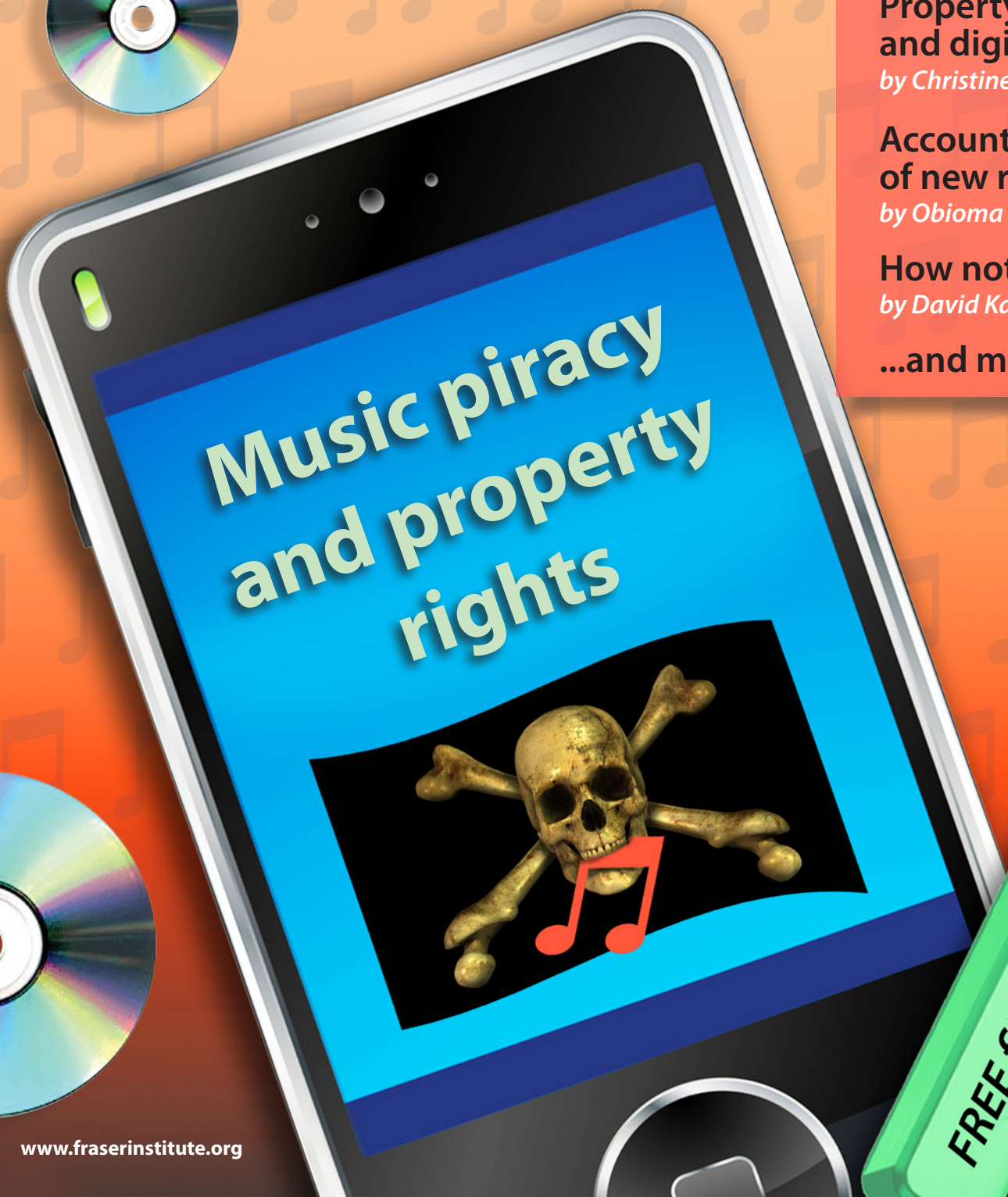


# Canadian student review



**Property rights  
and digital music**  
*by Christine van Geyn*

**Accounting the cost  
of new regulation**  
*by Obioma Osuji*

**How not to vote**  
*by David Karp*

**...and much more**





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# Canadian student review

## Welcome!

We live in a world of constant innovation in technology and communications. These innovations increase productivity and raise our standards of living. However, as we so often see, this evolution is not without some growing pains. This issue of *Canadian Student Review* looks at some of the legal and regulatory issues that have surfaced because of new innovations in various industries.



In this issue, Christine van Geyn examines the legality of peer-to-peer file-sharing networks and addresses the property rights debate in the music industry. In another article, Obioma Osuji looks at the arguments for and against Canada's accounting standards overhaul. The results of the referendum on electoral reform in British Columbia last May are also discussed in an article by David Karp, peer reviewed research is put under the microscope in "Things Folks Know," and the benefits of competition are examined in an excerpt from a recent "Ask the Professor" discussion.

