

A.I.E.R. AFTER 60 YEARS

Our History and Plans for the Future



ECONOMIC EDUCATION BULLETIN

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I.

INTRODUCING AIER

AMERICAN Institute for Economic Research, founded in 1933, is an independent scientific and educational organization. The Institute's research is planned to help individuals protect their personal interests and those of the Nation. The industrious and thrifty, those who pay most of the Nation's taxes, must be the principal guardians of American civilization. By publishing the results of scientific inquiry, carried on with diligence, independence, and integrity, American Institute for Economic Research hopes to help those citizens preserve the best of the Nation's heritage and choose wisely the policies that will determine the Nation's future.

The Institute represents no fund, concentration of wealth, or other special interests. Financial support for the Institute is provided primarily by the small annual fees from several thousand sustaining members, by receipts from sales of its publications, by tax-deductible contributions, and by the earnings of its wholly owned investment advisory organization, American Investment Services, Inc. Experience suggests that information and advice on economic subjects are most useful when they come from a source that is independent of special interests, either commercial or political. As described below, the provisions of its charter and bylaws ensure that neither the Institute itself nor members of its staff may derive profit from organizations or businesses that may benefit from the results of its research. Institute financial accounts are available for public inspection during normal working hours of the Institute.

AIER's Origins

Although serious intellectual work almost invariably requires the cooperation of — and draws on the knowledge accumulated by — others, the Institute's early work was shaped predominantly by the research of its founder and later Director Emeritus, Col. Edward C. Harwood (1900-1980). A graduate of the United States Military Academy, he was serving in the Army Corps of Engineers in the 1920s when, as an avocation, he undertook the intensive study of economics, with particular emphasis on money-credit problems. In 1928 and 1929, he warned in several articles that appeared in leading financial journals that the speculative "boom" then underway was attributable primarily to the excessive creation of purchasing media (*i.e.*, inflating the money supply) and that failure to stop the inflating process would lead to a major "bust."

By 1933, the magnitude of the Great Depression suggested the need for a research organization to inquire into the wide range of economic, social,

and monetary developments that had contributed to the catastrophic economic contraction. The hope was that by further developing and applying modern scientific procedures of inquiry, results could be obtained that would be useful to the Nation in avoiding a repetition of the disaster.

Col. Harwood deemed it necessary that such an organization avoid financial dependence either on Government sources of funding or on a few individuals or groups with pet panaceas or special interests. Dr. Vannevar Bush, then vice-president of the Massachusetts Institute of Technology, suggested that some of the results of such independent research might be helpful to individuals seeking to resolve their personal economic problems and that the sale of publications based on that research could provide a significant source of income. If, in addition, small annual contributions could be gained from thousands of individuals, an organization *entirely independent* of any one or a few wealthy individuals, or of a conventional endowment fund, might be possible.

With the sum of \$200, the Institute began operations in 1933 under Harwood's direction. The initial plan proved sound. Since its inception, Institute publications have enjoyed a wide sale, and thousands of Sustaining Members provide a financial base for its work.

Initially AIER was housed in the office of a staff member at the Massachusetts Institute of Technology, but soon expansion required more space. For several years the Institute occupied buildings in Cambridge, Massachusetts, prior to the move to the present property in the Berkshire Hills of western Massachusetts in 1946. By 1957, the Institute again was outgrowing its space and further expansion was required. In 1962, the E. C. Harwood research library was completed, and housing for staff members, graduate students, and Fellows was completed in 1968.

In 1993, a comprehensive renovation of the library building's 10,000-square-foot workspace was undertaken to accommodate the demands of the "computer age." With the installation of new hardware and software, AIER's computerized research facilities now employ "state of the art" information technology, including on-line access to most major libraries in the United States.

Related Organizations

On February 5, 1979, American Investment Services, Inc. (AIS), wholly owned by AIER, was registered with the SEC as an investment advisor and began operations. AIS applies AIER's fundamental research findings and procedures in developing its recommendations for individual investors, shares AIER's facilities, and is the only investment advisory organization that is recommended by AIER.

Although AIER's primary emphasis is on economic problems, those problems are related to many of the concerns — and inadequacies — of other behavioral science fields. In the early 1960s, with the aid of AIER and Col. Harwood, the Behavioral Research Council for Scientific Inquiry into the Problems of Humans in Society (BRC) was founded. Two of the books published by BRC, *A Current Appraisal of the Behavioral Sciences* and *Useful Procedures of Inquiry*, have been unusually successful. In 1984, BRC became a division of AIER. In 1968, again with the aid of AIER and stimulated by Col. Harwood, Progress Foundation was founded in Switzerland in order to foster research on the advance and retardation of civilizations.

AIER's independence from special-interest groups — and its close attention not only to proposed solutions to fundamental economic problems but also to useful procedures of inquiry into those problems — makes AIER unique among economic research organizations. AIER's longer-run success has been assisted greatly by a program of charitable giving, described in Chapter V, whereby donors transfer property to AIER as trustee and remainderman but reserve a life income interest for themselves and other beneficiaries. In mid-1993, the market value of the assets held in these trusts was in excess of \$90 million. As AIER receives the principal through the years, its scientific and educational work can be expanded.

Requirements of an Independent Research Organization

First and foremost, our efforts are directed toward the pursuit and dissemination of useful knowledge that is derived from *genuinely independent* scientific research. Our hope is that such efforts may foster greater understanding of the fundamental economic relationships affecting the citizens of the United States, both as individuals and as members of a complex society. In this respect, our ultimate objective is to advance the welfare of the American people.

To achieve this purpose, the Institute's *Bylaws* require that its operations adhere to a number of provisions that render it unique among "think tanks." Unlike other prominent charitable research organization with an interest in public policy, and unlike any number of "public interest" research groups that in effect are special-interest lobbies, AIER accepts no funding whatsoever either from Government sources or from large corporate donors and has no commercial connection with any outside enterprises. Unlike most academic institutions, the Institute is prohibited from maintaining any large endowment; rather, the funds it receives must be expended for Institute purposes within a reasonable time after receipt. We do not accept advertising of any sort in our publications, and we do not sell or rent the names of our subscribers or contributors to anyone else. No

shareholders or individuals may have a personal or private interest in the resources of the Institute. Moreover, the Institute is completely nonpolitical. None of the income or property of the Institute may be contributed to any political party or candidate, and Institute personnel are prohibited from engaging in political activities of any kind during regular hours of duty. In short, AIER has no commercial or political interest in promoting one product or policy over another, and it has no political or corporate patrons to whom it must cater. Our sole purpose is to serve the interests of the public and the Nation.

In this endeavor, we “live or die” by the market. The major portion of our revenue comes from sales of our research findings directly to individuals, and unless our readers judge that research useful, we will not prosper. Our situation thus differs markedly from that of most “ivory tower” academic departments, which are isolated from the market and largely out of touch with the genuine needs of most families and businesses. In this age of out-of-control educational costs and out-of-touch educational curricula, we believe that the need for useful low-cost information about matters of genuine importance to individuals and the Nation is greater than ever. Through our publications and other educational programs, American Institute for Economic Research is uniquely positioned to help lead the way toward a sensible approach to finding solutions to the problems that loom as the next century dawns.

II. PUBLICATIONS

MOST of the Institute's educational efforts are carried on through its publications, which we seek to distribute to as many readers as possible. To this end, we have tried to keep the costs of our published works as low as possible. They do not have slick covers (they look like this bulletin), and they are absent the patronizing illustrations and other "bells and whistles" found in many trendy business and personal financial publications that sell for many times the price.

Unlike the special interest organizations, we also have resisted hiring a professional public relations firm to design a "look" for the Institute's publications. Although they are plain (some might say old-fashioned) by industry standards, our publications are meaty, and contain very little wasted space. We trust that most readers who benefit from our publications value them for their content rather than their appearance.

That said, we generally assume that readers have little prior acquaintance with the technical aspects of the subject under consideration, and whenever possible we supplement written texts with graphic illustrations as an aid to comprehension. We do assume, however, a level of literacy that permits us to engage the reader's interest without resort to flashy gimmicks.

