

CM12: VOLUNTARY EXCHANGE (2/6/17)

MOST, BUT NOT ALL, OF WHAT YOU SHOULD KNOW

1. What is the difference between an involuntary and a voluntary exchange?
2. Why must a well-informed voluntary exchange make both parties to the exchange better off as far as they are concerned?
3. What does an economist mean by the term "equilibrium"?
4. In what sense is a set of scientific beliefs different from an ideology?
5. What do economists assume about tastes?
6. What do economists mean when they claim that consumers are maximizers?
7. What are firms assumed to maximize?
8. What sort of information are consumers assumed to possess?
9. If there were a momentary deviation from equilibrium, what do economists assume will happen?
10. Except for external effects (CM22), public goods (CM23) and information problems (CM24) is there any need for government intervention in economic activity if all of the six assumptions hold simultaneously?
11. Are the assumptions "natural laws" that must hold or are they positive statements that might be false?
12. Why do people work in sweatshops?
13. Why do most economists believe that banning sweatshops or boycotting the goods produced in sweatshops may harm the workers the measures are meant to help?
14. Do most children work in sweatshops?

15. If parents in LDCs love their children why do they allow them to work rather than attend school especially if the work the children do is dangerous?
16. What are the two ways in which the military can acquire personnel?
17. Why is a draft likely to be less efficient than a volunteer military?
18. In what ways is a draft likely to be inefficient?
19. What is the major difference in the incentive structures of a draft and a volunteer military?
20. When should we stop bribing people to move into the military?
21. What is the optimal allocation rule?
22. What is the opportunity cost of drafting someone?
23. How would we estimate the change in GDP when a civilian is moved into the military?
24. In what sense does the draft act as an implicit tax?
25. Is it possible to have an efficient draft?
26. Who would gain from an efficient draft?

"I'll make him an offer he can't refuse." Marlon Brando, *The Godfather* Part I

1. VOLUNTARY VERSUS INVOLUNTARY EXCHANGES

1. The economist's concept of an exchange is very broad, it refers to any type of transaction where there is a change in ownership of something – I exchange my labor for WWU's money, you exchange your money for a copy of a textbook from the bookstore. A *voluntary exchange* is one in which the participants have the right to refuse to participate. I can refuse to work for WWU if I don't like the pay they offer me; WWU does not have to rehire me. An *involuntary exchange* is one in which one party coerces the other into making the exchange. Command or centrally planned economies are characterized by involuntary exchanges –

you used to have a permit to live in Moscow. The Berlin wall was necessary not to keep people out but to keep them in.

2. All "well informed" voluntary exchanges **must**, *in the opinions of the participants*, be mutually, but not necessarily equally, beneficial because if the participants do not think the offer is to their benefit then they will refuse it. WWU pays me a pittance for my superb course so it gains more than I do, but I still gain enough to make it worth my time teaching you economics. Economics assumes that we are "well informed" with respect to what we are getting,¹ and that you are also aware of all of the available alternatives. Exchange or trade is not a "zero sum game", like poker, in which one-side gains at the expense of the other one, both parties to the exchange must believe that they gain or they will not trade.

3. If you are well informed concerning your alternatives, know your own preferences, and if you maximize those preferences subject to the constraints placed upon your purchases by your limited income and the positive prices of the things that you wish to purchase, then you cannot, in your opinion, be made worse off by the exchange. An economist would say you were in equilibrium. Therefore, government interventions (regulation) to prohibit or curtail your voluntary exchanges can only benefit you if they can provide a superior alternative that was not available to you. Walmart is often criticized for its employment practices but it employed 2.3m persons in 2016 (1.4m in the US). Unless there are **no** alternative employers locally why would someone work for Walmart if it were not the best alternative available? Which doesn't mean that Walmart jobs are good ones, it simply means that its employees do not know of better ones. The better educated usually have more, and more attractive, options than the less well educated, but we are all "wage slaves". If you are between a rock and a hard place then you are not likely to be happy whichever you choose.

