Letters

We welcome letters from readers, particularly commentaries that reflect upon or take issue with material we have published. The writer's name, affiliation, address, and telephone number should be included. Because of space limitations, letters are subject to abridgment.

Revisiting Narrow Banking

TO THE EDITOR:

As a proponent of a variation of "narrow banking," I was intrigued (to put it mildly) by the debate on the question between Jim Burnham and Bert Ely (*Regulation*, Vol. 14, No. 2, 1991). Not surprisingly (to those who know my views), I was much more persuaded by Burnham than Ely. Still, I have a few quibbles with Jim and some more fundamental bones to pick with Bert.

First, I have become more comfortable over the years with a less restrictive asset list—or a "fatter" narrow bank—than Jim has proposed. In particular, I see nothing inherently risky with permitting the narrow banks to invest in *any* readily marketable, investment-grade securities (not just government securities), such as highly rated commercial paper and corporate bonds, asset-backed securities, and municipal and state bonds. The keys are *safety* and *liquidity*. Broadening the asset list would ease the pressure on securities markets and reduce the potential disruption of switching to a narrow bank environment, all at relatively little cost.

Second, I still favor applying the narrow asset list requirements only to institutions that want to affiliate with a broad range of nonbanking activities. Put another way, I continue to see the narrow bank as the quid pro quo for getting the broader powers or right to affiliate with commercial concerns—a quid pro quo that assures the safety of the insurance fund without the need for complicated and ultimately unenforceable firewall provisions.

Jim and others will object, of course, that if the narrow bank requirement is so restricted, it will end up applying to only a few institutions—namely Morgan Guaranty and a few other large banks and to no one else—meaning that the safety of the overall banking system is not significantly enhanced. True, but a strict application of the about-to-be-enacted early intervention requirements is the best way to tackle the safety of the rest of the banks that do not exercise the broader powers. In addition, for those still worried about the propensity of banks to take greater risks, I profess an attachment to that part of Lowell Bryan's "core bank" (some would say "son of narrow bank") proposal that would tighten the loan-to-one-borrower limits for large banks, a step that would enhance loan diversification and thus help lower risk.

Now, some thoughts on Ely's objections to narrow banking. His most compelling argument, of course, is that if the narrow banking requirements are excessively strict, they will force much borrowing from uninsured financial institutions—securities firms, finance companies, and the like—that are highly susceptible to runs by their creditors, much as banks used to experience runs before deposit insurance. In addition, he argues that if, to forestall such runs, the Federal Reserve lends to such institutions, it will have recreated deposit insurance and the moral-hazard problem through the back door.

Ely is right that narrow banking would force more lending by uninsured institutions, but he neglects to mention that precisely because they are so much more exposed to runs, uninsured finance companies maintain twice the capital ratios of banks. By the way, Bert, when was the last time a major finance company failed?

Of course, if one did, the Fed could be faced with the prospect of a run. But the Fed need only be concerned if that run spread to other finance companies. During past troubles in the corporate and municipal bond markets, investors have distinguished between good and bad issuers: whole markets have not "tanked." And if the Fed were truly worried about such an event, it need not directly lend to the affected finance companies (as Burnham suggests), but instead it can do what it did after the October 1987 stock market crash: provide liquidity by buying T-bills and driving down their interest rates, a move that would widen the differential between rates on T-bills and commercial paper and thus eventually bring buyers back to the commercial paper market.

Bert is on stronger ground when he argues for more reliance on risk-based deposit insurance premiums, driven by a market for such insurance, as a market-based trigger for intervention. But, here he too has advocated a radical scheme: namely a dismantling of public deposit insurance in favor of a purely private system (albeit one backed by the Federal Reserve). Just as I am skeptical about the wisdom of backing the most radical version of narrow banking—namely one that would impose the requirement on all banks above a certain size (rather than simply as a quid pro quo for broader powers)—I am also skeptical about the wisdom and feasibility of any proposal that eliminates the government as the front-line insurer for bank deposits.

