THE FREEMAN
IDEAS ON LIBERTY

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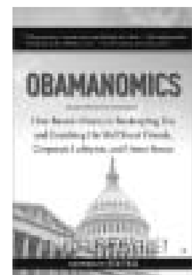

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Perspective

"What Sort of Despotism Democratic Nations Have to Fear"

I took that title from volume 2, section 4, chapter 6 of Alexis de Tocqueville's *Democracy in America* (1840). Considering what has been happening legislatively (and not just in the last year-plus), it seems like a good time to revisit Tocqueville's writing about democratic despotism.

He notes that despotism in a constitutional republic would be different from what it was in the Roman empire. How so? "[I]t would be more extensive and more mild; it would degrade men without tormenting them."

Specifically: "Above this race of men stands an immense and tutelary power, which takes upon itself alone to secure their gratifications and to watch over their fate. That power is absolute, minute, regular, provident, and mild. It would be like the authority of a parent if, like that authority, its object was to prepare men for manhood. . . ."

But that is not its object. Rather, "it seeks, on the contrary, to keep them in perpetual childhood. . . . For their happiness such a government willingly labors, but it chooses to be the sole agent and the only arbiter of that happiness; it provides for their security, foresees and supplies their necessities, facilitates their pleasures, manages their principal concerns, directs their industry, regulates the descent of property, and subdivides their inheritances: what remains, but to spare them all the care of thinking and all the trouble of living?"

He goes on with an almost spooky prophecy:

"After having thus successively taken each member of the community in its powerful grasp and fashioned him at will, the supreme power then extends its arm over the whole community. It covers the surface of society with a network of small complicated rules, minute and uniform, through which the most original minds and the most energetic characters cannot penetrate, to rise above the crowd. The will of man is not shattered, but softened, bent, and guided; men are seldom forced

by it to act, but they are constantly restrained from acting. Such a power does not destroy, but it prevents existence; it does not tyrannize, but it compresses, enervates, extinguishes, and stupefies a people, till each nation is reduced to nothing better than a flock of timid and industrious animals, of which the government is the shepherd."

Tocqueville also sees the paradoxes of democracy. How relevant they still are:

"I have always thought that servitude of the regular, quiet, and gentle kind which I have just described might be combined more easily than is commonly believed with some of the outward forms of freedom, and that it might even establish itself under the wing of the sovereignty of the people.

"Our contemporaries are constantly excited by two conflicting passions: they want to be led, and they wish to remain free. As they cannot destroy either the one or the other of these contrary propensities, they strive to satisfy them both at once. They devise a sole, tutelary, and all-powerful form of government, but elected by the people. They combine the principle of centralization and that of popular sovereignty; this gives them a respite: they console themselves for being in tutelage by the reflection that *they have chosen their own guardians*. Every man allows himself to be put in leading-strings, because he sees that it is not a person or a class of persons, but the people at large who hold the end of his chain." (Emphasis added.)

Tocqueville concludes, "Thus their spirit is gradually broken and their character enervated. . . . It is indeed difficult to conceive how men who have entirely given up the habit of self-government should succeed in making a proper choice of those by whom they are to be governed; and no one will ever believe that a liberal, wise, and energetic government can spring from the suffrages of a subservient people.

"A constitution [that is] republican in its head and ultra-monarchical in all its other parts has always appeared to me to be a short-lived monster."

Tocqueville might have had his timing off, but with a fiscal crisis on the horizon—the product of a bloated welfare state, an aging population, and a lackluster economy mired in corporatism—the "monster" is in trouble. Is it too late to turn things around?

* * *

One of the most politically safe government programs today is federal insurance of bank deposits. Yet there was a time when the idea of underwriting reckless bank behavior was thought so ridiculous that even President Franklin D. Roosevelt opposed it. Warren Gibson explores the FDIC.

It's not what we don't know that gets us into trouble. It's what we think we can model but can't. Max Borders explains.

The leading countries' pressure on offshore financial centers—that is, low-tax jurisdictions that respect people's privacy—is nothing less than an updated version of imperialism. So says Robert Stewart.

President Obama insists he wants to help small business create jobs. He even has a program for that. Is there less here than meets the eye? Bruce Yandle thinks so.

Americans rightly have an intuition that bureaucracies are inept. So why would the adoption of children be trusted to one? James Payne wants to know.

