.C.; Dr. Tonsor, University of Michigan; and Richard Ware.

BOARD MEMBER TO RECEIVE AWARD

Thomas R. "Bob" Frymire will receive the Distinguished Alumnus Award from the Association of Former Students and Texas A&M University during commencement exercises on May 9. Frymire is a member of the board of directors of the Center for Education and Research in Free Enterprise, and is a former student of Texas A&M. The center wishes to extend its special congratulations on this well-deserved honor.

J. PETER GRACE TO RECEIVE CENTER FOR FREE ENTERPRISE AWARD

The center's Free Enterprise Award for 1986 will be given to J. Peter Grace, chairman and CEO, W. R. Grace & Co., and chairman, Private Sector Survey on Cost Control. The award will be presented to Grace by last year's recipient, Edwin J. Feulner, president, The Heritage Foundation. The presentation will be made June 25 at the Loews Anatole Hotel in Dallas.

PRODUCT LIABILITY LAW: IT'S NO BETTER THAN A LOTTERY

In recent years, the law relating to accidents caused by the use of manufactured products has taken a dramatic turn. From the old view of *caveat emptor*—let the buyer beware—we have moved to a system in which manufacturers must pay most costs of injuries associated with the use of products. This may be appropriate in principle, but in practice there are problems.

Product liability law should be designed to lower the total cost to society of using helpful and desirable products, including the cost of injuries incurred by product users. Instead it has become a lottery system in which every injured person receives a ticket that gives a limited chance of winning a big prize. The operators of the game never lose, however.

The biggest problem with the lottery approach to liability rules is that non-gamblers have to play whether they like it or not. Costs of manufacturing, including liability for accidents, are ultimately passed along to consumers. Therefore, all consumers have to pay higher product prices whether they are injured or not and regardless of whether this would be their own preferred way of dealing with accident risk.

Defenders of this system argue that this is a form of insurance and that distributing the costs of injuries is a desirable way of spreading the risk of using dangerous products. But this insurance analogy raises serious questions. First of all, our product liability system costs far more than private insurance coverage would cost. Most accident insurance costs about $1.25 for each $1 ultimately paid back to policyholders. But fair estimates of our product liability system suggest that consumers receive back only about 50 cents for every $1 paid in the form of higher prices.

If consumers were allowed to contract directly with sellers for the amount of insurance they wanted, the price would be significantly less. One reason for this is that individuals never voluntarily purchase insurance to cover the risk of "pain and suffering," a large factor in many product liability judgments. Yet our present system imposes the cost of such "insurance" on consumers whether they want this coverage or not.

Our product liability system is also more costly than true insurance because all claims must be funneled through our legal system. Plaintiffs' lawyers alone receive, on average, about one-fourth of all the "insurance premiums" paid for this system through the higher prices charged for products.

And defense lawyers, mostly representing insurance companies, have to be paid, too, as do the medical and other experts who spend time in court arguing about the extent and costs of injuries.

The plaintiffs' lawyers are not on average getting unreasonably wealthy. Some do, however, hit the legal "jackpot" with a big verdict, but these have to be averaged with all the smaller recoveries and the failures. But litigation remains an expensive way to administer an insurance program.

The litigation process is an inherently inefficient way to redistribute wealth or to spread risks. Advocates of this system should stop implying that the litigation process is free or that it functions well to distribute costs. Courts, for instance, are provided through the courtesy of the taxpayers; they are not free. Lawyers who provide their services on a contingent-fee basis also cost money, even though they collect only when they are successful.

With a contingent-fee system, many less serious injuries go uncompensated altogether. Fees in these cases are too small to warrant a lawyer's effort, and the injured party may not want to guarantee a fee regardless of success in the case.

Nor do contingent fees guarantee appropriate representation of a client's interests. Lawyers and clients often have different preferences about how much risk to take on the amount and timing of a recovery. The client, for instance, may prefer a fast, smaller settlement, while the lawyer, with a number of cases going, is willing to accept more risk and delay in hopes of a large verdict.

A good insurance system provides certain and prompt payment when there is an injury. Our present products liability system certainly does not. Courts are notoriously slow. More importantly, the outcomes of trials are unpredictable for many reasons. If this were not the case, disputes could easily be settled without the necessity of a trial.