Sustaining Memberships with AIER

Two serials, the monthly *Economic Education Bulletin* and the twice-monthly *Research Reports*, form the core of the Institute's publications program and are sent to all individuals who enter a Sustaining Membership with the Institute (\$59 a year; see information at back of this booklet). Through these two publications, Sustaining Members are kept abreast not only of current issues on personal finance and public policy, but also of fundamental economic and monetary trends. For 60 years AIER's quiet research often has anticipated "popular wisdom" by months and sometimes years. Some of our work eventually finds its way into and is quoted in newspapers and magazines (e.g., *Barron's*, *Newsweek*, *Business Week*, *The New York Times*, *The Wall Street Journal*, *Fortune*, *Forbes*).

More often, confirmation of our findings has awaited the disclosure in the popular media of some crisis whose potential we identified long before (for example, the Medicare and Social Security "crises") or of other "surprising findings" that belatedly report matters about which our readers already are informed (for example, that rather than contracting in the "worst recession since the 1930s," the economy was expanding — and

had been doing so for many months — at the time of the 1992 presidential election). Either way, AIER Sustaining Members often have been privy to developments reported in *Research Reports* and the *Economic Education Bulletin* well before they were featured on the evening news.

Each issue of *Research Reports* discusses two or three current economic events in a concise 4- to 8-page newsletter with executive summaries at the beginning of each article. One *Research Reports* article each month is devoted to current business-cycle conditions. Each of these monthly discussions includes a full set of charts of AIER's primary leading, coincident, and lagging statistical indicators of business-cycle changes. Unlike the "snapshot" analyses in most popular news media, which often hype inconsequential monthly changes in one or two economic time series, AIER's analyses follow moving averages that capture cyclical trends. While many media reports show only a month or two (or perhaps a few years) of data, AIER Sustaining Members each month see historical data extending back to 1945, shaded business recessions, and insets that highlight recent changes. In short, Sustaining Members get to review data that place the economic statistics that feed the media grist mills in perspective.

Unlike many economists, we do not attempt to provide quantitative estimates of the future performance of the economy as we do not believe that such estimates can amount to more than guesswork or wishful thinking, at best, or telling clients what they want to hear, at worst.

In fact, we believe that a *quantitative* forecast that is *qualitatively* wrong is worse than no forecast at all and that, because quantitative forecasts are typically based on "models" (sets of algebraic formulae) that necessarily have strong biases toward extrapolating recent trends into the future, they are less likely to indicate turning points in economic activity than our procedure of looking for such turning points directly. Yet it is the turning points that are of most relevance to economic decision makers, and we believe our findings can be useful to businessmen, investors, consumers, or even to workers interested in changing jobs.

We do not claim that our procedures are infallible. They have changed considerably over the years and we are always looking for ways to improve them.

While *Research Reports* seeks to provide a concise discussion of some current issue, AIER's *Economic Education Bulletin* seeks to provide in-depth discussions of matters relating to fundamental questions in economics, personal finance, and general policy questions. The *Economic Education Bulletin*, which may vary in length from four pages to book-length studies of more than 150 pages, covers topics such as Social Security, Medicare, pension plans, homeownership, life insurance, taxes, inflation,

gold, mutual funds, and other personal financial information. Individuals may enter an Education Membership for \$25 a year and receive only the *Economic Education Bulletin* for 12 months.

In addition to revenues from AIER's Sustaining Memberships and Education Memberships, the Institute receives substantial revenue from sales of its booklets to nonmembers. Each year, tens of thousands of individuals purchase AIER's publications in response to direct-mail solicitation. In terms of the number, now more than 400,000, of recent purchasers of Institute publications, the Institute ranks as one of the largest providers of private economic education in the United States.

III.

OVERVIEW OF AIER's FINDINGS

ECONOMICS as a scientific field of inquiry presupposes no particular design of the economic order, such as socialism, fascism, or even capitalism. Rather, economic science *per se* eschews both the implicit and explicit normative judgments about outcomes that often are embodied in socio-political philosophies that espouse one or another version of "economic order." Rather, economists seek to ascertain and describe a wide variety of relationships, including socio-political relationships, that influence economic events. In doing so, they seek also to identify those human arrangements that tend to foster progress or regress in social welfare, where progress is described broadly by increases in standards of living, human longevity, and the greater satisfaction of human wants and needs.

Any number of social arrangements have occupied the pages of human history, and invariably all have included some method for allocating available resources among the members of the social group. Some provided for control by a few based on brute physical strength (tyrannical or warlord societies); on title by birth (monarchies and societies with rigid class distinctions); on mystical abilities (witch doctors and seers); and so forth. Judged by the criterion of progress described above, however, history suggests that those arrangements hardly have been successful.

In our view, the most revolutionary, and successful, social order to date has been that based on individual sovereignty, which began to evolve in late medieval England. The development of English Common Law, especially Magna Charta and the termination of Star Chamber proceedings, greatly advanced the rights of persons to be secure in their persons and possessions. However, the most significant subsequent experiment was the Constitution of the United States, and especially its Bill of Rights. The U.S. Constitution affirms the basic Common Law rights of each person to freedom from coercion by others, and embraces the fundamental dictum of equity justice that no one has a right to take without compensation the fruits of another's effort.

Although it often is overlooked (or taken for granted), this social order has enabled humans to achieve hitherto undreamed-of advances in satisfying their wants and needs, both material and psychological. Consider that only 2 centuries ago, the United States was an infant nation, an economic pygmy in a world dominated by a few economic giants. In only 150 years, this pygmy had grown to the stature of the greatest economic giant of all time.

To what aspects of the social order was such great progress attributable? Many have cited the abundant natural resources available in the new

Nation, and these no doubt helped. Yet, other nations such as Argentina, Brazil, and Russia enjoyed similar natural advantages but they did not flourish. Rather, what seems chiefly to have distinguished the experience of the United States were greater individual freedom and a legal structure that preserved individual property rights, both of which evidently promote rapid economic progress in a number of ways. For one, they foster individual enterprise. Persons who might have been prohibited from developing and using their talents in the more restrictive social orders, in the United States were permitted, indeed encouraged, to turn their efforts to any task for which they might be best suited. Not everyone will become a Thomas Edison or Henry Ford, but the more who have the opportunity to develop their full talents, the greater the chance that the specially gifted will be able to employ them for the benefit of themselves and the social group.

Underlying such a social order is the notion that the preservation of behavioral incentives fosters increases in both individual and social well-being. Increased productivity is encouraged, offering greater reward to those who better serve their fellows. This benefits society by making available to everyone, in proportion to their like contributions to output, more of the things that their fellow humans indicate they want. Provision of higher reward to the more productive promotes progress in another way. Larger rewards take the form of larger claims on the resources and products of the society. Thus, in providing larger rewards to those individuals who by their actions demonstrate an ability to serve better their fellow humans, society gives the successful more control of the limited resources available. Oppositely, those who fail to make available useful things lose their power to claim and “waste” resources continually. Accordingly, society automatically and continuously reallocates control of its limited resources away from the less successful and toward the more successful.

The inefficiencies possible in the absence of this market mechanism for economic reward and punishment are evidenced by any number of government-funded operations, which in spite of general recognition of their hopeless inefficiency not only continue in operation but also claim ever more resources in order to overcome the inefficiency. Such is possible by the force of law that government wields. Wherever government has interfered with appropriate rewards, wasteful inefficiency has been much in evidence.

Some Arrangements That Apparently Aid Progress

The key economic aspects of a social order founded on the above premises are grouped under the name, “free-enterprise competitive market capitalism.” “Free-enterprise” simply is recognition of the right of individuals to associate voluntarily in groups to process things. “Markets” reflect the striking of bargains between those wanting to exchange. (A

“seller” exchanges a particular thing for a claim to things in general, or money; the “buyer” exchanges the opposite.) “Competition” is another name for voluntary cooperation, as would-be sellers voluntarily strive to cooperate most effectively with would-be buyers and thereby earn the favor of an exchange. In doing so, would-be sellers voluntarily are guided into the economic roles where each can serve his fellows more effectively and thereby maximize his own reward. Capital is man-made wealth used to process other things; therefore, “capitalism” is the recognition of the private property rights of individuals applied to a particular type of man-made wealth, namely, that used for processing other things.