We always welcome articles on economics and public policy from new student authors. See the back cover of this issue to find out how you can get published in *CSR*.

Best wishes,

**Courtenay Vermeulen**  
Editor, *Canadian Student Review*

## Canadian student review

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**R**apid technological change has resulted in a widespread increase in online music piracy. Without copyright protection, artists and producers will profit less from their work, and with a smaller profit incentive, less music will be created and society may be worse off.

The solution to this problem is the creation of new business models and the abandonment of legal strategies. Apple's pay-per-download approach, combined with products like iPods which complement digital music, is a model of this new way of doing business.

## The music industry's first legal strategy: suing file-sharing networks

Copyright industries have always reacted negatively when a new copying technology has appeared. This was true of cassettes, videotapes, and photocopiers (Liebowitz, 2006: 2). For example, when VCRs were first introduced, Sony was sued because the film and television industry was concerned that taped recordings would allow consumers to bypass commercials and then the industry would lose its main source of revenue (see *Sony Corp. of Amer. v. Universal City Studios, Inc.*).

The music industry's initial response to file-sharing was similarly legalistic: the industry tried to enforce all of its property rights. In the United States, music piracy has been fought in court on the basis of contributory and vicarious liability. Under these principles, copyright holders sue parties that in some way contribute to or benefit from the infringing conduct instead of suing the individual users (Zentner, 2006: 87). By making a contributory infringer of property rights liable, the law reduces the cost of enforcing copyright since it would be very costly to sue every person who engages in file-sharing (Posner, 2005).

With the 2001 *A&M Record v. Napster* case, the music industry achieved an early legal victory. Napster, a peer-to-peer (P2P) file-sharing service, was found liable as a contributory infringer and was shut down. However, this victory was illusory. The number of active file-sharers has continued to grow since Napster was shut down (Liebowitz, 2006: 5). Though it has been possible to declare P2P file-sharing networks illegal, it is nearly impossible to actually eliminate these networks since their infrastructure is decentralized (von Walter and Hess, 2004: 2497). For example, Kazaa, another P2P network, is registered in the South Pacific island nation of Vanuatu, its software distributor is in Australia, and its servers are in the Netherlands (Zentner, 2006: 87).

Further, as these networks become more and more a part of modern life, courts will be less likely to find contributory infringement and more likely to find "fair use." [1] Difficulties arise when a product has both lawful and unlawful uses. In a comment on the 2005 case *MGM Studios Inc. v. Grokster Ltd. and StreamCast Networks Inc.*, Richard Posner, a judge in the United States Seventh Circuit Court of Appeals, stated that legal uses of Grokster (another P2P service) should prevent it from being found to be a contributory infringer (Posner, 2005). He also noted that it would be against public policy to shut down the legal file-sharing industry in its infancy (Posner, 2005).



## A new business model is required to deal with the difficulties of enforcing intellectual property rights in the digital age

### The music industry's second legal strategy: suing individual users

When lawsuits against file-sharing networks failed to stem the tide of illegal downloading, the record industry adopted a new strategy. Between 2003 and 2008, the Recording Industry Association of America (RIAA) sued about 35,000 people who were sharing substantial amounts of copyrighted music over P2P networks (McBride and Smith, 2008, Dec. 19).

This strategy was not helpful for the industry. It did nothing to stop illegal downloading, and it created a public relations nightmare for the industry (McBride and Smith, 2008, Dec. 19). Among the individuals targeted by the RIAA's lawsuits were several single mothers, a dead person, and a 13-year-old girl (McBride and Smith, 2008, Dec. 19). In December 2008, the RIAA announced that it was abandoning its strategy of suing individuals (McBride and Smith, 2008, Dec. 19).

### New business models: liberal downloading as a solution

A new business model is required to deal with the difficulties of enforcing intellectual property rights in the digital age. Allowing the liberal use of downloaded music is one such model, and Apple's iTunes Music Store is an example of this approach. The iTunes Music Store is the first successful commercial download service in history (von Walter and Hess, 2004: 2500). It has shown that at least some users are willing to pay for music downloads (von Walter and Hess, 2004: 2497).

Part of the iTunes Music Store's success can be attributed to Apple's recent decision to discard its digital rights manage-

ment (DRM) features, demonstrating that perfect technological control of legal property rights is not necessary. Even with the DRM features, consumers had proved willing to pay for quality, virus-free music if the use of that music was not restricted outright by technology and end-user licence agreements that prevented transferring, copying, and sharing (Lucchi, 2005).

