THE FREEMAN
IDEAS ON LIBERTY

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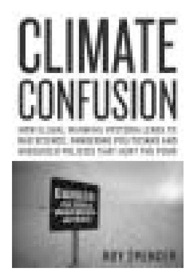

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IDEAS ON LIBERTY

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Perspective

Who Watches Our Guardians?

Sweep aside the phony "outrage" over nationalized AIG's $165 million in bonuses and ask yourself this: *Who gave the company the money?* When politicians dole out other people's money to business, they have no right to complain about the results—especially since the bonuses were allowed under the law passed by Congress.

As Adam Smith wrote in *The Wealth of Nations*, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the publick. . . . It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice. But though the law cannot hinder people of the same trade from sometimes assembling together, it ought to do nothing to facilitate such assemblies; much less to render them necessary."

You'll find no sympathy for AIG here, but let's have no more sanctimonious pronouncements from the facilitators on Capitol Hill.

Our "leaders" say the insurance behemoth had to be saved lest another Dark Age descend on the world. When have they been right before? Other firms would have salvaged the profitable parts of the company. As for AIG's counterparties in mortgage-related credit default swaps, they could better weather any storm from a bankruptcy if they weren't hogtied by arbitrary capital requirements imposed by unaccountable government authorities who can't possibly know the nuanced particulars of time and place.

On the other hand, have the bailout proponents tried calculating the consequences of the AIG rescue in terms of moral hazard? Will future counterparties exercise more or less diligence in light of this episode?

Predictably, the leading inquisitors into the causes of the financial turmoil are themselves among the most culpable: Rep. Barney Frank, Sen. Chris Dodd, and New York Attorney General Andrew Cuomo. AIG got into trouble because it in effect wrote insurance policies (credit default swaps) against the failure of securities based on mortgages, many of which were waiting to blow up when the housing bubble burst. Who created the housing bubble?

It may be hard to tell from the news coverage, but the central government deserves the lion's share of the blame, particularly for its government-sponsored enterprises (GSEs) Fannie Mae and Freddie Mac, which bought up and securitized a slew of bad mortgage loans, thereby encouraging lenders to write more of them.

Enter Frank, Dodd, and Cuomo. There were no bigger boosters of Fannie and Freddie in Congress than Frank and Dodd. (The GSEs were vigorous lobbyists and generous campaign donors.) Every time someone questioned the GSEs' fiscal integrity, these guys jumped in and assured us that everything was fine.

And then there's Cuomo, Bill Clinton's last secretary of housing and urban development (HUD) and close friend of the Mortgage Bankers Association, which likes any policy that makes writing mortgages safer—for its members. According to the *Village Voice* in 2008, Cuomo pushed the GSEs to buy more and more dubious mortgages, while requiring them to report less and less. "In other words," Wayne Barrett writes, "HUD wanted Fannie and Freddie to buy risky loans, but the department didn't want to hear just how risky they were." Cuomo also took steps "to reshape the Federal Housing Administration (FHA), which guarantees millions of mortgages. These actions, too, sought to maximize homeownership—this time by opening the FHA's door to borrowers unable to qualify in the past, a lofty goal that has also helped spur an FHA delinquency rate that exceeds its subprime competitors. . . . Cuomo even supported down-payment and closing-cost assistance programs that allowed FHA borrowers to buy a home without spending a cent of their own money up front." (If you want to appreciate what a sewer Washington is, read Barrett's article.)

Are these guys pursuing AIG out of guilty consciences? Political opportunism is more likely. Will they ever have their day in the hot seat? Not likely. That's how government works.

* * *

The change in administrations has brought no change in plans to build a fence along the southern border. Too bad, for reasons Becky Akers explains.

The budget deficit has exploded, but contrary to popular opinion, it doesn't mean we're spending the wealth of future generations. Roy Cordato tells why.

It's nearly unanimous. Commentators on the left and right agree that World War II ended the Great Depression. Art Carden says they are wrong.

Some say deregulation wrecked the economy, while others say regulation is the culprit. Both have a point, according to Sanford Ikeda. And speaking of regulations, James Payne has a few words for those who think just a few more will do the trick.

High gasoline prices once were used to justify land-use controls. Now that prices have fallen, the controllers need a new reason. Steven Greenhut shows they have had no problem finding one.

We like to think that economists make predictions in good faith on the basis of sound information. Anthony de Jasay suggests they could just be making bold career moves.

How often do "experts" say America needs more college graduates? George Leef politely responds that they don't know what they are talking about.

Here's what our columnists serve up: Lawrence Reed discusses the effort to make state government more transparent. Donald Boudreaux explains what's wrong with Keynes. Stephen Davies says beware fortune tellers and planners. John Stossel notes how easy it is for government to create jobs. David Henderson answers the "government fundamentalists." And Robert Murphy, reading the latest charge that oil prices are rigged, responds, "It Just Ain't So!"

Books coming under examination discuss global warming, irrationality, labor, and liberty.

In Capital Letters, Mark Skousen skirmishes with David Henderson and Jeffrey Hummel over the Greenspan Fed.

—*Sheldon Richman*
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Two Cheers for Transparency

BY LAWRENCE W. REED

If citizens knew more about how their governments really worked and what they spent other people's money on, it would not only make for better-informed citizens but for better (and hopefully *less*) government at the same time.

That's the theory behind a growing movement spearheaded by think tanks from coast to coast and in Canada. It's called "transparency."

Back in the 1980s this notion was the subject of an episode ("Open Government") of the British television sitcom *Yes Minister*. The following exchange among three bureaucrats illustrates just how difficult this whole business can be.

A: "What's wrong with open government? I mean, shouldn't the public know more about what's going on?"

B (with a look of disgust): "Are you serious?"

A: "Well, ah, yes, sir. I mean, it *is* the minister's policy after all."

B: "But it's a contradiction in terms. You can be open, or you can have government."

A: "But, but, surely the citizens of a democracy have a right to know."

C: "No. They have a right to be ignorant. Knowledge only means complicity and guilt. Ignorance has a certain (pause) dignity. You don't just give people what they want if it's not good for them! Do you give brandy to an alcoholic?"

B: "If people don't know what you're doing, then they don't know what you're doing wrong."

A: "I'm sorry, but I am the PM's private secretary and if that's what he wants, then . . ."

C: "You'll definitely not be serving your minister by helping him make a fool of himself. Look at the ministers we've had. Every one of them would have been a laughingstock in three months had it not been for the most rigid and impenetrable secrecy about what they were doing!"

As governments at all levels have mushroomed in recent decades, shining light on their activities presents no small challenge. One of the earliest transparency initiatives, I'm proud to say, came out of the organization I headed for 20 years, the Mackinac Center for Public Policy in Michigan. In September 2001, Mackinac launched the website "MichiganVotes.org" (MVO)—a one-stop shop for finding out what the state legislature is up to. The site's database now contains more than 16,000 bills, 15,000 roll-call votes, 12,000 amendments and 3,400 laws—all described in pithy, plain English and easily searchable.

What's in the Sausage is on the Website

More than 30 years ago, then-California state senator H. L. Richardson penned a memorable little book with the revealing title "What Makes You Think We Read the Bills?" In Michigan the Mackinac Center started reading all the bills in 2001, hasn't stopped since, and has trained site managers and editors to do the same thing for think tanks in nine other states. It has also posted on the web every collective-bargaining contract from every one of the state's public school districts. It pushed many of those districts and some municipalities into posting their check registers online so people can see how and where their tax dollars are spent. While it's debatable whether all this has yet made very many Michigan governments better or smaller, it has certainly made them more accountable—and controversial, too. Thousands of public comments on the MVO site suggest that citizens are increasingly unhappy with the sausage their political meat grinders are turning out.

Michigan governments aren't the only ones coming under new scrutiny. The Texas Public Policy Foundation launched its superb transparency portal, TexasBudgetSource.com, about a year ago. It houses

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all the budget and spending information of state and local governments within the Lone Star State. More than just an online warehouse for this vital data, it also includes original analysis and commentary to illustrate trends in state spending. The Foundation estimates that the transparency efforts it has helped the state put in place have led to changes that are on track to save Texas taxpayers more than $8 million by the end of this year.

In Illinois, a state rocked by high-level government corruption and secrecy, the Illinois Policy Institute (IPI) is coming to the rescue. CEO John Tillman says, "By creating a culture of transparency, it will no longer be necessary to learn what the government is doing through a wiretap, as we did with (impeached) Gov. Rod Blagojevich. Online transparency is the first step to cleaning up Illinois once and for all." IPI has recruited and trained 120 volunteers to promote transparency in their school districts, village boards, city councils, county boards, park districts, and every government body operating off tax dollars. It has tracked dozens of "transparency wins," which it lists on its special website, OpenIllinois.org, and it is collecting pledges from elected officials to support putting all government spending online in a searchable database.

The Evergreen Freedom Foundation in Washington state publishes the "Hey, Big Spender!" index that keeps track of all increased taxes and fees proposed or cosponsored by every legislator. The Foundation ranks legislators and compares their records with each other, which has some at the top of the big-spender list squirming and squealing in embarrassment.

The Sam Adams Alliance, based in Chicago, sponsors the government transparency website SunshineReview.com. In its first year of operation this wiki-style project generated more than a million page views. Nearly all 3,140 counties in the United States have been evaluated against a ten-point transparency checklist on the site, which is becoming a standard that government transparency projects are measured against.

Private think tanks are serving the public interest by offering information citizens need to know. But that raises the question, "Do citizens want to know?"

Virtually every member organization of the State Policy Network, the trade association of state-focused "free market" think tanks, is now leading or encouraging important new initiatives to pry government open. With the support of Gov. Mark Sanford, the South Carolina Policy Council has scored notable victories in getting the legislature to record the votes its members cast. The North Dakota Policy Council uses transparency arguments to advance tax reduction from its legislature in Bismarck.

A Lousy Record, Eh?

Transparency is becoming a cause célèbre in Canada too. The Fraser Institute produces powerful studies that inform people about the limits of the public sector. Its "Government Failure" series has exposed hundreds of instances of cost overruns, inaccurate reporting of financial information, unnecessary spending, improper program management, and violations of their own regulatory guidelines by governments themselves.

Fraser estimates "conservatively" that repeated government failure at the federal level alone cost Canadians over $100 billion in recent years. Says Niels Veldhuis, Fraser's director of fiscal studies, "Armed with a more realistic understanding of the motivations of politicians and bureaucrats, the rent-seeking nature of interest groups, and the institutional constraints of government bureaucracies, readers are less likely to fall for what economist Harold Demsetz characterized as the 'Nirvana fallacy.' That is, they are less likely to compare market results with wildly idealistic outcomes that governments actually almost never produce."

Private think tanks are serving the public interest by offering information citizens need to know. But that raises the questions, "Do citizens *want* to know?" and "Will they hold their leaders accountable for misbehavior?" Time will tell, but this much is clear now: You can't act on information you *don't* know. FEE

Oil Prices Are Rigged? It Just Ain't So!

BY ROBERT P. MURPHY

Even though oil prices have fallen and quieted the price-conspiracy mongers, you can bet that when prices go up again, they will be back in force. It happened last time. For example, in an article for *Time* last August, Ari Officer and Garrett Hayes ask, "Are Oil Prices Rigged?" (www.tinyurl.com/6dxkkj). Our cynical authors—who are Stanford graduate students in financial mathematics and materials science/engineering respectively—answer in the affirmative, but their arguments are shockingly ignorant of how markets work.

Officer and Hayes admit up front that oil speculators aren't the ones manipulating oil prices. Rather, they blame the oil *producers* for rigging the market, allegedly through the use of futures contracts:

> The price of oil reported in the news is actually the price of oil in the futures market. In this market, traders do not exchange physical barrels of oil, but instead trade contracts which obligate them to exchange oil at a quoted price at a specific date in the future. . . . Such a contract allows companies to hedge positions by locking in prices early. . . . It's all about reducing risk and uncertainty. But what if oil suppliers were instead buying oil futures, compounding their own risk and reaping enormous profits from the explosion in the price of physical oil?

An interesting possibility, to be sure, except for one nagging problem: If an oil producer is buying a futures contract *from himself*, that is equivalent to taking future supply off the market. To use a simplistic example, suppose a major producer estimates that he can sell 100,000 barrels of January 2010 oil at $90 per barrel or raise the price to $100 per barrel if he restricts his output to 75,000 barrels. The authors want to argue that he has a third option: "selling" 100,000 future barrels at $100, holding the price up himself by entering the futures market and snatching up those excess 25,000 barrels of January 2010 oil.

But in this third approach the producer is still extracting the same deal from his actual customers: They are giving him $100 each for 75,000 barrels of January 2010 oil. Since the producer himself bought the other 25,000 barrels, it is rather irrelevant that he received a high price for them; he can "pay himself" $100 a piece, if it makes him feel rich, but that still leaves him just as wealthy—and with just as much oil—as if he had simply cut his January 2010 output to 75,000 barrels. The existence of the futures market doesn't give our producer any more ability to gouge his customers than his ownership of the oil in the first place gives him.

Final Consumers Have the Final Word

There is no getting around this basic fact, try as the authors might to bring up subtleties of the futures market.

They argue, for example, that only "Hedge funds, oil companies, OPEC—the very people who profit from massive, consistent increases in prices," have access to the futures market. From this they conclude that, "we as oil consumers don't set the prices."

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That's simply untrue. Hedge funds can't force refiners to buy more oil than they want to at a given price. If the "fair" price of oil, as determined by the "fundamentals" of supply and demand, is $80 per barrel, but the greedy hedge funds and OPEC buy up futures contracts and push the price up to $120 per barrel, then there will be a glut. That is, more physical barrels of oil will come to market than the actual end users will purchase. Oil inventories would grow larger every day, as producers kept pumping more oil than consumers burned.

Incidentally, this outcome is certainly *possible*. For example, if a group of rich speculators foresaw an imminent attack on Iran, they could rush to buy up oil futures. This would push up the futures price, which would lead producers to lower current output and devote more of their finite supply to the future (where the new demand was). The reduction in current supply would drive up the spot price, forcing consumers to economize on oil in the present.

Maybe High Prices Aren't Such a Bad Thing

Let's carry this scenario just a bit further. Suppose the speculators were really convinced that war with Iran would happen within a few months and that the price of oil at that time would skyrocket to $200 per barrel. Then the speculators would continue buying futures contracts, so long as the futures price were below $200. Oil producers would be overjoyed at this incredible demand, and would gladly sell more and more futures contracts. At some point, the producers would realize that they had promised as many barrels in future months as they could physically pump. Then it would become profitable to pump oil in the interim and physically warehouse it.

Thus the speculators' actions would a) drive up the spot price of oil to cause consumers to restrict their use of oil in the present, and b) induce stockpiling of oil. Notice that these effects are exactly what we *want* to happen. If the speculators were right and war broke out, the spot price would not jump as sharply because it would have been pushed up already. The larger stockpiles of physical oil would help ease the crunch when Iran stopped exporting.