A society so ordered implies a limited role for government, inasmuch as history records that more people have been oppressed through the mechanism of government than through any other device. This is not to say that government has no legitimate role; quite the contrary. Our Constitution sets forth clear tasks for government, which can be summarized as the protection of freedom and justice from those — domestic or foreign — who would deny them. Thus, defense of the Nation’s borders from would-be conquerors is a proper province of government. The institution and administration of a legal system clearly is another legitimate task of government, but the system of laws and the administration of them must have as their objective the advancement of liberty if progress is to be optimized. In summary, the system should work toward providing and protecting a “fair field with no favor” in which each individual’s freedom is restricted only as necessary to protect the equal freedom of others. This would appear to be a useful gauge by which to assess the probability that specific laws will foster progress or regress of the social order.

In practice, accurate prediction of the results of particular laws often has proven difficult, if not impossible. Even with the best knowledge and intentions, laws may be passed from time to time that lead to regress rather than progress. In our view, the legal system will function usefully only if laws are considered tentative, are reviewed continually for their effect on the social order, and are changed readily when there is substantial doubt that they foster progress. Moreover, given its tentative and experimental character, the process of legislating might usefully pursue incremental decisions that limit the effects of bad laws rather than “all or nothing, go for broke” legislative programs that, if wrong-headed, are disastrous to society.

A Truncated Revolution?

In spite of widespread advances in individual liberty and the economic progress it fostered, at the turn of the present century the social revolution described above was far from complete. Imperfect competition among

market participants fostered glaring abuses that few could ignore: women and children worked 12 and 14 hour days in sweat shops; urban slums were a common blight; and ostentatious wealth contrasted starkly with deep poverty.

In the haste to eliminate glaring social inequities and problems, many well-intentioned reformers apparently overlooked the possibility that a major source of society's problems lay in the direction of imperfect, or incomplete, freedom. While the social arrangements of the time amply encouraged the efforts of the Henry Fords and Thomas Edisons to increase man-made wealth, they also enabled the likes of the Astor family to amass huge wealth not by processing things wanted by their fellow humans but by purchasing much of the land in New York City and claiming as theirs the profit on that land arising from the value added to the site location by society's investment in the community around the sites. The injustice of an order that allows individuals to appropriate for their private use the natural resource wealth of the community was described vividly by Henry George in *Progress and Poverty*, first published in 1879. But this terribly harmful special privilege was not eliminated by appropriate reforms then, and it remains among the greatest injustices of the U.S. social order to this day.

An apparent remedy to the social ills deriving from incomplete freedom is the further extension of opportunity and justice through the elimination of all special privilege. But all too often, the solution to the inequities resulting from the retention and accumulation of special privileges by some parties (which are vestiges of older regimes rather than by-products of the new) has been government intervention that bestows yet more special privileges on others. Since the 1930s, government program after government program has been legislated ostensibly to reduce the suffering of us all, but in practice simply advantage one or another interest group. Federal deficit has piled on top of Federal deficit, year after year; yet, there is no evidence that long-run economic advance has been stimulated. On the contrary, the evidence strongly indicates that Government meddling with free enterprise, especially in the form of inflationary policies, fosters economic inefficiency.

Economists of today cannot agree on a set of policies that would end inflating, maintain economic expansion, and promote a high rate of economic growth. It should not be surprising that these desirable objectives seem beyond reach. Why should anyone expect that a complex and relatively free social structure like that of the U.S. economy would function without dislocations developing from time to time? Literally billions of transactions occur daily among millions of persons, each reflecting personal preferences, an accumulated capital structure and productive machinery, a particular level of technology and of labor skills, a massive

distribution network, and so forth. In addition, most of these things are changing daily, requiring that accurate information be available to producers, savers, investors, consumers, etc., in order that they may adjust their behavior appropriately.

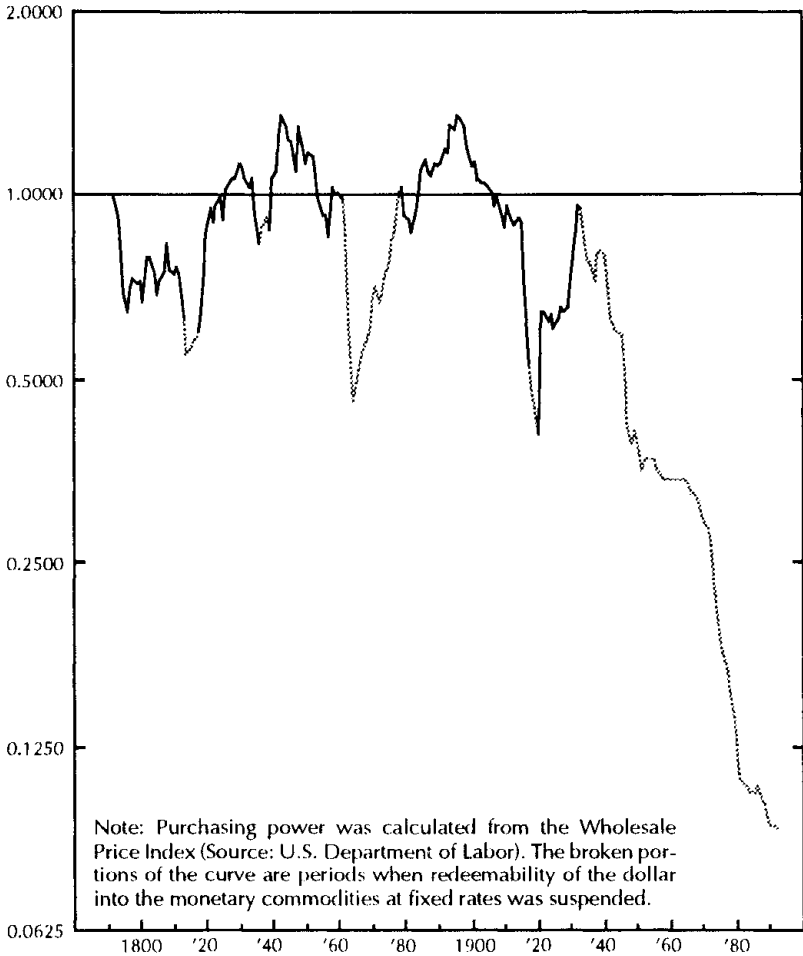
In short, some — but not necessarily extreme — fluctuations in business activity appear to be an inevitable part of a dynamic, free-enterprise capitalistic economy. Corrective contractions perhaps are no more avoidable than are the mistakes people must be allowed to make if they are to develop sound judgment. In this way, economic freedom not only is consistent with the breadth and depth of human experience but also is conducive to a high rate of advance in economic well-being. Efforts to rid the economy of temporary adversities have had the unintended effect of preventing early corrections of distortions, of inhibiting the full development of economic capability, and of denying humans their sovereignty.

Students of American economic history generally have discovered that business activity tends to move in a cyclical fashion. A cycle, put simply, constitutes a period of time in which series of events repeat themselves more or less regularly and in roughly the same order. The tendency of business activity to move in a cyclical manner has been traced back in the United States to 1854, at least. From that time through 1993, 31 complete business cycles have been identified (we are now in our 32nd cycle). The structure of our economy has changed greatly since 1854, yet the business cycle persists. The occurrence of business cycles appears to be one of the few economic events one can count on and AIER has long devoted much effort toward the understanding and description of such cycles.

As mentioned above, during the 1920s, E. C. Harwood published his findings concerning the then ominous business-cycle implications of unsound credit creation and it was the evident accuracy of his findings that facilitated AIER's founding in 1933. Over the years, we have revised and expanded our efforts to monitor closely current business-cycle developments (see page 6) and analyses of money and credit trends remain an important part of that process.