2. ECONOMIC IDEOLOGY

1. An ideology is a set of beliefs such as Marxism, socialism, fascism, libertarianism, liberalism, environmentalism, and the beliefs of various religious groups. The persons who hold these beliefs do not question them since they "know" that they are true. Unlike science, which welcomes change, which is

¹ But remember the old legal maxim, Caveat emptor, buyer beware, before you buy an expensive watch at a bargain price sold from a suitcase on Fifth Avenue.

willing to admit to error, which seeks to eliminate inconsistent arguments, and which insists on empirical verification of its beliefs, an ideology resists change, ignores or “explains away” inconsistencies², and treats dissent as anathema.

2. In CM1 I argued that economics has largely purged itself of value judgments, but although economists seldom make explicit value judgments I believe there is a strong implicit ideological bias in much of economics. I believe that economists share an implicit set of beliefs that, because they are implicit, goes largely unquestioned and that amounts to an ideology, an ideology that tends to argue in favor of market solutions and against government intervention in markets. I do not believe that most academic economists have explicit ideological agendas, although some clearly do, or that academic economists in general deliberately set out to indoctrinate their students with a particular set of pro-market ideas.³

3. I believe that economists have become so used to making certain assumptions about how the economy works that they often forget that they are making these assumptions; and I think that these assumptions collectively constitute an implicit economic ideology – an unquestioned belief system. Much of standard economics implicitly, and sometimes explicitly, makes six assumptions about how individuals behave:

1. Economic actors know their own tastes; they know what they believe is best for themselves.
2. Those tastes are given and stable.
3. Economic agents maximize subject to constraints. This means two things. (1) Consumers are assumed to maximize their satisfaction subject to a budget constraint – because they have limited incomes and wealth and because prices are positive consumers can only purchase a limited number of goods and services; they are forced to make choices and

² Much theology seeks to explain such apparent anomalies as a belief in a loving, all-knowing, and all-powerful God who allows bad things to happen to good people

³ There are different schools of economics of which the Chicago School is the most famous, and American economists are often divided into fresh water economists (conservative and pro-market) and saltwater economists (liberal and more interventionist). Freshwater economics is associated with the universities of Chicago, Minnesota and Rochester located near the fresh water Great Lakes, and saltwater economics with MIT and Harvard, Berkeley and Stanford located near the salty oceans.

economists say that they must trade-off some goods in order to acquire other goods. Economists characterize this maximization as being self-interested (other people prefer the term greedy), because economists usually assume that the consumers are only interested in their own well being when making their decisions. Economists argue that although altruistic behavior clearly exists⁴ it is also subject to constraints and therefore subject to careful self-interested calculation. For example, charitable giving reflects the preferences of the person doing the giving – Catholics give to Catholic charities and Jews give to Jewish charities. And because altruism is also subject to budget constraints, you have a limited amount to give to charity, such giving involves careful calculations; although “Saint Theresa” probably did not spend a cent of her million dollar Nobel Peace Prize on herself, she almost certainly spent the money with extreme care so as to maximize the good that she could do with the money.⁵

But maximization can be thought of as “getting the last cents worth of benefit out of every dollar spent” and it is easy to end up thinking that this behavior is not only normal but also commendable, after all, “the invisible hand” doctrine that many economists espouse claims that when you consider only your own interests you are promoting the general good.⁶

(2) Firms are assumed to attempt to maximize profits subject to the limitations imposed by a given stock of technological knowledge which defines the ways in which they can convert labor and capital and raw materials into goods and services, and subject to the fact that these scarce resources have positive prices, which the firms must take into account when determining which inputs to use. Ariel Rubinstein, a distinguished Israeli economist, has argued that emphasis on profit

⁴ Otherwise you would not be here, although we sometimes wish to strangle other people's ill-behaved children, and, occasionally, our own.

⁵ Which Included flying to Ireland to campaign against divorce.