Pumping Out Evidence to the Contrary

To return to the *Time* article, the authors have spelled out a mechanism through which rich institutions could push up the price of oil. But they haven't followed out the implications of their thesis and checked to see whether this was actually happening. Unfortunately for their claim, oil inventories have been fairly constant over the last several years, and—most damning of all—world oil production *increased* from 2007 through 2008, exactly the period when prices skyrocketed. (See my article "Oil Speculators: Bad or Good?" [www.tinyurl.com/ad7bqf] for more details.)

> Consumers still decide how many barrels they want to buy at a given price.

To repeat: Consumers still decide how many barrels they want to buy at a given price. If outside parties push up the price (and they can, if they are willing to risk enough money), then consumers will buy fewer barrels. Therefore, if the high price of oil were due to manipulation, we would observe either a restriction in output and/or accumulating inventories. We see neither.

In reality, all prices are determined by supply and demand, properly defined. Outside investors with lots of money can certainly influence prices, but there are always risks. Funds that had large "long" bets on commodities took a bath as oil fell from its July 2008 high of $145 down to well below $50 a few months later. Futures markets allow producers and consumers to hedge against needless risk by locking in prices, and they allow speculators with superior foresight to improve the allocation of resources over time. Our *Time* authors think they've shown that the oil market is rigged, but it just ain't so! FEE

Mr. Obama, Tear Down This Wall!

BY BECKY AKERS

In its zeal to protect us from Mexicans who want to pick our fruit and clean our homes, the federal government is walling off our southwestern border. Congress passed the Secure Fence Act (SFA) in 2006, authorizing barriers along some portions of the 1,969-mile boundary; other stretches will be fitted with a "virtual" wall of motion sensors and cameras. The Department of Homeland Security (DHS) was supposed to have built almost 700 miles of physical fence by the close of 2008 and the Bush administration. We can assume it fell short since the federal government is ever incompetent and has been tight-lipped about how many miles it has completed.

More people cross this international boundary each year than any other in the world—250 million with government permission, a fraction of that without. (Estimates range from 400,000 to a million.) Patches of the border, particularly urban ones, have been fenced and policed for decades. But this dotted line inconvenienced rather than stopped folks who neglected to secure a bureaucrat's consent for their trip: Travelers trying to exercise their inalienable right to free movement simply went around the barriers. The feds never like being outfoxed, so they extended the fencing beyond populated areas. This drove migrants into increasingly remote and hostile terrain. There they not only had to survive encounters with America's Border Patrol but also dehydration and other dangers in the desert. No More Deaths, a group that caches food and water along routes migrants are likely to take, estimates that at least 238 travelers perished in Arizona alone in 2006, with more than 4,000 "men, women, and children [losing] their lives in the deserts of the US-Mexico borderlands" from 1998 to the present.

Walling off Rights

You might think that would be tragedy enough for anyone. But as former President George W. Bush said when he signed the SFA, "We have a responsibility to enforce our laws. We have a responsibility to secure our borders. We take this responsibility seriously." Apparently far more seriously than we do corpses or constitutional limits on government. And so the Act "authorize[d] the Department of Homeland Security to increase the use of advanced technology, like cameras and satellites and unmanned aerial vehicles to reinforce our infrastructure at the border."

Authorizing DHS to grab more power is about as necessary as authorizing sparks to fly upward. Nevertheless, Congress exempted DHS from all federal laws as part of its 2005 REAL ID legislation. All it has to do is claim that a law impedes progress on the wall. Section 102 (c)1 of the REAL ID Act says, "Notwithstanding any other provision of law, the Secretary of Homeland Security shall have the authority to waive, and shall waive, all laws such Secretary, in such Secretary's sole

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discretion, determines necessary to ensure expeditious construction of the barriers and roads under this section."

This immunity extends all the way to judicial review: Judges can't "order compensatory, declaratory, injunctive, equitable, or any other relief for damage alleged to arise from any such action or decision," according to Section 102 (c) 2B. So far the unrelieved victims have been mostly Americans whose property the agency has seized or destroyed. Surely even those most opposed to immigration would agree that stopping it does not excuse such tyranny and injustice against citizens.

Environmental Destruction

Among the many regulations DHS is ignoring are environmental ones. But Mother Nature isn't as easily overridden. There are consequences for flouting the laws of physics, for example. And DHS's insouciance towards things like gravity and water has already hurt the government's own property.

So far the unrelieved victims of DHS have been mostly Americans whose property it has seized or destroyed.

On July 12, 2008, a heavy rain near Ajo, Arizona, clogged drains in completed sections of the fence, damming the downpour and flooding Organ Pipe Cactus National Monument, the only area in the United States where the plant grows wild. Park superintendent Lee Baiza told the Associated Press, "[We] had suggested that [DHS] take into consideration everything that can happen with a weather event. . . . We had a concern that this was going to happen." And this storm wasn't even a hurricane such as frequently roars through the Gulf and neighboring Texas.

The Rio Grande River separates Texas from Mexico for 1,254 miles before heading north. It waters a huge variety of wildlife, and that abundance draws conservancies to the area. Some are private, such as the Sabal Palm Audubon Center in Brownsville, Texas. Others are government-held lands that the U.S. Fish and Wildlife or National Parks Service manage. Over the decades, these organizations have cooperated with one another and the Mexican government to form a "wildlife corridor" so animals can range freely even if people can't. The corridor also acts as a sanctuary for rare or endangered species. But DHS seems as hostile to animal life as it does to human life. It is hacking through this territory with a wide corridor of walls running parallel to one another, asphalt roads between, and hundreds of yards of cleared land to the north and south.

Barriers for stopping bipeds stop quadrupeds, too. This imperils animals that wander widely to feed or mate. *Audubon Magazine* points out that the inbreeding the wall compels will weaken if not exterminate America's last colony of ocelots. This cat once roamed the Rio Grande and southern Arizona but now counts fewer than 100 members on the Texas side of the border.

A biologist at the University of New Mexico worries about other predators as well. Dr. Joe Cook told the Inter Press Service, "There is no question that jaguars . . . in the U.S. and northern Mexico would be significantly affected by the wall. . . . The only hope to preserve large carnivores in the wild is to have large areas of continuous, unfragmented habitat."

The Mississippi and Central migratory flyways meet at the Rio Grande. Birds that once rested there during thousand-mile journeys will now contend with barren, paved land instead of trees, bushes, nuts, and seeds. Floodlights that turn desert night into day to discover migrants are already disorienting not only birds but bats and butterflies as well.

Financial Destruction

Matching the wall's environmental disasters are its financial ones. In January 2007 the Congressional Research Service figured that 700 miles would cost about $49 billion, including maintenance. But as usual with the state's estimates, this one probably isn't worth the paper it's printed on, especially if the rest of the barrier is anything like the 14 miles that wind inward from the California coast at San Diego. The first fence there—ten-foot-tall walls of welded steel—went up in 1993. Next came a "secondary" wall, this one 14 feet high, about 103 feet to the north. A chain-link fence runs parallel to that, with "stadium lighting" throwing every ugly detail into sharp relief. This monstrosity was supposed to cost $1 million per mile, but that skyrocketed to $3.8 million. And construction isn't yet finished, in part because the California Coastal Commission frets about erosion. The bit that remains unfenced meanders through more challenging terrain, with construction estimated to reach $10 million per mile. If the price for the other 700 miles escalates proportionally, we are looking at an outlay of anywhere from $200 to $490 *billion*.

There are other, more hidden expenses. For example, the Fish & Wildlife Service has spent $100 million of our money over the last three decades to buy and replant land near the Rio Grande. The wall will ruin that investment. It will also end "eco-tourism" and the $125 million that 200,000 visitors annually spend in the hopes of glimpsing an ocelot or a Muscovy duck.

Naturally, while most Americans pay for the fence, a select few profit. DHS hired Boeing to implement its Secure Border Initiative (SBI) in September 2006. The company will install 1,800 towers as a "virtual fence" on our northern and southern borders within three years to "detect and track intruders through the use of cameras, sensors and motion detectors," as *Federal Computer Week* puts it—all for only $2.5 billion. Needless to say, Boeing and DHS trumpeted their lucrative deal as a revolutionary, unprecedented, sure-fire solution for the "border problem" the feds have created. But the *Washington Post* took a more jaundiced view, citing the government's "series of failures [in] control[ling] U.S. borders." So did agents on the ground. Rich Pierce, executive vice president of the Border Patrol's union, told *Federal Computer News,* "[SBI]—it's been tried and it's failed. . . . They're not going to try anything new. . . . The people in the field know it's not going to work."

So did the legislators voting the funds. Rep. Harold Rogers was chairman of the Homeland Security Subcommittee from 2003 until January. According to the June 26, 2006 issue of *Government Computer News*, he "noted that spending on border security since 1995 has 'quadrupled from $5.1 billion to over $17.9 billion,' and the number of agents has jumped from 5,000 to 12,319. 'However, during this same period, the number of illegal immigrants has jumped from 5 million to an estimated 12 million,' Rogers said. 'The policy of more money and no results is no longer in effect. We will not fund programs with false expectations.'" That would explain his subcommittee's handing $39.9 *billion* to DHS in FY2009 with Rogers's "support," as he proclaimed on his website, despite the agency's reputation even among the feds as one of their most wasteful and dysfunctional bureaucracies.

> Congress handed DHS $40 billion despite the agency's reputation even among the feds as one of their most wasteful and dysfunctional bureaucracies.

Sending Property Owners to Limbo . . .

Knowing that the fence won't stop immigration, that it merely allows politicians to look as though they're fixing an issue they've ginned up into a crisis, must particularly gall the property owners losing homes and businesses. Most of those victims live in Texas since the feds already own much of the land along the other states' borders.

The barriers have always been more of a sieve than a fence since they proceed in fits and starts with long gaps between. The new miles of fence will not be much different, according to the Border Patrol: Tom Rudd, the Patrol's chief in Brownsville, Texas, is "expecting a total of nine miles of fence segments," according to PBS. "The segments, Rudd says, will act like funnels, pushing migrants into areas where his agents will be waiting to capture them."

Those funnels bisect plenty of private property, including homes, farms, businesses, and nature preserves, as well as national parks and even towns. Stunningly, they don't line the actual border. Some of the wall lies as much as two miles north of it. Landowners whose properties fall within that region face a bizarre limbo, severed from the rest of the country—and from the services their taxes supposedly buy them. *Audubon*

Magazine quotes the Society's executive director in Texas, Anne Brown, on the fate of its Sabal Palm Center: "From what we've heard, we'll have to close. We can't figure a way to keep it open, because we'll be cut off from the rest of the United States. Will we be insured? Will we receive city services? We can't let Ernie [the caretaker] live here anymore." The magazine adds, "The sanctuary and its unique plants and wildlife will be taken from the American people, and what survives will be, for all intents and purposes, ceded to Mexico."

Ordinary owners in Limbo Land also face extraordinary challenges. Pamela Taylor is an elderly émigré from England who married an American soldier 50 years ago, then moved to Brownsville with him. If anyone should welcome the protection the wall allegedly provides, it would be Mrs. Taylor. She once arrived home to find a migrant hiding from the Border Patrol in her living room. But she fears DHS and its fence far more than she does people looking for jobs and better lives. "They said the fence was gonna go right across the street," she told PBS. "And . . . my son-in-law asked, 'Well, do you mind, how are we going to get out?' And the fellow from the Corps of Engineers said, 'Well, you know, we hadn't really thought about that. I guess you're gonna have to follow the border patrol out.' " Obviously, that enormously complicates even the simple errand of buying groceries. And it could be fatal should Mrs. Taylor need a doctor.

> Many victims have noticed that while DHS expects them to sacrifice their interests, it is skirting property belonging to wealthy, politically connected neighbors.

PBS asked the Border Patrol's Rudd about ingress and egress for the Americans caught in this quandary. Rudd said there will be "gates" and that "we're still lookin' right now—at different—locking mechanisms of what's gonna work best in certain areas. . . . [O]ne approach that I'm lookin' at . . . is—a push-key type, you know, the—the number system, a push pad . . . enforced with a camera—so we can make sure that that number or that combination—doesn't get compromised . . . basically work with the owner to find out who's gonna be in that area, what kinda vehicle they'd be driving." The government hasn't touched Mrs. Taylor's property and so isn't offering even eminent domain's pittance, but it robs her nonetheless. Her land will be worthless. What buyer wants a hassle every time he needs a quart of milk?

DHS plans to swipe some properties lying directly in the fence's path in their entirety, particularly when the parcel is small because the owner is poor. Other times, the fence threatens only a portion of the property—but it might as well take the whole piece because once again it's destroying the land's value. Leonard and Debbie Loop and their children own a 1,000-acre farm in Brownsville. But the wall will exile 800 acres to Limbo Land.

. . . Unless They're Rich or Connected

Given that the wall doesn't follow the border, as well as its frequent stops and starts, its placement is arbitrary at best. Many victims have noticed that while DHS expects them to sacrifice their interests, it is skirting property belonging to wealthy, politically connected neighbors. One victim, Eloisa Tamez, is a 72-year-old woman who still lives on some of the 12,000 acres her ancestors received in a Spanish land grant. She's been down this road before. The feds stole more than half her holdings in the 1930s to build levees, and they didn't pay a dime for any of it. The *Texas Observer* reports that now they want more. But the wall gobbling Ms. Tamez's home stops short two miles down the road. That just happens to be the edge of Sharyland Plantation, 6,000 acres that billionaire Ray L. Hunt is developing into a luxurious, gated community of million-dollar homes. Hunt, of course, is not only George W. Bush's buddy but his benefactor, too, since he's kicking in $35 million toward the presidential library. The wall resumes on the other side of Sharyland.

Under former secretary Michael Chertoff, DHS refused to answer questions from folks like Ms. Tamez. But silence has long been one of the agency's favorite tactics. It almost always withholds information on the grounds that telling the citizens who pay its bills what it's doing with their money would jeopardize national security. It will neither confirm nor deny who's on its notorious Terrorist Watch List, for instance, not even to the victims themselves. And so it goes with the wall. DHS refuses to verify its plans or discuss its rationale for the wall's route. That leaves many owners grappling with rumors and stomach-churning uncertainty. Others are fairly sure DHS will steal their holdings because it has already ordered them to sign waivers allowing surveyors to measure their property. Those who refuse find themselves facing condemnation of their land.

Chertoff tried to cast cooperating with the agency's theft as a patriotic duty. Despite abundant evidence to the contrary, he announced in February 2008, "I respect private property. But you cannot make border security and national security an individual choice for each individual landowner. . . . [W]hen people are smuggling drugs and human beings across the border, for an individual landowner to say, 'I don't care. I want to make sure that my view of the river is unobstructed,' is not an acceptable answer."