Once upon a time, central and eastern Europe were ruled by brutal and incompetent communist regimes. And back then, when the World Bank thought Romania had an enlightened despot, James Bovard took a little tour. He reminisces inside.

One of the founders of the modern libertarian movement was a newspaper magnate named R. C. Hoiles. Nothing raised his ire like government-run schools. Wendy McElroy tells why.

And if that's not enough, there are the columnists: Lawrence Reed looks back at FDR's great bait-and-switch in 1932. Donald Boudreaux considers the private provision of public goods. Burton Folsom sees ominous parallels between Roosevelt and Obama. John Stossel is outraged that we need government permission to pursue many occupations. Walter Williams wants no part of the "war on drugs." And Art Carden and Mike Hammock, encountering the argument that government should underwrite investments in nuclear power, proclaim, "It Just Ain't So!"

Books on Obamanomics, big government, race, and the financial mess come under our reviewers' scrutiny.

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The 1932 Bait-and-Switch

BY LAWRENCE W. REED

Harry Truman once said, "The only thing new in the world is the history you don't know." That observation applies especially well to what tens of millions of Americans have been taught about Franklin Delano Roosevelt, the man under whom Truman served as vice president for about a month. Recent scholarship (including a highly acclaimed book, *New Deal or Raw Deal*, by FEE senior historian Burton Folsom) is thankfully disabusing Americans of the once-popular myth that FDR saved us from the Great Depression.

Another example is a 2004 article by two UCLA economists—Harold L. Cole and Lee E. Ohanian—in the important mainstream *Journal of Political Economy*. They observed that Franklin Roosevelt extended the Great Depression by seven long years. "The economy was poised for a beautiful recovery," the authors show, "but that recovery was stalled by these misguided policies."

In 1932, the country elected a man whose subsequent performance looks little like the platform and promises on which he ran.

In a commentary on Cole and Ohanian's research, Loyola University economist Thomas DiLorenzo pointed out that six years after FDR took office, unemployment was almost six times the pre-Depression level. Per capita GDP, personal consumption expenditures, and net private investment were all lower in 1939 than they were in 1929.

"The fact that it has taken 'mainstream' neoclassical economists so long to recognize [that FDR's policies exacerbated the disaster]," notes DiLorenzo, "is truly astounding," but still "better late than never."

Part of the Great FDR Myth is the notion that he won the presidency in 1932 with a mandate for central planning. My own essay on this period ("Great Myths of the Great Depression"; www.tinyurl.com/7eecje) argued otherwise, based on the very platform and promises on which FDR ran. But until a few months ago I was unaware of a long-forgotten book that makes the case as well as any.

Hell Bent for Election was written by James P. Warburg, a banker who witnessed the 1932 election and the first two years of Roosevelt's first term from the inside. Warburg, the son of prominent financier and Federal Reserve cofounder Paul Warburg, was no less than a high-level financial adviser to FDR himself. Disillusioned with the President, he left the administration in 1934 and wrote his book a year later.

Warburg voted for the man who said this on March 2, 1930, as governor of New York:

> The doctrine of regulation and legislation by "master minds," in whose judgment and will all the people may gladly and quietly acquiesce, has been too glaringly apparent at Washington during these last ten years. Were it possible to find "master minds" so unselfish, so willing to decide unhesitatingly against their own personal interests or private prejudices, men almost godlike in their ability to hold the scales of justice with an even hand, such a government might be to the interests of the country; but there are none such on our political horizon, and we cannot expect a complete reversal of all the teachings of history.

What Warburg and the country actually elected in 1932 was a man whose subsequent performance looks little like the platform and promises on which he ran

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and a lot like those of that year's Socialist Party candidate, Norman Thomas.

Who campaigned for a "drastic" reduction of 25 percent in federal spending, a balanced federal budget, a rollback of government intrusion into agriculture, and restoration of a sound gold currency? Roosevelt did. Who called the administration of incumbent Herbert Hoover "the greatest spending administration in peace time in all our history" and assailed it for raising taxes and tariffs? Roosevelt did. FDR's running mate, John Nance Garner, even declared that Hoover "was leading the country down the road to socialism."

