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IDEAS ON LIBERTY

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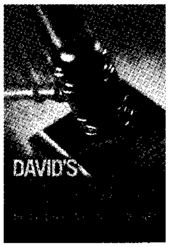

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Perspective

Government Schools and the Housing Mess

The Law of Unintended Consequences is a fascinating thing. You can never be entirely sure what the second-, third-, etc.- order effects of any action will be. This is especially so with government policy because centralized decision-making can do so much damage to so many people. That ought to humble the politicians and bureaucrats, but it never does.

Take the possible connection between the "public schools" and the current housing and mortgage woes.

Robert Frank, drawing on a 2003 book by Elizabeth Warren and Amelia Warren Tyagi, *The Two-Income Trap*, suggests that one factor in the housing mess is the government school system. In an April 27 *Washington Post* op-ed, Frank wrote that since the assignment of children to government schools is determined by geography, the way for parents to get their kids into putatively better schools is to buy homes in the best districts and neighborhoods they can. That system, they claim, encourages families to strain their budgets and to bid up the price of those houses.

Governments have traditionally assigned students to schools by district and neighborhood, regardless of parents' wishes. District and intra-district boundaries could not be crossed without special permission. In rebellion against this system, parents have been known to lie about their address to get their children into better schools. But parents who didn't want to lie might have instead bought more house than they could afford.

"Public schooling" is said to be free, but of course it can't really be free. Parents (and others) pay through their taxes. Frank's point is that parents also pay through their mortgage. Instead of paying higher tuition for better schools, they take on bigger mortgage payments by buying houses in more expensive neighborhoods with what they believe to be better schools. "[W]hen a family buys a house, it buys much more than shelter from the rain. It also buys a public-school system," Warren and Tyagi write.

A couple naturally asks, "How are the schools?," when scouting a prospective home. Government policy thus has made education a key factor when people buy houses.

This has long been true, of course, but the limits on such behavior were once stricter. Frank writes, "In the 1950s, as now, families tried to buy houses in the best school districts they could afford. But strict credit limits held the bidding in check. Lenders typically required down payments of 20 percent or more and would not issue loans for more than three times a borrower's annual income."

However the architects of public policy decided there should be no such barriers to the American Dream of home ownership. So a constellation of federal agencies and government-sponsored enterprises proceeded to subsidize ownership by providing mortgage insurance and other ways to avoid stringent income requirements and large down payments. "Down payment requirements fell steadily, and in recent years, many houses were bought with no money down. Adjustable-rate mortgages and balloon payments further boosted families' ability to bid for housing," Frank adds.

In other words, the politicians invented ways to weaken the credit market's natural checks on excessive risk.

If Frank, Warren, and Tyagi are right—the thesis may provide a piece of the housing-bubble puzzle, but it has its critics and empirical work needs to be done—we can say one thing with certainty: the phenomenon couldn't have occurred in a free market for education. There you wouldn't have to live in the same neighborhood as your children's schools because education entrepreneurs would not limit their customers to a given zip code. Thus no direct connection would exist between the size of your mortgage and the quality of the schools your kids attended.

I don't know how much if anything the state school system contributed to the housing bubble and resulting problems. But it stands to reason that it played some role.

* * *

Dropping housing values, burgeoning mortgage defaults, and the rippling effects in the credit markets have spawned a variety of proposals for government interference with lending and investment. All would make the situation worse, reports Robert Murphy.

Free-market economists agree we live in a world of scarcity. Yet they also optimistically insist we need not run out of resources as living standards rise. Can this paradox be resolved? Yes, it can, says Steven Horwitz.

Advocates of the freedom philosophy often preface their remarks with the words "In a free market . . ." because we *don't have* a free market today. Interventionism has been significant throughout even American history. As Kevin Carson writes, that legacy has had lasting and distorting effects.

One of the great tragedies of the second half of the twentieth century was China's one-child policy to combat alleged overpopulation. Wendy McElroy has the details of the shameful episode that is not over yet.

John Taylor of Caroline trusted freedom and distrusted centralized power. In his second article about Taylor, Joseph Stromberg surveys the early American's positions on political economy.

Freeman columnists serve up a cornucopia of insights this issue. Richard Ebeling relates the Austrian theory of the business cycle to current economic events. Donald Boudreaux explores why the statist left is willing to believe every gloomy report about people's economic circumstances. Robert Higgs revisits a construction boom and bust from the past. John Stossel goes after lawyers who abuse the tort system. Charles Baird predicts bad things for universities just getting faculty unions. And Aeon Skoble, pondering the claim that only government can save people from dying for lack of medical insurance, responds, "It Just Ain't So!"

Our book reviewers have consumed volumes on judicial activism, government planning, eminent domain, and consumer-driven health care.

—*Sheldon Richman*
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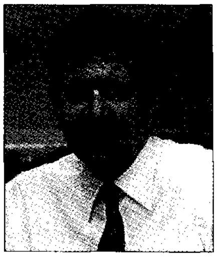
From the President

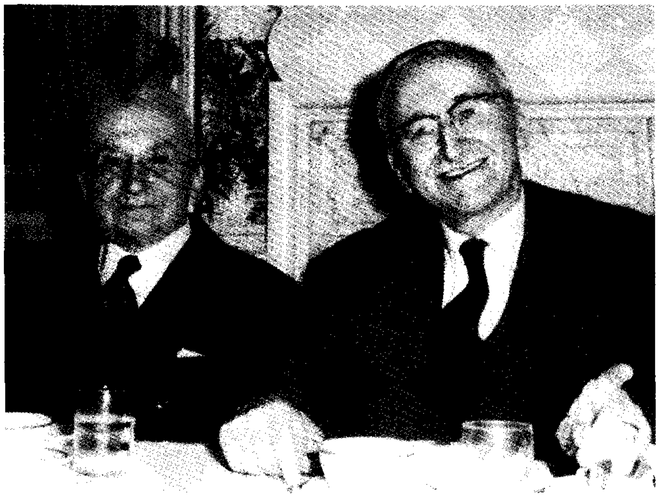
The Current Economic Crisis and the Austrian Theory of the Business Cycle



BY RICHARD M. EBELING

The current financial crisis emerged out of an economic boom that began in 2003 and saw rising stock values, increasing home prices, and high levels of employment and production. The upturn followed a downturn that hit in 2001 after the dazzling prosperity during the second half of the 1990s.

In other words, over slightly more than one decade, the economy has gone through two swings of the business cycle, with still no certainty about how long and severe the recession phase of the present cycle will turn out to be.



Ludwig von Mises and F. A. Hayek
FEE Archives

Many mainstream economists are baffled about these events. The Keynesians certainly cannot claim there has been any shortfall in "aggregate demand." Both in America and around the world, the demand for raw materials and consumer goods has been riding high for a long time.

On the other hand, the monetarists believe monetary policy has not been excessive; price inflation has remained pretty much in check, with consumer prices only rising at 2 to 3 percent a year for a long time.

So what has caused these economic crises? The answer can be found in the ideas of another group of economists, those of the Austrian School. Though this school of thought developed in Austria in the late nineteenth century and the first half of the twentieth century, most "Austrian" economists are Americans living in the United States.

The two leading figures of the school in the twentieth century (and who were originally from Austria) were Ludwig von Mises and F. A. Hayek, who won the Nobel Prize in economics in 1974 partly for his work on business cycles.

For many Austrian economists the past two business cycles have been, in the words of Yogi Berra, "like déjà vu, all over again." Mises and Hayek had first developed their theory of the business cycle in the 1920s, when the American economy experienced numerous technological innovations that lowered manufacturing costs, raised labor productivity, and thus resulted in an expanding supply of consumer goods, along with a rising stock market and a massive real estate boom. And all the while the general level of prices was rising at no more than 2 percent a year.

There was much talk of a "new economic era" and the "death" of the business cycle. One of America's most renowned economists, Yale professor Irving Fisher, publicly declared in the spring and summer of 1929 that the stock market had reached a plateau from which it could only go higher. That was just months before the great stock-market crash in October.

The Austrians argued, both before and after 1929, that the cause of the boom and the inevitable depression was Federal Reserve monetary policy. Under the influence of a variety of economists, including Fisher, the Federal Reserve had sought to stabilize the general price level on the rationale that both inflation (rising prices) and deflation (falling prices) were harmful.

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Given the expansion of the supply of goods and services during the 1920s, prices throughout the economy would have been expected to fall slowly, and this likely would have happened if not for the Fed's policy.

Viewing any decline in the price level as a sign of "bad" deflation, the monetary authorities pumped additional quantities of money and credit into the banking system to prevent prices from falling. The banks could lend this newly created money only by lowering interest rates below what the Austrians call their "natural," or equilibrium, level, where the amount of money demanded by borrowers would equal the amount saved by income earners. Thus there were insufficient savings to complete and maintain many of the investment projects that were undertaken.

Because monetary expansion prevented prices from falling, no harmful price inflation appeared. Thus the magnitude of the *monetary* inflation was hidden by the stable price level. Nevertheless, the investment distortions and imbalance between savings and investment were real.

In late 1928 and early 1929, the Fed became concerned that its expansionary monetary policy was finally threatening a significant rise in the price level. The bank put on the monetary brakes, and in late 1929 and 1930 the stock-market, investment, and real-estate house of cards came tumbling down.

The severity and the duration of what soon became labeled the Great Depression were caused by the interventionist policies of first the Hoover and then the Roosevelt administrations. Rather than allow the market to adjust to the new noninflationary environment—which would have required timely downward adjustments in prices, wages, and shifts in production and employment—the government used various pressures and controls to prevent these changes. The American economy for a long time was caught in "disequilibrium" relationships between costs and prices, supply and demand, and production and consumption—not because of any "failure of capitalism" but because the heavy hand of government prevented the market from reestablishing "full employment."

How similar this is to the events of the last decade! Technological innovations, cost efficiencies, greater output and new goods on the market, along with booming stock prices and real-estate values—all occurring mostly with an annual price inflation of around 1 or 2 percent.

But throughout the second half of the 1990s and then again after 2003, the Fed undertook expansionary monetary policies, with the money supply sometimes increasing annually at double-digit rates. Interest rates were pushed to 1 to 2 percent and were even at times negative, when adjusted for price inflation. Money for investment and other purposes was being given away virtually for free.

Is it any wonder that financial markets boomed, that standards of creditworthiness for investment and mortgage loans almost disappeared, that real-estate prices went up and up? Both in 2000 and in 2007, when the Fed became concerned that its policy was creating an unstable and unsustainable inflationary environment did it put on the brakes. And both times the Fed-created house of cards came tumbling down.

Like all forms of central planning, monetary planning is heavy-handed, clumsy, and pervasive in its effects throughout the economy.

Every historical episode has its own unique features. History never mechanically repeats itself. But like causes do bring about like effects. The concentration of monetary control in a central bank means that those who manage monetary policy are in effect central planners. Like all forms of central planning, monetary planning is heavy-handed, clumsy, and pervasive in its effects throughout the economy.

We will see the same inevitable sequence again and again for as long as money is in the hands of a monopoly central bank and the central bankers believe they are sufficiently knowledgeable, wise, and able to manage the society's economic affairs.

Coercion Is the Only Way to Ensure Health? It Just Ain't So!

BY AEON J. SKOBLE

In his April 11 *New York Times* column, economist Paul Krugman discusses the minor trouble then-presidential candidate Hillary Clinton got into when an anecdote she told about a woman who died because she didn't have medical coverage was found to be inaccurate. Clinton had used the story in support of her proposal for mandatory medical insurance. Krugman argued that, true or not, the story makes "a valid point about the state of health care in this country."

On April 14 Krugman conceded that the woman did indeed have insurance, but he maintained that since many people do die from lack of insurance, his earlier column was worthwhile anyway.

I agree that the merits of Krugman's argument do not stand or fall with the veracity of the anecdote. But while Krugman's attitude seems to be, "Even if the woman was not uninsured, it's still true that we need universal care to avoid similar tragedies," mine would be, "Even if Clinton's anecdote were accurate, it wouldn't demonstrate that the only way for society to avoid such tragedies is through coercive national health insurance."

Mandating that people buy something won't suddenly make it affordable.

Part of the problem in discussing this issue is the tendency to conflate several distinct concepts: the ideas that 1) everyone should have access to health care, 2) everyone is entitled to equal levels of health care, and 3) a coercive federal mandate is the only way to accomplish either of those goals. The first is true, but does not imply the second. I doubt that the second is true, but even if it were, it wouldn't imply the third.

People sometimes mean different things when they speak of access. It would be strikingly immoral for there to be a class of citizens who were forbidden to seek medical attention. Happily, we do not live in such a society. But there are other senses of the word.

Do I have access to a Mercedes? Well, in one sense, yes—if I could afford to buy one, no one would be legally empowered to stop me from doing so.

But I can imagine someone arguing that since, in fact, I cannot afford one, I don't have "access." So the argument is not that some people are legally locked out of access to medical care, but that they cannot afford it and in that sense lack access. The very poor are already eligible for government-subsidized medical care, so this argument seems to be directed at uninsured people who make too much money to qualify for Medicaid. But how would mandatory national health insurance fix *that* problem? Mandating that people buy something won't suddenly make it affordable.

Why don't some people have insurance? They may work for employers who do not offer it as a fringe benefit. But they could still enroll in an HMO or in a Blue Cross-type insurance plan. Why don't they? One possible reason is that they cannot afford the premiums. This means they choose to spend their money in other ways. (Remember, we are not talking about the seriously poor, as they are already covered by government programs.) When I say, "I cannot afford a huge flat-screen

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TV," what I mean is that I choose not to afford it; I am saving my money for something else—a new lawnmower, my kids' college fund, retirement, or what have you. I have assigned a lower priority to a new TV than to several other things.

But wait, comes the rejoinder, flat-screen TVs are a luxury no one needs, but everyone needs health insurance. (Technically, that's not true, but let's assume it is.) Then the problem must be that people are arranging their financial priorities erroneously. Mandatory insurance would solve *that* problem. It would rescue them from their own folly.

This is the core premise of what Krugman calls Progressivism. People do not choose wisely; therefore, for their own good, they must have some choices mandated for them. This premise, of course, is profoundly antithetical to the classical-liberal tradition, in which people's autonomy and liberty are to be accorded the highest priority unless their actions infringe the equal rights of others. To assume that people cannot be trusted to make wise choices about their welfare is bad enough; it's worse to add the assumption that a policy wonk is better qualified.

Even if we grant that some people who choose to go uninsured are foolish and ought to be compelled, that wouldn't address the problem of those who make this choice not out of foolishness, but because they really are so strapped for money that they "cannot afford it" in the ordinary sense of that expression. The mandate then would have the effect of making those people even more impoverished. But at least they wouldn't die from lack of insurance.

Government has many other policies that restrict supply and make medical care artificially expensive. Let's get rid of them.

That's Progressivism? But, a Progressive might reply, isn't saving lives an important part of the government's responsibility? Citing the Urban Institute, Krugman says that lack of health insurance kills 27,000 people a year. That's awful, but the important question is *why* this happens. More precisely, does government policy make it easier or harder for people to afford medical coverage?

Krugman and Clinton are aware of the affordability problem, but they think the way to address it is through tax-financed subsidies. Here's a different idea: create market conditions under which lower-income people could receive the coverage and care they currently cannot afford. Contrary to what many think, we have no free market in medical care. Government is pervasive, and that's the problem. Removing current restrictions would go a long way toward changing this. For example, many routine services could easily be provided by physician's assistants, nurse-practitioners, or, as they were in the old days, pharmacists.

Imagine if Jiffy Lube had to employ factory-certified master mechanics at $80 an hour to do oil changes. You'd likely get fewer oil changes because they would cost a lot more. But without regular oil changes, your car would be at risk for more serious trouble. When a big problem occurred, people would lament that it could have been prevented with regular maintenance. Some would propose that the government should require people to get regular oil changes even if they can't afford them. But another approach would be to allow a free market in oil changes, which, as we know, keeps prices low, and enables everyone to get regular care.

Government has many other policies that restrict supply and make medical care artificially expensive. Let's get rid of them. Why resort to force? Freedom works.

If saving lives is as important a part of the government's responsibility as Krugman suggests, Progressives would do well to rethink their impulse to regulate behavior. Phrases such as "unregulated markets in health care" evoke the specter of either skyrocketing costs or substandard care. But ironically, that's the dilemma created by government regulation. Costs for simple preventive care are kept artificially high, so some don't get it. But unlike the inconvenience of a broken car, this can result in death. Coercion won't solve the problem.

Can the Feds Save the Housing Market?