For all these reasons, it is more correct to analogize our product liability system to a lottery than to an insurance scheme. As with lotteries, there are a few big winners. Verdicts run as high as $8 million to $10 million and more.

And a $10 million verdict does have some positive effect besides the obvious one to the winner. It concentrates manufacturers' attentions on issues of consumer safety. But there lies the rub. It may make manufacturers take more care than consumers really want, given the fact that consumers have to pay for it. But while large verdicts are prominently covered by the media, their effect on prices is almost hidden from popular view.

Too much concern for safety may also force manufacturers to avoid a valuable new product, or stop producing an old one, even if the product would do more good than harm. This is peculiarly a problem for pharmaceutical products, for which the value of beneficial but risky drugs foregone can never be included in a court's calculation of a proper judgment. Again, this cost is rarely noticed by the public.

Thus, in total, the few big payoffs to unfortunate victims of product defects cost everyone far more than the victims gain in their lawsuits. Unfortunately, our present system provides no device for balancing these interests.

—Henry G. Manne
Dean, George Mason University Law School

FREEDOM IN THE SOVIET UNION

An instructor is reading a lecture during the political indoctrination session for Soviet citizens:

"The Soviet Constitution guarantees freedom of expression."

A listener asks: "How about freedom *after* the expression?"

SOVIET POWER

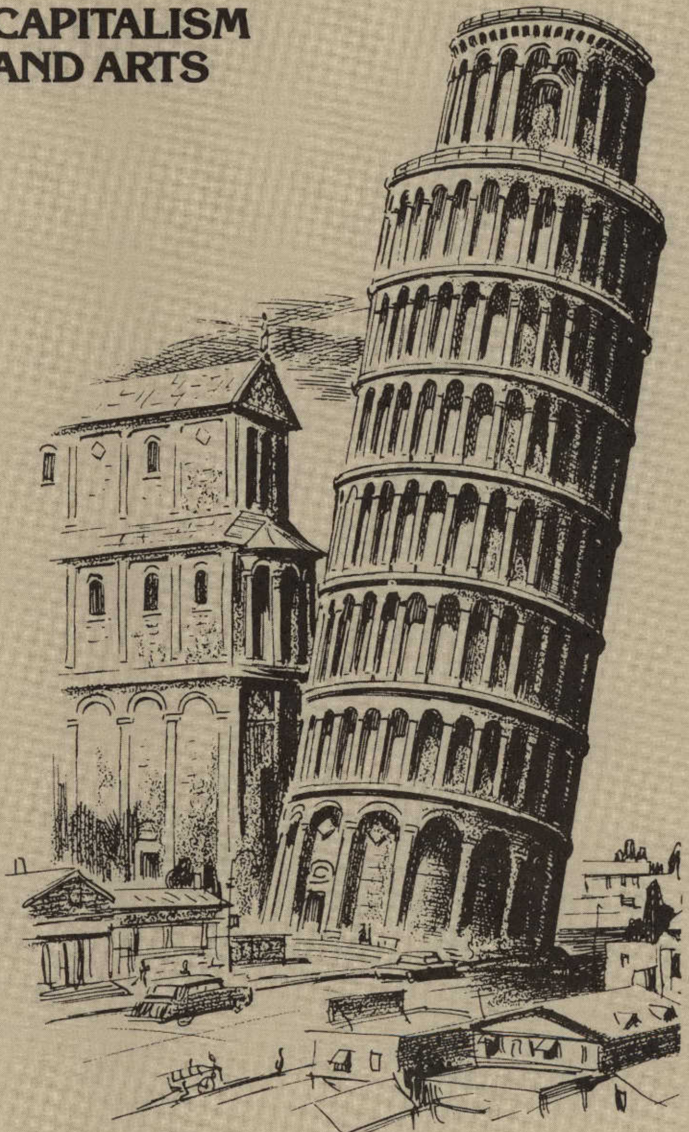
Alexander the Great, Caesar and Napolean were watching a Soviet military parade on Red Square.

Alexander the Great said, "If I had had Soviet tanks, I would have conquered the whole world!"

Caesar said, "If I had had Soviet troops, I would have conquered the whole world!"

Napolean said, "If I had had the newspaper *Pravda,* the world still would not have known about Waterloo!"