Still, however, as I have tried to convince Bert in the past, he can claim victory with a much less ambitious version of market-based deposit insurance pricing. The proposal I have in mind is Sen. Alan Dixon's clever concept of having the FDIC reinsure with the private market a small pro rata portion of its risk on the largest banks. In that way market pricing can be introduced without replacing the FDIC. More to the point, once a competitive market develops in providing such reinsurance, the FDIC can be guided in its early intervention decisions by reinsurers' cancellations of their FDIC insurance contracts on specific banks. As I write, Sen. Dixon's plan has been included in the draft banking reform plan offered by the Senate Banking Committee, and hopefully it will survive the legislative tortures ahead.

Notwithstanding the above comments, I thought both articles pre-

sented very well the pros and cons of narrow banking.

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Promoting Mutual Recognition

TO THE EDITOR:

The article on "Regulation of International Securities Issues" (Vol. 14, No. 2, 1991) by Professor Paul G. Mahoney urges mutual recognition of securities disclosure requirements as a route to the trading of foreign issues in the United States. As Professor Mahoney points out, the Securities and Exchange Commission (SEC) has preferred harmonization or the convergence of national standards over reciprocal treatment and has only accepted de facto mutual recognition through the backdoor route of exemptions from registration of issuers under the federal securities laws. However, the SEC's Rule 144A initiative has been a marketplace failure and has not served to facilitate the purchase of foreign equities by U.S. investors. Furthermore, even if Rule 144A were better utilized, it would only help large institutional investors and would provide no relief for individuals who wish to diversify their portfolios through the purchase of foreign equities.

There is a widespread assumption which seems to be shared by Professor Mahoney that foreign issuer disclosure regulation would require statutory amendment. This is not so. The SEC has ample rulemaking power to permit foreign securities to trade in the United States through a regime involving mutual recognition. The SEC already differentiates between disclosure by U.S. issuers and disclosure by foreign issuers by having special forms for the registration of foreign securities.

There are at least two ways in which the SEC could embrace mutual recognition as a principle to permit the trading of foreign equities in U.S. markets. The SEC could simply expand an existing exemption from registration provided by Rule 12g3-2(b) under the Securities Exchange Act of 1934 to any class of foreign issuers meeting whatever accounting and disclosure standards the SEC might establish. For example, any world-class company trading on any recognized foreign market could be allowed to utilize this exemption by furnishing to the SEC its home country disclosure documents.

Second, the SEC could recognize a body of international accounting standards such as those of the International Accounting Standards Committee (IASC) as international generally accepted accounting principles (GAAP) acceptable for filings in SEC registration statements. In February 1991 I presented a report and recommendations to the New York Stock Exchange, Inc., on barriers to foreign issuer listings that contain these and certain other recommendations that could serve as a basis for the trading of world-class issues in U.S. securities markets.

The SEC has thus far been opposed to mutual recognition because it is afraid that U.S. issuers will object if foreign issuers are subject to accounting standards perceived as less rigorous than U.S. GAAP. However, there is little or no evidence that this is so. Perhaps the SEC's real fear is that U.S. issuers might seize on such a step to their advantage in the debate over whether the costs of U.S. accounting regulation exceed its benefits. The likelihood is that objections to any relaxation of foreign issuer disclosure and accounting standards will come not from issuers but from those constituencies that benefit the most from current SEC policies—U.S. lawyers, accountants, and financial analysts.

Professor Mahoney argues that regulatory arbitrage would occur and be beneficial if the SEC were to adopt mutual recognition of foreign issuer disclosure and accounting standards. As suggested above, the SEC also believes in regulatory arbitrage, but would not view such a development as positive. However, better and more soundly based arguments exist for mutual recognition.