BY ROBERT P. MURPHY

It seems each passing week we are treated to yet more record-breaking dismal housing news. As of this writing, the latest report of the respected S&P/Case-Shiller Home Price Indices reveals that in February 2008, its ten-city composite suffered the largest year-over-year decline ever of 13.6 percent. Perhaps more troubling, February's drop of 2.9 percent was the largest monthly decline in the index's history, going back to January 1987. (Data are available at http://tinyurl.com/3c8uag.) So not only is the housing market continuing to fall, its drop is arguably accelerating.

Not only is the housing market continuing to fall, its drop is arguably accelerating.

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In this environment, it's natural that the government—and in particular the presidential candidates—are offering their "solutions." As we'll see, most of these proposals would only make things worse. To see why, we first need to understand what went wrong in the housing market.

To put it simply, there was an unsustainable bubble in home prices. From June 2001 to June 2006, the ten-city composite index mentioned above rose a whopping 89 percent. Now an average annualized return of over 13 percent isn't bad, especially when you can live in the investment or rent it out for income. Consequently, more and more people entered the housing market. Some bought more expensive homes than they otherwise would have, and others even began buying homes purely as investments to "flip" once they had appreciated. As in any market, when prices exploded producers began cranking out more product—homebuilders were very busy, and their stock did very well during this period.

Another important part of the story is the revolution in financing that blossomed at the same time, which both benefited from and exacerbated the housing boom. In a traditional arrangement people in a community deposit funds with the local bank, which pays them a low interest rate in return. Then the bank takes this large pool of individual deposits and grants mortgages to qualified applicants, charging them a higher (but fixed) interest rate to compensate both for the bank's overhead and the possibility of default. To make sure its loans went to responsible borrowers, and to align everyone's incentives, the bank would insist on a hefty down payment, often 20 percent of the price of the house.

Yet things didn't always happen this way during the recent housing boom. Rather than conventional fixed-rate mortgages, eager buyers were granted adjustable-rate mortgages (ARMs) that offered low upfront rates, which would then reset down the road. This allowed people to buy much more expensive homes, because

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they could handle the monthly payment at the "teaser" rate. Many buyers figured they could either flip the house before the ARM reset, or they could refinance at that time into a fixed mortgage.

Besides ARMs, other unorthodox practices occurred. People might be granted interest-only mortgages, where the borrower treads water with each payment, or even "negative amortization" ones, where the principal owed to the bank actually grows over time. Naturally, people signing up for all of these low-pain mortgages didn't have money for a down payment, and here too the banks were very obliging. Before discussing the innovations on the mortgage-holder side of the market, I should stress that the above patterns aren't as crazy as they now appear in retrospect. If home prices had continued their double-digit rates of appreciation, these practices all made perfect sense. It was only when the housing market collapsed that the borrowers were caught with their pants down.

On the banking side, here too practices deviated from the old ways. Rather than keeping mortgages on their balance sheets, local banks would sell them off to middlemen, who would ultimately pass them on to the giant investment banks headquartered on Wall Street. These organizations would turn to their "financial engineers" to bundle pools of mortgages into a new entity, broadly classified as a collateralized debt obligation (CDO). Outside investors could then buy bonds issued by the CDO. The flow of monthly mortgage payments into the CDO funded the flow of coupon payments to the bondholders. In the event of defaults, there were pre-determined rules for which CDO bondholders took the hit first. Naturally, the riskier classes (or "tranches") of CDO bonds offered higher rates of return at the outset.

The growth in popularity of CDOs allowed institutional investors to participate in the booming housing market. Someone managing a pension fund didn't have to do research on employment and default rates in Sacramento to gain exposure to real estate; all he had to do was buy bonds issued by the relevant CDOs. The high ratings granted by Moody's and other agencies satisfied contractual and regulatory requirements, and reassured these outside investors that such investments were safe. Sure, any individual borrower could default, but the Ph.D.s at the investment banks had quantified the risks so everybody (apparently) knew exactly what he was buying into.

Of course, the party ended once housing prices peaked, and things turned ugly when prices began falling sharply. Most obvious, homebuilders were caught flat-footed, with more inventory in the pipeline that now had no buyers. But the fall in prices also devastated those borrowers who had been banking (literally) on the opposite expectation; with negative equity and no buyer, they were stuck with mortgage payments (especially those with resetting ARMs) they couldn't afford.

As is well known, the housing bust wreaked havoc in the credit markets as well. CDOs involving real estate were suddenly dangerous. The mathematical models that had previously been used to value them were obviously deficient, yet market prices weren't available because nobody wanted to purchase the securities. Thus beginning in August 2007 and continuing to this day, banks have been reluctant to lend to each other because they couldn't really trust the solvency of their counterparties. (A bank asking for a short-term loan might have $1 billion in mortgage-backed securities on its books to pledge as collateral, but how much were those assets *really* worth?)

Because of banks' reticence to lend not only to regular people but also to *each other*, the housing bust led to a much broader credit crunch. The process was a vicious circle.

Because of banks' reticence to lend not only to regular people but also to *each other*, the housing bust led to a much broader credit crunch. The process was a vicious circle. Spooked by the debacle, banks became much more stringent in their standards when evaluating new mortgage applications. This has only intensified the fall in house prices, as willing buyers can't obtain financing.

How Government Caused the Trouble

Now that we have a better grasp of exactly what happened, the next issue is, "Why?" The typical answer is greed, on the part of investment banks, real-estate brokers, and speculators. But unless someone can explain why financiers and speculators were greedier in the mid-'00s than at other times, this explanation isn't too helpful.

The free-market economist has learned from many different examples that when individuals and firms systematically make boneheaded decisions that lose them gobs of money, there is usually a government policy driving the madness. And in the housing bust, the pattern holds.

First and most obvious, the Federal Reserve had an easy-money policy to try to rescue the economy from the dot-com crash. In 2001 alone, the federal funds target rate was slashed from 6.50 percent down to 1.75 percent; the target eventually reached an incredibly low 1 percent by June 2003, where the Fed held it for an entire year. Then from June 2004 through June 2006, the target was steadily hiked back up to 5.25 percent. Although the correlation isn't perfect, when the federal funds rate is cut, other interest rates—including mortgage rates—generally fall with it. Given the close connection between mortgage rates and home prices, even mainstream analysts have blamed the Fed for its role in the housing crisis.

Given the close connection between mortgage rates and home prices, even mainstream analysts have blamed the Fed for its role in the housing crisis.

Another obvious government distortion resulted from the actions of the Federal Housing Administration (FHA), which provides insurance for mortgage holders in the event of a default by borrowers. To see the connection between the FHA's activities and the housing boom, we need only quote from the main page of its website: "Unlike conventional loans that adhere to strict underwriting guidelines, FHA-insured loans require very little cash investment to close a loan. There is more flexibility in calculating household income and payment ratios."

Implicit Government Guarantees

Freddie Mac and Fannie Mae, major participants in the secondary market for mortgages, also share a portion of the blame. They buy mortgages from originators (banks, thrifts, credit unions, and so on), package them into bundled securities, and then sell the new assets to outside investors. As so-called government-sponsored enterprises, they do not directly receive tax dollars or explicit government assistance. However, many investors believe there is an implicit federal guarantee behind these agencies, and their regulatory requirements are also looser than for their purely private-sector counterparts.

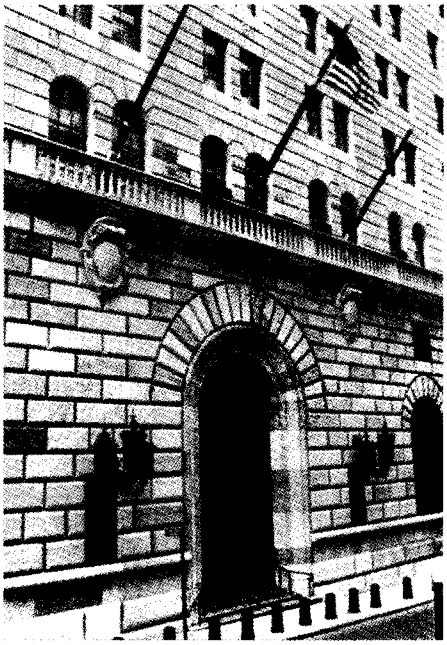
Because of these advantages, when mortgage originators know a loan will be eligible for purchase by Freddie Mac and Fannie Mae, they can charge home buyers lower rates than would otherwise be profitable. Indeed, part of the official mission of these companies is to make the dream of homeownership attainable for millions of low- and moderate-income families. When trying to understand why so many obviously unqualified people were able to obtain financing during the housing boom, we shouldn't ignore the role of large intermediaries explicitly designed to "soften" the strict requirements of the pure market.

Pressure to loosen underwriting standards was placed on private lenders as well in the name of avoiding discriminatory "redlining." Stan Liebowitz, an economics professor at the University of Texas at Dallas, has been a critic of such political correctness for over a decade. In a February 5 *New York Post* op-ed (http://tinyurl.com/2ahdkd), he explains how beginning in the 1980s, activist groups such as ACORN (Association of Community Organizations for Reform Now) agitated against lending practices that yielded fewer approvals for minority and other low-income applicants.

In 1992 the Boston Fed produced an academic study that purportedly verified this bias in lending and distributed a manual for lenders that said the use of "arbitrary or outdated" criteria could be evidence of discrimination. Some of these criteria included income verification and the credit history of the mortgage applicant.

In 1995 the fuzzy-sounding 1970s Community Reinvestment Act (CRA) was strengthened. Henceforth, all banks and thrifts that enjoyed deposit insurance had an affirmative duty to lend throughout the regions in which they accepted deposits, notably including poor neighborhoods. If they received bad marks on this score, they could be subject to direct or indirect sanction, such as having merger plans held up by the Department of Justice. Studies by both the Federal Reserve and Harvard's Joint Center for Housing Studies found that the CRA achieved its goal—namely, higher rates of homeownership in poorer communities.

Although some defenders of the CRA have pointed out that half the subprime loans were made by institutions outside the law's purview (http://tinyurl.com/3sjcfj), surely government and activist efforts to shame lenders into loosening standards must play some role in our story. To quote Liebowitz:



The Federal Reserve Bank of New York (pictured) notoriously assisted with JPMorgan's rescue of Bear Stearns in March.

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> Ironically, an enthusiastic Fannie Mae Foundation report singled out one paragon of nondiscriminatory lending, which worked with community activists and followed "the most flexible underwriting criteria permitted." That lender's $1 billion commitment to low-income loans in 1992 had grown to $80 billion by 1999 and $600 billion by early 2003.
>
> Who was that virtuous lender? Why—Countrywide, the nation's largest mortgage lender, recently in the headlines as it hurtled toward bankruptcy.
>
> In an earlier newspaper story extolling the virtues of relaxed underwriting standards, Countrywide's chief executive bragged that, to approve minority applications that would otherwise be rejected "lenders have had to stretch the rules a bit." He's not bragging now.

Finally, there is the matter of the ratings agencies. Had they done their job properly, and given more accurate estimates of the riskiness of the rather exotic CDOs with which many investors were unfamiliar, then the housing boom would not have gained so much momentum. As usual, critics of capitalism attribute their mistakes to simple greed or even corruption.

Yet we have to ask: Don't agencies such as Moody's and Standard and Poor's have an incentive for honest and accurate reports? Aren't they suffering now for their wildly overoptimistic ratings, the way Countrywide and other lenders have either gone bust or are on the verge of doing so?

The answer is no. State and federal regulations of entities such as banks, insurance companies, and broker-dealers often rely on the creditworthiness of the bonds on the books of these organizations. Naturally the government then has to specify which ratings agencies are legitimate for this purpose; a banker can't simply get a letter from his brother-in-law declaring his bonds to be "investment grade." Although space does not permit a full treatment here, suffice it to say that the major ratings agencies are largely shielded from open competition (http://tinyurl.com/5akgq3). Consequently they will not be ruined by the housing bust, and it is no wonder then that they were so reckless with their profitable (at the time) evaluations.

Now that we understand the problem with the housing and credit markets, and how misguided government policies caused or at least greatly exacerbated the mess in the first place, we can quickly evaluate the likely effectiveness of some of the recent and suggested moves to fix things:

Cutting the federal funds rate. From September 2007 through April 2008, the Fed cut its target rate from 5.25 to 2 percent. Not surprisingly, things are still awful in the housing market, and the credit markets are still unsettled. As we've seen above, it was arguably Fed rate cuts that *caused* the housing boom in the first place. At this point, everyone is spooked; newly created dollars won't flow into housing, but rather some *other* sector, such as commodities.

Bailouts of firms judged "too big to fail." The Federal Reserve Bank of New York notoriously assisted with JPMorgan's rescue of Bear Stearns in March on the grounds that its collapse would have led to widespread panic and further failures. As many critics have argued, such rescue attempts lead to a "moral hazard" that will only further encourage risky practices in the future. For a market to work, we need to rely on the profit-*and-loss* mechanism. Bear Stearns was heavily invested in mortgage-backed securities (MBS) and should have been left to suffer its fate on the open market. The only way to reward firms that wisely eschew hot items during a boom is to allow their competitors to go bust.

The problem in the credit markets isn't simply the massive losses from bad loans. It's also the uncertainty caused by the large holdings of derivative assets tied to mortgages.

Accepting mortgage-backed securities as collateral for short-term loans. On March 11, the Federal Reserve announced the Term Securities Lending Facility, authorized to lend up to $200 billion of the Fed's holdings of Treasury securities to primary dealers in 28-day loans. The Fed agreed to accept MBS as collateral for these loans. The move promoted "liquidity" because it is much easier to raise cash in the market with bonds issued by the federal government (Treasurys), rather than securities tied to mortgages at risk of massive defaults.

There are several problems with this arrangement and others like it. First, it obviously puts taxpayers on the line if the primary dealers default and the Fed is stuck with (grossly overvalued) MBS. Second, it intensifies the moral hazard discussed above; it benefits those who hold a large amount of MBS—precisely the investors with poor foresight. Finally, it perversely encourages holders of MBS to keep them off the market, since the Fed will accept them at an unrealistic book value.

To repeat, the problem in the credit markets isn't simply the massive losses from bad loans. It's also the *uncertainty* caused by the large holdings of derivative assets tied to mortgages. Only when institutions bite the bullet and begin selling these assets, presumably at large losses, can realistic market prices be established. Only then will banks be able to assess each other's creditworthiness, and only then will they begin lending freely to one another. Government efforts to prop up the MBS market perversely stall this shakeout.

Rewriting contracts in favor of the homebuyer. Senator Hillary Clinton has been the most aggressive in this area. In December she called for a 90-day moratorium on certain types of foreclosures, and a five-year moratorium on ARM resets. Although these measures would help some existing homeowners in the short run, they would make it harder for newcomers to obtain financing to purchase a house. After all, the reason a bank is willing to lend out such large sums to a young couple is that the loan is *secured*; the bank can take possession of the house if the couple defaults. As far as ARM resets, it obviously doesn't help the beleaguered holders of MBS to be told that the government has codified their fears of nonperformance.

A federal "loan substitution" program. In a March 7 op-ed in the *Wall Street Journal* (http://tinyurl.com/2zo6nm), economist Martin Feldstein proposed that the federal government pay off 20 percent of the mortgages of homeowners who opt into the program. They would repay the government over 15 years at the rate earned by two-year Treasurys (1.6 percent when Feldstein was writing). The point of the plan would be to encourage homeowners—especially those with negative equity—to continue making their monthly mortgage payments, rather than walk away.

Feldstein said the plan would be financed "by issuing new two-year debt until the loans are fully repaid, thus eliminating any net cost to the government." It is rather shocking that Feldstein, chairman of the Council of Economic Advisers under President Reagan, didn't consider that some of the participants in the plan might default on their debt to the government. As usual, the taxpayer would ultimately foot the bill for this massive handout to the mortgage industry.

Enhanced regulation. Almost every "serious" commentator on the housing crisis, including the allegedly laissez-faire Treasury Secretary Henry Paulson, has called for enhanced government oversight of the financial sector. It is ironic that in February the constraints on Freddie Mac and Fannie Mae were considerably *loosened* to allow them greater leeway in buying mortgages—and this just as the companies were reporting losses in the billions of dollars in the fourth quarter alone of 2007.

Where Do We Go from Here?

There are two distinct approaches the government can take to discourage institutions from engaging in reckless financial transactions. One is to let them do whatever they want (subject to prohibitions on outright fraud and theft) and let them go bankrupt if they screw up. The other is to hold their hands every step of the way, bailing them out of trouble but also second-guessing every decision they make.

In light of the complex and quickly moving financial system, as well as the politicians' own dismal record on matters of honest bookkeeping, I think the first approach is far more sensible.

Unfortunately, even some nominal friends of markets have argued the housing crisis is too serious to ignore. If the government sits back waiting for prices to hit bottom, we are told, there will be unacceptable ripple effects throughout the rest of the economy. Yet as we have seen, most of the proposed interventions would make the housing crisis worse; any alleged ripples would turn into tidal wives. Beyond that observation, we should also remember that prices really do serve a function in a market economy. The politicians have already caused real damage, and people need market prices to know how to make the best of a bad situation. Propping up home prices at unrealistic levels will simply waste tax dollars and hamper the correction.