However, Apple's success is not built on its music sales. Although Apple CEO Steve Jobs says that Apple is a music company, the company does not generate much revenue from the sale of music files. Instead, most of its revenue comes from the sale of complementary hardware like the iPod (von Walter and Hess, 2004: 2501). In some ways, music has become a marketing tool used to promote the sale of MP3 players, like the iPod, and concert tickets.

### New business models: complementary products as a solution

The iTunes Music Store provides an example of an alternative business model for the music industry. If the music industry broadened its scope to include complementary products, it could absorb its own losses and profit from the complementary products. Alternatively, the complementary product market may absorb the record industry. In the future, the music industry will likely look very different and have a much broader scope.

There is a wide range of products that complement free digital music. Those who produce and sell MP3 players, high-speed internet access, storage devices, CD



burners, blank CDs, and so on can all profit from the availability of free music. For example, in 2001, unit sales of blank CDs (1.1 billion) exceeded sales of pre-recorded CDs (968 million) for the first time. In the same year, there was a 90% increase in the number of new computer owners with a CD burner. Moreover, the number of portable MP3 players more than doubled in the previous two years (Anand and Galetovic, 2003: 37).

Apple may have incentives to encourage the trend towards cheap and widely available music. As an industry observer has noted, "In many ways, [Apple's] business model for the iTunes service is very closely aligned to that of the online pirates they're so desperate to destroy" (Anand and Galetovic, 2003).

### Conclusion: creative destruction

Capitalism is by nature a form or method of economic change (Schumpeter, 1983: 82). The opening up of new markets and the creation of new products and technologies illustrates the process of industrial mutation. This process revolutionizes the economic structure from within, destroying the old one and creating a new one. This process, which economist Joseph Schumpeter called "creative destruction," is an essential component of capitalism (Schumpeter, 1983: 83).

We should not mourn the loss of old industries. The digitization of music is irreversible. Cultural, technological, and economic progress is the result of the free circulation of ideas and knowledge. Creative destruction allows new markets to open and creates new opportunities for commercial exploitation (Lucchi, 2005). It gives consumers new products that improve their lives and enhance our society. ■

#### Note

**1 Fair use.** A reasonable and limited use of a copyrighted work without the author's permission, such as quoting from a book in a book review or using parts of it in a parody (Black's Law Dictionary).



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## Should Canada adopt new accounting standards?

by Obioma Osuji

The Canadian Accounting Standards Board (AcSB) sets the national accounting standards for Canada. In 2006, the AcSB announced that public companies must switch from the Generally Accepted Accounting Principles (GAAP) to the International Financial Reporting Standards (IFRS) by 2011. The IFRS is a “global” accounting standard used in over 113 countries, while there are various regional versions of the GAAP that are used in less than 40 countries (World GAAP Info, 2008). The accounting standards of the Canadian GAAP have been evolving since the 1940s (McWatters, 1998). These standards are continually updated by the AcSB to reflect Canada’s changing economic environment.

The GAAP generally has stricter and more explicit accounting rules than the IFRS. At a time when the risks of complex financial contracts on Wall Street are at the forefront of debate, we may wonder whether more accounting flex-

ibility is desirable. Companies reporting with the IFRS have more discretion with the value of assets and the recognition of revenues, which may add an element of unreliability to financial statements. In fact, Canada’s adoption of the IFRS occurred at the same time as the United States decided to delay adoption for at least 10 years due to the vagueness of its standards, which may allow companies to hide balance sheet problems (Rosen and Rosen, 2009, May 13).

Proponents of the IFRS claim that the main benefit of adoption is comparability. Information asymmetry, which makes less informed investors reluctant to trade with better informed investors, decreases the liquidity of markets. In 2007, professors at Queen’s University and the University of British Columbia conducted a study based on data collected between 1998 and 2004. The study supports a switch to the IFRS, as it concluded that differences in localized GAAP standards among a sample of mostly European countries led to an

unwillingness to cover firms among foreign analysts. However, the data was unable to prove that these analysts’ forecasts regarding the GAAP-using European firms were less accurate than the forecasts for firms they covered under the IFRS (Bae et al., 2007). Competition in the field would probably lead analysts to become capable of deciphering quantitative and qualitative information regardless of accounting standards. We should be suspicious of claims that one standard would lead to more accuracy among analysts’ forecasts than another would.

Additionally, the Canadian GAAP is based on the same conceptual frameworks as the IFRS and almost always reaches the same conclusions on all issues (AcSB, 2005). Consequently, a switch to the IFRS in Canada will likely not provide a significant improvement in market liquidity at all (Hail et al., 2009). Since 2007, other researchers have tried to prove that a global accounting standard would significantly

reduce trading costs and increase market liquidity, but they have been unsuccessful (Platikanova, 2007).