We have also maintained a focus on the long-run implications of the distortions fostered by unsound money and credit practices. These enabled AIER to predict that the economy would eventually recover from the Great Depression, that a prolonged boom would follow World War II (at the time, the vast majority of economists were predicting chronic "secular stagnation"), and also that official disregard of even the minimal discipline imposed by the gold-exchange Bretton Woods monetary system would lead to its rejection and a marked surge in price inflation. The most obvious and lasting effect of these developments has been the destruction

PURCHASING POWER OF THE DOLLAR
(1792 = 1.00)



For roughly 150 years after the Mint Act of 1792, by which Congress established and defined the Nation's currency, the purchasing power of the dollar fluctuated in a relatively narrow range. At the end of World War II, the price level was close to the peaks (and the purchasing power of the dollar close to the troughs) reached after the War of 1812, the Civil War, and World War I. In contrast to those earlier episodes, full convertibility of the dollar into gold was not restored after 1945, and prices continued to increase. The loss of the dollar's purchasing power accelerated greatly after 1971, when the last link between the dollar and gold was severed. By 1992, the dollar had lost 90 percent of its original purchasing power.

of over 90 percent of the purchasing power of the dollar during the past 60 years (see the chart on page 13), but it has been the increasing government constraint on the economic decisions of citizens that has been even more insidious. Freedom has been most at risk at business-cycle troughs, when its enemies have the maximum opportunities to gain acceptance of the proposition that alternative institutions must be substituted for the free interaction of producers and consumers because “the market has failed.”

As discussed below, such coercive government intervention in economic affairs can take many forms. For convenience all of them may be described as “Socialism.” Among the most encouraging developments of the past decade or so has been a worldwide tendency to reject government intervention as a panacea for economic problems (a development in which we believe AIER has played some part, however small).

Is Socialism Dead?

All around the world, socialist policies are on the wane. Experience has at last forced many advocates of socialism to concede that it is not a more efficient system. But many socialists continue to advocate centralized control of economic decisions (which is the essential ingredient of many “isms” besides socialism) on other grounds, such as morality or justice. Other, more doctrinaire, socialists deny that the actual experience of socialism is a valid test of its efficacy, *i.e.*, they claim that “genuine socialism has yet to be tried.” Neither of these propositions can be disproved intellectually. The irony of this situation is that they are likely to retain their greatest plausibility in countries with the least experience with socialism in practice.

Socialists have been thrown out of office in many of the industrialized democracies of the “first world,” and the policies of those who remained, such as President Mitterand in France, have become more moderate. Many of the nations of the “third world” have begun to question and change the socialist policies that have led to their stagnation and bankruptcy rather than their advancement. Even in the “second world” of centrally planned communist societies, the dogmas of Marxism have been overthrown to permit individual rewards, risks, and choices. The practitioners of socialism are on the defensive around the globe.

The Idea of Socialism

We should first attempt to understand what it is that makes a given proposal or policy “socialistic.” There are many varieties of socialism and despite entire libraries of gobbledygook concerning the economics of socialism, there is only one basic notion involved. This notion is that *the allocation of resources must be guided by an elite group*, who must be given the power to override the decisions of ordinary people. Although most

socialists probably would be infuriated by reduction of their elaborate analytic and historical arguments to this simple proposition, there really is little else that is essential to the socialists' position.

Socialists share the assumption that allocation of economic resources by a small group is preferable, if not inevitable, with some strange bed-fellows — monarchists, mercantilists, theocrats, and fascists, to name a few. The issues such as the ownership of the means of production, control of the distribution of goods, criteria for admission to the elite, etc., that distinguish socialists from, say, monarchists are less economically fundamental than the belief in centralized control that they share. All such groups, in theory, share the same goals of justice and prosperity (no one advocates a particular system as a way of fostering injustice and misery, after all), and they all reject or ignore the findings of Adam Smith and other students of market processes.

Thus, the central economic issue for socialists is who is to be in charge of the allocation of resources. This explains not only why disputes among socialists tend to be bitter and vicious, but also why socialists had to posit "capitalism" as its major rival. But "capitalism" as a doctrine exists only in the minds of socialists.

The main challenge to socialism and the system that socialists wish to supplant is what most of the world continues to call "liberalism." (In the United States, this name has been stood on its head — U.S. "liberals" today advocate policies, such as wage and price controls, protectionism, regulation, subsidies, etc., that liberals traditionally opposed.) And, as F. A. Hayek observed, "There is nothing in the basic principle of liberalism to make it a stationary creed; there are no hard-and-fast rules fixed once and for all. The fundamental principle that in the ordering of our affairs we should make as much use as possible of the spontaneous forces of society, and resort as little as possible to coercion, is capable of an infinite variety of applications."*

During the 19th century, liberal policies brought about an unprecedented prosperity in places where they were implemented. At the same time, a new type of individual, the entrepreneur or "capitalist," emerged as the dominant force in economic life. Inasmuch as such persons appeared to be the main beneficiaries of liberalism, in terms of wealth and power, socialists apparently concluded that liberalism was simply the means by which the capitalists had shouldered aside the aristocrats, landlords, and clerics that had previously dominated society.

So it was that classical liberalism was transformed into "capitalism" in the socialists' thinking. What they overlooked or denied was the fact that an

* *The Road to Serfdom*, University of Chicago Press, 1944, p. 19.

individual entrepreneur only acquired or maintained prominence to the extent that he or she served the rest of society, *i.e.*, the position of an individual capitalist was not acquired or maintained by law, custom, a self-perpetuating oligarchy, or by raw force.

Some socialists, notably John Kenneth Galbraith, have addressed this issue by asserting that consumers are simply manipulated by businessmen (via advertising and other means) into purchasing whatever it is that the businessmen decide to produce. But this simply amounts to the assumption that the consumer is incapable of acting in his or her own best interest and a restatement of the notion that, since economic decisions will always be made by an elite, the fundamental issue of economics is how the elite is selected and what its goals are.

The Practice of Socialism

There are many ways in which a small group can assert control over economic decisions. They range from the confiscation of some or all private property, which, despite the rhetoric (“it now belongs to everyone”), means that the control of property is concentrated in far fewer hands, to subsidies and/or “normative” taxation of private transactions (*i.e.*, taxes designed more to influence private economic decisions than to raise revenue). In between lie an almost infinite variety of regulations affecting who may do what where. What all such measures have in common is that prices will differ from what they would be in their absence. Indeed, the notion that prices should not deviate from levels deemed to be “just,” “fair,” or simply reasonable underlies all forms of official intervention in economic life. In a full-blown “command economy” (with all enterprises owned by the state), nominal prices are set by fiat.* Elsewhere, tariffs are imposed and domestic monopolies (*e.g.*, labor unions or the post office) are supported to prevent “unfair” competition from, respectively, foreigners or less favored domestic producers. Rent controls are imposed to prevent “gouging” by landlords, and so forth. In these situations, someone has a notion of what prices should or should not be and the political clout to impose that notion on others.

As long as such measures are the most significant determinants of economic life, socialists probably are correct in their belief in the primary importance of the selection of the elite and its goals. For example, when the British Parliament was dominated by the “landed gentry,” it enacted *maximum* wage laws making it a crime to pay an employee more than a certain amount, in marked contrast to today’s minimum wage laws. In this example, liberals (in the sense used by Professor Hayek, above) long ago

* Of course, in such situations the real price usually is the nominal price plus the costs of standing in line, bribing sales clerks, or doing without, and was amply demonstrated by the experience of communist economies.

concluded that proscribing wages above a ceiling reduced the supply of labor (some employers could not obtain workers at the maximum wage that they could have obtained at a higher wage), thereby curtailing economic activity. (By the same token, minimum wages curtail the demand for labor.) In short, when prices are not free to reflect supply and demand, the result is a chronic shortage or an unsalable glut. Either situation indicates that an economy is not performing at its current potential.