Our current housing and credit crises are quite serious—perhaps the worst since the Great Depression. As usual, the free market is not to blame; numerous government policies caused or exacerbated the situation. The host of "solutions" being implemented or recommended will only make matters worse.

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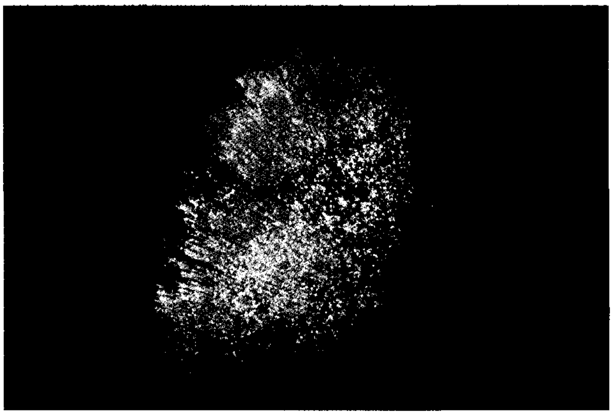
Economists and Scarcity

BY STEVEN HORWITZ

In a world where concerns about the environment and resources dominate political discussion and, for people like Al Gore, are a "generational mission [that gives] moral purpose" to our lives, thinking clearly about these issues is crucial. Economics can contribute to this discussion by providing its perspective on words such as "scarcity" and "resources," which are often contested or misunderstood.

But how economists use those words is vulnerable to misunderstanding. For example, some environmentalists think that certain economists deny that scarcity even exists when they argue that we are not really running out of resources or that technology can solve any problem in this regard. The sorts of arguments criticized by the environmentalists are most closely connected with the work of the late Julian Simon, especially in his book *The Ultimate Resource 2*. However, the criticism reveals a misunderstanding of Simon's and other market-friendly economists' views.



New technology might enable us to use an existing resource more efficiently, but it can also provide a new solution to the same problem.

Photo of fiber-optic cable, Laser Center, SUNY Stony Brook

It is certainly true that nonrenewable resources are limited in physical terms. From the perspective of the geologist, there is only "so much" oil to be extracted.

However, from the economist's perspective, what matters is not physical quantity, but how efficiently a resource meets a human need. We care about oil because we want energy. If through new technology we can create the same or more energy with less oil, then in an important sense we have more oil than we had before. The existing quantity of oil can now serve more human needs. Moreover, falling costs of extraction can also lead us to find previously undiscovered oil or to tap into known supplies that had been too costly to reach.

So advances in technology do indeed matter, not because they abolish scarcity but because they enable us to stretch the resources we have so that they are *functionally less scarce* than they were before.

When we speak of improvements in technology, we really mean new and more efficient ways to achieve the ends to which the old resources were a means. New technology might enable us to use an existing resource, such as oil, more efficiently, but it can also provide a new solution to the same problem. For decades, the human voice and data were transmitted by copper wires. Eventually, copper's price rose to where entrepreneurs had a strong incentive to find another way to provide the service. Eventually they developed sand-based fiber-optic cable, which can carry thousands of times the data for a fraction of the cost of copper. The development of the soft-sided beverage containers—juice boxes—is a similar story, and it is worth

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noting that their lighter weight reduces gasoline use per unit.

When economists say, "We will never run out of resources," what they often mean is that faced with increasing scarcity of one resource, we will always find new solutions to the problem that that resource originally solved. In an important sense, the actual economic resource was not copper but "the ability to convey voice and data." And that resource has become "less scarce" by the substitution of sand. This illustrates Simon's point that the "ultimate resource" is the human ingenuity that finds new and better ways of using physical resources.

Although technology can fix things, it does not exist in a vacuum. Technological solutions emerge because the right economic institutions are in place. The market provides signals which inform people that a resource is growing more scarce and provide *incentives* to address the problem. Even some critics of environmentalist arguments forget this point. The role of institutions is clear where technology has not stopped resource depletion, such as overfishing, because the absence of private property and meaningful prices has created a "tragedy of the commons." The tragedy is that no one has an incentive to husband the resource. This is not a failure of technology but a lack of proper institutions. If the commons are privatized, incentives will exist to develop resource-conserving technologies.

The whole case for free markets is about allocating resources most efficiently to push back scarcity and communicating when a resource has become so scarce that we need to cut our use and find substitutes.

The Central Concern of Economics

What's so absurd about the criticism of economists for not caring about resource scarcity is that the problem of scarcity—and how to handle it—are at the *center* of the discipline. The whole case for free markets is about allocating resources most efficiently to push back scarcity and communicating when a resource has become so scarce that we need to cut our use and find substitutes. That's what market prices determined through the exchange of private property do. This is also why many economists have concerns about the institutional changes advocated by many environmentalists. Limits on property ownership undermine the very processes that would solve many of the problems they identify.

Can it be *proven* that technology will always provide an alternative when a resource becomes too scarce? Not in any rationalistic sense. We can offer lots of arguments from theory and history, but we cannot guarantee it 100 percent. However, the evidence and theory overwhelmingly indicate that we do not run out of resources when market institutions are in place and people are more or less free. Certainly markets do not solve problems perfectly, but imperfections do not make alternative institutions better. They may well be worse.

Scarcity is like gravity: it is omnipresent, and much of our lives is a struggle to find ways to overcome it. The existence of elevators and airplanes is not evidence that gravity is a myth. They are attempts to defy its very reality. Elevators improve our lives by giving us a way to push back at gravity and reduce the ways it frustrates our efforts.

Market institutions enable us to push back at scarcity as much as possible, much as elevators push back at gravity, and in so doing, make it considerably easier for individuals to achieve their myriad goals.

Some critics of the economic arguments for markets also suggest that economists dismiss scarcity whenever they claim that markets are positive-sum "games." It is true that economists understand that exchange creates wealth for all parties, while the critics seem to believe that any gains are offset by losses, even that the wealth of the few causes the poverty of the rest. At first glance, one can see why this criticism might be valid: how does exchange create wealth out of nowhere? Does that not seem to suggest we are not acknowledging scarcity?

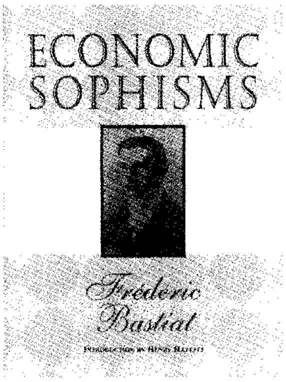
Not at all. In the short run, exchange—whether a trade between two people or an act of production that trades inputs for outputs—makes people better off. This results not by creating more physical stuff but by rearranging what exists to make it more valuable to human beings. While we each think we're better off when we make an exchange, mutual benefit does not require a denial of scarcity; rather, exchange is one more way we push back against it.

This mutual benefit reinforces the point that value is a product of human minds, not of the objective physical world. In fact, we cannot even understand the concept "resource" without recognizing this point. For most of human history oil was a nuisance. People didn't want land with oil on it because it polluted the soil. However, once human minds realized that it could be converted to energy, it *became* a resource, and as we begin to create substitutes for it, as with copper wire, it will become less of a resource. From an economic perspective, what makes something a resource and what determines its scarcity is the interplay between its physical quantity and the human mind's perception that it can satisfy human wants.

In the longer run, the benefits of exchange, when combined with the institutions of the market, create the wealth that people can save in order to finance the investments that will lead to better and cheaper products for exchange. Real, tangible economic growth happens—not just for the wealthy, but for all. Again, we stretch the resources we *do* have even farther.

Theory aside, it would also be hard to deny that several centuries of more or less free markets have produced a tremendous rise in the living standards of the poorest people in the West. The same is beginning to happen elsewhere. To argue that the wealth of the wealthy is the cause of the poverty of the poor (the "some win at the expense of others" argument) flies in the face of historical facts.

Poverty and early death have been the norm throughout history. The power of private property, free exchange, and markets to change that norm has been the single most progressive force in human history. Scarcity is all too real and causes all too much human suffering, which is why we need genuine market institutions to continue to reduce its effects, especially on those who suffer most.



Economic Sophisms
By Frédéric Bastiat
Introduction by Henry Hazlitt

Although written 150 years ago, Bastiat's devastatingly accurate attacks on the illogical, self-serving arguments of protectionists remain both relevant and entertaining. Among the gems in *Sophisms* are "The Negative Railroad," "Petition of the Candlemakers," and "The Physiology of Plunder."

Perhaps the best recommendation for *Sophisms* comes from renowned journalist and FEE founding trustee Henry Hazlitt. In his introduction to the book, Hazlitt declares:

We could use more Bastiats today. We have, in fact, desperate need of them. But we do, thank Heaven, have Bastiat himself, . . . and the reader of these pages will not only still find them, as Cobden did, "as amusing as a novel," but astonishingly modern, for the sophisms he answers are still making their appearance, in the same form and almost in the same words, in nearly every issue of today's newspapers.

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Interpreting the State of the World

BY DONALD J. BOUDREAUX

Why are optimists about the state of the world disproportionately represented by classical liberals, libertarians, and free-market conservatives, while pessimists about the state of the world are disproportionately represented by statists?

Why do left-leaning media such as the *New York Times* and CNN devote so much ink and airtime alleging that middle-class Americans have made little or no economic progress over the past 35 years and that the planet continues to spiral into imminent catastrophe?

Why, whenever the *New York Times*'s Paul Krugman and the *Washington Post*'s Harold Meyerson write (as they do, almost weekly) that ordinary Americans are trapped in a no-growth economic situation by "the rich" and powerful, do market-oriented bloggers respond with data showing that this claim is false?

And why, whenever the *Los Angeles Times* or *The New Yorker* publishes yet another "report" allegedly documenting continuing environmental degradation, do so many market-oriented scholars frequently expose these reports as being factually wrong or poorly reasoned, or both?

This pattern is so familiar that it eludes our attention. And yet reflection on it is fascinating. There's no obvious reason why persons on the left should be biased into perceiving the state of the current world to be especially dire, and no obvious reason why market-friendly people should be biased into perceiving roses where there is really only rot.

As documented often in this publication (and in several others) over the past few years, Americans' living standards are today at an all-time high. Data on what ordinary, and even poor, American households regularly consume make clear that our prosperity is immense and growing. Likewise, the real value of workers' total compensation (wages plus fringe benefits) continues to rise. Leisure time—leisure both from our jobs and from tedious household chores—continues to increase, as do our real expenditures on recreational equipment and activities. Life expectancy in the United States is at an all-time high.

In addition, the planet is neither running out of resources nor heading for environmental Armageddon. The works of the late Julian Simon and, more recently, of Bjørn Lomborg and Indur Goklany are important sources of careful documentation of these facts.

We're living longer and healthier, working less, playing more, and consuming more, all on a planet that is resource-rich and vibrant.

We're living longer and healthier, working less, playing more, and consuming more, all on a planet that is resource-rich and vibrant.

If I were a champion of big government, rather than deny these facts, I'd trumpet them as evidence that the interventionist policies pursued since the New Deal work wonders. Real household incomes are higher (I'd allege) because of Social Security, minimum-wage legislation, and several anti-discrimination statutes. We're healthier and living longer (I'd allege) because of Medicare and Medicaid, a variety of product- and workplace-safety regulations, the efforts of the Environmental Protection Agency, and government's crackdown on tobacco use.

And the natural environment is in fine health (I'd allege) because of the EPA and the plethora of national, state, and local regulations aimed at protecting it.

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Yet if we are to believe the factual claims issued by the modern left about the state of the world, it is quite plausible to conclude that not one of their cherished programs works very well. Ordinary Americans and the earth stand on the brink of the abyss despite generations of government growth and increasing intervention.

Seems an odd claim, coming as it does chiefly from the left.

Perhaps equally odd is the consistent optimism about the state of the world by market-friendly scholars. It would hardly be surprising if, the moment someone asserted that the living standards of ordinary Americans have stagnated now for nearly two generations, students of Milton Friedman and scholars inspired by Mises and Hayek would accept such claims at face value and pronounce, "See! We told you so. First came the expansion of Uncle Sam's power under Woodrow Wilson, and then came the explosion of such power under Herbert Hoover and Franklin Roosevelt, followed by increases in power ever since. The stagnation of incomes and the degradation of the environment surely are the result of the growth of the state during the twentieth and very early 21st centuries—or, at the very least, the growth of the state has done nothing to prevent these problems."

But the typical free-market advocate resists this temptation. He or she examines the facts and correctly concludes that living standards and the state of the environment are much better today than they were 30 or 40 years ago.

Of course, it remains possible for the free-market advocate still to make a strong case against the many government interventions that today crowd our lives. But much, if not all, of that case is in the form of a counterfactual: *If* government were less intrusive, the economy and the environment would be even better than they currently are. However strong such a case is, the truth remains that the intrusive, grasping, and powerful government of the past few generations has not absolutely reduced our living standards.

So why do free-market advocates consistently proclaim that living standards and the state of the world are generally improving?

Call me biased, but I'm pretty sure that free-market advocates look at the facts straight on and (although it would further strengthen the case against government) refuse to massage the data in ways that make reality appear to be worse than it is.

The more interesting question is why do statists—by repeatedly alleging that the economy is horrific and the environment a cauldron of toxins—effectively (if unconsciously) insist that their cherished programs have failed. Given the overwhelming evidence that our material lives are today better along most dimensions, I'm frankly astonished that so few statists accept this evidence.

Problem-Mongering

Or, more precisely, I *used to be* astonished. I am no longer, because I believe that I now understand why opponents of liberty constantly bemoan the current state of the world. Quite simply, problem-mongering is the surest path to power. No matter how good things are, we humans can always imagine them being even better. No matter how clearly the data show progress, data can be cherry-picked and interpreted to make matters appear grim.

And no matter how much freedom government has stripped from us, as long as some economic freedoms remain, those on the left will see such freedoms as the source not only of real imperfections, but also of failures to attain what can be achieved only in the fantasies of those with ample faith in the power of the state.

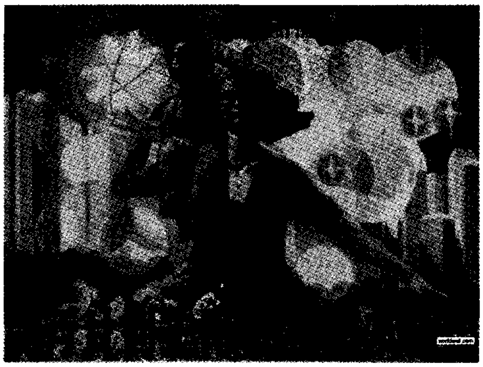
Friends of liberty are under no delusions that even maximum liberty governed by the best-possible rule of law will create heaven on earth. Opponents of liberty, in contrast, are convinced that the impossible becomes possible by giving the state more resources and power. And as long as there are still more resources and power for the state to acquire, the real world's inability to live up to our fondest imaginations will be described by those on the left as "failure" and serve as an excuse for further limitations on liberty.

China's One-Child Disaster

BY WENDY MCELROY

On February 28 a Reuters news story quoted Zhao Baige, the Chinese vice minister of the National Population and Family Planning Commission (NPFPC), as indicating that the People's Republic of China might change its "one-child policy." That population-control policy limits the number of children Chinese couples are legally permitted to have. The default number is one child, but China's actual birth rate is estimated at 1.8 children per couple because of exemptions and lawbreakers who are often aided by the widespread corruption of bribable officials.

By February 29 the *New York Times*, *International Herald Tribune*, and several UK papers quoted Zhao and speculated that the reason behind a loosening of policy was China's urgent need for more young people who could be taxed in the future and otherwise care for China's huge aging population. The NPFPC rapidly quashed the rumor of impending changes, and in a March 5 speech, Chinese Premier Wen Jia Bao specifically affirmed China's intention to retain its current birth-control policy.



"Carry out family planning, Implement the basic national policy"

There are several reasons why the news story spread so quickly. The one-child policy has stirred worldwide controversy both for its violation of civil rights (including the forced abortion of "extra" children) and for its unintended consequences (for example, a preference for sons has created a sex ratio of almost 120 boys to every 100 girls born).

Moreover, the specter of world overpopulation has been a political hot button for decades; an alleged inadequacy of food supplies is, perhaps, the most common argument advanced for mandatory population control. In a *New York Times* article titled "A Global Need for Grain that Farms Can't Fill" (March 9), David Streitfeld wrote, "Everywhere, the cost of food is rising sharply. Whether the world is in for a long period of continued increases has become one of the most urgent issues in economics."