⁶ The invisible hand doctrine goes back to Adam Smith but a careful reading of “*The Theory of Moral Sentiments*” and “*The Wealth of Nations*” shows that Smith was far from sanguine when considering the likelihood that in the real world that self-interested behavior would *necessarily* lead to the general good. In “*The Wealth of Nations*” Smith wrote: “By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it.” (Emphasis added.) Smith believed that we have empathy for our fellow humans and that empathy and the positive effects of competition would lead markets to generate beneficial outcomes.

maximization in economics courses taught to MBA students makes those students excessively concerned with short-term profit compared with other considerations.⁷

4. Economic agents are well informed about the quality and availability and prices of all goods and services.

5. Economic agents are in equilibrium, which to an economist means that they actually maximize and therefore purchase those goods and services, and undertake those activities, which maximize their satisfactions or their profits.

6. Any deviation from equilibrium will disappear rapidly as rational economic agents quickly adjust to the incentives that exist when they are not in equilibrium. Economists joke that there cannot really be a \$100 bill lying on the sidewalk because if it were then someone would already have picked it up, but this assumes rapid adjustment to disequilibrium.⁸

4. If these assumptions hold then it appears that we live in the best of all *attainable* worlds, a Panglossian economy. We know what we want, we know what we can get, and we choose the things that make us happiest. If we are rational in the economist's sense of the term – we are consistent and we are maximizers – then we have arrived at the outcome that we believe is the best possible for us. The only function for a government in such a world would seem to be to deal with market failures: correct external effects and provide public goods and services and deal with information asymmetries (CM20-22).⁹

⁷ Notice that I have not mentioned the possibility that firms might make mistakes.

⁸ If you have purchased books and videos on Amazon you will have noticed that the same good is not always offered at the same price, which would be the case if everyone was well informed and sellers adjusted their prices to what other sellers were offering to trade at.

⁹ "I think that modern neoclassical economics is in fine shape as long as it is understood as the ideological and substantive legitimating doctrine of the political theory of possessive individualism. As long as we have relatively-self-interested liberal individuals who have relatively-strong beliefs that things are theirs, the competitive market in equilibrium is an absolutely wonderful mechanism for achieving truly extraordinary degree of societal coordination and productivity. We need to understand that. We need to value that. And that is what neoclassical economics does, and does well." Brad De Long's Blog: 1/18/14.

6. As we saw in CM4 economists are reluctant to make explicit value judgments and therefore will not make “interpersonal comparisons of utility”(an interpersonal comparison of utility means a comparison of one person’s wellbeing compared to that of another person).¹⁰ Economists are therefore reluctant to discuss the desirability of redistributing income and wealth. Of course, a refusal to discuss an issue can be interpreted as providing tacit support for the status quo ante; the existing distribution of income and wealth becomes something that is not challenged.

7. Most economists are closet utilitarians. Roughly speaking utilitarians believe that policies should be evaluated in terms of their consequences, and that a policy is “better” if it brings more people more happiness than some other policy: the greatest good to the greatest number. Utilitarianism is a hotly debated issue amongst moral philosophers but economists do not want to get tied down in these sort of arguments and so while we preach that economics should be “value free”, and we should not make ethical judgments, in practice there is an implicit ethical stance, Utilitarianism, underlying much of economics. (Think of the “Trolley” Problem.)

8. All six of the assumptions listed above are formulated as positive statements. But we have empirical evidence that most of them are at least questionable; and in some cases they may simply be false. Assumption 1 ignores the fact that firms use marketing techniques to attempt to mold our tastes, and that (as we shall see in CM18) such techniques bias us towards individual, rather than, collective consumption goods. (It is even debatable whether firms know what their profit maximizing decisions should be.)

Economists often argue that they adopt assumption 2 because they do not want to explain away inconvenient observed behavior by simply saying that tastes have changed.

Assumption 3 is also questionable, people make mistakes and sometimes they cannot be bothered to do the calculations that are necessary to truly maximize.¹¹ For example, you might be willing to take the time and go to some

¹⁰ The prohibition against making interpersonal comparisons of utility also explains why economists take smokers’ and drug addicts’ benefits into account when discussing the regulation of cigarettes and drugs, and the benefits and costs of muggers when evaluating crime.