It was, to repeat, an increased reliance on what Hayek called the “spontaneous forces of society” that produced the greatest and most rapid transformation of economic life in the history of the world. From the beginning there were critics, who opposed this transformation because they believed that they were losing status and/or because they longed for a simpler pastoral society where “everyone knew his place.” What distinguished the socialists from other critics was their claim that their proposals would end what they perceived as the “inefficiency and waste of ruinous competition,” and promote sound and perhaps even more rapid economic growth with a more equitable distribution of consumption. Central control of the means of production and investment flows, they believed, would facilitate “more rational” planning.

Some socialist economists recognize the importance for economic efficiency of setting prices so that the amount produced equals the amount purchased. But they approach the question as an algebra problem, ultimately solvable with improved “models” and techniques, such as linear programming, high-speed computers, or input-output analysis. The difficulty is that the map is not the same as the territory — even if the planners were free from political interference, they can never respond to technological innovation, or even to unforeseen circumstances (such as the bugaboo of Soviet agriculture — “bad weather”) as quickly or even as “rationally” as free markets.

Despite the theories, “Socialism as a system of political economy has come a cropper wherever it has been tried. It has turned out to be politically oppressive, culturally stifling, and economically disastrous.”* This accounts for the current retreat of socialists and socialism. As George Gilder has written, “. . . years of socialist reality, in every partial and plenary form, leave little room for idealistic reverie. . . . socialist ideals have withered in the shadows of Stalin and Mao, Sweden and Tanzania, gulag and bureaucracy.”

The recognition that socialism simply does not work as promised or expected accounts for the political and ideological shifts around the globe. There are some minor holdouts against the trend (such as Fidel Castro), but

* John Neuhaus, “A Death Much Exaggerated,” *National Review*, August 28, 1987, p. 44.

SOCIALISM IN THE UNITED STATES

Socialism as an international political movement never made much headway in the United States. Indeed, politicians of an interventionist bent long ago learned never to use the “S-word” in describing their policies.

Nevertheless, many, if not most, of the programs advocated by the U.S. Socialist Party during the early decades of this century have been adopted in one form or another. Moreover, many aspects of the taxation and regulation of economic activity in the United States today employ the techniques of socialism even when they are used to advance purposes (such as sectional interests, special privilege, or “environmentalism”) that were not incorporated into traditional socialists’ goals.

Our progress toward reducing the extent of interventionism in the U.S. economy during recent years has been relatively minor in comparison to that in many other countries. One reason, of course, is that we have had much less to remove. For example, Margaret Thatcher had many more opportunities to “privatize” industry than Ronald Reagan, simply because large segments of British industry already were nationalized when she took office. But another factor may be that the U.S. electorate is less conditioned to recognizing intervention for what it is — the substitution of the judgment of a small, often unaccountable group, for that of the vast majority of producers and consumers in the marketplace.

If the recent trajectories of change are maintained, it is possible that the U.S. economy could eventually become more socialist in practice than other countries, even those that proclaim themselves to be socialist.

it is remarkable and pervasive. The most significant aspect is not specific changes of the past decade, such as the establishment of a stock exchange in mainland China and private businesses in the former Soviet Union, the “privatization” of large segments of industry in Great Britain (and elsewhere), or the marked reduction in the top rate of personal income taxation in the United States from the 70 percent that prevailed as recently as 1981. One could have predicted these changes 15 years ago only at the risk of being called a lunatic, but the even more astonishing change that underlies all the rest is that it is now difficult to find a socialist who will argue that the traditional socialist policies will lead to a more efficient and productive economy. In this sense (as a coherent, practical program) socialism seems to have “died.”

The Socialist Dream

Nevertheless, there are some who cling to their socialist dreams. These include the (no doubt more comfortable) intellectual heirs of the “old bolsheviks” sent to the *gulag*, by Stalin himself, who believed that things would be different “if only Stalin knew.” For some, no amount of experience

can shake the faith in the possibility of socialist perfection. It may be noted that such persons seldom achieve or retain positions of power, in any system, with their illusions intact. A second group continues to advance socialist nostrums in the recognition that they would be costly in terms of economic efficiency, but are desirable nevertheless because they are “moral,” “just,” or even the “safe” thing to do.

For both groups, in short, socialism would seem to be a matter of religious faith rather than behavioral science. (Indeed, clerics, such as the Catholic Bishops or the hierarchy of most “mainstream” Protestant denominations in this country, seem especially susceptible in this regard.) In this sense socialism will never die as long as people can exercise selective imagination and assume either that society can be improved at no cost and/or that they can better assess the costs than anyone else.

IV.

THE GRADUATE FELLOWSHIP PROGRAM

MOST of AIER's educational efforts are carried out through the sale and distribution of its publications to the general public. However, for many years the Institute also has sponsored a variety of fellowship programs that provide direct training and financial support to advanced students of economics. As is suggested below, our fellowship programs form a key part of the Institute's educational efforts.

Early History

In order to "aid in the development of economic scientists," in 1946 the Institute established a competitive 2-year graduate fellowship designed to train students while in residence here at Great Barrington. World War II had interrupted the formal education of a great number of students. And while many possessed the enthusiasm and intellectual capacity for graduate training, at war's end many also were understandably deficient in subjects that are crucial to any advanced program of study in economics. Thus, the Institute's earliest fellowship programs offered students a wide range of relatively remedial tutorials before they proceeded to advanced courses in economics: basic instruction in English composition, semantics, logic, and economics.

Only after they had completed a first-year "refresher" curriculum in these subjects did they receive advanced instruction in money and banking, business-cycle analysis, American economic history, the development of political and economic thought, and the evolution of modern scientific method — topics that today form the core curriculum of the Institute's summer program.

Given the relative dearth of developed graduate programs in economics, this early program met with some success. It was, however, soon interrupted by the onset of the Korean War. Again, the formal education of many young men was interrupted. For a time, graduate applications dropped to the point that no qualified students could be found for the program.

In response to this unavoidable setback, the fellowship program was reorganized in the mid-1950s under the administration of the Interfoundation Committee for Economic Scholarships, which drew support from five participating organizations: AIER, the Economic Education Institute, the Economic Education League, the John C. Lincoln Foundation, and the Robert Schalkenbach Foundation. The Interfoundation Committee was formed to award scholarships to promising undergraduates who showed interest in economic subjects. Roughly 200 undergraduate

scholars were accepted in the program each year, and each was encouraged, but not required, to elect a college curriculum consistent with the requirements necessary for advanced study in economics. It was hoped that as these students “came of age” academically, they would form a substantial pool of applicants for AIER’s graduate fellowship program.

As events turned, however, a rapid expansion of the graduate fellowship program did not occur. During the late 1950s and early 1960s, small numbers (one or two) of highly qualified students continued to enter the graduate fellowship program each year, but in effect the program became an early casualty of vastly expanded Government spending on academic research programs. Very simply, an abundance of Federal support via research grants and scholarships and private scholarship endowments such as the Fulbright Scholarship (and the National Merit Scholarship program for undergraduates) placed the Institute’s program at a severe competitive disadvantage. Understandably, many graduate students of the highest caliber were attracted to the prestigious universities that offered the most grant money for research projects in their field of interest.

A period of considerable uncertainty as to the future of the fellowship program followed. In part as a result of the attractiveness of the National Merit program, the Interfoundation Committee’s undergraduate scholarship program was discontinued and the summer fellowship program was broadened to include both graduate students and a small number of distinguished undergraduates. Even so, in some years during the late 1960s and 1970s, no fellowships whatsoever were awarded.

In recent years the fellowship program has enjoyed considerable success. But its early experiences would seem to provide a textbook illustration of some of the (perhaps) unintended consequences of Government funding of “scientific” research: namely, the distortion of the intellectual marketplace in ways that are detrimental to genuinely independent research and education. As related below, this is not a “new problem.”

Government-Funded Research and Education: A Booby Trap?

For many years popular sentiment apparently has favored the expansion of Government spending on research and education on a wide variety of human problems. However, the complexity of the relation of behavioral scientists in particular to the Government has yet to be explored adequately. Often, the assumptions underlying popular beliefs about Government-sponsored science seem naive or inconsistent.