A company doing business in its home market and having its common stock traded there will have its securities priced on investment decisions in the home market based on local GAAP and disclosure standards. Accordingly, while reconciliation to U.S. GAAP may be of interest to analysts and others, U.S. GAAP financial statements do not affect stock prices for foreign issuers the way they do for U.S. issuers. Further, in an efficient market, which exists for world-class securities in mature foreign markets, reconciliation to U.S. GAAP generally produces no surprises.

The investing public in the United States, whether institutional or individual, is becoming increasingly sophisticated. Although education concerning foreign accounting practices and foreign financial statements, as well as the work of the IASC, would be useful, translation into U.S. GAAP may not always be necessary. On the contrary, having two sets of financial figures circulating in the market may be confusing to investors. Unsophisticated retail investors may be more confused than enlightened by learning that company X made $1 a share last year under its home country GAAP and $1.15 under U.S. GAAP. On the other hand, sophisticated analysts and institutional investors who understand the reasons for such discrepancies are generally more interested in home country financial information because they know that these figures establish share prices in the home market. Where such home markets are mature and efficient, the home market price establishes stock market pricing worldwide. Therefore, mutual recognition makes more sense than trying to impose U.S. disclosure and accounting standards on the rest of the world.

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Asserting Shareholders' Rights

TO THE EDITOR:

My good friend Fred McChesney is uncharacteristically wrong in the piece he and William J. Carney wrote on the Delaware Supreme Court's decision in the *Time-Warner* case ("The Theft of Time, Inc.: Efficient Law and Efficient Markets," Vol. 14, No. 2, 1991). They argued that the court correctly left the issue to be resolved by the relationship between shareholders and management. Indeed, that was just what the court prevented, by allowing the Time board to push through a version of the deal hastily reconstructed just to take the decision away from the shareholders. The board's utter disregard for the rights of share-

"Do you have anything for a board of directors?"

holders was demonstrated even further by the line of succession it established for directing the company, which is supposed to be determined by shareholders.

McChesney and Carney, like the court, place considerable weight on the Time board's two-year process of considering the merger with Warner, which included consideration and rejection of a merger with Paramount. They neglect to point out that the board also included consideration and rejection of a merger with Warner on the very terms that ultimately went through—the debt deal that was only attractive when it was necessary to thwart shareholder consideration (and rejection) of the equity deal.

McChesney and Carney say in one line that "Time's board never considered the Paramount bid seriously..." and then say in the next, "The board also concluded that Paramount's initial offer was inadequate." Which was it? Which was the exercise of business judgment that the authors are so anxious to protect? As for editorial independence, assured, in the authors' view, by having the senior editor of *Time* report to a special committee of the board itself, it seems that they, and perhaps the board itself, forgot that there were other publications to worry about. If they had remembered, perhaps Graef Crystal would not have found it necessary to sever his ties with *Fortune*, owing to editorial interference with his criticism of outrageous pay packages, including that of Time-Warner's Steve Ross.

What troubles me most, though, about their article, is their conclusion that court intervention is unnecessary because shareholders have alternatives. According to McChesney and Carney, shareholders can "reserve to themselves any decision that they wish to make," and they can "punish errors after the fact by removing erring managers." In the words the authors themselves quote, I suggest that finding examples of such alternatives is "a search for a very small number of needles in a very large haystack." And I suggest further that this is not evidence of satisfaction with the current system, as the Panglossian efficient market theorists would suggest, but rather evidence of the obstacles to the free market that corporate management has been successful at constructing.

"Shareholders can always punish mistakes by changing directors," according to McChesney and Carney. "And shareholders can and frequently do protect against excessive management interest in job preservation, in the form of stock ownership and options, to align their interests with those of shareholders." In fact, shareholders have virtually no role in the selection of directors or the design of option plans. The collective choice problem and profound conflicts of interest have prevented shareholders from any meaningful involvement in these matters, or in the other avenue for change the authors suggest, amendment of the corporate charter.