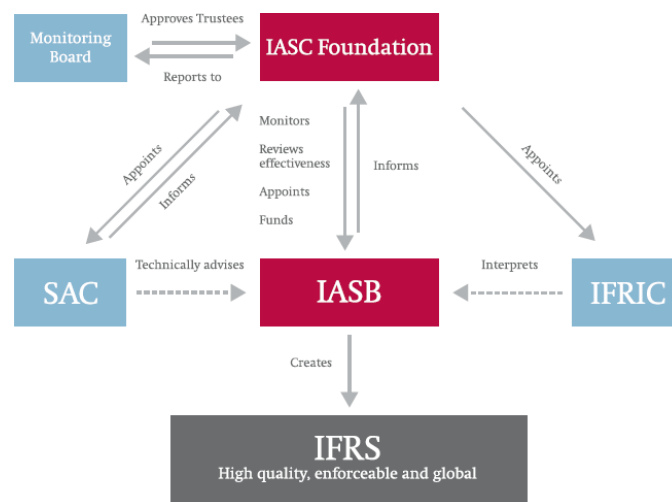
The Canadian firms that will be forced to adopt the IFRS have also shown a lack of interest in the standard. The Canadian Financial Executives Research Foundation polled 256 organizations, asking accountants and financial executives about their opinions of the IFRS. The poll revealed that, though the announcement of the IFRS switch was made in 2006, 80% of the public firms surveyed had not passed the halfway mark in their conversion process (Price-waterhouseCoopers, 2009). A similar survey conducted in the United States by the American Institute of Certified Public Accountants showed that almost half of respondents said the IFRS would bring them no benefits and that the costs of adoption outweighed the benefits. Less than one in 10 believed that adopting the IFRS would increase transparency (AICPA, 2009).

The biggest cost of adopting the IFRS for Canada will be losing control over the nation's accounting practices. The IFRS is most influential in Europe, and thus the majority of the International Accounting Standards Board's (IASB) seats are held by European nations. The IASB, which governs the IFRS, is headquartered in London, England. Moreover, the IASB is quite complex, as it is a subsidiary of a larger foundation with a monitoring committee, an advisory council, and an interpretations committee.

Almost half of respondents said the costs of adoption outweighed the benefits

Global adoption of the IFRS would eliminate competition between the IASB and regional standard-setters, conferring monopoly status onto the IASB. In general, monopolies tend to be inefficient, slow to change, and prone

### How the International Accounting Standards Board (IASB) is structured



Source: International Accounting Standards Board, www.iasb.org

to lobbying (Hail et al., 2009).

The International Accounting Standards Committee (IASC) Foundation, which runs the IASB, has proposed that four of the board's sixteen seats go to North America (Gill, 2008). The United States is by far the largest economy in the world, and with less than 10% of the United States' GDP, Canada is not likely to get more than one full seat out of the four North American seats. The United States' watchdog organization, the Securities and Exchange Commission, will take a seat on the IASB's monitoring board. The Canadian AcSB will continue to watch over Canada's accounting practices, but it will only have the power to send recommendations to IASB headquarters in Europe (AcSB, n.d.).

Given these facts, one might wonder why the AcSB would allow such power to slip from their grasp, especially when the potential benefits of the IFRS are unproven. According to some critics, the answer may lie in the AcSB's funding source. The AcSB is supported financially by auditing firms and the

conversion to IFRS will require certified accountants, triggering hundreds of millions of dollars in fees to be paid to auditing firms that help companies transition to the IFRS (Rosen and Rosen, 2009, May 13).

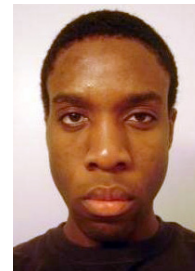
The Canadian government also has something to gain from Canadian firms' adopting the IFRS. The Canadian Securities Administrators (CSA) is a group of provincial regulators that sets harmonized federal securities regulations across the nation. The CSA often works in conjunction with the AcSB (CSA, 2008). Firms that report with the IFRS tend to report higher pre-tax revenues than comparable GAAP firms, and higher revenues mean higher corporate taxes paid to the government. A study was conducted of 100 foreign firms that filed under both the US GAAP and the IFRS. Results showed that 75% of these firms reported IFRS income to be higher than GAAP income (Hail et al., 2009). Petroleum, metals, and chemical companies will see the biggest change in pre-tax earnings. If the IFRS were applied to these firms' 2007 statements,



their pre-tax income would increase by about 12% on average (Johnson, 2008, Dec. 22). The metals and mining industries make up a big portion of Canada's economy, and thus we can expect to see higher tax revenues for the federal and provincial governments after the conversion to IFRS.