If the price of food continues to rise and if food riots like the recent ones in Haiti spread, then calls for population control will almost certainly increase and China's one-child policy will be scrutinized for signs of success or failure.

In fact, the one-child policy has been a devastating failure that was based on a shaky assumption: namely, that the world is overpopulated, and so reproduction must be controlled. Additionally, "one-child" is an example of a social-engineering program that was launched to correct the unintended consequences of an earlier social-engineering program that encouraged large families. Indeed, China has recently launched yet another program called The Care for Girls program. This is a social program introduced to remedy a social program that was introduced to remedy a social program. (More on this below.)

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Let's grant for the moment and for the sake of argument that the world is overpopulated. Can social engineering cure the "problem"?

Social engineering occurs when a centralized power tries to manipulate or override people's preferences to make them behave according to an artificial social blueprint. It is the opposite of allowing a culture to evolve naturally according to the preferences of individuals, which are often based on economic factors, such as what they can afford. Social engineering imposes rules, sometimes by dangling carrots, sometimes by wielding sticks.

In pursuing conflicting population policies, China has mixed carrots and sticks for over half a century now.

In a 1949 speech titled "The Bankruptcy of the Idealist Concept of History," the then-leader of Communist China, Mao Zedong, declared, "It is a very good thing that China has a big population. Even if China's population multiplies many times, she is fully capable of finding a solution; the solution is production. The absurd argument of bourgeois Western economists like Malthus that increases in food cannot keep up with increases in population was not only refuted long ago by Marxists, but has also been completely exploded by the realities in the Soviet Union and the liberated areas of China after the revolution."

Social engineering occurs when a centralized power tries to manipulate or override people's preferences to make them behave according to an artificial social blueprint.

To Mao a large population was "a very good thing" for several reasons; for one, it represented more labor power. The main reason, however, was Mao's fear of an armed conflict with "the West"—specifically with the United States.

A Cold War between the communist East and the Western world had followed on the heels of World War II. Korea was a flashpoint; the nation had been divided into two zones, with the North being controlled by the Soviet Union and the South by the United States. Although those nations withdrew militarily, they left their respective zones well armed. On June 25, 1950, North Korea invaded the South. In response the United Nations sent troops to Korea to reverse the invasion and with the ultimate goal of assuming control of the North, which shared a border with China.

The Chinese counterattacked, and the conflict settled into a seesaw of military actions. This was the Korean War; it ended three years later in a stalemate that preserved the North-South division of the country.

There was a clear reason why a poorly equipped China was able to hold off the West: superior numbers. During the war the United States incurred an estimated 33,600 casualties; its UN allies 16,000 more. Chinese casualties are estimated at 900,000. Mao wrote, "In every battle . . . an absolutely superior force (two, three, four, and sometimes even five or six times the enemy's strength), encircle the enemy forces completely, strive to wipe them out thoroughly, and do not let any escape from the net." The strategy became known as "the human wave tactic."

During the 1950s and '60s, Chinese women were encouraged to reproduce and given awards for doing so. Advocates of population control were sometimes imprisoned although family planning became more acceptable as the '60s evolved. Thus China experienced a massive increase in population. As a result, by the 1970s family planning had displaced the admonition to reproduce, but the policy was not coercively enforced except on the authority and discretion of local officials.

The One-Child Policy Is Implemented

In 1979, three years after Mao's death, the new leader of China, Deng Xiaoping, announced the "one-child policy." Vice Premier Chen Muhua described the policy as one "of encouragement and punishment for maternity, with encouragement as the main feature. . . . Parents having one child will be encouraged, and strict measures will be enforced to control the birth of two or more babies. Everything should be done to insure that the natural population growth rate in China falls to zero by 2000."

The policy was enforced nationwide in 1981 and has remained the law of the land since, although significant changes have occurred.

What hasn't changed, however, is that China regulates and controls the procreation of its citizens more strictly and universally than any nation except, perhaps, communist Romania under Ceausescu.

From its outset, the one-child policy has been criticized for violating the basic human right to reproduce and for the brutal manner in which it was implemented. Moreover, it has been called a form of "genocide against minorities," especially against the Uyghur peoples in the Eastern Turkistan regions, who are politically unpopular because they seek an independent homeland.

More pragmatic criticisms of the policy revolve around its unintended negative consequences. One of the consequences was well expressed by Richard Jackson, a demographer at the Center for Strategic and International Studies in Washington, D.C. Jackson explained, "You have the prospect of 400 million Chinese elders, age 60 and over, by 2040, 80 percent of whom, do not have any formal retirement pension, either public or private, most of whom won't have access to government-financed health care. They're depending on the extended family, but the government told them not to have children, or not to have more than one—or, in some cases, two."

In short, each "only child" might become solely responsible for two aging parents and as many as four grandparents; known as the "4-2-1" problem, it is a responsibility that many or most of the "one-child" generation may be unable to meet.

The most publicized negative consequence, however, is the severe skewing of the population toward males. The Chinese are known for having a high preference for sons. This preference has resulted in a high rate of female infanticide (and, later, sex-selective abortions) to remove first-born daughters and, so, to clear the legal path to have a son. According to China's official news agency, 119 boys are now born for every 100 girls; the ratio in natural circumstances is 103 to 107 boys for every 100 girls. By 2020 China may contain 30 to 40 million restless bachelors—known in China as "bare branches"—and worried observers predict everything from a steep increase in rape to wars aimed at securing brides.

In recognition of the problem, China adopted a significant change to the one-child policy in the mid-1980s. In the rural areas, where survival often requires hard labor and males are thus especially valued, China allowed a second child if the first born was either female or disabled. This evolved into what some now claim is a de facto two-child policy for the countryside. Nevertheless, the sex skewing seems to continue relatively unabated.

When government begins to dictate choices, it prevents individuals from adapting and evolving solutions. Society loses the resilience it requires to solve problems.

The gender imbalance in China is what the social theorist F. A. Hayek called an "unintended consequence." Every act has unforeseen and unintended results that may determine its impact far more than the act's intended goal.

Hayek saw at least two practical problems with social engineering, both of which involve such unintended consequences. The first problem speaks to the nature of a healthy society. If left to the ingenuity and preferences of individual members, society tends over time to naturally evolve answers to the problems confronting it. For example, if there is a shortage of food, families tend to limit themselves to a supportable number. But when government begins to dictate choices, it prevents individuals from adapting and evolving solutions. Society loses the resilience it requires to solve problems.

The second practical difficulty with social engineering was "the knowledge problem." In accepting the 1974 Nobel Prize for economics, Hayek explained, "The recognition of the insuperable limits to his [the bureaucrat's] knowledge ought [to guard] the student of society . . . against becoming an accomplice in men's fatal striving to control society—a striving, which makes him not only a tyrant over his fellows, but which may well make him the destroyer of a civilization which no brain has designed but which has grown from the free efforts of millions of individuals."

A centralized bureaucracy cannot control the outcomes of choices made by hundreds of millions of people, nor can it know all the results of its policies. All a bureaucracy can do is impose policies. The more important the area of life being controlled is—such as reproduction—the more draconian the imposition must be to render even minimal compliance. The longer social control is imposed and the more policies are introduced, the greater the number of unintended consequences, such as the skewing of the gender ratio.

As noted, the proposed remedy for sex skewing in China is the introduction of yet another social-engineering policy, exemplified by the Care For Girls (CFG) program. The administration of CFG in East China's Anhui province is probably typical. There, CFG was initiated in 2000 and includes lecturing the populace against sex bias, offering loans to families with daughters, training women to become wage earners, and checking girls for signs of abuse. The unintended consequences of the relatively new CFG program are not yet apparent. The ultimate folly, however, is that the stated goal may require nothing more than leaving the situation alone. Simply by becoming scarce, girls have become more highly valued and, with a new appreciation of their importance to society, the role of women in China seems poised for redefinition. The Chinese government could best help by simply getting out of the way.

The Chinese government continues to insist that it must control reproduction because the nation's resources, especially its food and water, cannot sustain a large increase in the population.

This is not likely to happen. The Chinese government continues to insist that it must control reproduction because the nation's resources, especially its food and water, cannot sustain a large increase in the population.

Although the claim is not self-evidently true, it is rarely questioned because it conforms to the widely held and politically popular belief that the planet is overpopulated. Over the past decade polls have indicated that most Americans blame overpopulation for contributing to or causing an impressive range of social ills from pollution to illiteracy, from poverty to famine.

Overpopulation theory is often dated back to Thomas Malthus and his work *An Essay on the Principle of Population* (1798) in which he argued that resources grow linearly while population grows exponentially. Unless human reproduction was controlled, he believed, the population would be too large for the earth's resources to support. Ironically, Malthus predicted that a tipping point and famine would occur in the mid-nineteenth century; this prediction came on the cusp of the world's experiencing a vast expansion in the food supply due to the Industrial Revolution and advances in agriculture.

Since Malthus, many overpopulation zealots have made equally false predictions about the exhaustion of the planet. For example, Paul R. Ehrlich, author of *The Population Bomb* (1968), wrote, "The population of the U.S. will shrink from 250 million to about 22.5 million before 1999 because of famine and global warming."

Current fears of overpopulation may be equally groundless. One of the difficulties in judging the matter, however, is that no one seems to have a good definition of what is the "proper" population; that is, how many people can the earth support without calamities like mass starvation?

Even a good guess at an answer would require information that is difficult or impossible to secure. For example, it would be necessary to calculate what percentage of massive human tragedies, such as famine, are due to entirely artificial and imposed factors like war. The current shortage of rice in Asia, for example, is not due to natural factors but to a constellation of artificial ones such as the diversion of food crops like corn into the production of ethanol. This diversion has driven up the global price of the crops that serve as alternatives, such as rice. Whatever percentage of hunger is due to artificial factors should not be blamed on limitations of the earth.

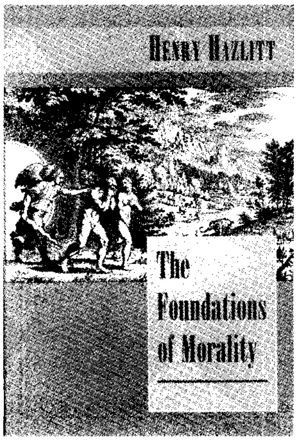
Moreover, recent developments in agriculture, like the previous Green Revolution in the twentieth century, may dramatically increase food resources. For example, recently developed biotech crops both increase productivity and reduce the need for insecticides.

Thus the one-child policy has not only been disastrous both in terms of human rights and practical consequences for generations to come; it is far from clear that its rationale is even valid.

In 1999, analyst Stephen Moore, formerly of the Cato Institute, wrote in "Defusing the Population Bomb": "[W]e are nowhere near running out of room on the planet. If every one of the 6 billion of us resided in Texas, there would be room enough for every family of four to have a house and an 1/8th of acre of land—and the rest of the globe would be vacant. . . . The dreaded population bomb that emerged as a worldwide obsession in the 1960s and 1970s has been all but defused. The birthrate in developing countries has plummeted from just more than six children per couple in 1950 to just more than 3 per couple today. The major explanation for smaller family sizes, even in China, has been economic growth, not condom distributions or coercive birth control measures."

Moore commented on China specifically in another article, "Don't Fund UNFPA Population Control" (2000), "To this day no one knows precisely how many babies and women have died at the hands of the population control fanatics in China. What we do know is that this program will go down in history as one of the greatest abuses of human rights in the 20th century."

Moore concluded, "[T]he cause of world hunger and environmental disasters in the world today is not too many people. It is too much statism."



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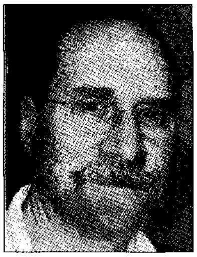
Bailout Hypocrisy



BY SHELDON RICHMAN

Thud. That was the sound of the other shoe dropping.

In response to severe problems in the credit markets, thanks to years of government intervention, the Federal Reserve—the government's counterfeiter and chief culprit in the current crisis—has opened its discount window to the investment banks. Interest rate: 2.5 percent. Until recently, only commercial banks could borrow money from the Fed. But now investment banks may also—and here's the kicker: They can put up shaky mortgage-backed securities as collateral. That means the American people are potentially on the hook for those loans. Should they go bad, we will pay either in inflation-induced higher prices or in higher taxes.

Investment banks that may have invested in bad mortgages are already taking advantage of the new opportunity. Is this a great country or what?

The *Wall Street Journal* says the banks' willingness to borrow comes as a relief to government officials "who had worried that the stigma of borrowing from the Fed could keep firms away."

Yes, that would have been a shame. Thank goodness the stigma of high-rolling Wall Street firms' going on the dole has disappeared.

The opening of the loan window was the first shoe. The other shoe is the demand for new regulations on the investment-banking industry in return for the Fed's help. Democrats Representative Barney Frank and Senator Charles Schumer say that if the investment banks are going to have the same access as commercial banks to the Fed's discount window, they should have to live by the same, or similar, rules as commercial banks. Those rules would govern things like reserve requirements but would likely go beyond that and include new oversight by regulators.

"If investment banks are able to borrow from the Federal Reserve's discount window, then they must be subject to greater regulatory scrutiny," Schumer wrote in the *Wall Street Journal.*

"A central bank acting as a lender needs to be able to evaluate the solvency and liquidity of a borrowing institution," said Eric Rosengren, president of the Federal Reserve Bank of Boston. "Knowing how likely it is that an institution's sources of funds will evaporate during times of financial stress requires a significant understanding of the institution's liabilities and its counterparty relationships."

Rescued once, why wouldn't a lending institution expect to be rescued again—especially if it saw itself as too big to fail?

What can the banks say to Frank, Schumer, and Rosengren? If one accepts the principle that the government agency ought to be ready to rescue these institutions, how can one also object to the quid pro quo of regulation? Granted the premise, the logic is sound.

It's the bailout premise that has to be challenged. The Fed should not have opened the window to the investment banks if for no other reason than that new regulation would inevitably follow. (Of course, there should *be* no Fed in the first place. But that's for another column.)

Widening the Fed's scope for rescue and regulation only asks for trouble. Government rescues breed irresponsibility. This is the moral-hazard principle. Rescued once, why wouldn't a lending institution expect to be rescued again—especially if it saw itself as too big to fail?

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Second, the quid-pro-quo regulations will make things worse. People prone to blame deregulation and even laissez faire (!) for the current economic mess point out that the evolution of complicated investment instruments occurs so quickly that people in the industry itself have trouble understanding them. Maybe so. Will the regulators understand them better? No way. Markets move too quickly for regulators to keep up with because the participants make spot decisions in part using tacit knowledge that is never articulated.

The only way for bureaucrats to even attempt to keep up would be to assert the authority to approve innovations before they are introduced. But that would be destructively inhibiting. Wealth creation would be stymied, and we'd all be poorer. Why should anyone believe that regulators know what they would need to know before they could pass judgment on new ideas?

This is not to deny that reckless—and even shady—activity can take place and hurt innocent bystanders. The point is that regulation makes such activity more, not less, likely. Adam Smith famously wrote in *The Wealth of Nations* that "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

He wasn't calling for regulation of economic affairs, because he immediately added, "It is impossible indeed to prevent such meetings, by any law which either could be executed, or would be consistent with liberty and justice."

Significantly, he continued, "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" (emphasis added).

What most critics of free markets overlook is that the corporatist state in fact *does* facilitate such assemblies. Regulation, which forces standards across an industry, reduces the vigor of the competitive process by removing the factors subject to regulation from contention. A regulatory regime to some extent cartelizes industries.

Yet anything that reduces competition is harmful to the public because competition is what disciplines market participants. To the extent the competitive process is blunted, businesses are licensed to engage in the activities Adam Smith had in mind.

Deregulation All The Way Down

Here's the response to those who blame financial deregulation for the current predicament: Deregulation has been only partial and therefore rigged. Remember the S&Ls? They were deregulated too—but not all the way. Restrictions were removed from the kind of investments they could make, *but* deposit insurance guaranteed that the taxpayers would cover the losses. That's not real deregulation; that's corporatist favor-granting by another name.

Today, establishment voices of "capitalism" (which is *not* to say the free market) have little credibility when they oppose new regulation of investment banking. That's because they are all too content with the current deeply rooted network of subsidies, bailout promises, and competition-suppressing interventions. If these are the only voices against new regulation, we will surely have it. This will mean a greater burden for smaller and yet-to-be-formed companies.

