**Economics on Trial** **by Mark Skousen**

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# Y2K and Entrepreneurial Error

"No businessman in the real world is equipped with perfect foresight; all make errors."

—Murray N. Rothbard[1]

Over the past year, I've been involved in a series of debates over the impact of the Year 2000 Problem, the potential collapse of computers—and perhaps of the economy—owing to the fact that since computer programs use two digits instead of four to indicate years, the year 2000 will be treated as 1900. On the one extreme is Gary North, who claims that the Y2K problem is so serious that it will gravely disrupt society for years. On the other end is Harry Browne, who says that enlightened entrepreneurs will avert a worldwide disaster.

What's interesting about the debate is that free-market advocates are found on both sides. North and other naysayers focus on the propensity of market players to make entrepreneurial errors and engage in shortsightedness. Browne and other optimists stress the entrepreneurs' ability to solve problems, especially when so much is at stake. (Some businesses could go bankrupt if they don't address the Y2K problem.) In short, the market works.

My concern is that the "market always works" camp comprises true believers who blindly think the market can solve all problems almost automatically. They seem to fit into the rational equilibrium-always school of economics where entrepreneurial misjudgment, imperfect knowledge, and uncertainty play little or no role.

## Markets Are Not Perfect

The Austrian economists teach otherwise. Israel Kirzner, noted for his studies on entrepreneurship, attacks the model of perfect efficiency as "wholly unsatisfying." He adds that "It is most embarrassing to have to grapple with the grossly inefficient world we know with economic tools that assume away the essence of the problem with which we wish to deal."[2]

The market is characterized by profit and loss, success and failure, certainty and uncertainty. There is always room for improvement, and the entrepreneur's role is to eliminate errors and inefficiencies. Thus, it should come as no surprise that many businesses and financial institutions are making significant headway in fixing their computer programs to avert the Y2K problem.

On the other hand, it would be folly to ignore that many businesses have budgeted insufficient time and money to fix or replace their computers. Evidence is growing that most firms, especially small businesses, are

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not doing enough. Many major corporations and government agencies, both here and abroad, admit that they only have time to fix critical systems. The rest will fail on January 1, 2000.

Free-market advocates sometimes place too much faith in the market's ability to solve problems and ignore ubiquitous error in an entrepreneurial economy. Think about all the ways people make mistakes every day in the marketplace: Investors buy the wrong stock. Businessmen declare bankruptcy. Marriages break up. Consumers over-spend and over-eat, especially during the holidays. Kids fail to do homework. Drivers have accidents. Ships sink. Builders don't meet deadlines. Economists make false predictions. Entrepreneurs cut corners, deceive customers, and embezzle funds. Economic failure, stupidity, and incompetence are common to human nature. As Ludwig von Mises noted, "To make mistakes in pursuing one's ends is a widespread human weakness."[3]

The decision by computer programmers in the early 1950s to use two digits instead of four is a classic example of individual shortsightedness. To save space, they cut corners, and now, a generation later, the whole world is paying a heavy price for their blunder.

## Cluster of Errors

In most cases, entrepreneurial error is random, unpredictable, and self-correcting. As Murray Rothbard stated, "As a rule only some businessmen suffer losses at any one time; the bulk either break even or earn profits."[4]

There are, however, cases of widespread error—mistakes that affect virtually every part of an industry or economy. Rothbard, in standard Austrian school fashion, explained depressions in terms of "a sudden general cluster of business errors."[5] Of course, the Austrians attribute those errors and the business cycle in general to monetary inflation by government.

Yet can't error with far-reaching harm occur in the market without government being responsible? Austrian economists don't normally discuss this possibility, but it undoubtedly exists. Market decision-makers have made shortsighted blunders that have had universal consequences. Examples of such error include asbestos in construction, pesticides in agriculture, and air and water pollution in manufacturing. The Y2K computer glitch is a particularly tough challenge because it is universal and time-sensitive. In most cases, the deadline cannot be postponed.

## The Market's Self-Correcting Mechanism

Fortunately, the market has a built-in mechanism to minimize mistakes and entrepreneurial error. The market penalizes mistakes and rewards correct behavior. Business leaders know that computer problems can destroy their business; fixing the Y2K bug will avoid losses and may even be profitable. They are willing to pay the price. As Kirzner has said, "Pure profit opportunities exist whenever error occurs."[6] At the same time, the market will severely penalize businesses that have ignored the Y2K problem or have procrastinated.