Copying Hoover and the Socialists

It was socialist Norman Thomas, not Franklin Roosevelt, who proposed massive increases in federal spending and deficits and sweeping interventions into the private economy—and he barely mustered 2 percent of the vote. When the dust settled, Warburg shows, we got what Thomas promised, more of what Hoover had been lambasted for, and almost nothing that FDR himself had pledged. FDR employed more "master minds" to plan the economy than perhaps all previous presidents combined.

FDR misled the country with his promises and put personal ambition and power lust in charge.

After detailing the promises and the duplicity, Warburg offered this assessment of the man who betrayed him and the country:

> Much as I dislike to say so, it is my honest conviction that Mr. Roosevelt has utterly lost his sense of proportion. He sees himself as the one man who can save the country, as the one man who can "save capitalism from itself," as the one man who knows what is good for us and what is not. He sees himself as indispensable. And when a man thinks of himself as being indispensable . . . that man is headed for trouble.

Was FDR an economic wizard? Warburg reveals nothing of the sort, observing that FDR was "undeniably and shockingly superficial about anything that relates to finance." He was driven not by logic, facts, or humility but by "his emotional desires, predilections, and prejudices."

"Mr. Roosevelt," wrote Warburg, "gives me the impression that he can really believe what he wants to believe, really think what he wants to think, and really remember what he wants to remember, to a greater extent than anyone I have ever known." Less charitable observers might diagnose the problem as "delusions of grandeur."

"I believe that Mr. Roosevelt is so charmed with the fun of brandishing the band leader's baton at the head of the parade, so pleased with the picture he sees of himself, that he is no longer capable of recognizing that the human power to lead is limited, that the 'new ideas' of leadership dished up to him by his bright young men in the Brain Trust are nothing but old ideas that have been tried before, and that one cannot uphold the social order defined in the Constitution and at the same time undermine it," Warburg lamented.

So if Warburg was right (and I believe he was), Franklin Delano Roosevelt misled the country with his promises in 1932 and put personal ambition and power lust in charge—not a very uncommon thing as politicians go. In any event, the country got a nice little bait-and-switch deal, and the economy languished as a result.

In the world of economics and free exchange, the rule is that you get what you pay for. The 1932 election is perhaps the best example of the rule that prevails all too often in the political world: You get what you voted against. FEE

Nuclear Energy Should Be Subsidized? It Just Ain't So!

BY ART CARDEN AND MIKE HAMMOCK

In a March 5 *Los Angeles Times* op-ed, "Jump-starting Nuclear Energy" (www.tinyurl.com/yb6ot4z), Greenpeace founder Patrick Moore, who now co-chairs the Clean and Safe Energy Coalition, lauds the Obama administration for its decision to "guarantee loans for two advance-design nuclear plants in Georgia." Nuclear energy diversifies our energy portfolio and doesn't pollute the air the way fossil fuels do. We certainly should eliminate barriers to its use.

But that doesn't mean federal loan guarantees are in order.

Government should not be trying to pick winners and losers in the energy industry. If one company has its loans backed by the government, other companies without guarantees will have trouble borrowing capital. Bureaucrats don't know and can't know whether (or in what combination) nuclear energy, biodiesel, ethanol, solar energy, hydroelectricity, fuel cells, or any other alternatives are "best" for meeting our energy needs. This information can only emerge through market competition.

This is not just about energy. We don't know—once and for all—the best way to build a computer chip. We don't know the ingredients for the next tasty trend in food. We're ignorant about a lot of things we would like to know. Markets—and competition—produce the information that allows us to make decisions. But governments distort it by intervening in the capital markets, by doing things like guaranteeing loans to particular firms.

> We certainly should eliminate barriers to the use of nuclear power. But that doesn't mean federal loan guarantees are in order.

In other words, we do not find the best way to build a computer chip by having the government offer loan guarantees to firms that use particular production processes. We let firms compete for customers, and in a free market without government interference, firms earn profits when they use resources wisely and produce things people want at prices they are willing to pay.

Solving these problems—what to produce and how—requires information embodied in prices. Few of us buy golden faucets, because they're too expensive. Prices help producers decide whether to use gold or steel, or try to come up with something better. F. A. Hayek called competition a "discovery procedure." As they compete with one another for profits, firms *discover* the best way to produce things. The firms that can maximize the difference between the price of what they produce and the cost of producing it will survive and thrive; those that cannot must change or perish.