¹¹ The Nobel laureate, Herbert Simon, argued that most economic agents are “satisfiers” rather than maximizers because there are limits to our cognitive abilities and to the amount of time available to make decisions.

inconvenience to save \$20 on a \$100 dollar item but would you be willing to make the same effort to save \$20 on a \$1,500 big-ticket item? Economics says that you are irrational, inconsistent, if you answer yes to the first question but no to the second – a dollar is a dollar is a dollar.

Assumption 4 is seldom true. Economists concede this and we will discuss the economics of asymmetric information in CM22. However, economists seldom phrase this problem of withholding information in terms of cheating, fraud and misrepresentation. There are many situations in which we are not fully informed about the quality of the goods and services that we purchase – people sometimes die because they purchase and consume products that are toxic. And sometimes sellers deliberately misrepresent or conceal the properties of the goods and services they sell in order to defraud their customers. Think of the General Motors ignition switch scandal and how some financial institutions sold derivative assets that they knew to be much riskier than they claimed.

It is not obvious how we determine empirically whether assumption 5 is correct.

There is considerable evidence that assumption 6 is violated in labor markets.

9. I would argue that economics becomes ideological when it is uncritically assumed that all six assumptions *must* be correct. Their combined effect is to suggest that whatever we observe people doing must be in their best interest: that the unemployed are taking a vacation rather than not working because they have lost a job and cannot find another one. (At the beginning of the Great Recession there were a large number of firings, not voluntary quits, and the ratio of job vacancies to the unemployed fell rapidly.)

3. SWEATSHOPS

1. The term sweatshop comes from the early years of the English Industrial Revolution (1760s to 1800s) when much cloth production was done on a piece rate basis (paid per yard of acceptable cloth produced), in cottages where the raw materials were provided by the cloth merchant and woven on hand looms – with the whole family working very long hours under very poor conditions. A "sweater" was the middleman who delivered the wool and paid as little as possible for what he deemed acceptable work. In 2017 the term sweatshop is usually used to refer to a small manufacturing business, such as a clothing factory, where working conditions are poor and sometimes unsafe.

2. It is often forgotten that working and living conditions, health and life expectancy, and pollution in England during the Industrial Revolution (1760s to 1880s?) and America (1800s to 1890s?) were as bad, and often worse, than in LDCs in the 21st century.

3. Economists would be happy to see sweatshops disappear, as they have in Europe and North America, but economists are also reluctant to support measures designed to do away with sweatshops that do not take into account the harsh realities of the real world. When thinking about sweatshops the crucial issue is: can we come up with superior alternatives to sweatshops? Just banning the sale of their output is most likely to cause the businesses to become uncompetitive and go out of business thus denying their workers the ability to work in jobs that they have voluntarily chosen. The industries that use "sweated labor" are usually operating in highly competitive global markets where profit margins are low. However, if wages and conditions could be increased simultaneously in all sweatshops in the industry throughout the world, then the extra costs associated with the better wages and conditions could be passed on to the consumers in industrialized countries who would have to pay higher prices for those goods. It may be very difficult for western firms to monitor conditions in the sub-contractors' establishments in their supply-chains. However, it is also possible that the managements of the western firms simply choose to ignore what they suspect is going on.

4. It is often argued that one reason Africa south of the Sahara is so poor is that there are very few sweatshops there. Recently China has started to invest heavily in Africa south of the Sahara and there are even Chinese who have started to farm in Southern Africa. Recently there have been complaints about the pay and conditions in some of those Chinese plants.

5. The key idea when thinking about sweatshops is that shutting them down is not going to help the workers unless you can provide alternative employment. The workers earn so little because they have low productivity, which doesn't mean that they do not work very hard but that their work does not produce much in terms of saleable product; cheap sandals and mats are cheap because they are produced with labor that has almost no human capital and which is working with almost no physical capital, perhaps a few sewing machines in a dilapidated building. As workers become better educated they can switch to better paying jobs that require more skill to perform and their labor will be

replaced by machines, or the owners will find other places to produce where labor costs are lower.