CAPITALISM AND ARTS



Moving around in the dark, candle-lit sacristy, Filippo Brunelleschi undoubtedly surveyed the day's work to see if his carefully laid out plans were being adhered to. The sacristy of San Lorenzo was an important project for Brunelleschi because it had been commissioned by none other than Giovanni di Bicci dé Medici. Not only was Giovanni one of the most influential bankers in Florence, Italy, but he was Filippo Brunelleschi's first patron, and Brunelleschi undoubtedly wanted to impress him.

In Florence, there were many artists who became among the best known and most respected in the world. In addition to Brunelleschi, there was Donato di Niccolò di Betto Bardi, known to us as Donatello. Donatello had already cast a fountain statue of David, the first bronze fountain piece in the modern world.

The Renaissance can trace its roots to Italy—and, more specifically, to the heart of Tuscany—Florence. Italian Renaissance art was both publicly and privately commissioned. The guilds and merchant families of Florence were responsible not only for commissioning some of the greatest art works, but also for initiating the style and subject matter as well. An important point is that the birth of Italian Renaissance art and its flourishing culture were merely the *result* of the development of early capitalism.

The 12th and the early 13th centuries saw the rise of early capitalism in Italy. The first of these active commercial centers was Venice; then came Pisa, Genoa and Florence. As free trade developed, arts flourished.

In commerce, there emerged partnerships in which merchants who took the voyage provided a smaller portion of the capital than those who stayed at home. From these beginnings, large-scale businesses were formed, which made the period down through the early 14th century one of economic growth. It was an arrangement such as this from which the great family businesses evolved in the late 13th and early 14th centuries. These families included Scali, Bardi and Peruzzi. Commercial expansion produced a new class of bourgeoisie, which in Florence included the banking company of the Medici.

Florence was a leader. Its citizens were interested in political development and got involved in a passionate discussion over the commissioning of public art. The bankers' and other Florentine merchants' influence on art was direct in that they commissioned and bought it.

Why was Italy in the forefront of the Renaissance? Crusaders brought back new ideas. The links with a superior authority were loosened as horizons of the laymen widened. Trading with distant countries increased, and unknown products emerged for the first time in Europe. The study of law, primarily at Bologna University, had great influence upon the economic and political situation. Roman law, as studied at Bologna University, was being taught *to* laymen *by* laymen at a time when a conflict between the kings and the pope was raging.

As trade began with the East, places from which this trade could logically take place prospered. These were primarily the city-states of northern Italy. The artistic talents were used on spiritual matters, but more and more humanism and secularization of art occurred as the patrons had themselves painted into pictures which, heretofore, were strictly religion-oriented. Thus, families like the Medicis found themselves with significant amounts of money. They turned to Brunelleschi, Donatello and Lippi and encouraged them to learn about antiquity, and to bring lasting change into the cultural aspects of life.

The rise of early capitalism in Italian cities gave birth to the Renaissance. Wealthy Italian families developed a lively interest in the process of creation as well as the finished work of art. They wished increasingly to be judged for their taste as well as their munificence, and this led them to encourage works of art.

— Dennis McCuistion
Reason Foundation
Irving, Texas

CENTER RELEASES INCOME TAX STUDY

On February 12, the center held its first press conference to introduce the latest study: "Report on an Income Tax in Texas." The study, written by Dr. Melvin Greenhut, distinguished professor of economics at Texas A&M, shows the state income taxes are major impediments to economic growth. The study was requested by State Rep. Bill Ceverha of Richardson, who supports a constitutional amendment to ban a state income tax in Texas.

Excerpts from newspapers:

". . . state income taxes are major impediments to economic growth."

The Houston Chronicle

"A state income tax 'is the worst of all taxes' and a poor choice to solve Texas' fiscal problems, concludes a Texas A&M University-sponsored study. . . ."

Reporter-Telegram, Midland

"'The most detrimental effect of a state income tax, in addition to reducing work effort and investment, is that it reduces the rate of economic growth,' said Steve Pejovich, a professor at the Texas A&M Center for Education and Research in Free Enterprise."

The American-Statesman, Austin

"A state income tax would impede the economy and destroy the incentive of citizens to work harder and save money, according to a study released . . . by Texas A&M University."