Just two of the many examples are: Norton's defeating a hostile takeover attempt by pushing through an amendment to the state law *requiring* all companies to have staggered boards (an option that was already available *with* shareholder approval) and Sears' defeating my colleague Bob Monks' contest for one board seat by (1) budgeting $5.5 million (or, as *Crain's Chicago Business* pointed out, one out of every seven dollars the retail operation made last year) and (2) playing "Honey, I shrunk the board," by eliminating three directors and thus making it virtually impossible for him to win, as a matter of mathematics.

Time management was faced with a choice between a deal carefully crafted to protect its own managers and one that was not, but which offered a substantial premium to shareholders. Should they be the ones to make that decision? I think it should be the shareholders. Their money is on the line; let them decide whether they can do better in the long term to take Paramount's cash offer (and then reinvest that cash profit wherever they choose, even in Paramount) or support the Time-Warner merger and realize greater gains later on.

The lower court said that "[d]irectors may operate on the theory that the stock market valuation is 'wrong' in some sense without breaching faith with shareholders." But they may

only operate on that theory if they base it on fact. Let the board demonstrate to the shareholders that they can do better. Without that, we abandon any pretense of a market test, in favor of "expert opinion," paid for by management, usually with a contingent "success factor." While adherence to such notions may have surface appeal in providing a basis for deciding certain cases, the decision denies owners the right to sell their shares to a willing buyer at a mutually agreeable price. And *that* is what the market is about.

When directors, owing to the impact various alternatives will have on their compensation and employment, have a conflict of interest that prevents their fulfilling their obligation as fiduciaries to protect the interests of the shareholders, then the decision should be made by the shareholders. That is the critical issue ignored by the court and the authors of this article.

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Honoring Corporations' Rights

McCHESNEY and CARNEY reply:

Ms. Minow's letter exemplifies perfectly why we wrote our article. Like most observers, she prefers to talk about why the Time board made a bad business decision—which it certainly did.

Our article noted, though, that the existing contractual and legal allocation of property rights within the corporation means that shareholders assume the risk of directors' honest but mistaken actions. Share prices, management salaries, and other relevant prices reflect this well-established allocation of rights and risks, known legally as the "business judgment rule."

Many who assume risks ex ante and then suffer losses ex post turn next to legislators and judges, claiming that the rules were wrong or unfair. Ms. Minow apparently does not like the business judgment rule when shareholders lose. (She says nothing about gains to shareholders overall from the rule, which was the focus of our piece.) Her dislike of the rule and preference for government intervention are hardly reasons for courts to ignore well-established rules allocating rights within the corporation.

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Pursuing Academic Freedom?

TO THE EDITOR:

It is interesting that neither author of "Keep Mandatory Retirement for Tenured Faculty" (Vol. 14, No. 2, 1991) is an economist. The authors, Richard A. Epstein and Saunders Mac Lane, employ the typical "economic reasoning" that has led to numerous jokes about economists' dealing with various situations. The punch lines of all these jokes begin: "First, you assume...."

Indeed, this is exactly what Epstein and Mac Lane do. They assume their way right to the conclusion expressed in the article's title. Their assumptions that whatever the market does is good and whatever government does is bad will be welcomed by other worshippers at the altar of free-market efficiency. However, their religious fervor should be recognized as such and as a poor substitute for scholarly analysis and intellectual inquiry.

The assumption critical to their entire argument is that older faculty are less desirable than younger faculty. Yet despite this assumption, they note that retired academics often continue teaching and writing and are in some cases sought after by other institutions. It sounds as if they believe that at least some of these less desirable teacher-scholars are still viable as teacher-scholars. Heaven forbid they change careers to become President of the United States or a Supreme Court Justice!

Even if on average their assumption is true, that does not justify allowing the imposition of a blanket rule to deny any consideration for those capable older faculty members to continue in their current positions. Should we then allow colleges and universities to exclude women from consideration for long-term, tenure-track positions because women, on average, leave the work force for some period of time to raise children more frequently than men? The adoption of such blanket rules because they are easy to administer is no more fair than necessarily economically efficient.