Here are some links that are pro-sweatshops:

<http://www.nytimes.com/library/magazine/home/20000924mag-sweatshops.html>

http://www.nytimes.com/2009/01/15/opinion/15kristof.htm?_r=1

<http://dollarsandsense.org/blog/2009/01/kristoff-apologist-for-sweatshops.html>

<http://www.nytimes.com/2001/04/22/opinion/reckonings-hearts-and-heads.html>

4. CHILD LABOR

1. Most child labor is in agriculture not in factories or sweatshops and girl children do massive amounts of work in and around the home, for example getting water from the nearest source which may be five miles away, and some work which is dangerous, for example, five year old girls cooking over open fires.

<http://www.nytimes.com/2005/07/14/business/14scene.html>

2. There is no reason to believe that parents in LDCs love their children less than parents in rich countries do. But if you are desperately poor then you may be forced to keep your children working on the farm, or send them to work in sweatshops or factories or brickfields, or sell them into prostitution or slavery, rather than sending them to school. The evidence shows that as parents' incomes rise parents send their children to school. (LDCs need more schools, more school equipment, and more teachers – especially ones who actually turn up and teach.)

3. While these are not voluntary exchanges by the children they are voluntary exchanges by the parents on behalf of the family – the alternative to selling one of your children may be that the whole family dies.

In famines babies and small children sometimes starve because it makes sense to give food to the viable adults and older children. Amartya Sen has shown that famines are not usually the result of lack of food but of the poor distribution of the food and high prices that make the food unaffordable to the poor.

4. Banning products produced by child labor is not likely to help those children; we need to provide subsidies to the families that are contingent on their children being in school and we need to make education less expensive in LDCs. Education is not free in most LDCs.

<http://www.news.cornell.edu/releases/July98/Child.Labor.jw.html>

5. The next link is more sophisticated from an economic point of view. I am skeptical that anyone believes that children make their own trade-offs between work and education.

http://economistsview.typepad.com/economistsview/2007/02/child_labor.html

http://marginalrevolution.com/marginalrevolution/2003/09/the_economics_o_1.html

<http://www.economist.com/node/16690887>

5. THE ECONOMICS OF THE DRAFT

A. DRAFTS and VOLUNTEERS.

1. There are two ways to acquire military personnel: get them to volunteer by offering an attractive pay and benefits package (a voluntary exchange) – the method used by the US since 1973, or draft them (an involuntary exchange) – the method used in the US from 1940 to 1972.¹²

2. A draft is forced labor, like slavery or jury duty.¹³ The government requires you to serve and will imprison you and/or impose additional penalties if you refuse to serve. The government dictates the length of service (usually two years or less) and the pay and benefits of the draftees (the least amount politicians can get away with) and so any link between pay and benefits and productivity is broken.

3. Wars between nations have involved conscription (a draft) at least since the wars of the French Revolution (1791-1815). The US used drafts in the Revolutionary War, the Civil War, WW1, WW2, the Korean War, and the Vietnam War. I doubt if it would have been possible to get enough volunteers to have

¹² Historically foreign mercenaries have also been a source of military manpower.

¹³ Even with a volunteer military once you have signed on you are subject to the Military Code of Discipline and Congress can increase your length of service without consulting you, as happened in Iraq and Afghanistan – but didn't in Vietnam because that war was fought with draftees.

fought WW2, and I doubt that we would have invaded Iraq if the draft was still the major source of military manpower.

4. A volunteer military is an example of a voluntary exchange. The all-volunteer system uses positive incentives (rewards or bribes); but the draft is an involuntary exchange and uses negative incentives (penalties and punishment). Positive incentives are known to be much more effective than negative incentives. This asymmetry is one of the reasons that “market economies” are so much more effective and efficient at producing goods and services than “command economies” such as the defunct USSR, or Cuba, or North Korea. Humans are extraordinarily recalcitrant and difficult to coerce except with threats to “life and limb” and even those may not work (the Arab Spring/Schindler's List).