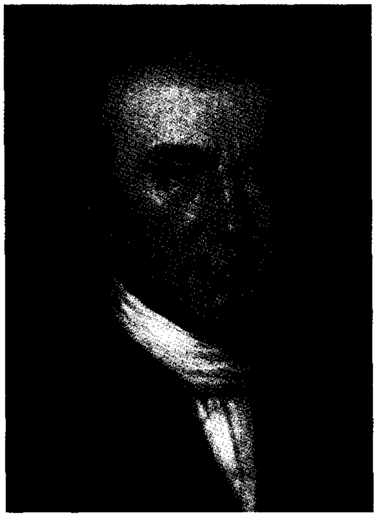
Finally, favoring government bailouts for connected Wall Street players but not for individual homeowners is a sure path to dismissal for callous hypocrisy. "Subsidizing these firms is an insult to Main Street. Many families are losing their homes as part of the mortgage crisis. If they had access to 2.5 percent financing that would not be happening," Thomas Palley of the Economics for Democratic & Open Societies Project writes. The only position that is internally consistent and consistent with justice is the no-bailout position. Banks and homeowners should work things out among themselves, aided if necessary by private philanthropic institutions.

Bailouts at the expense of unwilling third parties (taxpayers) are either proper or improper. (I say improper.) Those embracing the business-subsidy program should have the courtesy *not* to call themselves advocates of the "free market." (Listening, Mr. Kudlow?) Some of us are trying to keep that label clean. They already have "capitalism." Aren't they happy with it?

The Political Economy of John Taylor of Caroline

BY JOSEPH R. STROMBERG

As noted in the May *Freeman,* American revolutionaries mixed classical-republican and liberal political languages somewhat indiscriminately. Republicanism posited a relation between power and property in which independent proprietors were the bulwark of liberty. English critics of post-1688 Whig mercantilism deployed republican ideas, leading many historians to paint them as "agrarians" resisting capitalism, modernization, and social change. ("Social change" routinely looms large when historians wish to discount human agency.)



John Taylor of Caroline, 1753–1824

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John Taylor's writings show how an anti-mercantilist critique could be a *liberal* critique, despite detailed agreement with more strictly republican analyses. His *Inquiry* (1814), for example, was a belated reply to John Adams's *Defence of the Constitution of Government of the United States* (1787–88), in which Taylor explicitly rejected Adams's archaic-republican "social balance" between legally entrenched social orders. For Taylor, even such republican terms as "corruption" and "virtue" had different meanings in the American context.

Each of three historical ages, Taylor writes, had its own artificial aristocracy. The newest was a financial oligarchy—England's modern reality. American Federalists wanted it here. Oddly, he notes, colonial Americans had spotted abusive taxation more quickly than independent Americans did. Having managed to "explode . . . the antiquated social compact dogma," they succumbed to "modern law charter dogma" protecting state-created property as eternally inviolable.

Taylor treats "those possessions as property, which are fairly gained by talents and industry, or are capable of subsisting, without taking property from others by law." Absent church establishments and feudal dues, taxation was "the only engine for distributing and balancing property" and dividing society into "payers and receivers." National debt, too, was a key engine of oppression, reflecting the wish "to *anticipate* the riches of posterity and bequeath it [our] misfortunes."

Championing "labour" and "agriculture" against "paper feudalism," Taylor's class-conflict analysis highlighted the role of the state. In a world where numerous interests battened on the state, that analysis was an important tool. Taylor's political sociology shares much with the French Restoration liberalism of J.-B. Say, Destutt de Tracy, Charles Comte, Charles Dunoyer, and Augustin Thierry.

Like Jefferson, Taylor was conversant, not just with English economists, but also with Say and Tracy. But Taylor has flashes of complete originality. After all, none (or few) of the French or English writers had looked hard at the rising American system, which they wrongly fancied was repudiating European mercantilism. Taylor was breaking new ground.

In *Tyranny Unmasked* (1822), written mainly against protective tariffs, Taylor carried forward his political

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class analysis with great sociological penetration. Taylor writes that no "property-transferring policy . . . can enrich" workers or merchants in general. A few of the latter gain by "becoming bankers, lenders to government, or factory owners." Particular "mechanicks or agriculturists" might also profit: "A few individuals are enriched by every species of tyranny."

Expanding, in *Inquiry*, on the contrast between true and false (state-created) property, Taylor observes: "Despotick power strives to blend itself with a legitimate government, as paper stock does with private property." False property wrapped itself in the protective mantle of justly acquired property, and we must understand Federalist grumbling about "leveling" political tendencies in that light. Beneficiaries of mercantilist (re)distribution did not want their gains called into question. Finally, Taylor observes that in England, the financial aristocracy profits more from war than feudal aristocrats ever did, by gaining new fields for investment and by funding "the war which made the conquest." Increased taxes to pay the interest were a further boon to this class.

Banking and "Paper Feudalism"

State-connected banking—the Bank of England and the Bank of the United States—was a primary target of Taylor's political polemics. Here, a false analogy with everyday commercial borrowing confused matters. In Taylor's view, paper stock and public debt are not necessary to commerce, even if, coincidentally, "they exist together in England." That paper and debt were "the bane" of commerce could be "inferred from the necessity of England to resort to war and conquest to cultivate her commerce." Paper bills were "signs or representations" of real things and *a tax* on monetary circulation. Taylor is happy that the American Revolution "succeeded" *without* establishing permanent public debt in lieu of paper currency. Revolutionary currency lost value, to be sure, but it did not linger on as an excuse for future taxation. It disappeared, having done only limited harm.

Banking, as practiced, was generally bad. The advantage of coin is the difficulty of multiplying it. Noting that under hard money, any supply of money is optimal, Taylor notices the banker's "privilege" of keeping fractional reserves. With interest counting as assets, and multiple lendings of the same capital, massive transfers of *real goods* went forward. Again Taylor calls bank profits a "tax" paid to privileged corporations. Taylor's conclusion? "The tyranny of fraud is not less oppressive than that of force."

Taylor compares patronage gained by banking with that obtained by conquest. Where patronage "is obtained by foreign conquest, as in the acquisition of India by England, the people still suffer by *the unconstitutional power it confers*," even though domestic patronage was directly "more calamitous."

Taylor has a good grasp of international flows of money and goods—paper, specie, and commodities—and spots an illusion later central to Keynesian economic policy: "[A]n advancement of the price of labour, pari passu, would produce neither gain nor loss." He observes that a paper-military-patronage aristocracy does without titles of nobility, but is no less dangerous for that. "Money and armies are the instruments of power," he adds.

Everyday Class Conflict

Taylor believed that great extremes of wealth invariably sprang from extra-economic coercion and deceit. Here, he resembles that self-taught radical, Thomas Paine. Taylor sounds vaguely "Marxist," while explaining why protectionism does not help English workingmen: "[I]t has established a monopoly which operates only in favour of their employers, increases the expenses of government, and feeds unproductive capital by sacrificing productive labour"—especially in agricultural and seafaring occupations, where the workers have "very little capital except their bodily labour." Here is Marx's labour-power category several decades early.

Taylor did not need to be a "proto-Marxist," however, because liberals already possessed (but did not always employ) a theory of plunder ("spoliation") featuring the state apparatus as the major cause of social conflict.

State Capitalism

State-promoted business enterprise was at the heart of everything Taylor opposed. Echoing James

Harrington (1656), he writes that "enormous political power invariably accumulates enormous wealth, and enormous wealth invariably accumulates enormous political power." Asserting the parasitic character of state-created capital, he denounced transfers of real wealth from the economically productive and the aggressive alliance of artificial capitalists, corrupt courtiers, and officials who profited on them.

Taxes raised to pay public debt drained resources away from productive uses, and public credit funded the standing army, an instrument of constitutional subversion and empire. America, Taylor complains, has followed England's road to ruin, under Federalists and Republicans alike.

These considerations shed light on Jefferson's frequent references to the need for "periodic revolutions." Given the ills attending state-subsidized capitalism, the people must have room to undo state creation of wealth and classes. The Yazoo scandal comes readily to mind. Georgia lawmakers handed out millions of acres of western land to those who bribed them. When a later legislature undid the act, Chief Justice Marshall declared the grants a sacred trust under the federal contract clause, in a textbook example of English "charter law."

Corporations

In Taylor's day governments still chartered corporations as privileged monopolies for specific purposes "clothed" with a public interest. Taylor saw "hierarchy" (the established church) and "corporation" as "innately despotic," since both were "appurtenances of sovereignty" and, therefore, "appurtenances of despotism," because sovereignty "is indefinite." Taylor's insight seems ideally suited for understanding the triumph of American state capitalism, once we see that general incorporation laws in the Jacksonian Era left state-like corporate privileges intact while widening the base of privilege. (See Frank van Dun, "The Modern Business Corporation versus the Free Market?" *Freeman*, March 2003, pp. 29–33, and "Personal Freedom versus Corporate Liberties," *Philosophical Notes*, No. 76, Libertarian Alliance [London], 2006, pp. 1–19.) The deep roots of American corporatism suggest Taylor's relevance across most of American history.

War Finance

Taylor writes that debt financing renders a war "twice suffered; by the living, who supply all the expenses of war; by the unborn, who supply an equivalent sum, to take up certificates of the expenses. . . ." Debt issues had actually hampered the American Revolution, since "war carried on by paper, is starved by peculation, and produces the utmost degree of publick expense, with the least degree of publick spirit." (Here Taylor anticipated several Austrian School economists.)

Taylor's views on war and its financing deepened his critique of the presidency and centralization. The point of Taylor's antimilitarism was to avoid the fate of "European nations," which "exist for the benefit of armies and navies. . . ." War was "the keenest carving knife for cutting up nations into delicious morsels for parties and their leaders." It "swells a few people to enormous size"; "puts arms into the hands of ambition, avarice, pride, and self-love"; and "breeds a race of men, nominally heroes, mistaken for patriots, and really tyrants." Finally, party discipline gave 26 percent of the legislature—effectively controlling 51 percent—"the power of declaring war." Alluding to dear old National Security, Taylor reminds us: "Conquests abroad are rare, and no compensation for conquest at home."

Britain: The Negative Role Model

Unless we uprooted subsidized capitalism, America would become England—with Whig oligarchy, class conflict, economic crises, taxes, standing army, constant war, and a confusion of state-created and privately earned property. Britain was our negative role model, whose chief evils—empire and domestic oppression—were intertwined. "Compulsion" guarded English commerce: England "is enriched, because labour is her slave; goaded by a paper system, and she makes competition shrink by a fleet." Britain's relative *internal* freedom was little comfort to its dependencies, as "nearly demonstrated in the relations between England and Ireland, and quite so in India."

Empire, Monarchy, Oligarchy

England brings us—and Taylor—to the *structural logic* of empire. The English state was "a confederation of parties of interest," excluding the people, and consisting of "the church of England, the paper stock party, the East India company, the military party, the pensioned and sinecure party, and the ins and outs, once called whigs and tories," held together by the monarchy. The English nation "has no government," and "no British nation" existed beyond these interest groups. Taylor notes that Samuel Johnson, "the best informed tory," favored "a brisk circulation of money." But "a brisk circulation of power is also produced," and Dr. Johnson "neglected to tell us . . . that money attracts power, and power, money."

Taylor's works abound with examples of his realistic grasp of social interrelations. He addresses two common arguments for consolidated power: "uniformity of religion" and "the difficulty of governing an extensive territory." Europe had given up the former, and America the latter (in terms of monarchy). Practical knowledge being widely dispersed in a large state, "moral geometry" limits the "knowledge and will" of a king. Hence, "beyond his orbit, monarchy ceases and some anomalous government ensues; oligarchical, military, deputy-royal, tumultuous, or infinitely variegated by circumstances" and "neither the virtues nor vices of a monarch are felt at a distance from his person."

"Monarchy only succeeds," Taylor says, in "armies, garrisons, savage tribes and private families." The wider the sphere, the more a king has *only* a "power of changing oligarchs." This brings Taylor back to patronage, dependent on "the very worst kind of oligarchs . . . irresponsible and unknown." Here indeed was a government—neither republic nor monarchy. Where a republic and a monarchy each had the "power of distributing wealth," the monarchy was less burdensome, "because it is less expensive to gratify the rapaciousness of one, than of many."

Were America governed as a monarchy, it could "only retain the advantage of extensive territory, by an oligarchy composed of deputy-kings, bashaws, satraps or mandarins." As a decentralized confederation of self-governing members, America might expand indefinitely, "forming a great nation, by a chain of republicks." Here, Taylor sketches out the *possibility* of republican expansion, as opposed to Madison's belief in expansion as *necessity*.

False republics, Taylor says, have "the heaviest taxes." The American party system and presidential patronage bring forth oligarchy—and presidential power, war—spreading patronage and power economically and geographically. Here, domestic and foreign concerns are joined.

Republican Nonintervention

Where national security intrudes, Taylor yields little to "realist" necessities. We Americans can resist the European system "more successfully than any other nation." America, "possessed of extensive territory, happily removed from real causes of collision with other nations . . . is peculiarly favoured by providence" for avoiding "the artifice of legal wars," to which small nations succumb.

The Balance of Power

Taylor denied that the laws of nations conferred sovereignty on any American government. In agreement with many liberal thinkers, he doubted the "balance of power" principle. That doctrine fostered war by assuming inherent hostility between nations, and was thus "the most complete invention imaginable for involving one combination of states, in a war with another." (Neither was Taylor impressed with the "balance of trade.")

Within the union, the balance-of-power idea fared no better. After the Missouri Compromise, geographical blocs defined by slavery loomed. Balance-of-power politics implied tinkering and brokering outside the Constitution; and a sustained antislavery campaign against the South *as a bloc*, he wrote, "would certainly destroy the union." Taylor foresaw "civil" war, with massive death and destruction. He makes the unkind aside that, "if our consciences tell us that we ought to enslave freemen, to make slaves free," reformers might perhaps crusade in Brazil, Cuba, or Africa, rather than at home.

Slavery and Colonization

Taylor, who himself owned slaves, describes slavery as "an evil which the United States must look in the face. To whine over it, is cowardly; to aggravate it, criminal; and to forbear to alleviate it, because it cannot be wholly cured, foolish." He hoped the slaves might "be gradually re-exported" through colonization—a point where he is no worse than his contemporaries and successors, including Abraham Lincoln. Taylor could be quite realistic about slavery. His frequent assertions that financial exploitation is worse than slavery cut both ways. In mitigation, he pleaded: "The profit extorted from the negro slave is moderated by the immediate interest of his master . . . the master's benevolence and . . . respect for his own reputation."

Although Taylor, like most of his contemporaries, believed whites were intellectually superior to blacks, he denied that this justified establishing privileged castes. Free use of "intelligence" improved church and state, and we should expect the same result with "labour." He asks, "Are slaves free, because their labour is made more productive . . . by the intelligence of their masters? Is the white population of the world justified in converting to its own use the labour of Africa, on account of superiority of intellect?" The answer assumed is "no."

Against Institutional Fixity

Taylor writes that "If a number of people should inclose themselves within a triangle, they would hear with great astonishment, that they had lost the power of changing the form of the inclosure; and that *the dead form* of the triangle governed living beings, instead of living beings who created that figure, governing it" (italics supplied).

Taylor is not abandoning law, institutions, or everyday morality. He does want to avoid being locked, *beforehand,* into eternally fixed political institutions, including the federal union. He was eager to discredit artificial intermediate institutions. As, in effect, a liberal methodological individualist, Taylor took the society he knew as given and spent little time on naturally existing intermediate institutions, which in his day remained intact.

Agrarianism and Economic Development

Literary historian M. E. Bradford sees Taylor as a defender of "closed, rural, religious, and corporate societies." Such republics were not *anti*-commercial, but neither did they need the state as economic broker, promoter, and subsidizer. Taylor has of course some agrarian themes, but unlike Jefferson, he never asked to be on the *literally isolated* "footing of China." Taylor's society was already agrarian, and he hoped his political liberalism (*called* "republicanism") would, in a decentralized federation, allow agrarian communities to flourish.

Some might suppose that Taylor's ideas would, in practice, have blocked American economic growth. Writing of the English Enclosures, French historian Paul Mantoux comments that if "the bulk of the rural population remained on the land, the triumph of the factory system might have come later, but it could not have been indefinitely postponed." This suggests that "modernization" under republican liberalism was feasible enough, and that such modernization might have been *slower,* more organic, and less chaotic than the state-dependent path actually taken. (The federal center long set a bad example of providing wars for the "primitive accumulation" of Indian lands, making it unlikely that a market economy without massive state assistance would ever enjoy long-lasting political popularity.)

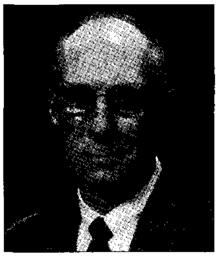
The Continuing Relevance of John Taylor

Taylor summed up his outlook as follows: "Our policy divides power, and unites the nation in one interest; Mr. Adams's divides a nation into several interests and unites power." For a brief period after his death, Taylor became a prophet for hard-money, free-trade advocates in the wider Jacksonian movement.