Dictatorical and Dishonest

That's not only arrogant and dictatorial, it's also profoundly dishonest. Protestors do not mourn vanishing vistas. They are instead defending their homes and businesses, some of which have been handed down through their families for generations. Meanwhile, the U.S. government's unconstitutional jihads against those drugs and people it doesn't like forces folks who want to transport either to smuggle them. Politicians have tried to control people's movements and have failed at this immoral task; nevertheless, they expect the rest of us to cooperate with their new, desperate, criminal measures. Why?

Unfortunately, Leviathan has convinced most Americans that its campaign against "illegal" drugs justifies any and all abuses. So now it excuses its militarization of the Mexican border because of the marijuana crossing it. The feds take the same tack with "illegal" immigration. But they also spin things a bit differently to hide their heartlessness. They bewail the "smuggling of human beings," conflating immigration with—incredibly enough—slavery.

In a speech on September 9, 2008, at the "Stop Human Trafficking Symposium," conveniently sponsored by Customs and Border Patrol, Chertoff announced that "the line between so-called voluntary migration and human trafficking is not a very bold line. It is often the case that people who begin the movement across the border in a voluntary way . . . quickly turn into victims when they are held for ransom, or when they are required to work off the cost of the smuggling by paying

Photo courtesy Brad Pease

off the vast majority of their wages to the smuggling organizations." That may be exploitative, but it isn't slavery since slaves seldom receive wages and so can't "work off" any "cost." And Chertoff ignores the fact that the government's criminalization of migration gives those few entrepreneurs who do victimize their clients the chokehold they need: A "restaurant owner" who allegedly "trafficked hundreds of adults and children into the United States . . . threatened to turn them in to the authorities as illegal aliens if they tried to escape," according to the *Columbia* (Missouri) *Daily Tribune*.

DHS portrays as vicious criminals guides who conduct people through hostile terrain and help them avoid the Border Patrol. The agency then presents its own ferocious attacks on immigrants, its armed patrols and cameras, its dogs, handcuffs, and holding pens, its hunts through the desert in air-conditioned ATVs for exhausted, fleeing families, as "rescuing" them from "human traffickers." Odd, isn't it, that migrants pay these "traffickers" to chaperone them across the border but try to fend off their "rescuers" by throwing rocks. They seldom succeed. Rather, they play right into the government's hands: it charges them with the "crime" of self-defense, AKA, "assaulting a federal officer." This inflates the number of "felons" crossing the border so that the feds "save" us from an even bigger menace.


New DHS secretary Janet Napolitano, as implacable an enemy of free movement as her predecessor was.
commons.wikimedia.org

An Unconstitutional Line in the Sand

Whether they're between states or countries, borders soon cease to be noticed by most people living along them. They marry one another, establish businesses, visit, laugh, cry, agree, disagree, and dream together. So it is along the U.S.-Mexican boundary. The wall will sunder these families and friends as mercilessly as Berlin's barricade did Germans.

The Founding Fathers understood government's essence, its cruelty and callousness, far better than do modern Americans. That's why their Constitution never empowers politicians to regulate anyone's movement into or out of the country (except for slaves, fittingly enough: What else are we when we beg a bureaucrat, "Please, may I enter?"). Article 1, Section 9 bars Congress from "prohibit[ing]" the "Migration or Importation" of "such Persons as any of the States now existing shall think proper to admit" until 1808. If we dismiss the doctrine of enumerated powers, this implies that Congress may prohibit all the migrating and importing it likes thereafter. And if we also dismiss the literary and historical context that limits Article 1, Section 9 to slaves, it appears the feds may indeed control anyone's immigration after 1808—but only in those states existing at the Constitution's adoption. None of those border Mexico, and mighty few do Canada. DHS needs to relocate its wall down the Atlantic coast.

Nor does the Constitution deputize the central government to "protect" the country's borders, much less build walls "funneling" migrants through deadly desert where cops lurk to kidnap them. Immigration ought never to have been federalized in the first place; government had no business arrogating an "interest" in it during the 1870s, then tightening its vise each decade since. Immigration is an issue of property rights—not the DHS's infernal abrogation of them, but a decision by the folks Michael Chertoff so despises, "each individual landowner," as to whether migrants may cross his property.

Despite its utter lack of constitutional authority, DHS will probably continue militarizing our borders. Its current secretary, Janet Napolitano, opposed a *physical* wall when she was governor of Arizona. As she told AP, "You show me a 50-foot wall and I'll show you a 51-foot ladder at the border." Heavily implied is her support for more border agents as well as more high-tech surveillance. Napolitano is as implacable an enemy of freedom of movement as her predecessor Chertoff was, even if her methods differ.

Meanwhile, America has another border to the north, which Boeing's contract covers as well. Landowners there should be very worried, given the abuses their southern brothers have suffered.

Indeed, all of us should worry, if not panic, when we remember that the walls keeping others out also keep us in. FEE

Deficit Spending and Future Generations: Not What You Might Think

BY ROY CORDATO

Conventional wisdom on both the right and the left says that because the "stimulus" package is being financed by deficit spending—that is, borrowing now, taxing later—Congress and the President are forcing future generations to pay for our problems. As the story goes, we are shifting the costs of this massive spending scheme to our children. While this sounds accurate, it is in fact impossible to shift costs this way.

Neither the government nor anyone else can spend future dollars. In reality all current spending must come from current revenues and can use only existing resources. Every dollar the government spends, even if borrowed, has to come out of some existing person's pocket and therefore preempts the use of that dollar somewhere else in the economy—not in the future, but here and now.

The government can obtain its borrowed money by selling Treasury bonds to either American citizens or foreigners. If it borrows from domestic sources, it is getting money that Americans would have either invested somewhere in the economy or spent on goods and services. Government borrowing simply diverts the cash from other uses, just as if its spending were financed by taxation. Economists call this the "crowding out effect."

A typical response is that most of the government borrowing will be from foreigners and that the Obama deficit won't crowd out economic activity in the United States. Thus we are said to be mortgaging our children's future to people in other countries. The first thing to notice is that we can't know who the bondholders will be in the future when the loans come due. Treasuries are sold and resold many times over. This is also true of debt originally issued to Americans.

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The real problem has nothing to do with who holds the note at the time of repayment. A good economist asks what else these foreigners would be doing with their dollars. Because they are lending dollars, as opposed to euros or yen, this money would ultimately be either spent on American goods, thereby increasing exports, or invested in the U.S. economy. We reach the same conclusion regardless of who lends the government the money. The real costs of government spending, no matter how it is financed, are experienced here and now.

Government Spending Always Competes with Private Spending

Also, regardless of where the money comes from—taxation, borrowing, or printing press—government spending always preempts other spending in the economy. Those who get the borrowed money have purchasing power transferred to them that will increase the demand for the resources they use. That will increase the cost of those resources to other buyers.

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Government spending thus always competes with private-sector spending for scarce resources and preempts growth.

This is not to argue that deficit spending is the same as tax-financed spending. It is not. Deficit spending creates the occasion for coercive wealth transfers from future taxpayers to future government bondholders. When the bills come due, most of our children and grandchildren will have part of their incomes coercively transferred through higher taxes to those who hold the Treasury notes. Government debt makes our children less free.

> Deficit spending leads people to believe they are getting something for nothing. This is why politicians find deficit spending so appealing.

Furthermore, deficit spending obfuscates the true cost of government, not only in lost liberty but also in lost productivity and wealth. Deficit spending is dishonest because it leads people to believe they are getting something for nothing while in reality their wealth is diminished just as if the spending were covered by taxation. But that cost is not seen in the tax bill. This is why politicians find deficit spending so appealing. It is a tool for pulling the wool over citizens' eyes while rewarding special-interest groups and expanding the state's control over the private sector.

Ultimately, the real choice is not between deficit-financed and tax-financed spending. The moral question is whether we should have more spending and bigger government with less liberty or less spending with a smaller government and more liberty. The hand-wringing on the left and right about passing the cost of "stimulating" our economy onto future generations is misplaced. No matter how it's financed, Obama's new spending has the potential to stimulate only one thing: the size, scope, and power of government. FEE

The Return of Keynesianism

BY DONALD J. BOUDREAUX

In our Brave New World of Change We Can Believe In, I wonder about some recent changes—changes that I can't believe in.

For example, why are so many economists suddenly changing their minds about the economics of John Maynard Keynes (1883–1946)? Veritable stampedes of my fellow economists are rushing to take up again the banner of Keynesian economics, which most economists had abandoned by 1980.

Keynesian economics is an account of economywide employment that rather too simply alleges that economic health and growth—and, hence, the number of jobs—declines with decreases in "aggregate demand" and improves with increases in "aggregate demand." No need to bother with questions about how well individual markets are working; no need to worry that the money supply might be growing too fast and causing individual prices to be out of whack—no! The economy is really much simpler, said Keynes, than those silly classical economists, such as Adam Smith, made it out to be.

> Keynesian economics is an account of economywide employment that rather too simply alleges that economic health and growth—and, hence, the number of jobs—declines with decreases in "aggregate demand."

All that really matters is the total demand for output ("aggregate demand"). If consumers cut back on their spending to save more, aggregate demand falls. As aggregate demand falls, firms scale back their operations. Workers are laid off. As workers are laid off, aggregate demand falls even further, causing even more layoffs. The economy spirals down into an "unemployment equilibrium."

Only higher spending can salvage the situation, and the only agency sufficiently immune to animal spirits to know what to do—and that has the wherewithal to spend with sufficient gusto—is government. If government spends, the resulting increase in aggregate demand will restore "confidence" to the economy. Business people will again be confident that they can sell what they produce, so they'll hire more workers. These newly hired workers will also spend. The economy will be saved.

The only trick is to make sure that the government doesn't spend *too* much. If it does, the result will be inflation.

Economists before Keynes (at least, those who were taken seriously) rejected such ideas. These economists—labeled disparagingly by Keynes as "classical economists"—pointed out that if people reduce their consumption expenditures and save more, the additional savings push down interest rates and prompt entrepreneurs to invest more. Rather than disappear from the spending stream, these savings are spent, but they're spent as demand for investment goods rather than as demand for consumer goods.

Classical economists argued, therefore, that higher savings were good, for they meant that the size of the economy's capital stock would increase. More saving meant more and better machinery, larger factories, more R&D, more worker training, more infrastructure. Over time this larger capital stock makes workers more productive and thus pushes real wage rates higher. Living standards increase.

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"Pshaw!" respond the Keynesians. "If consumers spend less on consumption goods, why would entrepreneurs increase the capacity of their operations? Moreover, even if people saved more today with the goal of consuming more tomorrow, investors' motives are so haunted by animal spirits that we can't rely on investors to read lower interest rates as a signal to invest more. Alas, only government can provide the rationality, stability, and spending necessary to keep the economy at full employment."

The "classical economists"—which include in this case not just scholars who preceded Keynes, but also the likes of Frank Knight, Ludwig von Mises, and F. A. Hayek, who were contemporary with Keynes or even younger than him—pointed out that an increase in savings doesn't mean a permanent desire to consume less in an absolute sense. It means a desire to spend a lower *portion* of income on consumption goods. As income increases, consumption will rise in an absolute sense.

> Professor Smith or Dr. Jones stands a much better chance of being consulted by our leaders if the economists are prepared to tell them what our they want to hear.

A person saves more today, first, to increase his income and wealth over time so he can consume more in the future while still preserving or even growing his wealth, and, second, to be able to consume comfortably when illness or retirement makes further work impossible. The notion that people work to produce valuable output without any desire ultimately to consume the fruits of their labor is really rather bizarre, when you think about it, but it forms part of the foundation of Keynesian economics.

Short Memories

Another mysterious thing about economists' sudden renewed infatuation with Keynesianism is the flimsiness of the reason. It seems as if a year-long and (at least as of mid-April 2009) still-mild slowdown in economic activity has caused economists to forget an entire decade of experience. Are the 1970s *that* distant a memory?

Remember the disco decade? In addition to bad fashion, it featured high and rising unemployment along with high and rising inflation. Keynesian theory, unless it is contorted beyond recognition, doesn't allow both of these things to occur simultaneously. So the 1970s "stagflation" prompted economists to reassess Keynesian theory and the policies it suggested. Although no single macroeconomic consensus replaced the then-discarded economics of Keynes, economists finally recognized Keynesianism to be seriously flawed.

But here we are, a mere 30 years later, and it's as if the 1970s didn't happen. The lessons of an entire decade of harsh reality contradicting Keynesianism are cast from economists' memories by a burst housing bubble, a few months of economic slowdown, and an unemployment rate (again, as of April 2009) that hasn't been seen since way, way, way back in the 1980s.

What's going on? Why *this* change away from sounder macroeconomic reasoning by economists toward a once-discredited (and never really sound) Keynesianism?

I wish I knew the answer. But all I have are guesses. Part of the reason is that economists' memories are indeed shockingly short. Being experts at blackboard theorizing and computer simulations, too few economists familiarize themselves with economic reality. Another reason, at least for those economists who crave to be advisers to presidents and other government pooh-bahs, is that Keynesianism supplies ideal intellectual cover for the irresponsible spending that politicians long to do. Professor Smith or Dr. Jones stands a much better chance of being consulted by our leaders if the economists are prepared to tell them what they want to hear.

I hope against hope that matters will change. But I fear that my hope is too audacious. FEE

The Great Depression and World War II

BY ART CARDEN

The current economic climate has a lot of people talking about the Great Depression. In particular, it has been said by people of divergent political views (George Will and Paul Krugman, for example) that World War II ended the decade-long economic nightmare. Examining this claim is worthwhile because it has implications for whether government intervention generally and in connection with war specifically are good for the economy. Further, this examination will help us understand how policy changes alter incentives. Finally, it will shed light on features of the New Deal era that have ominous parallels with what's happening today.

In *Depression, War, and Cold War*, Robert Higgs divides the Great Depression into three phases. The Great Contraction occurred during the Hoover years and went from 1929 to 1933. During this period private investment fell by about 84 percent. This set the stage for the Great Duration, 1933–1945. As Higgs shows, GDP and private investment increased during the early years of the New Deal, but as the 1930s wore on, President Franklin Roosevelt became ever bolder about undermining property rights. This delayed complete recovery. Finally, there was the Great Escape, which occurred after and in spite of World War II, not because of it. Higgs argues that the Great Escape occurred as a result of a partial dismantling of the regulatory infrastructure that had grown up during the Depression and the war; in effect, it was a rediscovery of the market and a new birth of freedom for entrepreneurs and workers.

> The Roosevelt administration's aggressive interventions produced considerable uncertainty in the entrepreneurial environment.

In discussing the Great Duration, Higgs introduces the term "regime uncertainty" to argue that the Roosevelt administration's aggressive interventions produced considerable uncertainty in the entrepreneurial environment. Investors did not know whether they would enjoy the fruits of their investments. One of my mentors in graduate school, a Keynesian, pointed out once that firms will not produce what they do not expect to sell. I would generalize this to say that they will not invest what they do not expect to control. The possibility of incurring the costs of an investment without enjoying any of the benefits made private investment much less attractive.