Although most people apparently assume that scientific considerations “automatically” outweigh political considerations in the exchange of money

for results, history plainly suggests the opposite. Even the briefest reflection on some of the official “scientific” findings in Nazi Germany suggests the extent to which unbiased inquiry can be subverted by the political process. Seemingly, the more extreme the politics, the more extreme the distortions of scientific procedure.

And as unfortunate as the case may be, even under a relatively benign regime, scientifically warranted assertions (and policy recommendations based on those assertions) may be so unpalatable to politicians that they will not provide the financial support desired or needed. The lure of large amounts of Federal money, for example, may lead behavioral scientists into a situation in which they cannot function as scientists but can function only as special pleaders for the politicians in power (or politicians they hope will come to power and provide them with patronage). The current “scientific” debate over any number of environmental and health issues — from the greenhouse effect to AIDS — seems a case in point.

Already apparent is the fact that Governments recognize how important the work of behavioral scientists has become. For example: the Communist party in the now-defunct Soviet Union took great pains to control the work of behavioral scientists with a view of ensuring that they serve the interests of those in power. In the United States during recent years, each political party when in office has used some behavioral scientists in ways evidently intended to further the retention of power.

Many people today seem so impressed with the benign aspects of democratic or republican forms of Government that they forget the lessons of history. The first democratic Government in Europe following the French Revolution, which was inspired in part by the success of the American Revolution, beheaded Lavoisier, the father of modern chemistry. On the other hand, much early scientific work in the 17th and 18th centuries was made possible because benevolent despots in various European countries chose to defy some religious leaders and protect a few scientists as well as support their inquiries. More recently, the economic advisers of American Presidents have endorsed economic action so unsound that, in the words of a distinguished Harvard professor, it should “make every economist blush.”

In our view, an important lesson to be learned from the experiences of history is that scientists should not expect to be assured of unrestricted freedom of inquiry and discussion as the servants of the government, any form of government, nor by any vested interest having special privileges or positions of power that those interests desire to defend and perpetuate. Especially should behavioral scientists be wary of becoming the tool of agencies that may inhibit full freedom of inquiry and discussion, because,

of the three major fields of science — physical, physiological, and behavioral — the last deals almost continuously with controversial matters of consequence to one or another vested interest.

The apparent fact is that no government of any form yet devised has demonstrated that it can be trusted to assure scientists full freedom of inquiry and discussion. It has been AIER's view that this major difficulty confronting behavioral scientists might be solved if an important group of them could derive the principal support for their continuing research and education from many thousands of citizens rather than from the Government or from powerful private entities that may have special-interest agendas of their own.

Development of AIER's Procedures of Inquiry

Even the most independent research and education program has little hope of yielding useful results if it is devoted to "bad" science. A major component of the Institute's ongoing research, and especially of its summer fellowship program, is attention to useful procedures of inquiry. A primary requirement of participants in the summer fellowship program is that they study procedures of inquiry with a view toward developing a critical facility — especially with respect to a number of procedures that enjoy current popularity with professional economists but that in our view are seriously flawed.

In this latter respect, E. C. Harwood, AIER's founder, some 35 years ago wrote the following about the relation of economic conclusions to the methods of inquiry used by many economists. His words are just as pertinent today:

"That economists frequently do not agree has become so commonplace that some economists no longer seem to be troubled by the suggestion that such a state of affairs is scandalous. That many economists do agree on certain analyses and conclusions is equally scandalous from the viewpoint of modern science, however, because that agreement rests on methods of inquiry that have been found unreliable and have been discarded by capable scientists. The fact that a few conclusions on which some economists agree do have adequate scientific bases emphasizes by contrast the more fundamental disagreement among economists generally regarding the methods of inquiry that can be expected to yield useful results."

During subsequent years, we have developed and refined our views about procedures of inquiry. Among their key aspects, as presently evolved, are the following:

(1) An emphasis on the importance of "firm naming" in economic inquiry. Such naming, although firm in the sense that much terminology in

From the AIER Faculty Handbook

From its founding AIER has emphasized the importance of scientific procedures of inquiry. AIER has always represented to the public that its findings are so based, no matter how controversial or unpopular those findings might be. Since 1965, professional research employees have been required to state in writing their commitment to the following:

"My primary and overriding moral commitment or obligation is to serve as a behavioral scientist for the purpose of seeking solutions for the problems of humans in society and publicly informing my fellow citizens as to the results of such scientific method. This implies:

"a. Relying in such inquiries on the methods of modern sciences in the evolutionary development.

"b. Endeavoring continually to improve my own ability as a scientist to develop warranted 'if-then' conclusions or assertions by applying scientific methods and by subordinating any personal biases in order to assure objectivity in my work and findings.

"c. Avoiding all conflicts of interest (such as might result from employment by special interests, etc.) that might inhibit scientific work or bias me in any way tending to pervert scientific inquiry.

"d. Differentiating clearly in all writings and public statements so that those to whom I communicate will understand whether I am speaking or writing in my role as scientist within my field of competence or am simply urging in my role as a citizen or in some other specified role a course of action that I personally prefer.

"Criticizing as unscientific, without fear or favor, all purportedly scientific reports within my field of competence that (in the absence of such criticism) could be expected seriously to mislead my fellow citizens, whom I have chosen to serve."

developed fields is firm, is not final. As inquiry progresses, improvement in naming is to be expected, just as occurred with the name "atom" in physics. Much of the conventional work in economics is plunged almost immediately into a semantic swamp by the use of naming that is inconsistent, incoherent, and frequently based on ancient epistemological ideas that long have been outmoded.

(2) An emphasis on the entire pertinent transactional field, rather than on presumed separate and interacting "reals" making up that field. The "reality" of the various aspects and phases of the transaction generally

depends on the field itself. For example, borrowing cannot exist without lending, and vice versa. Concentration on too limited an area of transaction is associated with much of the inquiry conducted by conventional economists. For example, Keynesian economists have tended to emphasize the volume of current consumption to the exclusion or minimization of its effects on future production and consumption.

(3) An emphasis on the crucial importance of continuous testing of the conjectures (often called hypotheses) that are developed about what happens under specified circumstances by careful observation of available data and events. Conventional economic inquiry often proceeds by the development of elaborate conjectures far in advance of any significant testing of them or of their underlying assumptions against observed facts. Conventional economic inquiry relies on logical consistency, initial plausibility, assumed truisms, etc., and has resulted in elaborate theories or models in which the developers have great confidence. Unfortunately, the predictions based on such models often have been notably inaccurate, as subsequent events demonstrated.

The facts and notions with which we begin an inquiry also may turn out to be inaccurate, which requires that assertions following therefrom must be carefully qualified. Inquiry, then, neither begins with certainty nor attempts to achieve certainty; rather, the objective is the development of warranted (but not final or certain) assertions adequate to solve the problem at hand.

We also eschew the general procedure of inquiry, which has achieved dominance among academic economists, in which great emphasis is placed on the deductive and mathematical elaboration of a few "axioms." After the model is developed, supposedly it is to be tested against the facts, but in practice the major emphasis is placed on the "internal" deductive and mathematical elaboration.

To summarize, we long have maintained that the "quest for certainty," whether through deduction, revelation, intuition, or any other means, has not been a reliable source of useful solutions to human problems. That policy recommendations based on the results of such procedures often have proved disastrous supports this view. A major difficulty for economics today is that *a priori* beliefs, which pose a major obstacle to scientific inquiry, still are being celebrated by some as useful, and it would seem that little genuine progress has been made by economists during the past decade and a half toward developing procedures of inquiry that meet the requirements of a genuinely scientific approach. If such procedures are to gain wider acceptance, it would seem imperative that students of economics be introduced to them at the outset of their studies.

The Summer Fellowship Today

AIER currently awards about a dozen summer fellowships each year to college and university students in economics. Summer fellows come to the Institute for an 8-week period of study at the beginning of their graduate careers. Those who demonstrate exceptional potential during that program are awarded Fellowships In Absentia for the succeeding academic year, including full or partial payment of tuition and/or a monthly stipend for all or part of the academic year. As students progress toward the Ph.D., additional in-absentia awards are made on the basis of performance.