Taylor's work did not have the effect for which he hoped, but it has its merits as a critical benchmark by which to measure what has happened to the Old Republic. In Taylor's opinion, artificial aristocrats can only sustain their projects in the long run through some form of political despotism—consolidation, empire, or monarchy. These outcomes are all around us, and John T. Flynn could repeat all of Taylor's themes in the 1940s and early '50s. As historian J. G. A. Pocock writes, "America may have guaranteed the survival of the forms of corruption it was created to resist." We cannot say that John Taylor failed to warn us.

Our Economic Past

Construction Boom and Bust Between the World Wars



BY ROBERT HIGGS

Imagine a story about collapse of the real-estate markets that states: "Most of the millions piled up in paper profits had melted away, many of the millions sunk in developments had been sunk for good and all, the vast inverted pyramid of credit had toppled to earth, and the lesson of the economic falsity of a scheme of land values based upon grandiose plans, preposterous expectations, and hot air had been taught in a long agony of deflation."

A story written in 2008? No, an extract from Frederick Lewis Allen's 1931 book *Only Yesterday*. The real-estate boom and bust we are now experiencing had a spectacular predecessor during the 1920s and 1930s. History may not repeat itself exactly, but episodes composed of speculative mania, construction boom, financial misfeasance and malfeasance, and expansive monetary policy do recur from time to time.

Episodes composed of speculative mania, construction boom, financial misfeasance and malfeasance, and expansive monetary policy do recur from time to time.

When World War I ended, private construction activity, which had been substantially displaced in 1917 and 1918, resumed at a healthy pace. Even during the brief depression of 1920–21, construction did not decline greatly, and as the economy recovered, building activity grew smartly, approximately doubling between 1921 and 1925. During the second half of the 1920s, construction remained on a high plateau, though falling slightly after a peak in 1926, and gross private construction spending amounted to 62 percent of gross private domestic investment, on average.

Real-estate booms occurred in many parts of the country, affecting both residential and commercial construction. Skyscrapers sprang up in the downtown areas of many of the largest cities, and huge suburban developments appeared, catering to the rising middle class, whose members now possessed automobiles for commuting to work in the cities.

None of this activity could match the mania that propelled the development of properties in Florida. In the summer and autumn of 1925, wrote Allen, Miami "had become one frenzied real-estate exchange. There were said to be 2,000 real-estate offices and 25,000 agents marketing house-lots or acreage. . . . The warm air vibrated with the clatter of riveters, for the steel skeletons of skyscrapers were rising to give Miami a sky-line appropriate to its metropolitan destiny. . . . [T]he public utilities of the city were trying desperately to meet the suddenly multiplied demand for electricity and gas and telephone service."

People's wildest dreams were coming true. "Everybody was making money on land, prices were climbing to incredible heights, and those who came to scoff remained to speculate. . . . The whole strip of coast line from Palm Beach southward was being developed into an American Riviera. . . . The fever had spread to Tampa, Sarasota, St. Petersburg, and other cities and towns" on the state's west coast. Millions of dollars were being made almost overnight.

In 1926 the frenzy of the preceding two or three years began to cool noticeably. Then, in September, a hurricane focused its fury on the Miami area, killing about 400 people, injuring more than 6,000, and leaving 50,000 people homeless. At this point, the bloom was definitely off the Florida real-estate rose.

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By 1927 Florida presented a desolate scene. Henry S. Villard described his approach to Miami by road: "Dead subdivisions line the highway, their pompous names half-obliterated on crumbling stucco gates. Lonely white-way lights stand guard over miles of cement sidewalks, where grass and palmetto take the place of homes that were to be. . . . Whole sections of outlying subdivisions are composed of unoccupied houses, past which one speeds on broad thoroughfares as if traversing a city in the grip of death."

Elsewhere the ascent was not so breathtaking, nor the descent so devastating. Yet many parts of the country experienced a similar boom and bust. By 1929, for the country as a whole, real spending for gross private new construction was already down 17 percent from its peak in 1926, but the bulk of the collapse was still to come—by 1933, real construction spending had fallen 84 percent from the peak.

Alexander Field notes that "[r]esidential construction alone exceeded 8 percent of the GNP in each of the four years from 1924 to 1927, and the subsequent downturn was severe. Real spending on new private nonfarm housing fell 89 percent from its peak in 1926 to the trough in 1933."

Great Miami Hurricane of 1926
National Weather Service

Spending for private nonfarm commercial and industrial construction took a similar beating, falling in real value by 79 percent from its peak in 1929 to its trough in 1933. Allen wrote that "by the time the splendid shining tower of the Empire State Building stood clear of scaffolding [in 1931] there were apple salesmen shivering on the curbstone below. . . . [A]nd financiers were shaking their heads over the precarious condition of many realty investments in New York." Financiers in Chicago, San Francisco, and many other large cities across the country took a similar beating.

The construction boom of the 1920s consumed a great sum of loanable funds. Development corporations issued real-estate bonds secured by new structures they were building—forerunners of the recently issued, and now infamous, mortgage-backed securities at the heart of the current troubles in financial markets. Nonfarm residential mortgage debt increased from $9.4 billion in 1920, to $18.4 billion in 1925, and $30.2 billion in 1930. Such vast increases in lending could take place only if a permissive monetary policy created accommodative conditions.

The Federal Reserve banks created such conditions, in part because their managers hoped that a "regime of cheap money," as British economist Lionel Robbins described it, would ease the way for Great Britain to resume convertibility of the pound sterling in 1925 at its pre-war value relative to the dollar. This U.S. policy caused the money supply to grow faster than it otherwise would have grown, especially during the middle years of the 1920s, kept interest rates lower than they otherwise would have been, and thereby encouraged domestic investors to make more investments in structures and other long-lived, "higher-order" goods than they otherwise would have made.

Thus U.S. monetary policies had the effect of bringing about "malinvestments" in the United States and thereby distorting the structure of the capital stock in an unsustainable fashion because investments in structures and other long-lived capital goods will prove economically unwarranted when they are made in response to artificially low interest rates. Such projects ultimately will go bankrupt—as a great many did during the late 1920s and early 1930s, most visibly in the aftermath of the Florida boom.

Construction did not recover much in the 1930s. Despite some recovery in the latter half of the decade, the average real value of private construction during those years was less than 40 percent as great as it had been in the latter half of the 1920s, and investment in structures accounted for a substantially smaller fraction of total private investment, as investors, fearful for the security of their property rights under the New Deal, held back from making large long-term commitments. Only in the late 1940s, after the war had ended, were comparable amounts finally spent again for private construction.

The Subsidy of History

BY KEVIN CARSON

A considerable number of libertarian commentators have remarked on the sheer scale of subsidies and protections to big business, on their structural importance to the existing form of corporate capitalism, and on the close intermeshing of corporate and state interests in the present state capitalist economy. We pay less attention, however, to the role of *past* state coercion, in previous centuries, in laying the structural foundations of the present system. The extent to which present-day concentrations of wealth and corporate power are the legacy of past injustice, I call the subsidy of history.

The extent to which present-day concentrations of wealth and corporate power are the legacy of past injustice, I call the subsidy of history.

The first and probably the most important subsidy of history is land theft, by which peasant majorities were deprived of their just property rights and turned into tenants forced to pay rent based on the artificial "property" titles of state-privileged elites.

Of course, all such artificial titles not founded on appropriation by individual labor are completely illegitimate.

As Ludwig von Mises pointed out in *Socialism*, the normal functioning of the market never results in a state of affairs in which most of the land of a country is "owned" by a tiny class of absentee landlords and the peasant majority pay rent for the land they work. Wherever it is found, it is the result of past coercion and robbery.

Murray Rothbard, in *The Ethics of Liberty*, explained the injustice of feudal landlordism:

> But suppose that centuries ago, Smith was tilling the soil and therefore legitimately owning the land; and then that Jones came along and settled down near Smith, claiming by use of coercion the title to Smith's land, and extracting payment or "rent" from Smith for the privilege of continuing to till the soil. Suppose that now, centuries later, Smith's descendants (or, for that matter, other unrelated families) are now tilling the soil, while Jones's descendants, or those who purchased their claims, still continue to exact tribute from the modern tillers. Where is the true property right in such a case? It should be clear that here . . . we have a case of continuing aggression against the true owners—the true possessors—of the land, the tillers, or peasants, by the illegitimate owner, the man whose original and continuing claim to the land and its fruits has come from coercion and violence. Just as the original Jones was a continuing aggressor against the original Smith, so the modern peasants are being aggressed against by the modern holder of the Jones-derived land title. In this case of what we might call "feudalism" or "land monopoly," the feudal or monopolist landlords have no legitimate claim to the property. The current "tenants," or peasants, should be the absolute owners of their property, and, as in the case of slavery, the land titles should be transferred to the peasants, without compensation to the monopoly landlords.

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So rather than defending all existing land titles in the name of the "sanctity of property" and protesting when some left-wing government institutes a land reform that transfers feudal land titles to the peasantry, Rothbard favored 1) dividing up Southern plantations and giving freed American slaves "forty acres and a mule," and 2) transferring the *latifundia* from Latin American landed oligarchies to the peasants.

In the Old World, especially Britain (where the Industrial Revolution began), the expropriation of the peasant majority by a politically dominant landed oligarchy took place over several centuries in the late medieval and early modern period. It began with the enclosure of the open fields in the late Middle Ages. Under the Tudors, Church fiefdoms (especially monastic lands) were expropriated by the state and distributed among the landed aristocracy. The new "owners" evicted or rack-rented the peasants.

In the Old World, the expropriation of the peasant majority by a politically dominant landed oligarchy took place over several centuries.

Expropriating from the Peasantry

The Restoration Parliament of the seventeenth century carried out a series of land "reforms" that abolished feudal land tenure altogether—but only upward. There were two ways Parliament could have abolished feudalism and reformed property. It might have treated the customary possessive rights of the peasantry as genuine title to property in the modern sense, and then abolished their rents. But what it actually did, instead, was to treat the artificial "property rights" of the landed aristocracy, in feudal legal theory, as real property rights in the modern sense; the landed classes were given full legal title, and the peasants were transformed into tenants at will with no customary restriction on the rents that could be charged. The most important component of this "reform" was the Statute of Frauds of 1677, which nullified rights of copyhold by making them unenforceable in royal courts.

Finally, the Parliamentary Enclosures of the eighteenth and early nineteenth century robbed the peasantry of their rights of common. The propertied classes of England saw the economic independence provided by the commons as a threat, first to an adequate supply of agricultural wage labor on the landed oligarchy's own land, and later to an adequate supply of factory labor willing to work the long hours and low pay demanded by the owners. The literature of the propertied classes of the time was quite explicit on their motivation: the laboring classes would not work hard enough or cheaply enough so long as they had independent access to the means of subsistence. They had to be made as poor and hungry as possible so that they would be willing to accept work on whatever terms it was offered.

A version of the same phenomenon took place in the Third World. In European colonies where a large native peasantry already lived, states sometimes granted quasi-feudal titles to landed elites to collect rent from those already living on and cultivating the land; a good example is *latifundismo*, which prevails in Latin America to the present day. Another example is British East Africa. The most fertile 20 percent of Kenya was stolen by the colonial authorities, and the native peasantry evicted, so the land could be used for cash-crop farming by white settlers (using the labor of the evicted peasantry, of course, to work their own former land). As for those who remained on their own land, they were "encouraged" to enter the wage-labor market by a stiff poll tax that had to be paid in cash. Multiply these examples by a hundred and you get a bare hint of the sheer scale of robbery over the past 500 years.

Contrary to Mises's rosy version of the Industrial Revolution in *Human Action*, factory owners were not innocent in all of this. Mises claimed that the capital investments on which the factory system was built came largely from hard-working and thrifty workmen who saved their own earnings as investment capital. In fact, however, they were junior partners of the landed elites, with much of their investment capital coming either from the Whig landed oligarchy or from the overseas fruits of mercantilism, slavery, and colonialism.

In addition, factory employers depended on harsh authoritarian measures by the government to keep labor under control and reduce its bargaining power. In England the Laws of Settlement acted as a sort of internal passport system, preventing workers from traveling outside the parish of their birth without government permission. Thus workers were prevented from "voting with their feet" in search of better-paying jobs. You might think this would have worked to the disadvantage of employers in underpopulated areas, like Manchester and other areas of the industrial north. But never fear: the state came to the employers' rescue. Because workers were forbidden to migrate on their own in search of better pay, employers were freed from the necessity of offering high enough wages to attract free agents; instead, they were able to "hire" workers auctioned off by the parish Poor Law authorities on terms set by collusion between the authorities and employers.

Legalized Discrimination Against Laborers

The Combination Laws, which prevented workers from freely associating to bargain with employers, were enforced entirely by administrative law without any protections of common-law due process. And they were only enforced against combination by workers, not against combination by employers (such as blacklisting "troublemakers" and collusive setting of wages). The Riot Act (1714) and other police-state legislation during the Napoleonic Wars were used to stem the threat of domestic revolution, essentially turning the English working class into an occupied enemy population. Such legislation criminalized most forms of association.

Even fraternal associations for mutual aid, burial and sick benefits, and the like operated in the face of hostility from the state, according to historians of the friendly-society movement such as Bob James and Peter Gray. Under the terms of the Combination Act, friendly societies were subjected to close judicial supervision lest direct craft production be organized for barter among the unemployed, or the societies' benefits cross the line and function as de facto unemployment insurance for striking workers. The Corresponding Societies Act, passed around the same time, prohibited all societies that administered secret oaths or were federated on a national scale.

So the Industrial Revolution was, in fact, built on a system of legal peonage in which employers were directly implicated. The form taken by the factory system surely reflects this history. In a Britain composed of peasant smallholders, with no restraints on free association, workers would have been free to mobilize their own properties as capital through mutual credit institutions. Absentee ownership and hierarchy would likely have been far, far less prevalent, and the factory system where it existed far less oppressive and authoritarian.

In a Britain composed of peasant smallholders, with no restraints on free association, workers would have been free to mobilize their own properties as capital through mutual credit institutions.

A similar process occurred in the colonization of settler societies like America and Australia, by which the colonial powers and their landed elites attempted to replicate feudal patterns of property ownership. In such colonies, the state preempted ownership of vacant land and restricted working people's access to it. Sometimes they gave title to vacant land to privileged land speculators, who were able to charge rent to those who homesteaded it (the legitimate owners).

E. G. Wakefield, an early nineteenth-century British theorist of colonialism, advocated just such preemption on the same grounds that the propertied and employing classes of Britain had supported Enclosure: it was easier to hire labor on favorable terms to the employer. In *England and America*, he wrote:

> In colonies, labourers for hire are scarce. The scarcity of labourers for hire is the universal complaint of colonies. It is the one cause, both of the high wages which put the colonial labourer at his ease, and of the exorbitant wages which sometimes harass the capitalist. . . .

> Where land is cheap and all men are free, where every one who so pleases can obtain a piece of land for himself, not only is labour very dear, as respects the labourers' share of the product, but the difficulty is to obtain combined labour at any price.

Consequently, "[f]ew, even of those whose lives are unusually long, can accumulate great masses of wealth."

Wakefield's disciple, Thomas Merivale, wrote of the "urgent desire for cheaper and more subservient labourers—for a class to whom the capitalist might dictate terms, instead of being dictated to by them."

Land preemption was a major element of colonial policy in early American history. Gary Nash, in *Class and Society in Early America*, described land grants in colonial America comparable to those of William I in England after the Conquest. In New York, for example, the largest estates granted by the British colonial administration (after the New Netherlands was acquired in the Dutch Wars) ranged from the hundreds of thousands to over a million acres. Governors continued to grant tracts of land in the hundreds of thousands of acres to their favorites, well into the eighteenth century. Under Governor Fletcher, some three-quarters of available land was granted to 30 persons.

> Once the system was up and running, it depended on the state's ongoing efforts to maintain a legal structure of privilege.

Albert Jay Nock, in *Our Enemy, the State*, argued that "from the time of the first colonial settlement to the present day, America has been regarded as a practically limitless field for speculation in rental values." Many leading figures in the late colonial and early republican period were prominent investors in the great land companies, including George Washington in the Ohio, Mississippi, and Potomac Companies; Patrick Henry in the Yazoo Company; Benjamin Franklin in the Vandalia Company, and so forth.

In *The Ethics of Liberty* Rothbard condemned such preemption ("land-engrossing, where arbitrary claims to virgin land are used to keep first-transformers out of that land") on the same grounds that he criticized feudal landlordism. He called for voiding all current titles to vacant and unimproved land, and opening it up to free homesteading. In addition, in cases where current mortgage holders and landlords trace their title to state grants of land, the proper claim lies with those who first homesteaded the land, or their heirs and assigns.