How do we know that regime uncertainty was responsible for the lack of recovery? Higgs brings several types of evidence to bear on the issue. First, business leaders who were polled expressed uncertainty about the entrepreneurial climate. Second and more convincingly, Higgs shows that the risk premiums on long-term corporate bonds were substantial, suggesting fear of expropriation. A firm that wanted to borrow long-term

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had to pay much higher interest rates than firms that wanted to borrow short-term. This spread increased dramatically during the Roosevelt years.

The Great Depression did more than chill the investment climate. In *Crisis and Leviathan*, Higgs argues that during a crisis a "ratchet effect" produces net increases in government discretion, which is not completely reversed after the crisis. Two things happen when government intervenes. First, the bureaucracy naturally tends to expand beyond its stated goals—mission creep. Second, intervention alters incentives; that is, the creation of a bureaucracy to address some problem also spawns a rent-seeking pressure group with interests that will prevent reversion to the status quo ante.

Roosevelt's advisers saw in his program not merely a road to recovery but the opportunity to remake society. In *FDR's Folly*, Jim Powell, echoing an idea advanced by Milton Friedman, suggests that they "never appear to have considered the possibility that more power would magnify the harm done by human error or corruption." Their intellectual approach was to contrast "actual capitalism with ideal government," with intervention judged not on the basis of its effects but of its intentions. Further, the intellectual program of the New Deal was inconsistent and often contradictory. Powell argues that pragmatism and political expediency ruled the day:

> It didn't bother [Roosevelt] that New Deal policies contradicted one another. When an adviser gave FDR two different drafts of a speech, one defending high tariffs and the other urging low tariffs, FDR told the adviser: "Weave the two together." The Agricultural Adjustment Act forced food prices above market levels, in an effort to help farmers, but higher food prices hurt everybody who wasn't a farmer. The National Recovery Administration forced up prices of manufactured goods, hurting farmers who had to buy farm tools and equipment. Agricultural allotment policies cut cultivated acreage, while the Bureau of Reclamation increased cultivated acreage. Relief spending helped the unemployed, while corporate income taxes, undistributed profits taxes, Social Security taxes, minimum wage laws, and compulsory unionism led to higher unemployment rates. New Deal spending was supposed to stimulate the economy, but New Deal taxing depressed the economy.

The Depression and the War

What about World War II? Did it end the Great Depression? More generally, is war good for the economy? I answer both in the negative and borrow here from Ludwig von Mises: "War prosperity is like the prosperity that an earthquake or a plague brings." As Higgs points out, because of the array of interventions in the wartime economy, war materiel was valued incorrectly and therefore the GDP data overstate economic conditions. Moreover, conscription and arms production gave a misleading employment picture. Instead, Higgs argues, the war was a period of capital consumption rather than capital accumulation. Tanks, bombs, and helicopters have limited uses outside of military applications. The labor that was used to produce them was not available to produce consumer goods and services; in fact, people went without consumer goods. The warships at the bottom of the world's oceans represented lost opportunities for real consumption and prosperity. Conflict is sometimes necessary, but we should recognize what wartime expenditures represent: destruction of life and resources. If a depression constitutes a widespread contraction in living standards, then the Great Depression cannot have ended during the war.

We should recognize what wartime expenditures represent: destruction of life and resources.

The illusion of wartime prosperity is rooted partly in how national income is calculated and the statistics were compiled. Gross Domestic Product, one measure of a country's output, is defined as the sum of consumption expenditure, investment expenditure, government expenditure, and net exports. A serious problem arises with government spending: How do we assess something not traded in markets? We can assess my computer, my shirt, and my pen because I voluntarily exchanged money for them. How do we assess government purchases? In the national-income accounting they are valued at cost, but at best this only tells us what those resources could have earned in alternative lines of production. The costs don't indicate the value of what the government has produced. (This may not be the case when the government is providing a genuine public good or correcting a large externality, but much government action is aimed not at these things but at providing favors for well-connected constituencies.)

This problem was compounded by price controls during World War II—official prices simply did not reflect the true cost of the war. If we are going to have meaningful economic calculation, we need real market prices. Price controls and similar interventions introduce arbitrariness and uncertainty. Procurement at below-market prices is a way to mask the cost of any endeavor. Consider the draft, which forces people into military service at wages below what they would earn on the unhampered market. The amount spent on wages and board for conscripts is an underestimate of the real cost of maintaining the force.

Economists increasingly acknowledge that institutions—the rules, norms, and enforcement mechanisms that make up a society's structure of incentives—are important determinants of economic outcomes. Changing the rules changes people's incentives, and some of the long-run effects of the New Deal and World War II have encouraged people to use political means (expropriation and redistribution) rather than economic means (production and exchange) to gain wealth.

As an economist interested in institutions, I think that the relationship between the New Deal interventions and political incentives remains understudied. Higgs pointed out recently that part of the ideological and institutional legacy of the New Deal is apparent in the expanded powers exercised by the Bush administration. I would anticipate further expansion under the Obama administration. The protectionism and interventionism of the last several years have created incentives to seek wealth by developing cushy relationships with government officials instead of developing products people want to buy at attractive prices.

The protectionism and interventionism of the last several years have created incentives to seek wealth by developing cushy relationships with government officials instead of developing products people want to buy at attractive prices.

The experience of the last several centuries and of the American economy during the Great Depression and wartime suggests that the kinds of plans people advocate during crises require knowledge that is not merely beyond political leaders' grasp but that can only be revealed by the competitive market process. As we move further into the twenty-first century, I can only hope that we take those lessons to heart. FEE

The Dynamics of Disintervention

BY SANFORD IKEDA

In the October 2008 *Freeman*, Lawrence H. White wrote of the "unprecedented interventions" by the Federal Reserve that fueled the current financial turmoil ("The Subprime Crisis Shows that Government Intervenes Too Little in Financial Markets?" www.tinyurl.com/ctw4o4). In this way he and many libertarians have effectively challenged the argument that "the free market" created the turmoil.

An opposing position traces our current problems not to interventionism but instead to deregulation in the financial industry. Economists who argue this way, notably former Federal Reserve chairman Alan Greenspan, may merely be presenting the corollary to the "blame-the-free-market" position. But there is a certain sense in which the banking deregulation of 1980 and 1999 may in fact be to blame. How can one maintain that the free market is not to blame but at the same time see the problem stemming from deregulation?

This paradox exists because of an ambiguity in the way some economists have interpreted the "dynamics of interventionism"—the core concept in the political economic scholarship of Ludwig von Mises, F. A. Hayek, and Israel M. Kirzner. That ambiguity, I believe, arises from a natural tendency to overemphasize the "expansionary phase" of the interventionist process, in which the size and scope of the state are growing, and to neglect the dynamics of the "contractionary phase" when the state is "disintervening."

Interventions generate unintended consequences that frustrate the initial goals, spur further interventions, and end either in complete centralization or radically freer markets.

First, what exactly are the dynamics of interventionism in the expansionary phase? (For an extended treatment see Ludwig von Mises's *Interventionism: An Economic Analysis* [FEE] and my *Dynamics of the Mixed Economy* [Routledge].)

The core ideas are that 1) government interventions into the market process tend systematically to generate unintended consequences; 2) many of these unintended consequences frustrate the announced goals of those who support the interventions; 3) the response to these frustrated intentions tends strongly in the direction of further intervention; 4) the economic system performs less effectively in coordinating the plans of buyers and sellers as it becomes burdened with the cumulative effects of an increasingly chaotic mix of interventions; and 5) the process comes to an end when these cumulative effects result in a major system-wide crisis and public choosers decide to reject interventionism in favor either of comprehensive planning or radically freer markets.

The stages outlined above can apply at the level of the macroeconomy, such as the U.S. or global economy, or at the industry or sectoral level.

Examples of the move from piecemeal to comprehensive intervention are found in the 1930s after the collapse of social democratic policies in Weimar Ger-

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many and in the United States after the failed interventions of the Hoover administration. Both events heralded even more radical (and tragic) interventions.

What we witnessed in 2008 in the housing and financial markets exemplifies in many ways the interventionist process, although it's really just the latest stage (though not the last) of a long string of interventions begun decades ago.

Interventionist Origins of the Crisis

It's easy to show that there has been no "free market" in housing or finance in the United States in recent memory and that the idea that "the free market" caused the housing bubble is untenable. (The main sources for this section are Murray Rothbard's book *America's Great Depression*, Stan Liebowitz's "Anatomy of a Train Wreck" [www.tinyurl.com/3hpop7], and Roger Congleton's "Notes on the Financial Crisis and Bail Out" [www.tinyurl.com/3ucgl7].)

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Perhaps the place to begin is 1913, when the U.S. Congress created the Federal Reserve system to serve as the country's central bank and lender of last resort. In the 1920s the Fed discovered how to manipulate the interest rate—what we call today the federal funds rate—by buying and selling Treasury bonds from and to its member banks. It used this technique to create the artificial boom of the "Roaring Twenties." The result was the Crash of 1929 followed by the Great Depression of the 1930s. It was in the midst of the Great Depression, in 1938, that Congress created Fannie Mae, the Federal National Mortgage Administration, whose mission was to promote private home ownership, with government support, by insuring and buying mortgages originated by local banks. As a result of this artificial boost, home ownership in the United States increased from 43 percent of all residences in 1949 to 62 percent in 1960.

In 1970 Congress then created Freddie Mac, the Federal Home Loan Mortgage Corporation, which together with a revamped Fannie Mae were mandated to insure or to buy and repackage (securitize) mortgages as part of a deliberate government policy to boost homeownership further and promote the American construction industry. By 2008 Fannie and Freddie had issued more than 60 percent of these mortgage-backed securities (MBSs), of which they themselves held $1 trillion, and insured about half of all MBSs.

Congress and various presidential administrations pressured Fannie and Freddie to take on a larger portion of MBSs while encouraging banks to loosen their traditional lending standards, to promote homeownership among lower-income minority residents, many of whom could not meet traditional lending criteria. Congress then passed the Community Reinvestment Act (CRA) in 1977, as well as other supporting legislation, to monitor its implementation. The CRA was strengthened in 1999. The unintended consequence of this policy and the pressure brought to bear on both lending institutions and Fannie and Freddie was to significantly undermine lending standards across all segments of the industry, not just for the poor and higher-risk borrowers. From these circumstances blossomed the so-called "subprime lending market," which Congress and U.S. presidents encouraged Fannie and Freddie to make an increasing part of their own portfolios.

Meanwhile, the Fed drove the federal funds rate down from 6 percent in January 2001 to 1 percent in January 2004. Since mortgage rates generally track that rate (although they are substantially higher owing to higher default risk and other factors), these also fell during this same time period, fueling further borrowing and, most important, reckless speculation.

What Are "Disinterventionist Dynamics"?

The core ideas of the "contractionary phase" of interventionist dynamics are in many ways simply the reverse of the dynamics of the expansionary phase, but with some key differences:

1) In a systemic crisis it becomes obvious that the current system is untenable, so that public choosers have to decide whether to jettison interventionism for more comprehensive planning or for significantly freer markets; 2) the latter entails large-scale rather than piecemeal disintervention because minor changes would do little to untangle interventionist gridlock; 3) if, however, disintervention leaves important areas of the system under effective state control, entrepreneurial energies will tend to shift into relatively less-regulated areas, causing bottlenecks in those areas; 4) these bottlenecks create negative unintended consequences (shortages, sharply rising prices, or perverse investments) that frustrate the intentions of the supporters of disintervention; 5) the response by public choosers to these consequences will depend a great deal on their ideological commitment to disintervention, and because the ideology of interventionism is typically still fresh in public choosers' minds, recidivism—a return to state expansion—will usually occur.

Recall the experience with banking and finance in the 1970s. Among other interventions at that time, Regulation Q forbade banks to pay interest on checking accounts or branch out beyond the state in which they were chartered. Entrepreneurial pressure finally made matters untenable. For example, many banks resorted to offering their depositors toasters and other products in lieu of interest payments. By 1980 these market pressures compelled Congress to dramatically deregulate the banking industry, at the time one of the most regulated industries in the U.S. economy.

But it matters a great deal how and the extent to which disintervention occurs. The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980 permitted branch banking, mergers among banks, payment of interest on demand deposits (removing Regulation Q), and checkable deposits at credit unions and savings and loans (S&L). An unintended consequence of this partial deregulation, however, was the placement of the S&Ls in the untenable position of having to pay rising short-term interest rates on their deposits—inflation was raging—while being burdened with fixed-interest payments on long-term mortgage loans. This was "remedied" by letting the S&Ls make other kinds of investments. However, federal deposit insurance remained in place and even strengthened, buffering depositors from the S&Ls' reckless speculation. Hence the so-called S&L crisis of 1980s. Thus, bottlenecks occur with partial deregulation, which can generate negative unintended consequences that will encourage recidivism.

The inevitable consequence of piecemeal re-intervention is the socialization of the entire financial industry, to a state perhaps even worse than prevailed before the partial deregulation of 1980.

As noted, entrepreneurship flows to areas with less control and regulation. Critics of deregulation complain that trading in new financial derivatives, such as credit default swaps, occurred in an unregulated part of the market. Exactly. And if the current mood results in more intervention into the financial industry, "quicksilver capital" will find its way into other as yet unregulated areas. The inevitable consequence of this process of piecemeal re-intervention is the socialization of the entire financial industry, to a state perhaps even worse than prevailed before the partial deregulation of 1980.

That partial deregulation and the repeal in 1999 of the Glass-Steagall Act, which banned the same institution from engaging in both commercial and investment banking, went a long way to resolve the mounting contradictions within banking and finance that decades of regulation had produced. Unfortunately, these deregulatory steps left in place the government-sponsored enterprises Fannie Mae and Freddy Mac (as well as the Government National Mortgage Association or Ginnie Mae), and most important, the Federal Reserve itself, with its power to arbitrarily influence the structure of interest rates in the United States and indeed globally. These resulted in the pressures and policies discussed earlier.

People as different as Paul Krugman and Alan Greenspan blame deregulation for the mess Wall Street got itself into. Supporters of the free market respond, correctly, that the primary culprits are the incentives and pressures government created in the housing and finance industries that precipitated the housing bubble. But in the context of the theory of intervention outlined here, the grain of truth in what the market critics say is that *partial* deregulation, not deregulation *per se*, is to blame. The problem was not too much but too little deregulation.