5. A draft is an inefficient method of producing military output. (1) Because *labor is artificially cheap* the military will use too much of it – draftees doing laundry and chefs driving trucks and truck drivers becoming cooks. (2) *Supervision costs are very high* – the draftee is on the wrong side of an involuntary exchange and will “goof off” given the slightest opportunity and will not show initiative. When Microsoft or Boeing need more labor they entice workers to work for them by offering ever better wages and benefits. (3) *Turn-over costs are very high* – military personnel require a great deal of lengthy and very expensive training but the vast majority of draftees will leave after two years. Most of their two year term is taken up turning the recruits into effective members of their respective branches of the services. Imagine that you are the Human Resource manager for a Fortune 500 corporation and that you have to report that the firm's labor force is turning over approximately every two years.

6. These inefficiencies all arise from the fact that the draft uses negative incentives, coercion and punishment (sticks), whereas a volunteer military relies upon positive incentives and rewards (carrots). Social psychologists have collected overwhelming evidence that carrots are more effective than sticks.¹⁴ Capitalism is about *persuading* people to do what you want them to do – they will work in terrible and dangerous conditions if you reward them for doing so. If

¹⁴ So while you may be tempted to threaten your child with dire consequences – I brought you into this world and I can take you out – or punish your child after the event, you will find it more effective to bribe them before the event. (And ***always*** be consistent!)

you need people to work on an oilrig in the North Sea in the middle of winter then bribe them to do so.

B. EFFICIENCY AND OPPORTUNITY COST.

1. How large should the military be? There is no “correct” economic answer because that answer would involve value judgments, but an economist can define what would be an *efficient* allocation of labor between the civilian and military sectors. From society’s point of view (what would be best for the US) it would be efficient to transfer civilians into the military until the marginal social benefit to the US is equal to marginal social cost to the US. That is, $MB = MC$ (where the costs and benefits are those to society, the US, not to the individuals involved). $MB=MC$ is not likely to be achieved under a draft where draftees are selected by a lottery (semi-randomly), because you will end up with some ideal recruits and some lousy ones, and some ideal recruits will not volunteer at the draft wage and some persons who would be very valuable in the civilian sector will end up doing poorly in the military. With a volunteer military you would expect that the volunteers would be the persons most suitable for military service – they would self-select.

2. In general an optimal allocation of money or time would be one in which each activity gives the same rate of return per dollar, or per hour, spent on each activity, because if one activity gave a higher rate of return then we would gain by reallocating resources in its favor. An efficient allocation between three activities, a, b, and c, would be one in which $MB_a/P_a = MB_b/P_b = MB_c/P_c$ etc. where the Ps are the prices or costs of the alternative activities. For example: if you are interested in maximizing your grade point average then the last hour devoted to studying ECON 206 should give you the same benefit (increase in GPA) as the last hour devoted to any other course, where the benefit would be the increase in your grade weighted by how important that grade is to you (is it a crucial required course in your major?)

3. So we want to expand the armed forces until the last person recruited/drafted produces in the military (MB) exactly what they would have produced if they remained in the civilian sector (MC). The opportunity cost of moving someone from the civilian sector to the military sector consists of an explicit and an implicit cost. Say Jane Doe is making \$100,000 as a civilian programmer. She is drafted into the army where she is made a lieutenant and paid \$30,000 and receives other benefits (food, clothing, housing, transportation, medical and dental treatment) that costs another \$10,000 per year. Then the opportunity cost

to the US of drafting Jane is the explicit costs, the \$40,000 it costs the army in pay and benefits, plus the implicit costs of her lost civilian output, \$100,000. So the opportunity cost in her case is \$40,000 plus \$100,000 or \$140,000.

C. THE CHANGE IN GDP.

1. Say Hawkeye Pearce receives \$1,000,000 in pay and benefits as a civilian thoracic surgeon and that he would not volunteer for military service no matter how much money he was offered. Assume that as a captain in the army he gets \$100,000 in the form of pay and benefits. What would be the opportunity cost to the US of drafting Hawkeye? The explicit costs to the US would be the \$100,000 in pay and benefits, which could be used to purchase other goods and services – for example, better schools – and the implicit cost would be the lost output in the civilian sector. Economists normally assume that your pay and benefits reflect your productivity (which, as I have argued in previous lectures may not be true) and so they would use his \$1,000,000 civilian pay as a proxy (shadow price) for his civilian output. Therefore the opportunity cost to the US of drafting Hawkeye would be $\$100,000 + \$1,000,000 = \$1,100,000$.