The Homestead Act of 1862, an apparent exception to this general trend, was really just another illustration of it. The majority of land, rather than being claimed under the terms of the Homestead Act, was auctioned to the highest bidder. Even for land covered by the Act, according to Howard Zinn, the $200 fee was beyond the reach of many. As a result, much of the land was not homesteaded on Lockean principles at all, but initially went to speculators before being partitioned and resold to homesteaders. And compared to the 50 million acres covered by homestead legislation, 100 million acres were given away as railroad land grants during the Civil War—free of charge! In other words, the privileged classes got the gravy, and ordinary homesteaders got the bone.

Keeping the System Going

What I have described here are only the *initial* acts of coercion and robbery on which our existing form of industrial capitalism was *founded*. Of course it didn't stop there. Once the system was up and running, it depended on the state's ongoing efforts to maintain a legal structure of privilege, based on artificial property rights and artificial scarcity: enforcement of absentee titles to vacant and unimproved land; entry barriers for the banking industry to make credit artificially expensive and scarce; the artificial property rights of patent and copyright; and more. And starting in the late nineteenth century the modern form of corporate capitalism depended on even more massive state intervention: subsidies to long-distance shipping to make market areas and firm size artificially large; the cartelizing effects of patents and tariffs; regulatory cartelization; and entire industries and sectors of the economy either brought into existence or guaranteed a taxpayer-funded market by the post-1941 perpetual war economy.

Contrary to popular mythology, the New Deal was not a departure from some preexisting idyllic state of "laissez faire." There never was anything remotely approaching laissez faire. Capitalism—that is, the existing historical system as it actually developed—has had very little to do with free markets and a great deal to do with robbery and coercion.

This is not to say that all avenues to economic advancement through independent entrepreneurship have been closed off. But it's much more of an uphill struggle than it would be in a free market, and the field is unfairly tilted in favor of the big players.

In seeking to institute a genuine free market, libertarians shouldn't lose sight of these facts. What lessons are libertarians to learn from the previous historical account?

First, there is nothing "libertarian" about the instinctive tendency to rally to the defense of existing property titles without regard to justice. As Karl Hess said in *The Libertarian Forum*, back in 1969,

> [L]ibertarianism wants to advance principles of property but . . . it in no way wishes to defend . . . all property which now is called private.
>
> Much of that property is stolen. Much is of dubious title. All of it is deeply intertwined with an immoral, coercive state system which has condoned, built on, and profited from slavery; has expanded through and exploited a brutal and aggressive imperial and colonial foreign policy, and continues to hold the people in a roughly serf-master relationship to political-economic power concentrations.

Second, in advocating free-market reform, we must consider the role of this historical legacy of injustice (the subsidy of history) in determining the winners under the present system. A "free-market reform" that simply locks in the beneficiaries of past robbery and privilege, and ratifies the past theft from which they benefit, will merely reward injustice and secure its ill-gotten gains.

From a libertarian ethical standpoint, the standard model of "privatization" (selling off state property to a large, politically connected private corporation, on terms most advantageous to the corporation) is therefore highly dubious. That's especially true considering that much of the property was created in the first place—at taxpayer expense—for the primary purpose of subsidizing the operating costs of big business. Much of the state-owned utility and transportation infrastructure in the Third World was created, at the behest of transnational financial elites, as a precondition for profitable Western capital investment. And the odious debt thus incurred, often by corrupt dictatorships acting in collusion with global finance, is then used by the World Bank to blackmail those countries into selling off their infrastructure to the very same transnational corporations it was created to benefit—usually at pennies on the dollar.

Rothbard's model of privatization is far superior: to void state titles to property and treat it as unowned, subject to immediate homesteading by those actually mixing their labor with it.

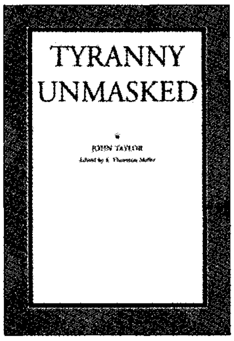
An Appropriate Model for Privatization

Rothbard's model of privatization is far superior: to void state titles to property and treat it as unowned, subject to immediate homesteading by those actually mixing their labor with it. That would mean that state universities would be transformed into the property of their students or faculty, as consumer or producer cooperatives. Government-owned utilities would become consumer cooperatives owned by ratepayers, and state-owned factories would be handed over to the work force and reorganized as worker cooperatives.

We must also be wary of pseudo-Coasean arguments that it "doesn't matter" who the property was originally stolen from, because it will end up in the hands of the "most efficient" owner. That's essentially the same argument used for eminent domain. Regardless of whose hands the property winds up in, the rightful owners and their descendants—who never received compensation—are out the value of what was stolen from them. And even the most inefficient ways of organizing production are pretty "efficient," comparatively speaking, when you have the competitive advantage of working with stolen property.

Besides, there is no such thing as generic "efficiency"; efficiency depends on the owner's purpose. The most efficient technique for subsistence farming on a small plot—economizing on land by building soil and adding intensive labor inputs—is entirely different from that for a feudal oligarch producing cash crops with access to more stolen land than he could possibly use, and often holding a majority of his stolen land out of use altogether. In any case, the rightful owner would no doubt find it far more "efficient" to be feeding himself on his own land, than starving in a shantytown because he can't afford to buy even the cheapest food from those "efficient" plantations occupying his stolen land.

The actual system of political economy that so many corporate apologists refer to as "our free market system" has in fact been characterized from the beginning by robbery. We must beware of "free market reforms" carried out by the robbers. They amount in practice to allowing the robbers—hands still full of loot—to say: "All right, no more stealing, starting . . . *now*!"



Tyranny Unmasked

By John Taylor of Caroline

Edited by F. Thornton Miller

In keeping with his lifelong mission as a "minority man," John Taylor wrote ***Tyranny Unmasked*** not only to assault the protective tariff and the mercantilist policies of the times but also "to examine general principles in relation to commerce, political economy, and a free government." Originally published in 1822, this edition was published in 1993 by Liberty Fund.

As an early discussion of the principles of governmental power and their relationship to political economy and liberty, ***Tyranny Unmasked*** is an important primary source in the study of American history and political thought.

As F. Thornton Miller wrote in his foreword to this edition, "[W]ith the continued increase of the power of the federal government and the pursuit of policies that benefit specific constituencies, the principles set out in *Tyranny Unmasked* are as relevant today as they were in 1822. Taylor admonished us to watch government, to inform the people when it encroached upon liberty and rights, and, like him, to be ready to unmask the tyrant for the public to see."

314 pages (includes foreword, selected bibliography, preface to the first edition, index)
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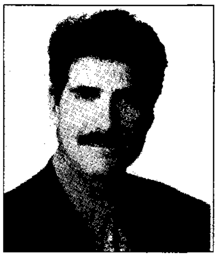
Bullies

BY JOHN STOSSEL



"We cannot use force."

That was my response when a lawyer shouted at me, "You media types are bullies, too!"

We were arguing about my April 4 *Wall Street Journal* op-ed that called class-action and securities lawyers bullies and parasites who enrich themselves through extortion. It's legal extortion, but extortion nonetheless.

These aggressive lawyers and their Naderite defenders don't get it. Or they pretend they don't.

There are only two ways to do things in life: voluntarily or forced. We reporters may be obnoxious, intrusive, stupid, rude, etc., but we cannot force anyone to do anything. All our work is in the voluntary sector.

But litigation is force. When a plaintiff sues, a defendant is forced to mount a defense. If he settles or loses, he's forced to pay. Government is the enforcer.

Sometimes we need force—including the force behind the litigators—to protect our freedoms, just as we may need missiles. But we try not to use our missiles because we understand that they do tremendous collateral damage. But litigation does collateral damage, too. The millions spent on legal defense can't be used to make life-enhancing—and life-saving—products.

There are only two ways to do things in life: voluntarily or forced. We reporters may be obnoxious, intrusive, stupid, rude, etc., but we cannot force anyone to do anything. All our work is in the voluntary sector.

We ought to avoid using lawyers the way we avoid firing missiles.

But we don't. State attorneys general even hire them to pursue unpopular businesses, like gun makers. When the lawyers make a killing in the name of "protecting the people," they give a piece of that money to the attorney general's political campaign. Somehow that is not considered a scandal.

The businesses that pay may have done nothing wrong. Once an attorney has rounded up lots of complainants, it's not hard to terrorize companies into settling. They could fight and maybe win, but that distracts managers from what they ought to be doing. And they might get a bad jury and lose the entire company. It's safer to settle.

Our legal system invites lawyers to act like bullies. Only in America can I sue you for dubious reasons, force you to spend thousands of dollars on lawyers (not to mention the psychic costs—the anxiety and lost sleep that lawsuits create), and when a judge rules that my claim is bunk, I don't even have to say "sorry." I can blithely move on to sue someone else. In other countries, I would have to pay your legal fees to at least compensate you for some of the financial damage I caused. "Loser pays," it's called.

The trial lawyers have even gamed the language. They call "loser pays" the "English Rule," as if it's some weird British law. But it's not. It's really the Rest of the World Rule. America is the odd man out because we rarely punish litigators who misuse force.

Litigators fight for a living, day after day. Practice makes perfect. They get good at winning. Because of their clout, "loser pays" never gets though the legislature.

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. Copyright 2007 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

So the lawyers go on bullying. After a recent "20/20" piece on lawyer bullies, viewers sent comments like this one:

"After a real estate deal fell through, the owner of the property, a lawyer, sued me for $25,000 in damages. After two years, I won a summary judgment, which he immediately appealed. We are still in litigation over this, and there is nothing I can do to stop the process. I have offered settlements all along the way, but at this point I have paid more for my mandatory defense than the entire case was worth. If that's not bullying, I don't know what is. He continues to do everything in his power to prolong the case, knowing full well what it is costing me. By the time this is all over and I 'win,' I will have spent $35,000 and dealt with the stress of the case for more than five years. We are a modest, middle-class family. What was once the hope of being able to pay for my children's college education now lines a lawyer's pockets. I have had no recourse but to take it."

America needs judges willing to say no to the lawyer bullies. America also needs "loser pays." Otherwise, the parasites will bully away your money and your choices.

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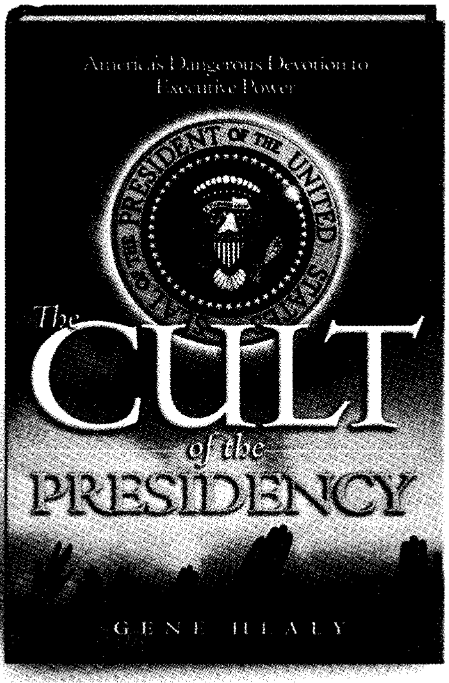
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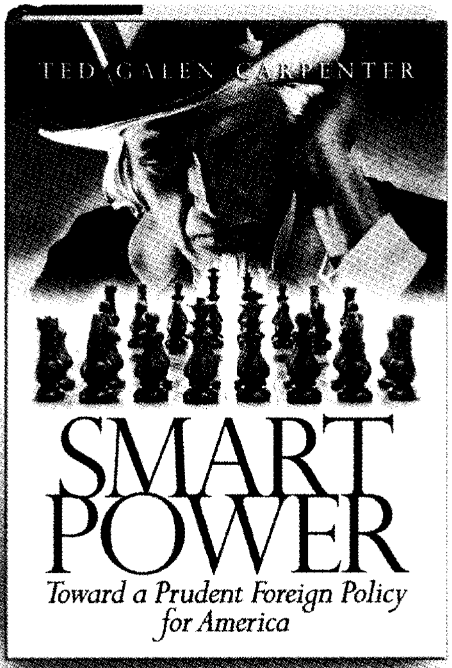
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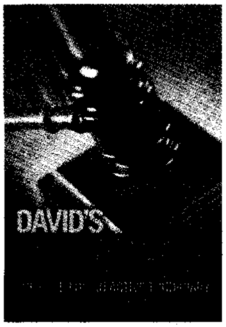
Book Reviews

David's Hammer: The Case for an Activist Judiciary

by Clint Bolick
Cato Institute • 2007 • 177 pages • $11.95 paperback

Reviewed by George C. Leef



In recent years "judicial activism" has been assailed from both ends of the political spectrum. Conservatives complain about "liberal" activism when courts strike down laws they favor, and "liberals" complain about conservative activism when judges interfere with any of their schemes for controlling society. Can anything be said in its defense?

Emphatically, yes, answers Clint Bolick in *David's Hammer.* Bolick, a veteran constitutional lawyer, contends that there is good judicial activism and bad judicial activism. The book is his attempt to sort the two out and explain why the good variety is important to a free society. He's right on target in saying, "With the explosive growth of government at every level and the concomitant erosion of liberty, what we really have to fear from the courts is not too much judicial activism, but too little."

Bolick argues that the Constitution meant for courts to assume an "activist" stance to protect the people's liberties against incursions by the other branches of government. Both the liberal and conservative critiques of judicial activism, unfortunately, amount to nothing more than unprincipled sniping at the courts for interfering with statutes and regulations they like. As an antidote to unprincipled activism (and its equally bad twin, inactivism), Bolick advocates five general rules for judges:

- Carefully review all contested actions by federal, state, and local governments that implicate individual liberty.
- Evaluate laws with a presumption that liberty should be preserved.
- Remember that the Constitution enumerates the proper sphere of government power, so if there is no legal basis for an exercise of power, it is void.
- Read the Constitution so as to give meaning to every word.
- Don't exercise legislative or executive powers.

Most of the book is devoted to cases Bolick has litigated that illustrate his philosophy about judicial activism. He begins with an excellent example, the case of Juanita Swedenburg. She grew grapes and made wine in Virginia and wished to be able to sell her products to customers around the country. The trouble was that many states had laws prohibiting interstate shipments of wine. Vintners like Swedenburg couldn't sell in New York unless they established a "physical presence" in the state, but doing that would be far too costly for small sellers. But why should they have to? Why should state borders and anticompetitive laws get in the way of commerce?

Bolick fought the case tooth and nail, battling an array of interest groups that wanted to see the law upheld. He won in district court, but lost on appeal in the Second Circuit. Fortunately, the Supreme Court took an activist approach. In a 5–4 decision, it struck down state laws against out-of-state wine shipments, observing that they "deprive citizens of their right to have access to the markets of other states on equal terms." This was laudable activism.

Another chapter covers the heated issue of eminent domain and gives us an inside look at a case that went against liberty, the infamous *Kelo v. New London, Connecticut. Kelo* resulted from the city's effort to seize the home of Suzette Kelo as part of a redevelopment project centered on a Pfizer Corporation office complex. Here is where Bolick's point about the need for judges to carefully read the Constitution is especially important. The Fifth Amendment states that government may use eminent domain to take property for *public use.* Unfortunately, the Court has decided to read that as meaning *public benefit*, so all politicians need to do is to say that the proposed use of land will in some way benefit "the public." Mostly that means the new owner will "pay higher taxes."

Kelo turned out badly, with the Court choosing to defer to the whims of local authorities. It was judicial inactivism.

Bolick has also been busy fighting laws that stifle people's freedom to enter into businesses and trades. He tells us, for instance, about Leroy Jones, who wanted to start a taxi company in Denver. He planned mainly to serve a minority section where residents often found it hard to get a cab from any of the three existing companies. Why couldn't Jones just go ahead? Answer: it's illegal to provide taxi service without having a "certificate of public convenience and necessity" from the Public Utilities Commission. The commission wouldn't issue the certificate unless Jones could somehow prove that the existing companies were unable to serve the area.

Bolick fought for Jones in court, but lost. More judicial inactivism. Freedom remains squashed.

This book should make you angry. The American colonists rebelled against much less, but today's petty tyrannies elicit only yawns from many judges.

George Leef (georgeleef@aol.com) is book review editor of The Freeman.

The Best-Laid Plans: How Government Planning Harms Your Quality of Life, Your Pocketbook, and Your Future

by Randal O'Toole
Cato Institute • 2007 • 355 pages • $22.95

Reviewed by Gary M. Galles

THE
Best-Laid
Plans
RANDAL O'TOOLE

In *The Best-Laid Plans,* policy analyst Randal O'Toole offers a well-documented case for why many government plans should be laid to rest. Its opening captures the central issue: "Somewhere in the United States today, government officials are writing a plan that will profoundly affect other people's lives, incomes, and property. . . . [T]he plan will go horribly wrong. The costs will be far higher than anticipated, the benefits will prove far smaller, and various unintended consequences will turn out to be worse than even the plan's critics predicted."