Since students not only attend classes at the Institute, but also share office space in the Harwood Library and take meals together with the staff, the summer program provides both formal and informal opportunities for the Institute staff and visiting senior fellows to exchange with students views they may not otherwise encounter.

The program's structure is always subject to revision, but in recent years usually has involved several major topic areas, including the methodology of economists, monetary economics, and business-cycle analysis, as well as a number of "mini-seminars" presented by visiting Senior fellows who bring expertise in a wide variety of fields related to AIER's research interests. In keeping with AIER's insistence that the pursuit of inquiry be grounded in observation, the summer program provides students with the chance to observe working economists in a practical environment that contrasts sharply with some purely academic settings. Here they are exposed to any variety of questions that confront "real world" analysis but that often are ignored by academic economists.

In contrast to the earlier difficulties described above, during the past decade the program has achieved marked success in attracting distinguished graduate students and visiting senior fellows. Although many factors no doubt are involved, perhaps the fellowship program's recent success is in part a gratuitous result of the "belt tightening" in higher academia that followed massive commitments of long-term funds to tenured faculty (itself the result of the earlier abundance of Federal funds). Whatever the cause, in recent years, U.S. colleges and universities represented in the Institute's fellowship program have included, among others: Brown, Case Western Reserve, Columbia, Cornell, Harvard, Indiana University, Johns Hopkins, MIT, Notre Dame, Penn, Princeton, Stanford, Syracuse, University of California, University of Chicago, University of Illinois, University of Michigan, Vanderbilt, and Yale.

From its earliest years, the fellowship program was designed to be international in scope, and in recent years has been enhanced by the

participation of students from Europe, Latin America, and Asia, representing institutions as diverse as Cambridge, Oxford, the London School of Economics, Rotterdam University (the Netherlands), the University of St. Gall (Switzerland), the University of Milan, the University of the Philippines, the University of Lima (Peru), and Fudan University (China).

Visiting senior fellows in recent years have included a number of luminaries, among them: former Congressman Ron Paul, author George Gilder, Joe Cobb of the Joint Economic Committee of the Congress, Professor C. Lowell Harriss of Columbia University, Professor Robert V. Andelson of Auburn University, Dr. Marvin Goodfriend of the Federal Reserve Bank of Richmond, Alan Reynolds, Dr. Marc Miles and Richard M. Salsman of H. C. Wainwright & Co. Economics, Inc., Social Security authority Dr. Marietta Constantinides, and Professor Andrea Terzi, who is E. C. Harwood Professor of the Behavioral Sciences at Franklin College, Switzerland.

Outlook

The AIER graduate fellowship program today shows the promise of fulfilling the hopes of its founder. As with all educational ventures, its eventual success (or failure) will depend on a variety of interrelated conditions. As a *sine qua non*, its reception will depend on the quality of its faculty and students and of their “product” — *i.e.*, research findings and professional training that can be usefully applied to genuine human problems.

Past experience suggests that, to a considerable extent, achieving this result may depend in turn on a political environment that provides incentives for (or at least tolerates) unbiased inquiry. Given the demand for increased Government funding for research on any variety of actual and imagined problems — and the apparent popular appetite for prescribed results — the maintenance of a climate favorable to genuinely independent inquiry into those problems is by no means assured.

The Institute’s by-laws require that all of its programs, including the fellowship program, remain independent of any special interest or concentration of wealth, whether Government agencies, private lobbies, corporate foundations, and the like. Unlike those of virtually any other organization with similar purposes, the Institute’s educational programs operate without benefit of either Government or substantial private institutional support. At bottom, the success of our graduate fellowship program (and all our other programs) thus depends upon the support of thousands of individuals who may benefit from our research and who value our efforts to promote independent scientific inquiry and education. In short, it depends on the generosity of readers of this bulletin and other Institute

publications. The description of AIER's charitable giving programs that follows will be of interest to those who may wish to help support our work by including the Institute in their financial plans.

For more information about our summer fellowship program and an application, please direct inquiries to:

**Pamela P. Allard,
Assistant to the Director
American Institute for Economic Research
Great Barrington, Massachusetts 01230
Telephone: (413) 528-1216
or FAX: (413) 528-0103**

V.

AIER's CHARITABLE GIVING PROGRAMS: They Can Benefit You As You Help the Institute

AS a qualified public charity with 501(c)3 status under the IRS Code, American Institute for Economic Research accepts charitable gifts in a variety of forms. Direct cash contributions to the Institute are deductible for income tax purposes, and each year we solicit the help of our sustaining members through fund drives that support our fellowship programs, our capital projects fund, and our general fund. Gifts made by will to AIER also are deductible from one's taxable estate, and such bequests in recent years have contributed measurably to the Institute's charitable income and to the expansion of our work. Perhaps most attractive to those who have appreciated assets are the Institute's "Invest by Giving" charitable remainder programs, described below, that provide substantial benefits to donors at the same time that they help to assure AIER's financial support in the decades to come.

Charitable Remainders: What They Are and How They Work

"Split-interest donations" to charities, in which the donor retains the right to receive income from the donated assets, are called charitable remainders. There are two main types maintained by AIER: Reserved Life Income Funds (RLIs) and Charitable Remainder Unitrusts (CRUs).

RLIs are "pooled income funds" maintained by AIER and are similar to mutual funds. The donor is assigned a number of units, according to the value of the donated assets. The income received by the fund (dividends, interest, etc.) is pooled, and distributed among the income beneficiaries according to the number of units so assigned.

When no further income distributions are due because the last income beneficiary named by the donor has died, the value of the units will be "severed" from the fund and made available for AIER's use.

In a CRU, the assets are held in a separate account and not "pooled" with other donations. It is required that the donor stipulate a fixed percentage (not less than 5 percent) of the value of the fund to be distributed annually to income beneficiaries. The donor may also stipulate that distributions are to be up to "income only," with or without a further stipulation that any shortfall of actual income received by the funds from the fixed percentage be "carried forward," and be available for distribution in subsequent years in which the actual income is in excess of the fixed percentage. The trustee of a CRU need not be AIER itself (although most of our donors have requested AIER to serve as trustee).

No Gains Taxes

Although there are many sound and useful reasons for making split-interest charitable remainder gifts, perhaps the most practical is that, when the gift is of appreciated property, no gains taxes are due even though the property is sold shortly thereafter by the RLI or CRU. This means that the donor can donate highly appreciated, but low yielding, investments and receive the income from the investment of the entire value of the donated assets.

Tax Deductions

Donors of charitable remainder gifts receive an income tax deduction in the year that the gift is made, but the deduction is less than the full value of the donated assets, because the value of funds to be received at a future date is less than that of funds that can be used immediately.

Donations of intangible property (such as common stocks) and real property are valued for the purpose of the charitable deduction at fair market value at the time of the gift. Deductions for charitable donations of such appreciated property are limited to 30 percent of income (as compared to 50 percent for other donations), but any unused portion may be carried forward up to 5 subsequent tax years. The valuation of tangible property (such as artwork) may be limited to the donor's cost.

The value of the deduction that can be claimed is determined by 1) the value of the gift, 2) the expected rate of return on the fund, and 3) the expected lifetimes of the named income beneficiaries.

In the instance of RLIs, the estimated rate of return is based on the past experience of the fund, and for CRUs it is based on the fixed percentage to be distributed.

The values of RLIs and CRUs are includable in the donor's taxable estate. However, the estate will receive a charitable deduction for the estimated value of the charity's remainder interest at the time. If there are no additional income beneficiaries living at the time of the donor's death, because none were named to begin with, because the named beneficiaries predeceased the donor, or because the donor revoked their income interest by will, the estate will receive a deduction for the full value of the RLI or CRU going to AIER.

Where there are successor beneficiaries other than a spouse, the income interest in an RLI can qualify for the marital deduction "QTIP" election so that the successor's income interest will be taxable only in the estate of the surviving spouse. However, the IRS takes the position that this does not apply to additional income interests in CRUs.