Indeed, administrators frequently may adopt such policies because they are easier than making a case-by-case judgment based on performance concerning when individual faculty members should be dismissed. They can avoid making such decisions because the quality of a school and the education it provides are difficult to judge, and such judgments are based on a myriad of factors, not just the hiring or retiring of older faculty. The minority of schools that hire retired faculty members have not been able to convince the market that this one factor makes them superior to all others in overall quality. Thus, administrators may impose this policy because the academia market is not sufficiently efficient to penalize it, but market efficiency is best served by having the best academics employed at the best institutions.

In discussions with my academic colleagues, I have noticed that they tend to disfavor tenure until they obtain it. Unlike Professors Epstein and Mac Lane, I have not obtained this most favored status, so it should not be surprising that I shall next attack their assumption that it is efficient.

They freely admit the shortcomings of the tenure system, namely, possible "retirement on the job," but again offer supplication to the "great free market" that has widely adopted the system. They further note that the market still provides incentives such as raises and perks for academics to continue working hard after tenure. Interestingly, they have little problem with performance reviews for making these determinations, but if possible dismissal were at stake—putting academics on an equal basis with most everyone else—they state that the "anxiety level would increase a thousandfold." They suggest that academics should not be subject to this type of incentive/stress that the common factory worker faces. I, and other untenured academics, of course, are subject to this "thousandfold" anxiety, and I would like to report that I, and others I know, are holding up rather well.

Epstein and Mac Lane trot out the hackneyed justification for tenure—academic freedom. Of course, giving someone lifetime employment to preserve the ability of scholars to research and write about whatever they

please is comparable to using a stealth bomber to kill a housefly. Both accomplish the objective, but do a lot of other damage. There are at least three flaws with using academic freedom as a justification for tenure.

First, who cares about academic freedom at a single institution? With the large diversity of schools, consulting firms, and think tanks that exist today, most every viewpoint is financially supported and represented in academic debate. Despite my earlier antimarket rhetoric, I actually would be confident that if a particular view was not well represented, it would be a market opportunity for one or more institutions to sponsor that view as a method of competition.

Second, if academic freedom should be zealously guarded at each academic institution—despite a lack of evidence that it was ever threatened at most—why not establish a faculty committee or outside arbitrator with complete authority in this area? The committee or arbitrator could overrule all adverse decisions such as dismissal or lack of promotion once the faculty member proved that the decision was intended to restrict academic freedom.

Finally, why does the market almost universally adopt the tenure system that I have argued is inefficient? The answer is simple. It does not. The tenure system is almost universally adopted because academics have effectively cartelized the market in this regard. They have persuaded state and federal governments that because the quality of higher education is difficult to evaluate, schools must be accredited as meeting a minimum standard of quality. Accreditation standards not only call for a system of tenure, but schools are judged by the proportion of their faculty that are on the tenure track.

I have often though that Babson College, as a business school, could abolish tenure and distinguish itself in the marketplace by announcing that its faculty members are qualified to teach about competition, because unlike schools with tenure, Babson College faculty members compete to retain their jobs every day. Unfortunately, any benefit to such a strategy would be outweighed by the loss of accreditation.

Epstein and Mac Lane raise an important policy issue in their article, but they should consider other alternatives for addressing the problem beyond the instinctual response of calling for less government intervention. Perhaps an antitrust case against accrediting boards for requiring tenure would solve the problems they raise, but still allow older scholars the same rights and dignities as most everyone else—not to be discriminated against because of their age.

Moreover, Epstein and Mac Lane should not discount the ability of the market to deal effectively with the possible change in the Age Discrimination in Employment Act. Even if some schools become bogged down with less productive, older faculty, other schools will be formed. Many states, such as Massachusetts, are having difficulty maintaining state-supported colleges. As private institutions replace at least some of these, these new schools can structure retirement incentives properly to be able to boast about their young, "cutting-edge" faculty. If tenure is not required for accreditation, then these new schools can offer higher job salaries in exchange for slightly less security. Then we shall truly have a competitive academic market that will enhance academic freedom and the intellectual capital of this country.