The best course of action for Canada would be to retain some form of the Canadian GAAP so that the AcSB could keep its jurisdiction over Canadian accounting standards and make amend-

ments without incurring consequences from the IASB. The AcSB should aim to attract donations from a variety of industries in addition to the accounting sector in order to better align its interests with the general public. Only then can the AcSB claim to truly represent the interests of Canadian institutions and investors. Because both the IFRS and the Canadian GAAP are high-quality standards, the issue is not which standard is better for Canada, but which governing organization can best represent the interests of Canadians. ■



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# How not to vote

## STV rejection is a step in the right direction

by David Karp

**W**hen 61% of BC voters said “no” to a new voting system in a referendum last May, they were making the right choice. Hopefully, the failed referendum, the province’s second in four years, will be the last nail in the coffin for the single transferable vote (STV) system. Our current voting system may not be ideal, but STV is not a good solution.

STV is a unique form of proportional representation (BC Citizens’ Assembly on Electoral Reform, 2004). Under STV, ridings are large and there are multiple seats available in each riding. For example, had BC adopted STV, the seven Greater Victoria ridings would have been merged into one large riding, with seven seats in that riding. Instead of choosing a single candidate, voters rank candidates in order of preference.

However, the biggest difference between STV and our current system is in how votes are counted. Under STV, after voters in a particular riding cast their votes, a threshold for how many votes a candidate needs to win a seat is calculated. That threshold depends on the number of candidates running in the riding, the number of votes cast, and the number of seats available.

In the first round of ballot counting, votes are allocated to each voter’s first choice candidate. If the number of votes a candidate receives exceeds the threshold, then the “excess” votes are “transferred” to the voters’ second preference. In other words, if a candidate had 25% more votes than was required to meet the threshold, then each person who voted for that candidate would have three-quarters of their vote allocated to the successful candidate and one-quarter of their vote transferred to their second choice.

If no candidate meets the threshold after the first round, then the candidate with the fewest votes is declared out of the running and all their votes are transferred to the voters’ second choice. This process—transferring the excess votes of successful candidates and

eliminating candidates with the fewest votes—continues until all the seats in the riding are filled.

If you’re still following me, then you should probably consider a career as a political scientist. The biggest problem with STV is that it is extremely complicated. Our current electoral system, the “first-past-the-post” system, is straightforward when compared with STV. Yet, despite its relative simplicity, a December 2008 poll conducted by Ipsos Reid for the Dominion Institute found that 51% of Canadians believe the Prime Minister is directly elected (for those who aren’t sure, he isn’t). When it comes to STV, the majority of voters are (understandably) even more clueless. An Ipsos Reid poll conducted in May 2005, just before BC voters faced their first referendum on STV, found that 66% of British Columbians knew “very little” or “nothing” about STV (Ipsos News Centre, 2005).

It would be troubling from a moral standpoint to implement a system that would confuse more voters. But STV may also have the effect of making fewer votes count. When New Zealand moved from first-past-the-post to STV for local health board elections, spoiled ballots increased fifteen-fold in some regions (New Zealand National Party, 2004).

STV also has some bizarre mathematical properties. While



most voting systems are monotonic (i.e., candidate X should not change from being a winner to a loser if X is ranked higher on some ballots without changing the rankings of the other candidates), STV isn't, meaning that in some situations a voter could actually hurt a candidate's chances of winning by ranking the candidate higher on his or her ballot (Quas, 2004: 2). But researchers have found that most people don't realize this because "voting strategically under STV is a mathematical puzzle" (Blais et al., 2009: 16).

STV may also change the incentives for politicians. Public choice theory suggests that politicians pursue actions that will maximize the number of votes they will receive in subsequent elections. Consequently, it is often in a politician's best interests to cater to special interests. As public choice theorists William C. Mitchell and Randy T. Simmons point out, "If a politician has a choice of dividing \$1 million equally among 1 million citizens or equally among 1,000 people, he will rationally opt for the latter because he is more likely to win the gratitude of those who gained \$1,000 than of those getting but \$1 apiece" (1994: 49).

STV would likely exacerbate this problem. Since there are multiple seats in one riding, candidates would need to appeal to a smaller proportion of a riding's voters to win a seat than they would under first-past-the-post, where only one seat is available. As such, STV would increase the incentives for politicians to choose policies that please smaller numbers of people rather than policies that provide the greatest benefits overall, though those benefits be thinly spread over a large proportion of voters.

There are other considerations, as well. As ridings would be merged, some rural ridings would be geographically large and more difficult to represent. STV would probably make it harder for independent candidates to fund campaigns against big parties in ridings that are many times the size of current ridings, and there would be many more candidates for independents to compete against.

First-past-the-post is not a perfect system. It can generate majority governments for parties that have a minority of the vote, and the votes of those who vote for a losing candidate are essentially wasted. There is room to improve the fairness of the current system. However, STV is not the answer.