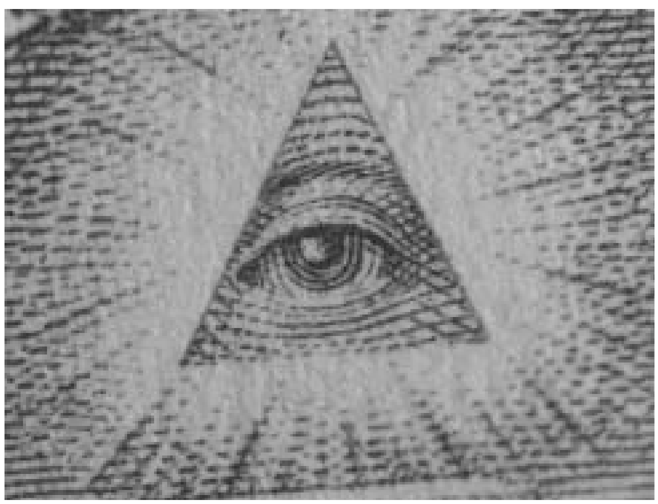
We face a serious economic crisis, one that may have determined the 2008 presidential election and strengthened one-party government in Washington, D.C. As such, it looks to be a turning point in the interventionist process. Unfortunately, it appears that for the time being the direction of politico-economic change, supported by popular sentiment, is toward more government and more inflation. But this is no time to give up hope. The past 30 years demonstrate that, as FEE's founder Leonard Read taught us, ideas matter. It's in times like these that our own commitment to learn and spread economic literacy is more important than ever. FEE

The "Watchful Eye" Fallacy

BY JAMES L. PAYNE

When it comes to regulation, hope springs eternal in Washington, D.C. No matter how many codes and decrees fill the law libraries, lawmakers seem to believe that just a few hundred thousand more pages of regulation will set the country right.

Unfortunately, this confidence in regulation is based on a logical error. I call it the "Watchful Eye" fallacy, employing the new president's phrase. In his inaugural address on January 20, 2009, Barack Obama said, "Nor is the question before us whether the market is a force for good or ill. Its power to generate wealth and expand freedom is unmatched, but this crisis has reminded us that without a watchful eye, the market can spin out of control."



The government wants to keep a watchful eye on your money.
commons.wikimedia.org

At first glance, this seems a plausible view. No one can deny that some of the people involved in market activities—investors, brokers, bankers, salesmen—are inept, shortsighted, or untrustworthy. Because of their human failings, harmful outcomes are possible. For example, thoughtless investors can be carried away by the idea that some particular activity is the wave of the future. When the speculative bubble pops, the contraction in economic activity is felt on Main Street. Or, to take another example, a dishonest salesman might peddle shares in an unsound company, leaving investors with losses when the fraud is discovered. To prevent such unfortunate episodes, says Obama, the market needs to be supervised and regulated by the watchful eye of government.

The fallacy in this view lies in the assumption that government regulators can rise above the human limitations that apply to everyone else. It assumes that while the businessman can be shortsighted, the senator will be farsighted, or that while the banker may be inattentive, the deputy undersecretary will not be.

The Same Human Stuff

The idea that government officials are more capable might be plausible if these officials came from a distinct social caste. If they were raised from birth by strict nannies, and taught exceptional academic and moral standards in special schools, there might be a case for claiming they are better than the rest of us. But government officials do not have a distinctive upbringing. The businessman we mistrusted because of his shady dealings in real estate can become a senator. The banker who was shortsighted in managing investments becomes an undersecretary of the Treasury. Does holding the new post suddenly make him wiser?

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Because they are made of the same human stuff, it is unreasonable to expect government officials to correct errors being made in the marketplace. A look at the market failures Obama alluded to in his speech bears this out. Take the speculative bubble in housing. Did senators see the danger before the rest of us and pass laws to limit the purchase of real estate? Of course not. They participated in the housing boom along with everyone else.

Another example was the subprime lending boom. Did legislators forbid banks to lend to homebuyers with poor credit? To the contrary: it was the political class that passed the Community Reinvestment Act in 1977, legislation that, in the end, all but forced banks to lend to borrowers with poor credit ratings. Did these lawmakers forbid Fannie Mae and Freddie Mac to buy up the subprime loans? No, they encouraged and protected these institutions even as analysts warned they were dangerously overextended.

Why should we expect government officials to be unusually acute, seeking out fires where no one else even saw smoke? Indeed, even when bureaucrats are given smoke to smell, it appears they are reluctant to suspect fire.

Ignoring the Smell Test

Maybe government officials aren't clever enough to buck unhealthy investment trends that fool the rest of us, but at least they can catch fraudulent operators, right? Not necessarily. After all, those who engage in deceptive practices look like respectable managers and trustworthy investment advisers. That's why they fool ordinary investors. Why should we expect government officials to be unusually acute, seeking out fires where no one else even saw smoke?

Indeed, even when bureaucrats are given smoke to smell, it appears they are reluctant to suspect fire. The notorious case of investment fraudster Bernie Madoff is instructive. A few insiders in the investment community knew something was fishy about his company. One, Harry Markopolos, spotted the fraud in 1999 and sent the Securities and Exchange Commission a detailed report listing 29 reasons why, as he entitled his report, "The World's Largest Hedge Fund is a Fraud." The SEC looked into the matter and found nothing wrong. After the scandal broke in 2008, the embarrassed chairman of the SEC, Christopher Cox, bemoaned the "multiple failures" of his staff that caused the agency to miss the fraud.

The idea that government regulation makes the market safe and fair is an illusion, a fallacy rooted in the belief that government is a God-like body casting a watchful eye over the doings of the human race. Government, alas, is staffed by mere mortals, ordinary men and women who exhibit the same lack of perception that enfeebles all human institutions. FEE

Fortune Tellers and Planners, Public and Private

BY STEPHEN DAVIES

Throughout history, as far back as we have records, there have been fortune tellers and magicians. That is, there have been people who claimed to have a means of knowing the future and others who purported to know how to manipulate or control the course of events by rituals or other means. All kinds of methods were used to divine the future, from the flight of birds to the shape of the livers of sacrificed oxen.

It would seem that thinking of this kind has a deep appeal to human beings, that we may even be hard-wired by evolution to be attracted to it. Seemingly the idea of a future that is somehow knowable and determinable eases anxiety and makes the world seem safer and tamer. (This also explains the persisting appeal of conspiracy-based theories of history and current affairs. Apparently many people would rather believe that the world is run by incredibly cunning and evil people than admit that no one is "in charge.")

Will the Dow hit 10,000 again?
commons.wikipedia.org

No One Knows

The claim to be able to predict or direct the future is wrong, and to the extent we believe it, we will do incredibly dangerous things. In some ways we can make predictions about what will happen—if we couldn't, life would simply be impossible. Thus on the basis of what has happened already, we can predict fairly confidently that the sun will rise in the east tomorrow. We can be almost as confident that the Chicago Cubs will not win the World Series—or can we? The problem with the second kind of prediction is that it works on the basis of past regularities or statistical aggregates involving human interaction. Most of the time these predictions pan out, but not always.

One major problem is unforeseen and (more importantly) unforeseeable events, which completely change what can reasonably be anticipated and make nonsense of what looked like sound expectations. Another problem is that people will change their behavior on the basis of what they confidently expect to happen. Sometimes this makes the anticipated event even more likely, but occasionally it has the opposite effect and confounds all the confident prognostications. In reality, while we can guess at bits of it and have reasonable expectations in some areas, the human future is ultimately radically unknowable merely on the basis of past experience, on both a micro and a macro level.

It is also true that all of us seek to influence the course of future events. Simply by living and acting we have an influence to some degree. This, however, is largely not a matter of definite purpose on our part. We influence the future in ways we do not anticipate or intend. Beyond that we often consciously try by acting in certain ways to make particular outcomes more likely and others less so. In other words, we make plans assuming that our actions will have the results we anticipate and desire. Sometimes things work out, but often they do not. The more elaborate and longer-term the plans, the greater the likelihood that things will not work out as expected. This applies to both individual and collective action.

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All of this has an obvious bearing on economic thinking and on what we can reasonably expect from public policy. Essentially, we should have modest and humble expectations of what it can achieve. We should be prepared to accept that most policies will fail; that is, they will not bring about their anticipated outcomes. We should also expect that in many cases public policy will have consequences that were not only unforeseen by those advocating them, but could not have been foreseen—even by critics.

Above all, this means that the idea of using political power to plan or guide the course of events is ultimately a fantasy, one that can only end in disappointment. Sometimes government policies will work out the way they were intended to, but more often something will derail them or they will produce unexpected and often unwelcome results. This is of course one of the central arguments made against government planning by the Austrian school of economists, most notably Mises and Hayek. The solution for them is to use the outcome of the interactions of individuals in markets and other social institutions to generate signals, such as prices, that correct errors and provide some degree of guidance as to what course of action one should follow to achieve a desired result. One of the most important aspects of this process is insurance, essentially a series of transactions (bets, effectively) that provide a rough guide to the chances of certain undesirable events happening.

The Austrian analysis, moreover, does not only apply to government. It also applies to private institutions. Thus much of the planning by large private firms or churches or charities fails in the same way that government planning does. It is less dangerous or apparent because firms and other private organizations, while organized on a nonmarket basis internally, are embedded in a wider system of market relations that swiftly reveal when plans are not working out. Therefore they are corrected more swiftly.

In the last ten to fifteen years, many market participants came to believe that the future was truly knowable in the sense that any possible outcome was somehow taken account of.

However, this self-correcting mechanism can break down. One problem is the one I touched on in a previous column ("The Recurring Crisis," www.tinyurl.com/de214b): the distorting effects of the government monopoly of money. As money is the medium in which prices are expressed, distortion of its supply will have systemic effects and delay corrections from taking place, making the problems more severe than they need be. This is exacerbated by another phenomenon that is purely private in origin and reflects the human weakness for certainty alluded to earlier. Just like the Romans, our own society has its class of augurs and fortune tellers, but now they appear as economic forecasters and academics. Individuals who take their omens and prophecies seriously will believe that they can know and control the future and act on that basis. This is bad enough, but it's made worse by another flaw in human psychology: our propensity for crowd manias. The combination of these traits with the government monopoly of money is what has produced a global financial crisis.

In the last ten to fifteen years a curious form of intellectual hubris came to possess the professions of economics and finance. Many participants came to believe that complicated mathematical modeling made it possible to estimate risks so accurately that the future was truly knowable in the sense that any possible outcome was somehow taken account of. The result was a misplaced confidence that led people to make highly risky bets on the basis of an assumed knowledge of the future returns on investment and growth in the value of various classes of assets. When combined with the mistaken monetary policy of the Fed, the result was disaster once things did not work out as expected.

What should we take from this? Mainly that we need to be more humble and aware of the limitations of human knowledge. Above all we should remember that government is no wiser and in many ways less well informed than private actors. FEE

Land-Use Controllers Never Quit

BY STEVEN GREENHUT

"Any excuse will serve a tyrant"
—Aesop

In a sensible world the folks who had predicted doom and gloom because of dramatic increases in the price of gasoline would be revising their scenarios now that gas prices have fallen.

My article in November's *Freeman* ("Gas Prices: The Latest Excuse to Re-engineer Society," www.tinyurl.com/cjlolx) extensively quoted environmetal/New Urbanist writer James Howard Kunstler gleefully pointing to soaring oil prices—the result, he argued, of "unsustainable" policies that promote urban sprawl. Those prices will signal the end, he added, of America's "Happy Motoring utopia." (I'd love some logical explanation of the word "sustainable," but I digress.)

A smart-growth housing project.
EPA Smart Growth

Then in the short period between my writing the article and its arrival in your mailbox, local gas prices fell from about $4.50 a gallon, with predictions by analysts of ever-escalating prices, shortages, and gas lines, to about 2 bucks a gallon, with predictions of prices going even lower. As I write this, there are no gas lines and local stations can barely give the stuff away at around $1.59. Who knows where prices are as you read this, but the fluctuations suggest that some economic factor is at work that probably can't be explained by Kunstler's "unsustainability" hysteria.

Yet his analysis hasn't changed. Writing in late November for the Whiskey and Gunpowder blog, Kunstler offers the same solutions without directly addressing the change in his oil-pricing forecasts, but this time he keys off the latest crisis du jour—the subprime housing problem and potential collapse of the U.S. auto industry: "All the activities based on getting something-for-nothing are dead or dying now, in particular buying houses and cars on credit and so it should not be a surprise that the two major victims are the housing and car industries. Notice, by the way, that these are the two major ingredients of an economy based on building suburban sprawl. That's over, too."

I quote Kunstler because he says forthrightly what most of those in the Smart Growth, New Urbanist, and environmental movements refuse to say directly. These folks want a radical transformation of the economic system in a statist direction (Kunstler argues that "a much larger proportion of the U.S. population will have to be employed in growing the food we eat"), complete government control over land-use decisions, and policies that coerce Americans out of their cars and into mass-transit systems, especially rail lines. Here's where the Aesop quote above comes in handy: No matter what the economic circumstances—high gas prices or low, housing boom or bust—Kunstler and his ilk declare that the situation is proof that Americans must radically change the way they live.

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None of this would be worth taking seriously except that recently the California legislature passed and Gov. Arnold Schwarzenegger signed a law that attempts to establish a planning regime based on the notions outlined above. Although gas prices and the housing situation were part of the debate for SB 375, the real rationale for its passage was—drum roll please—the so-called crisis of global warming. The bill radically changes land-use law in California, yet it was passed on a mostly partisan basis with little public discourse or notice. Granted, Californians are used to having their property rights assaulted for a variety of reasons, but this measure was big even for this state. Few newspapers extensively covered the debate over the bill, and those that did generally supported it. Few Californians have ever heard of it. I've talked with legislators—including a couple of supporters—who are unfamiliar with its contents, even though its advocates and detractors agree that it is one of the most significant laws to come out of Sacramento in a decade.

Californians are used to having their property rights assaulted for a variety of reasons, but this measure was big even for this state.

"This legislation constitutes the most sweeping revision of land-use policies since Gov. Ronald Reagan signed the California Environmental Quality Act," said Schwarzenegger. Its author, Senate Leader Darrell Steinberg, said the bill "will be used as the national framework for fighting sprawl and transforming inevitable growth to smart growth." Although the pro-Smart Growth California Planning and Development Report complained that the bill is too based on incentives rather than regulation, it declared: "It's more powerful than advertised because it contains potentially revolutionary changes in California's arcane processes of regional planning for transportation and housing—largely by mandating the creation of 'sustainable' regional growth plans. And those changes could become more important . . . when the California Air Resources Board is expected to double the greenhouse gas emissions reduction targets that local governments must meet through land-use planning."

Other supporters compare its passage to that of the California Coastal Act (creating the authoritarian California Coastal Commission, which has untrammeled power to dictate land-use decisions near the coast) and to Proposition 13 (limiting property taxes) in terms of significance. They appear to be right.

It All Started with Global Warming

In 2006 Schwarzenegger signed into law AB 32, designed to steeply reduce California's so-called greenhouse gas emissions. AB 32 gave state officials widespread authority to regulate business to halt these emissions, but it largely left untouched emissions from cars and trucks. That's where SB 375 comes in. Vehicle emissions are to be reduced partly through land-use plans designed to cut miles traveled.

It was an amazingly slippery slope that took California from the dubious theory of manmade global warming—and the even more dubious idea that the California legislature, which can't even come close to balancing its budget, can save the entire earth from temperature change—to draconian regulations that could outlaw (or at least severely punish local governments that allow) the creation of new suburban-style subdivisions in this largely suburban and quickly growing state.