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P.S. Please publish this letter so it will help me obtain tenure—I am somewhat anxious about it.

Academic Efficiency

TO THE EDITOR:

I just finished reading Richard A. Epstein and Saunders Mac Lane's article, "Keep Mandatory Retirement for Tenured Faculty" (Vol. 14, No. 2, 1991). I thought about this issue and prepared a short note for *Science* in 1979. I did not attach enough weight to the cost of monitoring performance. A university is a loose collection of nearly independent workers whose "outputs" are very different. Measuring the "output" of an experimental physicist poses a hard problem, and comparing it with the "output" of a musicologist is mind-boggling.

Data on academic salaries confirm the authors' claim that productivity declines with increasing age. The relation of salaries to age for full professors reveals that the coefficient of age is negative. From what I can gather, removing the upper age limit for retirement will have no effect on the age structure for faculties at most four-year colleges and state universities. Epstein and Mac Lane are right, namely, the impact will be felt at only a very small number of front-line universities. I would strongly endorse a proposal extending the present ruling applicable to executives to tenured professors. Specifically, if the university's retirement plan provides a pension of at least $44,000 a year, it can insist upon a contract calling for a mandatory retirement age.

Victor Fuchs and others have remarked on the relation of health to age. Aging is associated with a decrease in the mean level of health, but the most noticeable effect is its impact on dispersion. As we age, our states of physical and mental health fall apart at very different rates, and employers are faced with the problem of sorting and reassigning us to different tasks depending on our health state. When I was a kid, potatoes came in 100-pound sacks and were put into boxes at the corner grocery store. As the potatoes aged, the proprietor would spot the rotten spuds, throw them out, and sell the remainder. When potatoes were put into five- and ten-pound bags at a packing shed, it increased sorting costs. If one potato spoiled, it was cheaper to throw out the entire bag than to incur the cost of sorting and repackaging. Mandatory retirement is similar to throwing out the bag. The truly good spuds can be retained via individual term contracts; we always did this for the best professors. Indeed, the age of mandatory retirement in private Japanese corporations is inversely related to company size because in a smaller firm, sorting costs are lower. Employees are asked to retire at around 55 in the biggest firms and 65 in firms with less than 100 employees. Aging is never easy. A few months ago, my daughter read the following quotation to me: "The pity is not that the desire has failed, but that someone has to be told about it" (W. H. Auden). (It was on a calendar.) I hope that Epstein and Mac Lane's article has an impact on Congress. Our universities seem to be able to find ways to be inefficient. We do not need more federally mandated rules like uncapping retirement ages to encourage more inefficiency.

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Keeping University Governance

EPSTEIN and MAC LANE reply:

The letters of Professors Oi and Petty provide an instructive contrast in response to our article on "Mandatory Retirement for Tenured Faculty." To Professor Oi, we can only say thank you for providing additional empirical evidence and theoretical reasons to bolster our conclusion. To Professor Petty, we recommend that he study Professor Oi's letter and make some brief reply to his own rambling letter.

First, the key question with respect to mandatory retirement is whether the decision as to institutional structure should be made once and for all in Washington or by many independent academic institutions. Our ostensible "worship" at the altar of the free market is only a preference for decentralized decisions by institutions that have a strong incentive to find the right mix between case by case determinations (for example, awards of tenure) and blanket rules of retirement. There are no guarantees that these determinations will be correct, but the likelihood of error will be far lower than those generated by the political process, where very different incentives are at work. The record of government in running anything is hardly enviable. Universities are no exception to the basic rule. If Mr. Petty can persuade Babson College to scrap mandatory retirement for senior faculty, we have no wish to stop him. We only wish that the University of Chicago, like other universities and colleges, be free to reject his solutions to our problems.