Much was riding on the BC referendum. With other provinces considering electoral reform, a victory for STV in British Columbia could have given the system the legitimacy it needed to spread even further. Thankfully, it looks like BC voters made the right choice. ■



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# Things folks know that just ain't so

Peer reviewed research always makes for sound policy

## Why it ain't so...

by Courtenay Vermeulen

In 1992, economists at the Boston Federal Reserve published a paper in the prestigious *American Economic Review* that claimed there was statistically significant evidence of racial discrimination in US mortgage lending practices (Munnell et al., 1996). The study was used to back immediate changes to policy that loosened lending requirements in the United States. Since then, some have argued that the new mortgage lending policies the paper spurred ultimately caused the near collapse of the industry in 2008 (Liebowitz, 2009; Husock, 2003). Discredited almost six years after its publication, this paper is just one example of a study that was never independently replicated but was used to create misguided public policies.

In *Check the Numbers: The Case for Due Diligence in Policy Formation*, Bruce McCullough and Ross McKittrick examine the efforts of independent researchers to replicate empirical studies published in economic journals. They found that many non-academics were surprised to learn that the peer review process does not involve checking data and calculations, while many academics were surprised that anyone

thought it did. Their study reminds us that journal editors *do not* claim to check the accuracy of data and calculations, and that editors who publish a paper simply feel it is worthy of examination by others in the research community.

Independent researchers have the task of replicating peer reviewed studies in order to either support or dismiss the findings. But it appears that this is easier said than done. Of over a thousand peer reviewed papers examined by McCullough and McKittrick, more than half had no data set archived at all. When the authors were asked for their data, the majority reported being unable or unwilling to provide it. Where data was provided, the original computer code used to generate the results was rarely released along with it, making replication incredibly elusive. Overall, the vast majority of economics papers could not be independently verified, even in some cases where the authors of the papers agreed to assist with the replication efforts.

The paper from the Boston Federal Reserve is by no means the only unverified study that has been used to support disastrous changes to public policy. There is another more recent study that has negatively affected policy in countries around the world: the famous “hockey stick” graph created by Michael Mann and his colleagues in 1998 in a study of the climate history of the northern hemisphere. The graph illustrated a slight cooling trend over the last 900 years and a sudden spike in warming during the twentieth century, leading to the conclusion that humans are causing climate change. This graph was used widely by the United Nations Intergovernmental Panel on Climate Change to influence the ratification of the Kyoto Protocol in 2002.

McKittrick and Stephen McIntyre attempted to independently replicate the study using data provided by Mann and methods described in the original paper, but were not able to reproduce the results (McCullough and McKittrick, 2009: 16). In 2006, the US National Research Council also looked into Mann's study and found that it failed key tests of statistical validity (National Research Council, 2006), and an expert panel led by Edward Wegman, professor of statistics at George Mason University and Chairman of the National Academy of Sciences Committee on Theoretical and Applied Statistics, also found the study's conclusions to be erroneous (Wegman et al., 2006).

Another study that shocked the public and immediately prompted public spending on prevention programs was a 2004 study by researchers at the US Centers for Disease Control and Prevention (CDC). The study, published in the *Journal of the American Medical Association*, claimed that obesity kills 400,000 Americans each year (Mokdad et al., 2004). In response, \$60 million was injected into public

# UNRELIABLE

... it failed key tests of statistical validity

programs to fight the prevalence of this condition and save lives (US Department of Health and Human Services, 2004). Once again, independent researchers tried to replicate the study and found the data to be unreliable. The following year, the CDC estimated the number of deaths caused by obesity each year to be just 26,000, and began to shy away from offering any obesity-related death rate at all (McCullough and McKittrick, 2009). A variety of other studies with similar negative implications for policy are discussed in McCullough and McKittrick's 2009 study.

A common problem with peer reviewed studies is that it is often very difficult for other researchers to access original data sets and computations in order to independently replicate a study's findings. As a result, one of the foundational practices of science—testing the validity and reliability of another's conclusions while working under the same conditions—has been rendered nearly impossible. As McKittrick argues, the disclosure of data and code for the purpose of independent replication “in no way intrudes on or imperils academic freedom. Instead, it should be seen as essential to good scientific practice, as well as a contribution to better public decision making.”

Productive changes to public policy require solid scientific foundations built by the independent replication of studies. It is important for policy makers to remember the limitations of the peer review process when the results of peer reviewed studies suggest that immediate action is required.

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# HOT TOPICS!