O'Toole locates planning's failures in the challenging gauntlet that stands between planning and success, and which "almost always leads to disaster because . . . the task is too big for anyone to understand and the planning process is too slow to keep up with the realities of modern life. . . . [M]ost of the professionals who call themselves planners are poorly trained to do the work they set out to do. Even if scientific planning were possible and the right people were doing it . . . politics inevitably distort the results into something totally irrational."

Further, he traces planning's problems to the "disparity . . . between how planners think people should live and how people really live." Consequently, "[b]y failing to ask the right questions, planners end up with a totally wrong-headed view of urban problems. . . . In too many cases, the plans become a source of oppression instead of a way for people to improve their lives and their regions."

O'Toole relies heavily on two of F. A. Hayek's major themes. First, because central planning, unlike markets, cannot effectively use the valuable details of time and place that only some people know, its results will be inherently inefficient. Second, the problems caused by one government intervention lead to other interventions, resulting in an ever-growing encroachment on voluntary arrangements. These difficulties, plus those caused by the perverse incentives facing the political players involved, form the core of O'Toole's argument.

The author fills an important gap. Few people have thoroughly studied such a broad field as planning, largely because the number of different situations and the variety of interacting federal, state, and local programs are so overwhelming. Only someone who has devoted much of his life studying these areas could accumulate the knowledge for this book. We profit from O'Toole's investment.

The book must walk a fine line, however. He must get down to the details to see where the devil lurks—for example, because cities must repay federal funds on any abandoned rail project, even grotesquely inefficient projects are never admitted to be failures—without overwhelming the reader. The author does a good job in that regard, although the forest-planning section, which involves his greatest expertise, may be too complicated for many readers.

I found O'Toole's treatment of "smart growth" planning blunders particularly valuable. He offers useful discussions of how "smart growth" sharply increases housing prices, with regressive effects, and increases housing-price volatility; of planners' ill-considered assaults on cul-de-sacs; of how traffic-calming measures cost rather than save lives; of the bogus "we can't build our way out of congestion" attacks on freeway construction; of the misunderstanding behind pedestrian malls; of how urban renewal and mass transit were just special-interest politics, and much more.

O'Toole recognizes that so-called market failures are usually government failures, especially when the law makes it impossible for people to defend or sell their property. He also fleshes out why free markets can do nearly everything government planning does, but better and without resorting to coercion.

The Best-Laid Plans does an admirable job of dissecting the reasons for the failures of government planning. Its emphasis on replacing planning with markets is dead-on. The guidelines it offers for reforming government agencies, "minimizing the pitfalls of comprehensive, politically driven planning," are also useful, were they to be followed. Unfortunately, while O'Toole's proposals would advance Americans' well-being, by themselves they are not sufficient to overcome the special interests and "more for me" political pressures that created the increasingly dystopian planning results we now endure. That will take not only widespread knowledge of government failures and of the potential for market successes, but also a far more widespread commitment to liberty on the part of Americans.

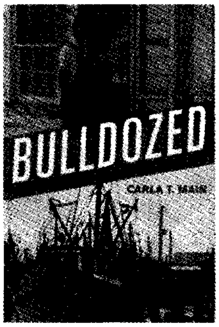
Gary Galles (gary.galles@pepperdine.edu) is a professor of economics at Pepperdine University.

Bulldozed: "Kelo," Eminent Domain, and the American Lust for Land

by Carla T. Main

Encounter Books • 2007 • 304 pages • $27.95

Reviewed by Steven Greenhut



Whenever local governments use eminent domain to acquire someone's property, they downplay the nature of what they are taking. Officials send in their hired appraisers, who undervalue the property, but that's not what I'm referring to here. Governments always treat the property as a mere piece of real estate. They never acknowledge that they are bulldozing the hopes, dreams, and life's work of a person or family. They never recognize they cause irreparable harm by demolishing an intricate network of social relationships. Victims of eminent domain tell me that when city governments look at businesses, they have no idea how much work and foresight go into meeting payrolls or planning for the future. Officials see only the buildings, never the enterprise or emotions behind them.

That's not surprising. Government is about power, and those who exert power don't usually care about the victims. City planners prattle about the importance of architecture, streetscapes, and other design elements in uplifting the human spirit. They talk that way mostly when they are promoting some new scheme, such as the common redevelopment plans to remake the downtowns of older cities or suburbs into pedestrian-friendly locales. Yet these same officials ignore how their planning schemes destroy the human spirit.

Carla Main captures that truth in her book, the subtitle of which refers to the U.S. Supreme Court's 2005 decision, *Kelo v. New London*, upholding the power of cities to use eminent domain for economic development. Main provides a detailed story of one Texas family's fight against city hall to save its waterfront property and the seafood business that took generations to build. It's a painful story—one I struggled to read, given that I've written about many families who have gone through similar experiences. City officials use their powers to declare a thriving business blighted, then take it away through a bitter legal process, and finally hand it over to someone else—a politically favored developer promising tax benefits and growth to the city. The victims always have a sense of disbelief. In this case, officials wanted to build a yacht marina.

Main's book artfully portrays what a piece of property means to a particular family, the Gores. She intertwines broader themes, but it's the family's story that's so compelling, an example of what Mindy Fullilove calls "Root Shock."

Main also readably tells the legal history of how eminent domain has changed from an exception for "public use" to a doctrine under which government can take whatever it pleases and give it to whomever it chooses. Main writes that the 1954 U.S. Supreme Court decision in *Berman v. Parker*, which allowed the government to use eminent domain to clean up a Washington, D.C., slum, "was a turning point in the history of American property rights . . . because it christened the great mother ship of urban renewal, allowing eminent domain to set sail over the American landscape and pick up passengers who were like devotees of a new municipal religion."

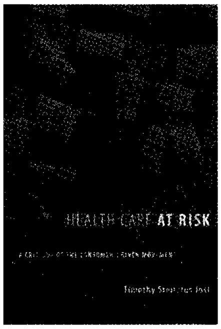
That's exactly right. As that passage suggests, Main occasionally indulges in overwriting and sometimes veers into an over-folksy manner, but those are minor flaws. Main puts the focus of eminent domain where it needs to go—on the effects of takings on the lives of those victimized by this abusive government power. Most Americans are not fully aware of what's at stake. Anyone who takes the time to read this book will understand that the post-Kelo debate is not really about property but about the right of ordinary Americans to pursue their lives and dreams, regardless of the designs of government planners.

Steven Greenhut (sgreenhut@ocregister.com) is a columnist at the Orange County Register *and author of* Abuse of Power: How the Government Misuses Eminent Domain *(2004).*

Health Care at Risk: A Critique of the Consumer-Driven Movement

by Timothy Stoltzfus Jost
Duke University Press • 2007 • 265 pages • $22.95

Reviewed by Diana M. Ernst



Timothy Stoltzfus Jost doesn't know what consumer-driven health care (CDHC) might bring, but he is afraid of it. That dialectic drives his book, *Health Care at Risk: A Critique of the Consumer-Driven Movement*, a defense of government-monopoly medicine, or what Jost hails as "solidarity based" health care.

Jost is a professor of law at Washington and Lee University, and his health-care proposal includes an expansion of federal health insurance, supplemented by private insurers that are prohibited from evaluating health risk and offering plans that don't cover routine expenses.

As for CDHC—a combination of direct consumer payment for routine medical expenses plus high-deductible insurance—Jost claims it failed the first time around. The fallacy is that he evaluates the current consumer-driven health-care effort against a consumer model of the 1920s, before insurance and other innovations. Back then, even when costs were much lower, people with major illnesses were unlikely to have saved enough money to pay for treatment. Today's CDHC endeavor is vastly different, however, based on modern insurance theory and social and medical norms that demand innovative, high quality, and often expensive health services.

The famous 1970s RAND health-insurance experiment shouldn't be taken as gospel, but the study did show that putting more dollars under patients' direct control worked for middle-class participants at no harm to their health. As for the poor, today's CDHC advocates propose reducing prices and increasing quality through competition, supplemented by tax credits to ensure that they have the broadest choice of health care possible.

"If 'consumer-driven health care' were advertised as a proposal to shift the weight of health care spending from healthy Americans to the shoulders of the chronically ill, it would probably not sell," says Jost. True, but that isn't what CDHC proposes. He notes, but fears, the positive impact of consumer-driven health care to date. Patients who control more of their health-care dollars are using doctors and emergency rooms less often, and more Americans are switching to generic drugs. Enrollees are searching for information on doctors. Patients are following treatments for chronic illness and not forgoing preventive care. Jost admits that these truths indicate cost savings in the long term, but declares, "But we must not just look at positive effects of CDHC, however, but also at its potential problems." This is the bulk of his harangue.

Why are CDHC advocates more critical of "solidarity based" health systems than of the American status quo? Jost answers his own question when he owns up to the troubles with "solidarity based" delivery: poor access, long waiting lists, and obsolete technology, with rapid care for ruling politicians and high incomes for powerful health-care interests. He laments that the poor in the United States face barriers to health care, but in none of his favored "solidarity based" systems are the poor likely to be as healthy as the affluent.

Americans' support for "solidarity based" systems deteriorates under the weight of the very facts Jost cites. He concedes that humankind's common experience is to respond to financial incentives and that we are more productive and creative when we enjoy the fruits of our labor. However, he still rejects markets as the best method to distribute goods, and he fears society's recognition of individual interests.

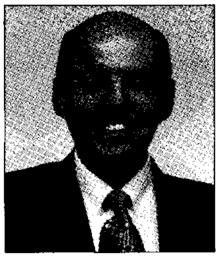
We don't have sufficient information to make choices that reflect our preferences, Jost writes, but even if we had perfect information, "it wouldn't be possible for the human mind to absorb and process it all." He expresses distaste for economic freedom and wealth—the money we could spend on health care, he says, we waste on toys, SUVs, and exotic coffee. But even he knows that the alternative is worse: "[G]overnments seldom increase the efficiency of markets and are often unproductive, if not corrupt."

It's not a panacea, but the facts look good for CDHC. According to recent reports, health-savings accounts and the corresponding high-deductible health plans are gaining popularity among Americans of all ages, education, and income levels. Consumers are becoming more knowledgeable about medical services and products. Patients are enjoying more control of their health care and relying less on third parties for payment. That will change providers' behavior and reduce the bureaucratic costs that waste so much money today. Freedom produces good results.

CDHC advocates do not believe in taking health-care dollars away from Americans and delivering them to unaccountable bureaucracies. They do believe that this money should be returned to patients, on the basis that patients can indeed make choices. Jost fundamentally distrusts not only competition, but each individual's capacity to be free. Those who cherish their freedom—and their health—should be wary of *Health Care at Risk*.

Diana Ernst (DErnst@pacificresearch.org) is Health Care Policy Fellow at Pacific Research Institute.

Faculty Unions Versus Academic Legitimacy



BY CHARLES W. BAIRD

The faculty at Montana State University in Bozeman will soon vote on whether to unionize. If a majority vote yes, the school will gradually descend into academic mediocrity or worse.

The vast majority of unionized faculty in higher education are employed in government colleges and universities. This is because in 1980 the U.S. Supreme Court, in *National Labor Relations Board v. Yeshiva University*, ruled that faculties in private higher education are "managers" and hence are exempted from the mandatory recognition and bargaining provisions of the National Labor Relations Act (NLRA). Private-sector college and university administrations may choose to recognize and bargain with faculty unions, but they are not compelled to do so even if a majority of faculty members want them to. By contrast, unionization in government colleges and universities (as well as K–12 education) is controlled by individual state laws. Most states have enacted statutes, modeled on the NLRA, that force administrations in government higher education to recognize and bargain with faculty unions if a majority of faculty members vote to unionize.

Unionists justify exclusive bargaining on the grounds that it is merely workplace democracy.

Consider the worst feature of NLRA-style unionism: exclusive representation. If 50 percent plus one of the members of a faculty vote to have, say, the local National Education Association (NEA) be their representative in bargaining with their university over the terms and conditions of employment, all faculty members who were eligible to vote must accept the union's representation whether they want it or not. Faculty who prefer another union or some non-union organization to represent them are out of luck. They are even forbidden to represent themselves. The winner of the election becomes the monopoly representative of the faculty, and there are no regularly scheduled reelections. As individuals, professors lose voice. All professors are treated exactly like all other professors. Excellence is not rewarded and often disparaged; poor performance is protected; individual autonomy vanishes; and strife replaces collegiality.

Unionists justify exclusive bargaining on the grounds that it is merely workplace democracy. Most faculty accept the legitimacy of majority rule in governmental matters. So, unionists argue, to be consistent, faculty must accept its legitimacy in the workplace. This is a silly, inapt analogy. There are three branches of American government— executive, legislative, and judicial. There is no fourth branch of government called unions. Democracy, forcing a numerical minority to submit to the will of a numerical majority, is appropriate in governmental matters but not in private matters. The sale and purchase of one's labor is a private matter.

On legitimately governmental matters individuals cannot be allowed to go their own way. Government makes decisions that must apply to all its citizens uniformly. But on private matters individuals must be allowed to go their own way subject only to the rule that no one can infringe on the equal rights of others to do the same. In the private sphere of human interactions, mutual consent, not majority rule, is the proper decision. Individuals may choose to associate with others who are willing to associate with them to pursue some common goal, but no one should be forced into any association by any means, including majority rule. If asked, most professors would agree that coerced associations are anathema to

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the academy. Too many professors fail to apply this admirable principle to faculty unionism. Logical consistency and academic freedom demand that they do so.

From the time of Plato's Academy and Aristotle's Lyceum, academic freedom and scholarly creativity have been highly prized academic values. Ideally, successes and failures of individual academics are based on the values that other academics (and students) place on their work. Performance, not politics, is what counts. Of course all academic institutions fall short of the ideal. Even at the best schools, campus politics intrudes into decision-making. But when it does, most academics struggle to minimize its impact. As soon as faculty unionism intrudes, politics displaces excellence. Professors come to be treated, by their unions as well as their administrations, like assembly-line workers whose responsibility is limited to playing the roles assigned to them in so-called collective-bargaining agreements. All degrees of freedom in decision-making are swallowed by slavish adherence to "the contract."

As soon as faculty unionism intrudes, politics displaces excellence.

The union that has monopoly representation privileges over the California State University faculty is the California Faculty Association (CFA). My experience with it is a cautionary tale. When CFA campaigned to become the monopoly faculty representative, it promised it would never try to compel payment of forced dues. Soon after becoming certified as the monopoly representative, it undertook a long campaign to do precisely that. It finally succeeded in 1999 by giving sufficient electoral support to Gray Davis in the 1998 gubernatorial election to bribe him into signing such legislation—a fine example of politics as exchange.

What else hath the CFA wrought? For one thing, it established de facto tenure for many adjunct faculty even though most of them never publish anything. For another, it quashed merit pay for faculty who demonstrate outstanding professional contributions. It asserted that all faculty contributions are equally meritorious. CFA also imposed a faculty staffing rule that says in the event of any downsizing, faculty must be let go in reverse order of seniority. Expertise and the needs of students and the integrity of the academic enterprise do not matter at all.

The CFA significantly impeded the 2005–2007 effort of the College of Business and Economics (CBE) at California State University, East Bay, to maintain its accreditation by the Association to Advance Collegiate Schools of Business (AACSB). In 2005 the administration hired a new dean and charged him to get the CBE ready for its reaccreditation review. It had been almost ten years since the previous review, and academic standards at the College had been allowed to decay in favor of keeping nonproducing faculty happy and quiet (that is, not filing complaints with the CFA) and boosting student enrollment. The new dean set out to remedy this decay as quickly as possible. Among other things, he tried to implement a set of incentives to get faculty to increase their research and publication activities. For example, he proposed to give faculty who published in reputable academic journals a reduced teaching load, and he proposed to give faculty who produced good research proposals financial bonuses and summer research grants to help them with their work.

The CFA, at the behest of some faculty who figured they could not compete on these grounds, intervened to impede these incentives on the grounds that they created invidious distinctions between members of the faculty. Five-year, post-tenure reviews of faculty have long been required in the California State University system. In practice they had become little more than pro forma endorsement of everyone under review. The dean attempted to strengthen these reviews as a way of reminding faculty of their academic responsibilities, particularly in research and publication. The CFA again intervened stating that "the contract" limited the post-tenure reviews to teaching performance. Notwithstanding "the contract," AACSB considers research and publication important criteria for accreditation.

In the end, CBE was not reaccredited, but was given three years to remedy its deficiencies. Failing that, CBE accreditation will be withdrawn. In a unionized environment it is doubtful that three years will be enough time for CBE to restore its academic legitimacy.