Followers of free markets should take note: markets may be self-correcting, but they are not all-seeing. □

1. Murray N. Rothbard, *Man, Economy and State* (Los Angeles: Nash Publishing, 1970), p. 746.
2. Israel M. Kirzner, "Economics and Error" in *Perception, Opportunity, and Profit* (Chicago: University of Chicago Press, 1979), p. 135.
3. Ludwig von Mises, *Theory and History* (New Haven: Yale University Press, 1957), p. 268. Mises adds that "Error, inefficiency, and failure must not be confused with irrationality. He who shoots wants, as a rule, to hit the mark. If he misses it, he is not 'irrational'; he is a poor marksman."
4. Murray N. Rothbard, *America's Great Depression*, 4th ed. (New York: Richardson & Snyder, 1983 [1963]), p. 16.
5. Ibid.
6. Kirzner, pp. 132–33.

# BOOKS

**For Your Own Good: The Anti-Smoking Crusade and the Tyranny of Public Health**

by Jacob Sullum

The Free Press • 1998 • 288 pages • $25.00

Reviewed by John Attarian

Hounded by billboards and other "public-service" exhortations, barred from lighting up almost everywhere but in their own cars and homes, and saddled with rising cigarette taxes, smokers are being treated like pariahs—for their own good, of course. The anti-smoking crusade asserts that tobacco companies concealed the dangers and addictive nature of cigarettes, and manipulated their nicotine content to addict smokers; that all tobacco forms are bad; that secondhand smoke greatly endangers others; that people, especially impressionable teenagers, smoke because of insidious advertisements like Joe Camel; and so on.

In this levelheaded and well-informed book, *Reason* magazine senior editor Jacob Sullum convincingly debunks these claims. Smoking's health hazards have been known, and openly discussed, for decades. So has manufacturers' control of cigarettes' nicotine levels. Cigars and smokeless tobacco are far less dangerous than cigarettes. No evidence exists that casual exposure to secondhand smoke is a significant danger. As for supposedly sinister old Joe, the most important factors influencing teenagers' decisions to smoke are their sense of smoking's risks and benefits, the demonstration effect of family members who smoke, and peer behavior.

Opposition to smoking, Sullum points out, is nothing new. King James I, Pope Innocent X, and others denounced tobacco as addictive, unhealthy, inconsiderate of others, and downright wicked. But people kept smoking for the benefits and pleasures they got from it, and brushed off warnings of health hazards.

The 1964 Surgeon General's report stated that smoking, linked to cancer and other ailments, was a health hazard serious enough to warrant "appropriate remedial action." This opened, in Sullum's words, "the most concerted, sustained, and successful effort in history to discourage the use of tobacco." *For Your Own Good* carefully narrates that effort. At first, public health officials realistically recognized that Americans would not abruptly kick the habit, and opted to steer them to safer cigarettes with low tar and nicotine. But gradually the objective changed to eliminating all tobacco use. The anti-smoking movement won several victories. Cigarette advertising on television and radio was banned after 1970. Increasingly blunt warnings were mandated on cigarette packs and cartons.

Feeling the pressure and terrified of lawsuits, the tobacco companies responded by criticizing the evidence of health hazards as inconclusive, sponsoring its own research into the link between tobacco and lung cancer, and introducing filter-tipped and other "safer" cigarettes. Sullum observes that this refusal to acknowledge smoking's well-known dangers "has made the cigarette business the most reviled and distrusted industry in America." The unrelenting threat of lawsuits finally broke the tobacco companies' resistance, and in 1997, to limit their liability, they offered the (in)famous $368.5 billion agreement with the federal government.

Sullum acknowledges the cancer risk and describes nicotine as "the most dangerous recreational drug." He describes the tobacco companies as "cynically dancing around the truth to ward off liability and protect [their] profits," but he adds that they "didn't fool anyone who didn't want to be fooled."

By contrast, one of the anti-smoking movement's worst aspects is its end-justifies-the-means dishonesty, which Sullum abundantly presents: twisting research to fit its agenda, attacking researchers for saying what they in fact did not say (for example, that some cigarettes are safe), and relying on hysterical rhetoric, ad hominem assertions, and outright falsehoods. Sullum himself has been smeared as being "in the pay of the tobacco industry," because R.J. Reynolds used one of his articles