## Canadian health care is failing patients and taxpayers

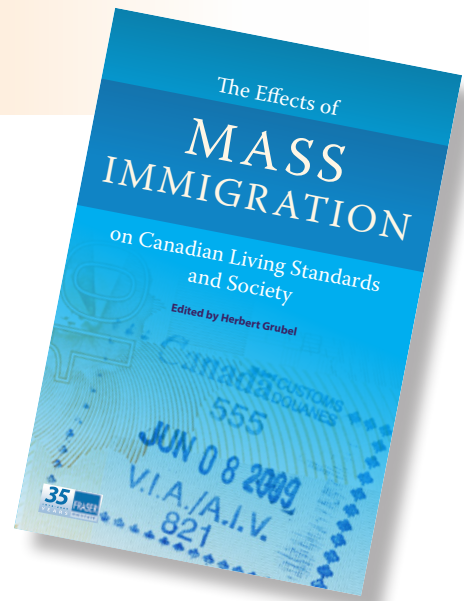
Canadian health policy is increasingly failing patients, exploiting medical providers, and is ultimately financially unsustainable in its present form, concludes a new book published by the Fraser Institute.

And things are likely to get worse unless Canada adopts policy alternatives that dramatically change the economic incentives in the health system, says Dr. Brett Skinner, Fraser Institute director of bio-pharma and health policy and author of *Canadian Health Policy Failures: What's Wrong? Who Gets Hurt? Why Nothing Changes*.

The book identifies six key areas where Canadian health policy is failing: unsustainable costs, shortages of health professionals, shortages of medical technology, long waits for treatment, inefficient drug spending, and a lack of access to new medicines.

"Canadians should be outraged by the serious problems plaguing our health care system and the government policies that are to blame," says Skinner. "Even worse, obvious solutions are ignored for purely political reasons."

However, Skinner believes informed voters can make a difference: "Discovering what's wrong, who gets hurt, and why nothing changes is the first step toward the liberalization of health policy in Canada." ■

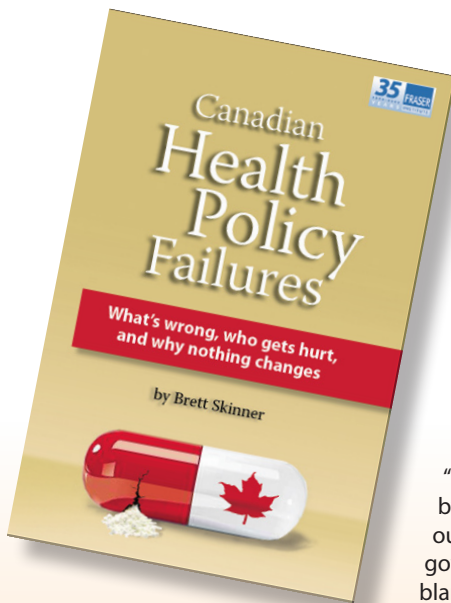


## Canada's immigration policies must be reviewed

Recent mass immigration has negatively affected Canadian living standards and is challenging the country's existing national identity, culture, and social fabric, according to *The Effects of Mass Immigration on Canadian Living Standards and Society*, a new book published by the Fraser Institute.

"Since 1990, Canada's annual rate of immigration has been the highest in the world, resulting in a population increase of 3.9 million people between 1990 and 2006," says Herbert Grubel, Fraser Institute senior fellow and co-editor of the book. "This mass immigration has had profound effects on Canada's economic, demographic, social, and political conditions, affecting the well-being of all Canadians including past immigrants."

The book provides analytically sound and well-documented empirical information about the significant positive and negative effects mass immigration has had on Canada. It concludes that Canada needs a better process for selecting immigrants, since the costs and problems of immigration are the direct consequence of the present system used to select immigrants. ■



The complete studies are available at [www.fraserinstitute.org](http://www.fraserinstitute.org).

# Ask the Professor



*This online column examines a new topic each month through the lens of economics, philosophy, and history. Join us on the Fraser Institute website for a live online discussion with students across Canada, or post your questions for the professor today!*

Here's an excerpt from September's Ask the Professor discussion about competition with Dr. Lawrence Reed, President of the Foundation for Economic Education (FEE), in Irvington, New York:

**Professor Reed writes:**

In economics, competition is not the antithesis of cooperation; rather, it is one of its highest and most beneficial forms. That may seem counterintuitive at first. Doesn't competition necessitate rivalrous or even "dog-eat-dog" behaviour? Don't some competitors lose out to those who are better, faster, or cheaper? A definition is in order. Competition in the marketplace means nothing less than striving for excellence in the service of others for self-benefit. In other words, sellers cooperate with consumers by catering to their needs and preferences.

**Kerry Simmons asks:**

How is the US economy supposed to compete with manufacturing giants like China and India? Isn't this a case where we should be protectionist and keep jobs in our own country? If the jobs leave, we won't have money to buy stuff from overseas anyway.