And despite the governor's prattle about "market mechanisms," there is nothing market-oriented about unelected regulators telling local officials that they must stop private developers from building what they term suburban sprawl or else lose transportation funds.

As with any political fad, it's hard to separate the shysters from the true believers. Many developers love Smart Growth because it provides a politically correct means to lobby for something they always want—approvals to build highly lucrative, higher-density housing projects. In many communities it's tough for developers to gain approval to build high rises, condominiums, and houses on tiny lots. It's not always easy to market these projects either, as long as there are readily available single-family alternatives. The current suburban zoning restrictions often forbid higher densities, and NIMBY (Not In My Back Yard) activists often oppose plans to add density to their neighborhoods.

Now, with global warming the "in" thing, developers can claim to be helping the environment. They can talk about how their projects conform to California's ever-tightening land-use restrictions. As a side note, I advocate dramatic reduction in land-use regulations of all kinds so that neither high-density nor low-density developments are mandated. The market should determine these matters, not regulators. It's true that what critics call sprawl has to a large degree been mandated by government, but the solution is to stop mandating, not to mandate urban-style developments that will supposedly help deal with global warming. Yet the latter is all the rage in the world of government planning.

Smart Growth blogger Paul Shigley, writing about a conference held by the California chapter of the American Planning Association last year, noted: "Clearly, land use planners have gotten the green religion. Every session—heck, every conversation in the hallway—seems to touch on global warming.

It's the old Baptist and Bootlegger scenario, like during Prohibition when the Baptist foes of liquor teamed up with bootleggers, who wanted to keep Prohibition going to stifle the legal competition. Here we see the true green religionists working with developers to assure that all California communities must promote high-density developments, transit-oriented projects, and other highly subsidized government-backed programs.

Some developers aren't all that keen on the new types of buildings that will be mandated, but they have accepted the "deal" that SB 375 will streamline the environmental review process. As conservative political observer Stephen Frank of the California Political News and Views explained, "They are in for a shock. The environmentalists will use other laws to end the streamlining, like AB 32 and federal regulations."

> It's strange that there is little discussion over whether forced urbanization will actually reduce global warming.

A Heated Argument

It's strange that there is little discussion over whether forced urbanization will actually reduce global warming. Libertarian blogger and activist Wayne Lusvardi of Pasadena argues on Frank's website that "Concentrating housing development in already highly dense urban areas will only worsen the urban heat island effect and thus increase 'global warming.' The obvious solution from the greenhouse effect resulting from pollution is dispersion, not concentration." The U.S. Environmental Protection Agency explains: "Heat islands can affect communities by increasing summertime peak energy demand, air conditioning costs, air pollution and greenhouse gas emissions, heat-related illness and mortality, and water quality."

It's a reasonable point to at least consider before undertaking government policies that cram more people into urban areas. Another related point raised by Lusvardi: "The environmental intent of SB 375 is to reduce auto commuter trips, air pollution and gasoline consumption. However, the legislation will unintentionally result in more reliance on imported water supplies from the Sacramento Delta, Mono Lake and the Colorado River for thirsty cities along California's coastline instead of diverting development to inland areas which have more 'sustainable' groundwater supplies."

Clearly, these are questions that need to be analyzed scientifically, but I have more than a small suspicion that those who promote urbanization will do so no matter what it does for the climate. The answer for them is always the same: more urbanization. Don't worry about the exact question.

The result of SB 375 will be that an "unaccountable tribunal can set any greenhouse-gas target for the 17 regional transportation agencies that it wants," wrote Auburn City Councilman Kevin Hanley in a September 29 *Sacramento Bee* column. "If this unaccountable tribunal decides that the 'sustainable communities strategy' doesn't cut the mustard, then the SACOG (Sacramento Area Council of Governments) will have to submit an 'alternative planning strategy' showing how the greenhouse-gas targets will be achieved in the region through alternative development patterns, infrastructure or additional transportation measures or policies. They want to change where we live and how we get to work."

Becoming like Marin

For a real-world idea of what these anti-global-warming crusaders have in mind, take a look at Marin County, the wealthy suburban county just north of San Francisco. Government officials in Marin have been doing for years what Attorney General Jerry Brown and other environmentalists want the rest of us in California to do. As *Sacramento Bee* columnist Dan Weintraub explains, "Brown, in fact, cites Marin as a model for how every local government should be complying with the California Environmental Quality Act, which requires cities and counties to identify potential environmental impacts from proposed developments and take reasonable measures to mitigate them."

Those who promote urbanization will do so no matter what it does for the climate. The answer for them is always the same: more urbanization. Don't worry about the exact question.

Marin County has overall low density but that's only because most of the land is off limits to development. Most people live in a few fairly dense communities along the main freeway, and Smart Growthers—in Marin and elsewhere—seek to force all new growth into the existing urban footprint.

One person's reasonableness is another's insanity. In an *Orange County Register* column in August 2007, I looked at how Marin deals with development matters. For instance, 84 percent of the county's land is set aside by the local, state, or federal government as permanent open space. The developers I know who have tried to build anything on the remaining 16 percent explain that local and county restrictions make it nearly impossible to do so. It's even worse to build there than in the rest of this highly restrictive state.

"California has more than 36 million residents and is expected by some projections to have 60 million by 2050," I wrote at the time. "If other counties embrace Marin's overall approach toward development, the newcomers will have nowhere to live. . . . Smug state officials might believe that Marin County is successfully battling global warming and urban sprawl, but these no-growth policies simply are pushing sprawl and all the global-warming-inducing development toward the outer reaches of the Bay Area."

With SB 375, state officials have the tools to stop the growth in those outer reaches. It's not hard to figure out what happens next. Although this is now state law, there still are a few years before its full implementation, which means there's still time for the legislature to turn this radical antisprawl law into something less destructive of property rights and the American Dream. But this being California, don't count on anything rational taking place in the legislature. FEE

Think of a Number: A Theory of Rational Forecasting

BY ANTHONY DE JASAY

Recently, an economist gained notoriety and filled his appointment diary with lucrative conferences by having some of his forecasts for U.S. economic data, made two years ago and looking quite eccentric at the time, come gloriously true. This random event inspires me to put forward the sketch of a theory of rational forecasting.

Suppose that 500 of the most distinguished academic, industry, and Wall Street economists are polled for their best guess of the U.S. unemployment rate and the Dow Jones Industrial Average 12 months from now. As each has a reputation to preserve, none will stick his neck out with an outlandish forecast that has but a tiny probability of coming out right—even though it would earn him a jackpot if it did. Therefore, the forecasts of the 500 will cluster in a narrow range of, say, 7–11 percent for the unemployment rate and between 7500 and 9500 for the Dow.


Philosopher and mathematician Blaise Pascal.

What is left for the 250,000 other, less-distinguished economists to do to gain fame and fortune? They too can offer forecasts and might put them on some record. If they place them in the cluster and the actual outcome is in the cluster, they remain unremarked and neither gain nor lose anything. If they go way outside the cluster and the outcome is in the cluster, nobody will remember the wrong forecast made a year earlier. They will again gain nothing and lose nothing. If their forecast is in the cluster and the actual outcome is way outside it, they will be in the good company of their 500 more-distinguished fellows and will again remain unremarked.

There is, therefore, a single rational forecasting mode for our undistinguished economist to adopt. Let him think of a number for the unemployment rate and one for the Dow Jones index—say 23 percent and 4000, respectively. He can easily draft a scenario for the next 12 months full of horrors and glitches that would make the forecast numbers plausible. The probability that either one of his numbers will turn out right is very small and that both will turn out right is even smaller. As we have seen, if both his numbers are wrong, he is no worse off. But if one is right, he is richly rewarded, while if both his numbers are right, he gets riches beyond the dreams of avarice (RBDA).

In slightly more formal terms, he has access to a positive-sum game against nature. The worst payoff is zero and the best is RBDA. The sum is necessarily pos-

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itive, for no matter how infinitesimally small the probability of a really horrible scenario, it cannot be zero. If he is rational, in the sense that his choice maximizes the expected value of the outcome, our economist must forecast horrors.

It would seem that many are in fact engaged in this positive-sum game. Of course, the more that do so, the more the horror story becomes a self-fulfilling prophecy. This calls to mind Blaise Pascal, the seventeenth-century French philosopher who taught that it was a command of reason to be God-fearing, for the reward, eternal salvation, had infinite value and however small one judged the probability that there was a God, the probability-adjusted value of infinity was still infinity. One might add that if one did not fear God, the smallest probability that He existed would put the expected value of eternal damnation at minus infinity.

There are, to my knowledge, no records showing how many people became God-fearing under the weight of Pascal's somewhat brazen appeal to canny calculation. Nor do we know how many bloodcurdling economic forecasts are the result of career planning rather than sincere professional conviction. What we do know, though, is that such forecasts are the best method of deepening the gloom, frightening the credulous, and making the worst more probable. FEE

Higher Education in America: Individualism or Central Planning?

BY GEORGE C. LEEF

In education individual decisions are determinative. Each person (for children, with the assistance of parents) is able to choose the best kind and the ideal duration of education. That is why it's foolish to talk about the "national education level" as too low or too high. There is no "national level." If any individual should decide that he would benefit from more education, he will act accordingly. There is no more need for government action here than on the "national fitness level" or "national artistic level."

America's higher education establishment, however, loves to think in aggregate terms. Two recent initiatives show its penchant for central planning rather than individualism.

It's foolish to talk about the "national education level" as too low or too high. There is no "national level."

Falling Behind

First, the College Board released a study, "Coming to Our Senses: Education and the American Future," (www.tinyurl.com/8zylg8), last year that advances the notion that unless the United States increases the percentage of young people with college degrees to 55 percent (currently 34 percent) by 2025, we will "fall behind" other nations, including Canada and Japan, where a higher percentage of young people are getting college degrees. If we attain this goal, we're told, the United States will be able to "to maintain the educational underpinnings of American democracy, improve the quality of American life, meet national workforce needs in a global economy, and re-establish the United States among international leaders in post-secondary education."

Second, last December the Carnegie Corporation released an "open letter" (www.tinyurl.com/dddaqf) signed by more than 40 education establishment dignitaries who pleaded for a 5 percent cut of any federal "economic stimulus" spending—around $50 billion—to be spent on campus construction projects. (In good Keynesian fashion, they assume that adding to construction demand in some college towns will "stimulate the economy." Of course, there is no mention of the opportunity cost of steering more money and resources into the pet projects of these education officials.)

What's most interesting about the letter is the justification it gives for this new federal spending: "For the first time in our history the cohort of Americans ages 25 to 34 is less well educated than the older cohorts that preceded it." And we had better worry about that: "We cannot accept such dangerous signs that our future prosperity and security will be weaker than in the past."

Again we see the central-planning mentality at work. *We're falling behind our educational targets! Bad things will happen unless we produce more college graduates!*

But how could anyone—even a group of "education experts"—know the right number or percentage of people with college degrees? It's simply impossible because the necessary information is dispersed, residing in the minds of individuals. That point is one of F. A.

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Hayek's greatest contributions to social understanding, but it's doubtful that any of the experts who think they know how many college graduates we need has ever read "The Use of Knowledge in Society" (www.tinyurl.com/ffadl). The optimal number of college graduates, like the optimal number of auto mechanics, painters, plastic surgeons and so on, depends on evaluations that only individuals can make regarding the costs and benefits of the choices they confront.

Is College Always a Good Idea?

Should Bill, a high school senior, go to college? That decision has nothing to do with any education statistics, national competitiveness, the underpinnings of democracy, or other airy considerations. It has to do only with the pros and cons of Bill (and his family) spending a large amount of time and money on college studies. If he's a sharp student with an aptitude for analytical thinking, it probably makes sense for him to enroll in a college or university that's a good fit for him. On the other hand, if he's an indifferent student, averse to academic pursuits, then it would most likely be a bad decision for him to go to college. (To go right after high school, anyway; many Americans figure out that some postsecondary education would be valuable after they have had more time to mature and have spent a few years in the labor force.)

That brings me back to the alleged problem that the United States is "under-producing" college graduates. Why is a smaller percentage of young Americans graduating from college than in the recent past?

Naturally, there is no single answer, but I strongly suspect that in many instances it's because of kitchen-table discussions that go something like this:

Mom and Dad: Bill, as you know, your sister graduated from XYZ State three years ago and since then she has been working as an aerobics instructor making $24,000 per year. You're no better a student than she was. Let's face it: you get by with as little studying as possible. We know that several of your best friends are going to XYZ State, but before we decide to do that, and further deplete our savings, how about considering something else—electrical work, maybe.

Bill: Those are good points. College would be fun, but I know there's good, steady money for electricians.

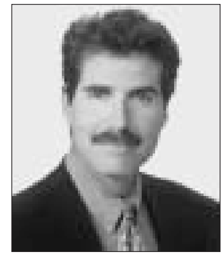
You Want Fries With That?

Despite the talk about the need for a workforce capable of competing in the global economy, the truth is that substantial numbers of Americans who earn college degrees now end up doing jobs that call for no academic preparation whatever. We find many college graduates now employed as travel agents, retail-sales supervisors, and the like. More and more people are finding out that one of the main sales pitches for higher education—that it means a big boost in lifetime earnings—isn't necessarily true.

For decades, the federal and state governments have been subsidizing higher education through loans, grants, and low tuition rates. As a result, the labor market is glutted with people who have college degrees. Because of that glut, many employers now use college credentials as a rough screening mechanism, requiring that applicants have a college degree to be considered. They usually aren't looking for particular skills or knowledge, but just don't want to bother with individuals who have lesser educational credentials. Observing that trend, Professors James Engell and Anthony Dangerfield write in their book *Saving Higher Education in the Age of Money*, "[T]he United States has become the most rigidly credentialized society in the world. A B.A. is required for jobs that by no stretch of imagination need two years of full-time training, let alone four."

And yet, the higher-education establishment solemnly proclaims that it's imperative we put more people through college to raise our "national educational level."

Nonsense. If individuals conclude that they would benefit from additional formal education, they can enroll and take courses. If employers conclude that they need more workers with certain abilities that call for postsecondary education, they can (and already do) encourage people to go into certain fields of study. We can rely on individualism and the invisible hand of the free market to find the optimal level of education. Central planning will end up benefiting only the education establishment. FEE



Real Jobs Create Wealth

BY JOHN STOSSEL

For a mere $787 billion, President Obama has pledged to "save or create" 3.5 million jobs. That's only $224,857 and change per job! (If I still have my job next year, will he take credit for saving it?)

But wait. Only 3.5 million jobs? Why so few? It's not like creating jobs is difficult.

Egypt built more than 100 pyramids beginning sometime in the third millennium B.C. to house the corpses of the pharaohs and their significant others. Think of all the jobs that project created. I'll bet the unemployment rate was something any pharaoh could have proudly campaigned for reelection on—if he faced election, that is. Pyramid-building is one heck of a public-works project.