2. What happens to GDP when Hawkeye is drafted? The change in GDP will be the difference between his civilian output and his military output. We have already decided to proxy (put a shadow price on) the civilian output by using the his civilian pay and benefits (\$1,000,000), but we cannot use his military pay and benefit as a proxy for his military output because that \$100,000 is essentially arbitrary, reflecting a political decision, not his actual productivity as a military surgeon. One way to proceed would be to use the average pay and benefit of an average civilian thoracic surgeon (a shadow price) – although Hawkeye is clearly an outstanding surgeon and would be paid above that average if “the market works”. If an average thoracic surgeon makes \$400,000 then using that figure as our proxy, drafting Hawkeye would cause GDP to fall by the difference between his civilian output (assumed to be equal to his civilian wage and benefits) minus his military output (where we use the average civilian pay as our proxy or shadow price) which is $\$1,000,000 - \$400,000 = \$600,000$. Clearly there are problems. We can't use this procedure for draftees who end up driving tanks, because there are no civilian equivalents. In the case of Hawkeye perhaps the change in GDP is zero because he continues to be a surgeon although he is doing general surgery not his specialty. In some cases GDP would rise, for example, drafting someone who was unemployed.

3. Say we have a plastic surgeon who makes \$800,000 doing “tummy tucks” and “boob jobs” as a civilian but as a military surgeon he works reconstructing the horribly mangled faces of eighteen year old boys – how valuable is his military output? Economics does not have an answer to this sort of question; economists deal in prices not in values. When we look at consumerism in CM18 all we can conclude is that some people are willing to pay very large sums of money for things that others would not even want to own.¹⁵ And remember that WTP is based on your ability to pay, your income and wealth.

D. AN IMPLICIT TAX

1. Politicians and the Pentagon favored the draft because it appeared to be a cheap way of acquiring military personnel. In particular the amount of tax that has to be raised to pay for military personnel is lower if you force a draftee to serve in the military for \$35,000 a year, than if you have to pay a volunteer \$60,000 a year to volunteer. Note that the draft will make those who would have volunteered for the military worse off – they are now drafted and get \$35,000 rather than the \$60,000 they would have received in a volunteer system.¹⁶

2. The draft was an implicit tax. Hawkeye would have earned \$1,000,000 as a civilian, but as a draftee he only gets \$100,000 so he is \$900,000 worse off – it is as if the government placed a \$900,000 per year tax on him during the two years he serves in the army. This tax had some interesting features: (1) It was

¹⁵ There were 650,000 cosmetic plastic surgeries in S. Korea in 2013. Some of them performed by “ghost doctors”, surgeons trained in other specialties, persons with MDs but no surgical training, and some people with no medical training at all. Many Chinese women go to S. Korea for cosmetic plastic surgery.

<http://www.nytimes.com/2014/12/24/business/international/plastic-surgery-tourism-brings-chinese-to-south-korea.html>

http://www.asianplasticsurgeryguide.com/news10-2/081003_south-korea-highest.html

¹⁶ Many men who were in the military during the Vietnam era were “volunteers” because “volunteering” gave you certain advantages such as choice of which branch of the military you would join.

sexist – because only males were drafted. (2) It was regressive – borne disproportionately by low-income groups – 76% from working or lower middle income households.¹⁷ (3) It was racist – assuming that minorities were predominantly low income (12.5% of deaths were among black Americans). (4) It was “ageist” – the young fight wars declared by their elders. (Kamikaze battalions of Hells Grannies to reduce 1 and 3? And the grannies don't add to civilian GDP!)¹⁸ The links below show there is a lot of controversy about whether the Vietnam war tax was regressive and/or racist.

<http://www.washingtonmonthly.com/features/2009/0911.fallows.html>

<http://www.theatlantic.com/magazine/archive/1993/04/low-class-conclusions/5404/>

<http://www.examiner.com/conservative-politics-in-national/myths-of-the-vietnam-war-part-3-age-race-and-class>

<http://www.militaryfactory.com/vietnam/casualties.asp>

<http://www.uswings.com/vietnamfacts.asp>

<http://www.nndb.com/event/806/000140386/>

3. Obviously there was a difference between being drafted and serving in the US, being drafted and serving in Vietnam, being drafted and being in a combat zone, and being drafted and seeing combat. The better educated were less likely to end up in the infantry.