Mr. Petty also misunderstands the arguments that are in favor of the current system. We do not praise administrative efficiency as an end in itself. But by the same token it is surely a relevant consideration. Administrators are normally drawn from academic ranks, and many administrative decisions are made by faculty members who have other demands on their time. We think that the overall operation of the university will be improved if their valuable time and effort can be diverted from costly and divisive reviews of individual retirement cases to new and vital university programs and projects.

Of course, the mandatory retirement rule (like all rules) has its costs, given the wide variation in abilities of faculty members both before and after retirement. But we have no doubt, first, that over time the abilities of

"JUST KEEP IN MIND THAT HE'S VERY UNPREDICTABLE."

academics do decline, and that there are few, if any, faculty members who do better work at 70 than they did at 40. That baseline information should not be ignored in making institutional judgments just because it represents statistical calculations and not necessary truths. After retirement, vigorous scholars can (at least in an academic market not constrained by mandatory retirement rules) seek a full range of positions, full and part time, at other institutions. Having faculty members return to the market will (a) encourage them to keep their skills current, (b) allow decisions on hiring to be made not by colleagues and friends but by independent persons, and (c) reduce the bitterness and frictions of litigation. These real and substantial advantages are destroyed by uncapping.

Mr. Petty also misfires when he compares age and sex discrimination. The simple point is, wholly apart from the antidiscrimination laws, the internal calculus of cost and benefit differs radically between these two practices. With sex discrimination, the question is whether one group should be excluded from the process throughout. It is not a question of all individuals' sharing in the lifetime benefits and burdens of a successful ongoing system. It is also difficult to conceive of any university that would define its own self-interest in a way that cuts it off from a major source of faculty talent, which exclusion by sex would do. Within universities the only debates over sex discrimination concern the vexed subject of affirmative action. Here Professor Petty would be wise to heed the lesson of the market. What is possibly gained by linking together practices so different in the costs and benefits that they create?

Finally, Mr. Petty misses the boat on tenure. Its disadvantages need not be rehearsed anew, but its benefits should be mentioned. Professor Petty does not address the governance issues we elaborated at length in our article. Nor does he consider its other advantages. Tenure frees faculty members to pursue long-term projects, perhaps with huge payoffs for knowledge and science, which they could not undertake if faced with yearly renewals. And his own rhetorical query, "Who cares about academic freedom at a single institution?" leaves us speechless. The dangers to academic freedom come both from centralized government control and from mass and popular movements. Is the memory of Sen. Joseph McCarthy so faint that we have forgotten lessons once well understood? Is political correctness not a problem today? By advocating a national legislative solution to the issue of mandatory retirement, Mr. Petty necessarily links the fate of scholars at one institution with the

fate of scholars at others. The diversity of institutions on which he relies to defend academic freedom is necessarily diminished by the national policy on mandatory retirement that he advocates. If officials in Washington can determine this issue, then why not any other?

Petty's sketchy alternative proposal is wanting as well. Using outside arbitrators to protect faculty members from threats to their academic freedom strikes us as cumbersome, counterproductive, and naive. Who appoints the arbitrator and ensures that he does not stray beyond his charge? But we may be wrong, and we are content to let any university or college adopt Petty's system, so long as those of us who disagree can reject it. We also doubt that tenure is merely a creature of external accreditation. If that system were changed tomorrow, tenure would remain for the internal advantages it creates. The competition among universities is evidence enough that tenure is not just a crude disguise for an academic cartel. But any institution persuaded by Mr. Petty's muddled arguments can drop tenure and bear the consequences of heeding his bad advice.