Egyptian make-work programs.
Ricardo Liberato

Pyramids, Earthquakes, Wars

Its economic significance was not lost on that great advocate of full employment through public works, John Maynard Keynes. The British economist, so in vogue today, famously wrote in *The General Theory on Employment, Interest, and Money* (1936), "Pyramid-building, earthquakes, even wars may serve to increase wealth."

In fact, pyramids are even better than the usual government project. Keynes said: "Two pyramids . . . are twice as good as one; but not so two railways from London to York."

Ancient Egypt's success has many applications today. We could have full employment overnight if the government simply outlawed machines. Today's 8 percent unemployment rate would vanish.

Again, we find an endorsement in Keynes's *General Theory*: "'To dig holes in the ground,' paid for out of savings, will increase, not only employment, but the real national dividend of useful goods and services."

Exhibit B is Franklin Delano Roosevelt. I don't mean his public-works projects, like the Civilian Conservation Corps. I'm talking about his most serious job-creating operation: the draft.

If You Can't Employ 'Em, Draft 'Em

In September 1940 Roosevelt signed the Selective Service Act, which ordered all males 21–35 to register for military service. "Of the 16 million persons who served in the armed forces at some time during the war, 10 million were conscripted, and many of those who volunteered did so only to avoid the draft. . . ." writes Robert Higgs in *Depression, War and Cold War*.

The draft marked the beginning of the end to the double-digit unemployment that had plagued America for a decade. Two years earlier, Roosevelt's treasury secretary, Henry Morgenthau, lamented, "[A]fter eight years of this administration we have just as much unemployment as when we started." The draft was the answer they had sought all that time.

So creating jobs is not difficult for government. What is difficult for government is creating jobs that produce *wealth*. Pyramids, holes in the ground and war do not produce wealth. They destroy wealth. They take valuable resources and convert them into something less valuable.

John Stossel is co-anchor of ABC News' "20/20" and the author of Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong, *now in paperback.*

Instead of iPods, great art, cures for diseases and machines that replace back-breaking work, we get the equivalent of digging holes and filling them up.

Under President Obama's "stimulus" plan, jobs will be created to weatherize buildings, construct schools and wind turbines, and repair roads and bridges. But outside the market process, there is no way to know whether those are better uses of scarce capital than whatever would have been produced had it been left in the private economy.

Since government services are paid for through the compulsion of taxes, they have no market price. But without market prices, we have no way of knowing the importance that free people would place on those services versus other things they want.

> Since government services are paid for through the compulsion of taxes, they have no market price. We have no way of knowing the importance that free people would place on those services.

So although we'll see the government putting people to work and even some new schools and bridges, we won't be able to calculate how much wealth we've lost because scarce resources were misallocated by the politicians.

Nevertheless, we can be sure we will have lost. If the government's projects were truly worthwhile, they would be undertaken by private efforts, and in their quest for profits, entrepreneurs would handle them more efficiently.

Remember this when President Obama begins to boast about how successful his stimulus plan is. FEE

Capital Letters

Is Greenspan Really Innocent of Causing the Housing Boom?

David Henderson and Jeff Hummel have written a remarkably pro-Greenspan article, "Was Money Really Easy Under Greenspan?" (www.tinyurl.com/cuf3ug). The authors overlooked several points that would undermine their portrayal of Fed chairman Alan Greenspan as an anti-inflationist and the best Fed chairman ever. (Better than Paul Volcker?) To conclude that Greenspan "oversaw relatively low and stable inflation" is surely missing the mark. Granted, the Consumer Price Index (CPI) rose "only" an average 3.1 percent a year during his tenure as Fed chairman (1987–2006), but I'd hardly call it anti-inflationary. Moreover, the CPI is a notorious price index aggregate that largely ignores price bubbles in areas such as real estate and the stock market. If you judge Greenspan by the value of the dollar—and certainly one of the missions of the Fed chairman is to defend the nation's currency—then Greenspan witnessed a substantial overall decline in the value of the dollar against the hard European currencies and the Japanese yen. The gold price, another bellwether, declined during most of the Greenspan years—a plus—but then took off, doubling in price during Greenspan's final years.

Messrs. Henderson and Hummel also largely ignored the frequent changes in monetary policy, from easy to tight and back again. As measured by the Fed's discount-rate policy, he switched policies seven times in 19 years. A stable non-inflationary monetary policy is surely the sign of a good Fed helmsman.

Clearly Greenspan's worst period was the cheap interest rate policies of 2002–04. The authors fatally underplay the role Greenspan played in cutting rates far below the natural rate, due to his unwarranted fear that the United States was facing a deflationary collapse a la Japan. As a practitioner on Wall Street, I witnessed firsthand the malinvestments that were caused by the Fed's deliberate plan. (I find it remarkable that Messrs. Henderson and Hummel made no reference in their article to the Wicksellian "natural" rate of interest hypothesis, a fundamental factor in the Austrian theory of the business cycle.)

Mortgage rates and real estate prices were clearly affected by this Greenspan cheap money policy, and so were the pricing of REITs [real estate investment trusts], closed-end income funds, and the carry trade, which sold at huge premiums as a result of 1 percent interest rates. Investment bankers and hedge-fund traders were constantly borrowing short and investing long during this 2002–04 time period. Then when the Fed started raising rates sharply, REITs and closed-end income funds collapsed very quickly, and the economy fell apart.

In short, the authors failed to disaggregate, as the Austrians are always emphasizing.

But their biggest sin of omission was to ignore the monstrous excessive monetary growth in the BRIC countries [Brazil, Russia, India, China] and emerging markets. The monetary aggregates rose much faster in China and the emerging markets than the G8 nations. We live in a global economy, and that money had to go somewhere, and it not only went into the BRIC economies, but also they bought a large amount of securitized U.S. mortgage securities, and profited from the yield spread.

Did Greenspan's low interest-rate policy contribute to the artificial mortgage boom? Despite his denials, it did very definitely. As the *Economist* states ("A Tale of Two Worlds," May 8, 2008), "Apart from the Gulf states, few countries still peg their currencies to the dollar, but most try to limit the amount of appreciation. This means that as the Fed cuts rates there is pressure on emerging economies to do the same, to prevent capital inflows pushing up their exchange rates." The worldwide easy money policies lead to worldwide asset bubbles, commodity inflation, and unsustainable economic growth.

Consequently: "Emerging economies were partly to blame for America's housing and credit bubble. As China and Gulf oil exporters purchased American

Treasury bonds in order to hold down their currencies, this pushed down bond yields and helped to fuel the housing boom. Low yields also encouraged investors to seek higher returns in riskier assets, such as mortgage-backed securities."

Finally, I find it incredible that Messrs. Henderson and Hummel would defend Mr. Greenspan's indefensible record as a bank regulator. The Fed's charter requires the chairman to oversee bank management policies, and the reckless way that banks promoted subprime and Alt-A mortgages can be laid at the feet of a complacent Federal Reserve Board. Contrast his approach to Canada's strict banking regulations, which categorically prohibited these shameless banking policies north of the border.

—MARK SKOUSEN
via email

David R. Henderson and Jeffrey Rogers Hummel respond:

Mr. Skousen would "hardly call" Alan Greenspan's average annual inflation rate of 3.1 percent "anti-inflationary." Neither would we. Nor did we. As Mr. Skousen admits, we wrote that Greenspan "oversaw relatively low and stable inflation." This is not perfect, as we noted in our article.

Mr. Skousen points out that the Consumer Price Index "largely ignores price bubbles in areas such as real estate and the stock market." True. The CPI measures the cost of living, not the value of assets. As for gold, the price on August 11, 1987, when Greenspan became Fed chairman, was $461.20 per ounce. It had risen to $568.75 by January 31, 2006, the day he left office. That's an increase of 23.3 percent, or an annual average of only 1.2 percent, far below the average inflation rate.

Mr. Skousen insists on measuring Fed policy by the discount rate. We argued that even the federal funds rate, which commentators other than Mr. Skousen tend to use, is not a good measure and that the best measure is the growth of the monetary aggregates. Mr. Skousen does not challenge our argument; he ignores it.

As for the real estate boom, we never denied it. Nor do we deny that low interest rates contributed to that boom. Rather, we questioned the role of the Federal Reserve in bringing about those low rates, an argument that Mr. Skousen does not grapple with.

Mr. Skousen claims our "biggest sin of omission" was to ignore the "monstrous excessive monetary growth" in other countries. Well, yes. We were evaluating Greenspan's policy, not the policy of other central banks.

Finally, Mr. Skousen faults Greenspan for not regulating banks more. Although we did write that Greenspan contributed to the "too big to fail" doctrine, our preference is still deregulation and, as we noted, ending the Federal Reserve.

Those who wish to read an extended reply to our critics can go to www.tinyurl.com/csuae8 for details.

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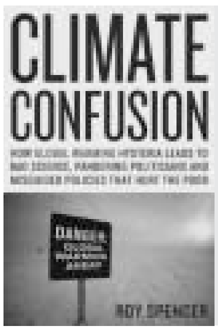
Book Reviews

Climate Confusion: How Global Warming Hysteria Leads to Bad Science, Pandering Politicians, and Misguided Policies that Hurt the Poor

by Roy Spencer

Encounter Books • 2008 • 150 pages • $21.95

Reviewed by Roy Cordato



"The only way to create wealth is for people to do useful things for each other." "[In a free market] the rich become rich only because consumers voluntarily give them money in exchange for the valuable goods and services they offer to society." "Wealth is only possible through free markets, allowing the people to decide what something is worth to them, rather than allowing government bureaucrats to decide." "Printing more money creates no new wealth. . . . [I]t lowers the value of all the money that is already in circulation. There is more money chasing the same number of goods and services, which then causes prices to rise."

None of those statements should come as news to the readers of *The Freeman*. Such precepts underpin most of what is written in these pages. What is remarkable is that they come in a book on global warming by a well-known climatologist with no training in economics.

Dr. Roy Spencer is the principal research scientist at the University of Alabama at Huntsville. He has a Ph.D. in meteorology and was a senior climate scientist at NASA. Along with his colleague Dr. John Christy, he developed the original method for precise monitoring of global temperatures from earth-orbiting satellites. But unlike many scientists whose work impinges on public-policy debates, Spencer understands the importance of economic analysis in answering the fundamental question: "What should be done?" He recognizes that just because science may indicate a causal connection between human activity and some negative consequence—either for the environment or for other human beings—it doesn't follow that policies should be implemented to curtail those activities. That is, the answer to the "should" question cannot come from the sciences.

That is why, in the middle of his book about global warming, Spencer includes a cogent and well-schooled chapter on both basic economics and the relationship between freedom and prosperity. The title, "It's the Economics, Stupid," conveys the importance he places on economic analysis not only for formulating policies toward global warming but also in determining whether there should be any such policies at all.

Some might interpret Spencer's excursion into economics as a form of disciplinary imperialism—pontificating in an area where he has no expertise. That would be wrong. In fact, it is an act of disciplinary humility. In writing this book on climate policy, Spencer realized that his own disciplines—meteorology and climatology—could not provide the answers to the policy questions. He understood that he needed to learn some economics. He did his homework well.

Ultimately though, the book is mostly about science and scientists. Indeed, it's as much about the latter as the former. Chapters 3 and 4 are especially important. In the former, "How Weather Works," Spencer addresses basic issues concerning weather, the climate, how the two are different, and how the former determines the latter. This is the background typically ignored in discussions about anthropogenic global warming. In Chapter 4 Spencer's skeptical stance on global warming is conveyed in the title, "How Global Warming (Allegedly) Works." Those chapters give the reader a solid, plain-language discussion of the science that almost anyone can understand.

As noted, much of the book is about scientists—their attitudes and the incentives they face. Spencer sets the tone with a cartoon showing three scientists standing in front of a battery of telescopes. The scientist in the middle is introducing a younger colleague to an older, more experienced researcher. The caption reads, "This is Doctor Bagshaw, discoverer of the infinitely expanding research grant." Spencer spends many pages dragging scientists down off their pedestals. He shows that what they research and what they conclude, particularly in an area like global warming, is as much a function of financial incentives, ideological and religious beliefs, and peer pressure as it is a function of the scientific method.

The past decade has produced a battery of books written on global warming from a skeptical perspective. I have read many of them. What makes Spencer's book stand out, in addition to its integration of sound economics with sound science, is its readability and sense of humor. It simplifies complex issues in climatology to a point where any reasonably intelligent person can understand them and keeps the reader continuously engaged.

Policies currently being enacted and proposed in the name of fighting global warming represent the biggest challenge to liberty of the last half-century. Those of us who cherish liberty need to come to grips with this issue and be able to discuss its ramifications intelligently. Spencer's book is a great place to start.

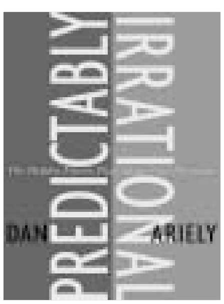
Roy Cordato (rcordato@johnlocke.org) is vice president for research at the John Locke Foundation in Raleigh, N.C.

Predictably Irrational: The Hidden Forces that Shape Our Decisions

by Dan Ariely

HarperCollins • 2008 • 304 pages • $25.95 hardcover; $34.95 audiobook (cd); $19.94 e-book

Reviewed by Dwight R. Lee



As the title suggests, *Predictably Irrational* is another offering on behavioral economics. The overriding theme is that people not only tend to behave irrationally, but they do so in systematic and predictable ways. Thus our lapses from rational behavior reinforce each other rather than cancelling out. The evidence for this comes largely from experiments which find people making decisions that deviate from what one would expect from the standard economic models of rational self-interest (for example, giving less weight to opportunity costs than to out-of-pocket costs). The robustness of some of these experiments is controversial in some academic circles, but for purposes of this review I accept the results as reported by Ariely (who teaches behavioral economics at Duke's Fuqua School of Business) and other experimental economists. My concern is with what Ariely sees as the implications of these deviations from rationality.

Ariely's book is more interesting than most on behavioral economics because of the bold claims he makes. Most behavioral economists see their findings as suggesting some qualifications to utility maximization as the basis for describing economic behavior. But most are cautious in concluding that the irrationalities they observe make a case for relying more on government to direct economic decisions. One suspects that some behavioral economists favor more government direction, but they typically argue for what they see as a benign government role. (The best example is the argument Richard Thaler and Cass Sunstein make for "libertarian paternalism.") Ariely shows no such restraint, saying that he wants more government regulation because irrationality renders markets unable to work properly.

Ariely's chapter "The Fallacy of Supply and Demand" begins with the story of an entrepreneur who took black pearls of "dubious worth" and turned them into a high-priced luxury item. He then discusses some experiments that he interprets as showing that "initial prices are largely 'arbitrary'" and influence "not only the immediate buying decision but many others that follow." In other words, if businesses can get us to pay high prices initially then we, as irrational as we are, continue to find those prices acceptable.