How You Can Benefit from a Charitable Remainder Gift to AIER

In 1993, the American Institute for Economic Research (AIER) paid out about \$3.9 million to income beneficiaries of its RLI funds and its CRUs. At the end of 1993 the assets held under these programs totaled over \$99 million.

Achieve Long-Term Financial Goals

Unlike many, if not most, charities, AIER accepts charitable remainders with no restrictions on the ages or number of named income beneficiaries beyond the statutory requirement that they be living at the time the gift is made.

This means that a CRU or RLI with AIER offers a sound way to provide a long-term source of income for your family (perhaps as long as 75 years or more). The individuals you designate as beneficiaries will receive quarterly payments from the CRU or RLI and you will have the assurance of knowing that their future income needs will be met in whole or in part.

Save on Taxes and Other Costs

No capital gains taxes will be due on any appreciation of donated assets. Their full value may be reinvested for income.

The estimated value of a remainder gift to AIER is deductible from taxable income and also from taxable estates. The amount of this income tax deduction will depend on the value of the assets donated and the ages of the income beneficiaries you name. The greater the number of life income beneficiaries and the younger they are at the time of a contribution, the less will be the income tax deduction.

The amount of the eventual estate tax deduction will depend on the value of the assets and the ages of the remaining income beneficiaries at the time. Where successor beneficiaries other than a spouse are named, gift taxes may be avoided if, at the time of the donation, you retain the power to revoke the successor beneficiaries' interests by will.

It is important for donors to retain the right to revoke by will the income interests of named beneficiaries. Relationships change, but, more significantly, the present value of irrevocable income interests in a charitable remainder are taxable gifts not subject to the gift tax exclusion. It is only gifts that are immediately available to the recipient that are eligible for the gift tax exclusion.

CRUs and RLIs are not subject to probate costs or executors' fees in most states. Continuing the income payments to successor beneficiaries is simply a matter of properly informing AIER. AIER does not charge for

administering its RLI funds or CRUs, but AIER does retain its wholly owned investment advisory firm, American Investment Services, Inc. (AIS), for investment supervision of these funds. The fees for these services compare very favorably with the fees charged by others you might select to manage your assets on behalf of yourself or your loved ones.

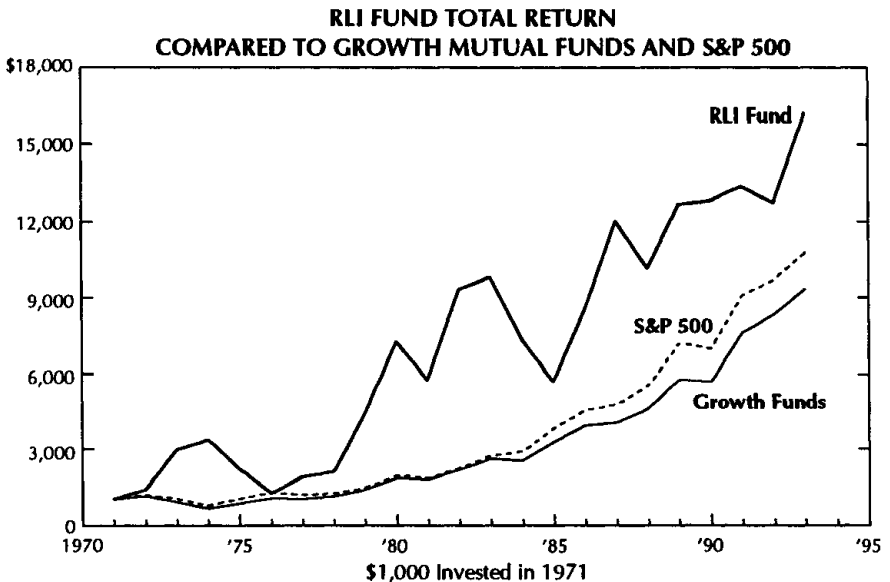
Fund Management by AIER and AIS

Since their inception in the early 1970s, AIER's RLI Fund investments have performed better than the S&P 500 index and the Weisenberger index of representative growth mutual funds (see the chart below). AIER's RLI funds are currently invested in Swiss franc and Deutsche mark denominated bonds, cash and equivalent investments, selected gold mining shares, and blue chip common stocks. AIER generally follows a similar strategy in investing the assets of a CRU, but tailors such investments to the needs of the particular beneficiaries.

As part of its research function, AIER continually monitors and assesses economic conditions. Of course, if fundamental economic conditions change, the investments will be revised accordingly.

Support AIER

A market-based economic system founded on individual liberties and property rights is the key to the advancement of our civilization. A charitable remainder gift to AIER eventually will be used to promote recognition of this view. If one cares enough about one's loved ones to want to



help with their financial needs, one also ought to be concerned about the type of society in which they will live.

How to Give to an RLI with AIER

You irrevocably transfer money, securities or other assets to the RLI, reserving an income interest in such assets for the life of one or more beneficiaries. AIER provides donors with a standard instrument of transfer form.

The income beneficiaries are assigned a number of “units of participation” in the RLI. To determine the number of “units of participation” the fair market value of your gift is divided by the fair market value of a unit in the RLI at the time of the gift. This method is similar to that used by mutual funds to determine the number of shares in the fund a given investment will purchase.

The net RLI income is distributed quarterly among income beneficiaries according to their respective units of participation. The distribution is taxable to the beneficiaries. (The RLI funds cannot invest in or accept as a gift tax-exempt securities.)

The individual beneficiaries designated by you may include you or your spouse, parent, child or grandchild or any other individuals for whom you wish to provide, subject only to the condition that such beneficiaries are “living or ascertainable” at the time of the transfer. The income interests of the beneficiaries may be concurrent, consecutive or both concurrent and consecutive. You may reserve the right exercisable only by will to revoke the income interest of any individual beneficiary. This is an important reservation, as it avoids gift tax on the interest in the RLI created for any beneficiary other than yourself.

Like a mutual fund, the property transferred by you to the RLI is pooled with property transferred to the RLI by other donors and managed and invested by AIER, as trustee.

Upon the termination of the interests of the life beneficiaries, AIER severs a portion of the assets from the RLI equal in value to the then-current value of the units assigned to your gift, and those assets are then used by AIER in its scientific and educational research activities.

How to Give to a CRU with AIER

You irrevocably transfer money, securities or other assets to a specially established trust of which AIER is the trustee. AIER has a standard form of CRU agreement that it provides donors and that has been specifically held by the IRS to fulfill the tax requirements for a charitable remainder unitrust.

You designate a fixed percentage (at least 5 percent) of the fair market value of the CRU assets, valued annually, to be paid each year to individuals designated by you (the unitrust payment). If you wish, the unitrust payment may be limited to the income of the CRU with any underpayments to be made up out of excess income in future years.

The unitrust payment will be distributed in quarterly installments to the beneficiaries designated by you and such payment will be taxable to them, except in the unusual case when all current and prior income of the CRU (including capital gains) has been distributed.

The beneficiaries can include you or your spouse, parent, child or grandchild or any other individuals for whom you wish to provide. The only limitation is that the individual beneficiaries must be "living or ascertainable" when the trust is created. Alternatively, the beneficiaries can include a "class" of individuals, such as your children or grandchildren, for a period of years (not to exceed 20), in which event the members of the class need not be "living or ascertainable" at such time.

The term of individual beneficiaries' interests may last for their lifetimes or for a term of years (up to 20). You may also provide that the term of an individual's interest will terminate earlier upon the occurrence of a contingency, such as remarriage. The interests of beneficiaries may be concurrent, consecutive or both concurrent and consecutive. In addition, you may reserve the right exercisable only by will to revoke the income interest of any individual beneficiary. This is an important reservation, as it avoids current gift tax on the interest in the CRU created for any beneficiary other than yourself.

As trustee, AIER invests and reinvests the principal of the CRU in a manner consistent with your long-term financial goals.

Upon termination of the interest of individual beneficiaries, the remaining CRU principal is paid to AIER for use in its scientific and educational research activities.

For further information about the "Invest by Giving" programs described here, please contact:

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Telephone (413) 528-1216
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