**Professor Reed writes:**

The way the US economy (or any economy, for that matter) competes is by finding out what it can produce at the lowest opportunity cost and/or the highest quality and then producing it. We can't compete with Honduras in banana production because that country has low labour costs and a favourable climate. We could slap a tariff on Honduran bananas and then grow them ourselves under glass in New York City, but it would represent a huge waste of scarce resources.

It may seem difficult for the Americans to compete with cheap Chinese labour, but, on the other hand, the Chinese sometimes wonder how they can compete with the low cost of American capital. What's ultimately most important in determining who produces what is the relative productivity of labour and the overall cost per unit produced, not the nominal wages per worker. Rather than artificially keeping Chinese goods out, we should focus on improving our own domestic business climate so that our entrepreneurs can be competitive in world markets.

**Harpreet asks:**

Would you say that taxes are anti-competitive, given that they leave the public with fewer resources to allocate however they see fit?

**Professor Reed writes:**

When taxes are minimal because they finance the cost of the government's core function of providing for a safe and trustworthy environment, they are not a problem. But the further taxes go beyond that, the more they exert an anti-competitive influence. They are not only a burden on those who pay them, but also a damper on entrepreneurship and job creation. High taxes often have the perverse effect of bestowing an inherent advantage on the already established and/or politically well-connected firms to the disadvantage of small start-ups that need the capital and make little profit in their early years. So, the higher the tax burden, the more taxes tend to freeze the economy in its place and stifle competition. ■



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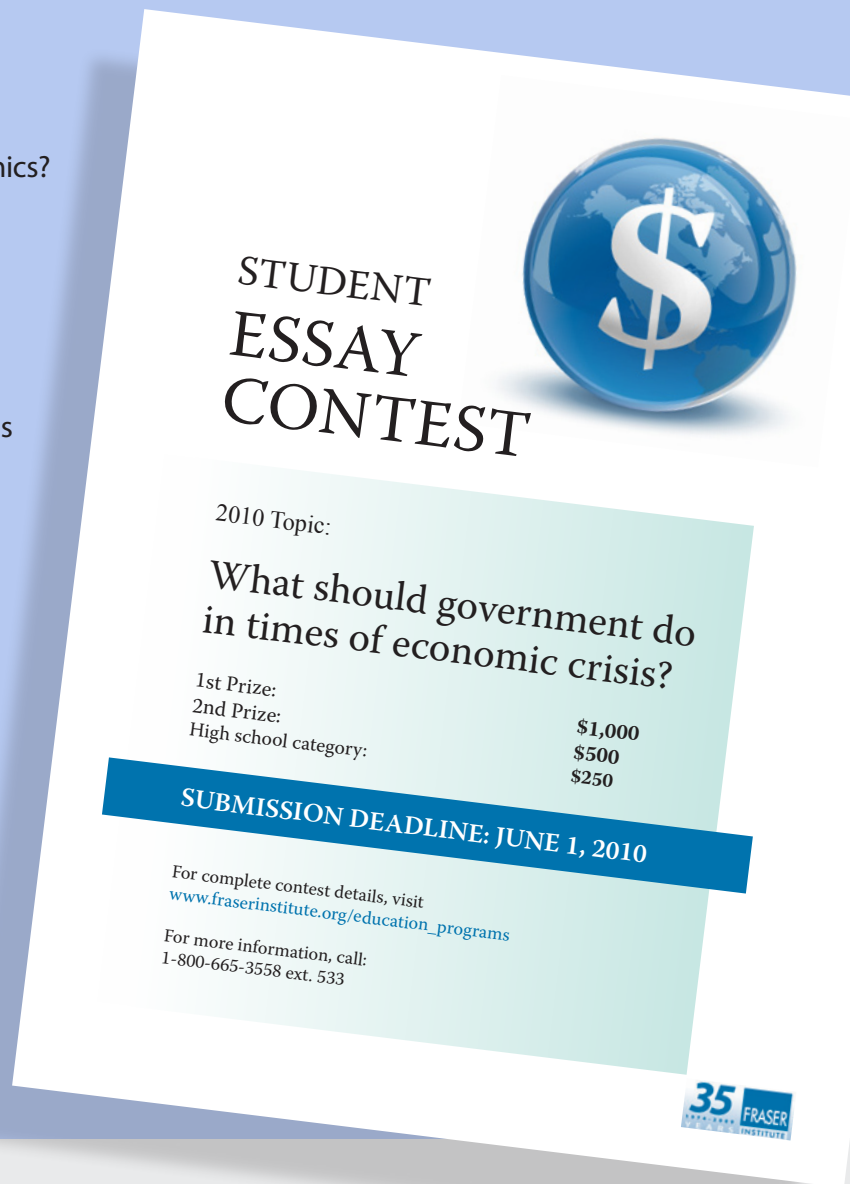
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