But even if consumers are as irrational as Ariely would have us believe, they are still protected by private-sector competition that has driven down the real prices—while improving the quality—of televisions, electronic calculators, digital cameras, personal computers, life-saving medications, and a host of other products. If Ariely has given the effect of competition any thought, he keeps it to himself. Instead, he concludes that if we cannot depend on markets "to help us maximize our utility, then we may need to look elsewhere [meaning government]. This is especially the case with society's essentials, such as health care, medicine, water, electricity, education and other critical resources."

Even if people are irrationally willing to continue paying the prices they initially pay for a product, that hardly makes a case for more government intervention. Would anyone argue that the Post Office (or Amtrak or Social Security) does a better job of providing consumers, irrational or not, with lower costs and increasing quality than private firms? Markets clearly do far better than governments at revealing the cost of goods and services and thereby enhancing rational choices.

Ariely emphasizes how consumers are misled by what he calls "decoy" prices, and other types of private-sector pricing. But market pricing, even at its most deceptive, reveals information on costs far more accurately and understandably than government pricing. Does anyone know how much Social Security costs (including its effect on wages), or the cost of public education, or the ethanol in the gasoline they buy? Ariely has an entire chapter on the high cost to consumers of being convinced by businesses they are getting something for nothing. Nowhere, however, does he mention the free-lunch political promises that end up increasing the cost of the "free" goods.

One of the most interesting of Ariely's chapters is on the importance of social norms and how they contrast with market norms. He does an admirable job pointing to the serious problems of applying market norms in situations involving families and close friendships. The problem is that he's sympathetic to applying social norms to the extended and impersonal relationships in business transactions. Ariely's concern with moving in the direction of treating businesses like a family is that businesses will fail to adhere to their social-norm responsibilities by laying off workers, cutting benefits, and reverting to market norms. He remains optimistic, however, that by doing it right, businesses can benefit from more reliance on social norms, citing Google as an example.

Ariely's book would have been better, though probably not as popular, had he balanced his discussion of irrationality in markets with some Public Choice implications of perverse political behavior. FEE

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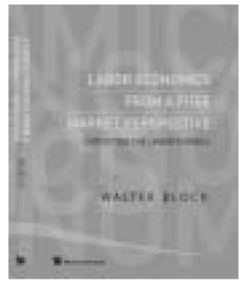
Labor Economics from a Free Market Perspective: Employing the Unemployable

by Walter Block

World Scientific Publishing • 2008 • 420 pages • $58.00 hardcover; $30 paperback

Reviewed by Charles W. Baird



Notwithstanding its title, this is not a textbook on labor economics. Rather, as the author stipulates in the introduction, it is "an ideological book." It is a collection of papers written, sometimes with coauthors, by Block during the 1990s and 2000s on various labor-related topics. Of the 29 chapters, all but three were first published elsewhere (some as blog posts).

Block's free-market perspective is libertarianism. Throughout, he searches for "the proper libertarian answer" to several labor-related questions. He begins, as did his mentor Murray Rothbard, with the two foundations of libertarian thought: The nonaggression principle and the law of free association. Taken together, Block writes, they imply, "In the free and prosperous society everyone may act precisely as he pleases, provided, only, that he does not initiate violence against non-aggressors." Following Rothbard, Block's theory of justice in original acquisition of property is the Lockean homestead principle, without Locke's famous proviso, and with Nozick's principle of justice in transfer of property rights based on voluntary exchange.

I think the book best serves as a handbook for teachers and students on how to apply libertarian thought to several labor questions. Unfortunately, the book has no index so it is rather difficult to find Block's treatment of any specific issue. For example, the National Labor Relations Act (NLRA) imposes mandatory good-faith bargaining, exclusive representation, and "union security" on private-sector collective bargaining. Each of these egregiously violates the law of free association. Block briefly considers these topics, but it is impossible to pick up the book and quickly find his statements about them. His main free-association argument against NLRA-style unionism focuses on the use of picket lines to stop "scabs" and others willing to engage in voluntary exchange with strike targets. His argument is brilliant, but I wish he had applied it to those other issues as well. On strikes, Block draws out the important distinction between NLRA-style strikes and strikes that can be justified as applications of the principles of voluntary exchange. Chapter 8 (a blog post) presents a short but effective argument in favor of "yellow dog" (union-free) contracts among consenting adults.

In addition to unions, Block and his coauthors discuss other standard labor topics, including wage determination, the minimum-wage laws, the negative income tax, academic tenure, worker's compensation, and unemployment insurance. In Chapter 15, Block chastises two Heritage Foundation authors for conceding too much to those in favor of increases of legal minimum wages. In Chapter 23 he demonstrates the irrelevance of "perfect competition" to policy questions. Chapter 25 is an interesting short paper which demonstrates that comparative advantage is a sufficient but not necessary condition for mutual gains from trade.

In three papers Block argues in favor of absolutely open borders for all immigrants who seek only to engage in voluntary exchange with natives. In two of these papers Block argues against the more restrictive views of his fellow libertarian Hans-Hermann Hoppe.

Two papers take up redistributive justice. In Chapter 21, which examines reparations for slavery, Block takes issue both with those who advocate reparations and also with David Horowitz, who famously opposes them. Here Block deploys his theory of justice in property rights to destroy the arguments of both sides of the debate. Chapter 22 is a devastating response to the Pontifical Council for Justice and Peace's ill-informed ruminations about land reform. As a Catholic I am constantly embarrassed by economically illiterate authoritative statements by spokesmen for the Church. Block demonstrates that if the Church were really interested in its vaunted "preferential option for the poor" it would join the fight to promote economic freedom rather than coercive redistributionism. His paper is an excellent addition to the growing effort to educate religious thinkers about free-market economics.

In sum, if you want to know to what conclusions a rigorous application of libertarian thought leads on several labor-related questions, this book is where they can be found. Block's arguments are on point, clever, pithy, humorous, and effective. Unfortunately it is not easy to find them.

Freeman *columnist Charles Baird (charles.baird@csueastbay.edu) is a retired economics professor who writes frequently on labor law.*

Inclined to Liberty: The Futile Attempt to Suppress the Human Spirit

by Louis E. Carabini
Ludwig von Mises Institute • 2008 • 112 pages • $10.00 paperback

Reviewed by George C. Leef

Some people, writes Louis Carabini, are naturally "inclined to liberty." That is, their thoughts revolve around voluntary action to accomplish their objectives and solve problems. As a *Freeman* reader, you are probably such an individual. On the other hand, there are many others who are instinctively drawn to coercion to accomplish their objectives and solve problems—people who are, as Carabini puts it, "inclined to mastery." They're the sorts of people who blurt out, "There ought to be a law!" whenever they encounter something that bothers them. They like liberty for themselves, but think that everyone else needs to be told what to do.

In this short and accessible book, Carabini gives us 34 chapters, usually only two or three pages each, exploring some facet of the intellectual clash between "liberty" people and "mastery" people. The idea for the book, he explains, arose out of a dinner party where he found himself confronting several guests who did not share his libertarian philosophy.

One topic of conversation was that of corporate responsibility for employees, and someone offered the opinion that businesses should not be allowed to terminate workers only to increase their profits. Carabini proceeds to show why that "mastery" idea is a bad one.

For one thing, if followed rigorously, it would mean that no profitable business would be allowed to reduce *any* expenditure, since doing so could cost some worker outside the company his job. For another, firms will be far less willing to hire people in the first place if required to employ them until the firms are in the red.

Carabini's answer to the authoritarian is short, but it gets the reader thinking about important matters: how laws change people's behavior and what the full ramifications might be. He's opening up the mental toolkit of "liberty" people for inspection.

The Damage Done by Coercion

A theme that Carabini weaves into the book at many points is the damage that's done by adopting the coercive mindset. One illustration is the way it leads to destructive "us versus them" political battles. "In a self-reliant society," he writes, "pet peeves may keep us awake at night, but in a democratic society we can spend a lifetime of energy creating one pet peeve after another and offering our solution because we have a voice." How true! Whereas people who are inclined to liberty take a live-and–let-live approach to life, those who are inclined to mastery turn to force (political or otherwise) to make others behave as they think they should. None of history's religious wars and genocides, for example, can be blamed on the former.

Another example of the harm done by "mastery" people is the ruinous "War on Poverty" begun under President Johnson. Carabini points out that this "war" requires the government to take money from taxpayers and give it to poor people. That probably sounds fine to "mastery" types, but such coercive transfers backfire as the poor change from trying to advance on their own to finding ways to qualify for government welfare programs. At the same time, the taxpayers have less money to donate to voluntary groups that attack poverty through carefully targeted assistance. The latter is more effective and has none of the bad side effects of the former.

There are many books that comprehensively explore the issues that Carabini raises. That isn't what he's trying to do, although I'm sure he could. What he has given us is a lovely and spirited introduction to the philosophy that embraces liberty and rejects coercion.

Reinforcement for Difficult Times

The book is particularly timely. In 2009 the United States is in the midst of a war. On one side are people who believe that the major problems of society are due to bad actions by individuals, mostly in pursuit of monetary gain, and that action by the government is necessary to remedy those problems. On the other side are people who know that the major problems we face stem from inappropriate actions by government that have upset the spontaneous order of society. They contend that solutions can only come if government restores the liberty it has taken away. At this moment, the initiative is with the "mastery" crowd; liberty is fighting a desperate defensive action. Carabini's book is a welcome reinforcement for our side.

Inclined to Liberty would be an excellent gift for a young person you would like to get started right in his thinking about government and economics. And if you could get one of those "mastery" types to read it, the book might just cause him to reconsider his beliefs. FEE

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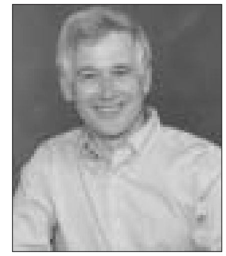

Government Fundamentalism

BY DAVID R. HENDERSON

In the last year or so, when I have advocated free-market solutions to specific problems, I've more and more frequently been dismissed as a "market fundamentalist." By hiding behind that term, the person on the other side deftly avoids actually addressing the specific case I'm making.

But an even bigger problem is the use of the term "fundamentalist." I understand Christian fundamentalists to be people who, as Bryan Caplan writes in *The Myth of the Rational Voter*, "ignore or twist the facts of geology and biology to match their prejudices." So wouldn't a market fundamentalist be someone who distorted facts to make the case for markets? We can certainly imagine such a person, but I'm not one—nor are many of the people who are strong advocates of free markets. It's not that I think markets will always work perfectly. It's just that they work so much better than the coercive solutions that are proposed by those who call me a "market fundamentalist." Of course, there are times when standard free markets might not work well, but in many of those cases, voluntary charitable activity and simple fellow feeling fill the gap. We don't think of it as a market transaction, for example, when a stranger in a strange city gives me directions to my hotel. But it certainly is an exercise of his freedom, and it generally works pretty well.

What should we call people who seem to regard government as the solution regardless of the evidence?

Government Fundamentalists

What should we call people who seem to regard government as the solution regardless of the evidence? I propose the term "government fundamentalists." How would you identify a government fundamentalist? One characteristic would be a tendency, after the person points out market failures, to argue for government intervention as the solution. Rarely does anyone who proposes a government solution spell out how the incentives will be set up so that the government will actually solve the problem. Even many economists who are strongly committed to free markets will agree that economic freedom can underprovide defense from foreign attackers because of the notorious free-rider problem: Those who refuse to pay will get the same defense as those who pay, giving all an incentive not to pay. The possible result is that national defense is underprovided. But I've yet to find an advocate of government provision of defense who can explain how incentives will be set up so that government actually defends us and doesn't simply engage in national "offense," picking fights with a dictator in Iraq or a demagogue in Panama, to cite two examples of the U.S. government's so-called defense.

But given that even some passionate advocates of economic freedom approve of government solutions to problems caused by market failure, we need another characteristic to distinguish government fundamentalists. Here's the characteristic I propose: a tendency to advocate government solutions even in the face of evidence that those very solutions have not worked.

Take the tax on gasoline. The original idea for taxing gasoline was that users of roads would pay for them. Even at its best, though, the gas tax was not a great solution. The revenues were put in a big pool and politically allocated. There was no necessary connection between

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where people valued having roads and where roads were built, a connection that automatically would have existed had the revenues been collected with tolls. Tolls, after all, are prices not taxes.

It got worse. In the late 1960s, governments started diverting some gasoline-tax revenues to other uses. The first big diversion was to government-run mass transit that couldn't survive on its own without subsidies. Later, more funds were diverted for bicycle lanes and lanes on roads and freeways that were dedicated to money-losing bus service. So the whole idea of user-supported roads has been steadily undercut.

Moreover, in response to higher gasoline prices, people have reduced their driving and shifted towards higher-fuel-economy vehicles. Because the federal tax on gasoline is in cents per gallon, revenues fell slightly, from $21.053 billion in fiscal year 2007 to $20.982 billion in fiscal year 2008, a drop of $71 million. In most years, by contrast, revenue grows as the number of drivers grows.

An automatic link between where people value having roads and where they're built.
www.thetollroads.com

What should be done? If you notice how politicized road construction is, if you notice that a gasoline tax that was supposed to be used only for roads is now used for other things, and if you notice that the shift to higher fuel economy is reducing the growth of revenues for road-building, you might consider a market solution. You might consider taking the issue out of politics, allowing private entrepreneurs to build roads and charge tolls for their use. You might realize that doing so would forever free road construction and maintenance from the vicissitudes of gasoline tax revenues and from the politically powerful governments that grab the funds for their money-losing projects.

More Government Will Fix Failed Government?

But what do many people advocate when they notice this problem? Higher gasoline taxes. If you assume that government solutions are better than free-market solutions, you would naturally conclude that the gasoline tax should be increased. But if you are to avoid being a government fundamentalist, shouldn't you actually look at the evidence on how well or badly gasoline taxes and government provision of roads have performed? Shouldn't you also look at the how well or badly toll roads work?

That's not what many people have done. Take political writer Thomas Frank. In a January 28 article in the *Wall Street Journal*, "Toll Roads Are Paved with Bad Intentions," Frank wrote that few state governments "are willing to raise the gasoline taxes which pay for the repairs" to government-owned roads. In other words, Frank sees that there is no necessary connection between the need for repairs and the willingness to raise gasoline taxes. Isn't this failure to fund roads a strike against government-funded roads? Not in Frank's mind. He points out a problem with an incomplete system of toll roads: Tolls will price some drivers out, and some of these drivers will then spill over to nontoll roads. But this wouldn't be a problem if all roads were toll roads. Frank, though, does not consider such a system.

Economist Jeff Hummel recently captured the essence of government fundamentalism this way: If markets don't work, have government intervene. If government intervention doesn't work, have government intervene further.

Notice the irony. Many free-market economists like me are quite willing to admit that markets don't work perfectly and to examine and accept government solutions if their advocates can show how governments can be motivated to actually carry them out. And yet we are called market fundamentalists. On the other hand, many people who call us that are unwilling to change any of their views about the efficacy of government intervention no matter how badly the intervention works. Who are the fundamentalists here? FEE