The Houston Post

"A personal or corporate income tax in Texas would impede economic development far more than a rise in the sales tax, a Texas A&M University study has concluded."

The Light, San Antonio

PATHFINDER OUTREACH

Senator Phil Gramm's article on "The New Protectionism," *Pathfinder,* December 1985, was reprinted by the Colorado Council on Economic Education in the spring issue of *CCEE News.* Charles Maurice's and Steve Pejovich's editorial on "Who Should Bail Out the Banks?," *Pathfinder,* June 1984, was reprinted in *La Prensa,* a major daily newspaper in Argentina. Another of their articles, "The Geneva Meeting Could Be A Mistake," *Pathfinder,* December 1985, and Sen. Phil Gramm's article, "New Protectionism—Old Sophistry," in the same issue, were reprinted in *El Diario de Caracas* (Venezuela).

INSIDE THE CENTER

Dr. H. O. Kunkel, a member of the center's Board of Directors, recently published *Nutritional Science at Texas A&M University, 1888-1984.* This document summarizes the evolutionary development of nutritional sciences at Texas A&M.

Dr. Pejovich spoke at the fourth annual Brazosport Free Enterprise Day sponsored by the Brazosport Rotary Club.

Tim Owen participated in the Free Enterprise Day at the University of Houston at Clear Lake, sponsored by the North Galveston Chamber of Commerce.

On March 26-29, the center participated in the WEALTH '86 trade show in Houston. Information regarding the center, its objectives and programs was distributed. Copies of *Pathfinder* and public issues series also were handed out. The event was organized by Resource Publications and was co-sponsored by *The Houston Post* and KTRH radio.

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THE EQUITY AND CHOICE ACT OF 1985 (TEACH)

The Equity and Choice Act of 1985—The TEACH Bill—has turned out to be quite controversial. Basically, TEACH is supposed to give the parents of educationally disadvantaged children (Chapter One participants) a greater range of educational alternatives. In order to inform our readers of this proposed voucher option, Pathfinder *asked William J. Bennett, Secretary of Education, to give us a brief explanation of the TEACH Bill.*

This legislation (the Equity and Choice Act of 1985) will accomplish three important goals for American education. First, it will increase real educational opportunity by creating choices for the educationally disadvantaged. Second, by providing parental choice, this proposal will encourage parental involvement in education. Educational research and common sense tell us that the more parents are involved in their children's education, the better that education is going to be. Third, this legislation will foster competition among all schools—among public schools, private schools, and between public and private schools. Competition would be healthy for our schools.

The critics assert that a voucher worth $600 isn't going to be enough to help anybody get a better education. One prominent member of the education establishment said that low-income parents won't be able "to use a $600 voucher toward tuition of $3,400 in a public school, or over $8,000 in a private school." Despite what some would have us believe, most private schools don't cost $8,000. The overwhelming majority of children receiving Chapter One services are in elementary school, and the average tuition for a private elementary school is $635—roughly the same as the average value of a voucher.

The proposal also would put more public schools within reach for many parents by allowing them to choose between schools in their own district or even outside their district. It is true that in many places the tuition for attending a public school outside one's own district would exceed the value of a voucher. But we should not assume a static universe. Vouchers would foster competition, and competition will bring prices and barriers down.

Some of the same critics who assert that these vouchers would not be enough to help pay for private school tuition also claim that the competition created by vouchers would "destroy" the public schools. The available evidence tells us that, given a choice, most parents still choose public schools. In Minnesota, Maine and Vermont, various choice mechanisms have long been in place, and there has never been any kind of exodus from the public schools. But competition will cause these schools to improve where improvement is needed.

Another criticism has been that using a voucher at a religiously affiliated school would violate the principle of separation between church and state. But we should remember that Congress currently requires Chapter One services be provided on an equitable basis to children enrolled in religiously affiliated schools. And we should also remember that our proposal gives aid to parents—not schools. This arrangement is similar to the one upheld by the Supreme Court in *Mueller* vs. *Allen,* where Minnesota allowed parents a tax deduction to help cover private or public school education.

We need a serious discussion of this legislation's merits. The education reform movement in this country has been successful so far because so many have been willing to engage in genuinely thoughtful debate about problems and remedies.

—William J. Bennett
U.S. Secretary of Education

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