E. AN EFFICIENT DRAFT?

1. What would be an efficient draft? A draft in which (1) there were *no deferments* except for independently verified (a panel from outside the local draft board area?) physical, psychological or hardship reasons and males with children. Everyone else would be chosen by a lottery; and (2) a draft where *those who were drafted could either pay not to serve or could provide an acceptable replacement* as in the Civil War (\$300 for a Vermont Commutation

¹⁷ The well-known journalist James Fallows starved himself until he weighed only 120 pounds despite the fact that he was six feet and one inch tall. He failed the draft not because he was emaciated but because he failed the psychological exam. Fallows estimates that of the 12,000 Harvard men who were potential draftees only 2 saw combat.

<http://www.washingtonmonthly.com/features/2009/0911.fallows.html>

¹⁸ The average age of a serviceman in the Vietnam War was 22, and in WW2 it was 26.

Certificate in 1863). Example: Frank Burns makes \$350,000 as a civilian surgeon. He would volunteer if his pay and benefits were \$550,000. Clearly Frank was acceptable to the army. Hawkeye pays Frank \$450,000 for each year he serves in Hawkeye's place. Frank accepts – we have converted an involuntary exchange into a voluntary exchange – since he now will get \$550,000, \$100,000 from the army and \$450,000 from Hawkeye. Hawkeye gains – it is a voluntary exchange – he pays Frank \$450,000, which is less than the implicit tax of \$900,000. The US gains \$650,000 the difference between Frank's civilian earnings and the amount that Hawkeye earns as a civilian. The opportunity cost of having Frank in the army is less than the opportunity cost of having Hawkeye transferred out of the civilian sector.

2. The Gates Commission examined the pros and cons of an all volunteer force and recommended dropping the draft.¹⁹ The Commission also noted that an all-volunteer force might encourage "Military adventurism" – if other people's children are forced to fight our wars then they and their parents may not vote for the politicians who declare the wars (although it is a long time since Congress has declared a war, except on drugs) and politicians may be less willing to go to war. If the all-volunteer military and their families are only a small fraction of voters then we can send them to fight our wars as the British did during the colonial wars of the 19th century.²⁰

¹⁹ Economists may have helped end the draft. Milton Friedman was strongly opposed to the draft on Libertarian principles. Friedman was a close friend of Jimmy Savage a very distinguished statistician and colleague at the university of Chicago. Savage was a friend of Nixon. Savage got Friedman access to then-Secretary of Defense Melvin Laird, who first moved the U.S. away from a conscript force. Friedman and General William Westmoreland were both members of the Gates Commission. When Westmoreland declared that he didn't want to command an army of mercenaries, Friedman rejoined: "Would you rather command an army of slaves?"

http://economistsview.typepad.com/economistsview/2007/01/david_warsh_fri.html

²⁰ The British invaded Afghanistan in 1839. When they retreated from Kabul in 1842 they had some 4,500 British and Indian troops and were accompanied by about 12,000 'camp followers'. Only one man returned to India and seven men were captured. A second force was sent into Afghanistan later in 1842 and pillaged much of the country, defeated the Afghans and freed the prisoners. It then retreated back to India and held the Khyber Pass for the next hundred years. [It took Alexander the Great seven years to subdue the Afghans, essentially by wiping most of them out.] Would the US have engaged in wars in Iraq and Afghanistan if they were fought with draftees?

http://en.wikipedia.org/wiki/First_Anglo-Afghan_War-Destruction_of_Elphinstone.27s_army

3. An all-volunteer force may save US and enemy lives because it is so much more efficient that it wins quickly when fighting draftees. (The six week "war" between the UK and Argentina in the Falklands in 1982, the Gulf War of 1990-1991, and the initial military campaign in Iraq in 2003.) (6,109)