In sum, Mr. Petty has not shown how universities will be improved if the mandatory retirement policy is removed by government fiat. We are not surprised. The recent report of the National Research Council under the auspices of the National Academy of Sciences *(Ending Mandatory Retirement for Tenured Faculty)* is, alas, also devoid of a single argument that explains why government uncapping of mandatory retirement policy will help universities and colleges better discharge their central missions of research and teaching. The success of American higher education is dependent upon the policies that have allowed its universities and colleges to reach a level of excellence obtained nowhere else in the world. We should not let ill-considered attacks on established practices fritter away one of the great American success stories.

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Antitrust's Longevity vs. Social Efficiency

TO THE EDITOR:

I found the "Defense of Antitrust" by FTC employees James Langenfeld and John R. Morris to be thoroughly unconvincing. Their argument that the "longevity" of the antitrust laws in the U.S. suggests the laws "improve social welfare" ignores both economic reasoning and common sense. Protectionism is another kind of law that has "longevity," but no economist worth his or her salt would argue that it is socially beneficial. The reason protectionism persists (and grows) is that it bestows benefits on relatively small, well-organized, and well-financed interest groups, while dispersing and disguising the costs. The same is true, I have argued, of antitrust. "Longevity" does not necessarily have anything to do with social efficiency.

These authors claim that my article, "The Origins of Antitrust: Rhetoric vs. Reality" (Vol. 13, No. 3, 1990) provided no evidence that antitrust laws restrain output and the growth of productivity. I did not set out to provide such evidence; the article did, however, refer to a voluminous literature that does. After accusing me of offering no "evidence" to support my assertions, they cite a *purely theoretical* article by Robert Lande claiming that the Sherman Act was passed to protect consumer interests. But Lande's article is not only void of any empirical evidence; it is also wrong. In the July 1988 issue of *Economic Inquiry* ("Antitrust and Competition, Historically Considered") Jack High and I documented that at the time the Sherman Act was passed the economics profession had no "efficiency rationale" for antitrust, as Lande incorrectly claims it did. The allocative efficiency rationale was invented decades later. In 1890 the economics profession was virtually unanimously opposed to the Sherman Act.

As virtually all government regulators do, Langenfeld and Morris believe in what Friedrich Hayek has called "the pretense of knowledge." They believe that a small number of "experts" in Washington can somehow possess all the knowledge required to determine what constitutes an "efficient" organization of industry. The fatal flaw in such reasoning is its failure to recognize that only the market process can reveal such information. For government regulators to pretend that they can possess such knowledge apart from the market process is truly pretentious. This is why Langenfeld and Morris and others believe (mistakenly, in my opinion) that it is possible for them to distinguish between "good" and "bad" predation. Their comment that "nonprice predation in fact occurs" is disingenuous. Of course predation occurs; the whole purpose of any *competitive* business is to underprice and outsell the competition—to prey on competitors. FTC interference with such practices is nothing but mischievous speculation dressed up in economic theory.

Finally, the larger issue here is noneconomic. The issue is whether private property and freedom of choice are to guide resource allocation decisions, or whether government control over the means of production—socialism—is more desired, at least in some circumstances. In their book *University Economics* (1967, p. 325) Armen Alchian and William Allen put this issue into proper perspective in their discussion of mergers. "Economics gives no judgment about this," they wrote, for "a proposal to prevent voluntary pooling of private wealth is denial of private-property rights. The criterion of 'misdirected' or inefficient use of resources is itself dependent on the normative premise that individuals should have the right to make the choices about use of goods. If we accept a criterion of efficiency relying on open market revelation of values, we cannot logically deny full contracting rights to achieve efficiency. . . . Yet that is what a refusal to allow mergers amounts to. Of course, there may be grounds *other* than efficiency for objecting to collusions and mergers —private property and individual choice may not be socially desirable institutions."

By claiming that government control over the means of production is in some cases desirable, Langenfeld and Morris and all other antitrust enthusiasts fall into the same pretense of knowledge trap that dooms all socialistic enterprises. The FTC, like all other socialistic enterprises, is inherently socially detrimental despite the best intentions of the people who work there.

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