Energy prices might not reflect the full costs of production and consumption. There are additional costs—the harm caused by air pollution or climate change (if that's what's going on)—that producers do not pay but are imposed on the public generally. Therefore they produce too much energy from dirty sources like coal and too little energy from clean sources like nuclear

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power. It is intuitively appealing, therefore, to have the government simply pick a cleaner energy source and subsidize it. But this is a mistake that leaves too many questions unanswered. It is a mistake for the same reason that it would be a mistake to order all chip manufacturers to use a 32-nanometer process, or subsidize cake makers that use margarine: The government is in no position to know if these are the best processes to produce the desired results. A 32-nanometer process would be expensive overkill for a pocket calculator, and many people prefer cakes made with butter. The market reaches these conclusions by punishing firms that ignore them.

Similarly, we do not know how much more nuclear power to use, how many more plants to build, and at what point we should start using other energy sources instead.

Firms competing in truly free markets will find the best ways to get desired results. Competition forces the answers on them.

The government should stop trying to pick winners and let the competitive process sort things out.

What About Externalities?

But what about those costs that aren't reflected in prices, the ones from so-called externalities like pollution?

In principle there are better alternatives to government interventions that choose winners and losers. While far from ideal, pollution could be taxed or tradable permits to emit certain pollutants could be established. Power companies with dirtier plants would suddenly find themselves at a disadvantage versus other companies with cleaner plants and would have an incentive to shift toward cleaner energy. Pollution-reduction mechanisms we haven't even imagined could emerge as firms search for ways to reduce their pollution costs. Maybe nuclear power would make huge gains in the resulting competition; maybe it would not. We cannot know, but we can say that the resulting victors in that competition will be the energy providers that found ways to reduce pollution at the lowest cost.

These are superior, more market-oriented alternatives, but their effective implementation rests on similarly implausible assumptions about the policymakers' knowledge and incentives. They assume we know (or can know) all the relevant external costs of pollution. They further assume we know (or can know) the socially optimal level of emissions that would prevail in the absence of externalities. They also assume that people acting through the political process are immune to the perverse incentives the programs create. At various times and places environmental initiatives have been co-opted by special interests. Thus we should keep in mind that even more market-oriented regulations will be difficult to get right. There's no real substitute for the free market.

We can take other actions in addition to those designed to internalize the externalities. For example, government-granted advantages for other forms of energy production should be repealed—the special tax treatment for oil exploration, wind, and ethanol should be eliminated. Instead of targeted favors, taxes should be cut across the board. We should remove regulatory barriers that make it hard to start new power plants but easy to keep innovative competitors out. And, importantly, special limited tort liability must not be permitted for nuclear power or anyone else; thus the Price-Anderson Act, which was passed in 1957 to encourage civilian nuclear power, should be repealed.

The government should stop trying to pick winners and let the competitive process sort things out.

Moore argues that the nuclear plants will create jobs, but this is a canard. When the government assumes a company's risks, it does not create net new economic activity. It merely reallocates it from one line of production to another. Having government-guaranteed loans for a nuclear power company means other businesses go without loans. Without undistorted prices, profits, and losses, there is no way to know whether value has been created or destroyed. FEE

Federal Deposit Insurance: A Banking System Built on Sand

BY WARREN C. GIBSON

Federal deposit insurance grew out of a turbulent time in American history: the Great Depression. During two waves of bank failures in the 1930s an astonishing 9,000 banks closed and millions of depositors lost some or all of their savings. The Federal Deposit Insurance Corporation (FDIC) began operations in 1934, insuring deposit accounts up to $5,000 per person (roughly $80,000 in today's money).

The bank failure rate then dropped dramatically and never again rose anywhere close to the level of the 1930s. And such bank failures that have occurred have cost insured depositors nothing; many uninsured depositors were made whole as well. Bank runs are a distant memory, revived occasionally by reruns of *It's a Wonderful Life*.

Yet it may be premature to pronounce deposit insurance a success. It can take a long time for an unsustainable program to unravel: Witness Social Security and Medicare. Seventy-five years after the start of Social Security and 45 years into Medicare, it's common knowledge that both programs are headed for a financial cliff. A closer look at deposit insurance will show cracks in its edifice, raising questions about its sustainability as well as the distortions that it has introduced into the economy.

Before we take that closer look we might ask whether, as is widely assumed, the bank failures of the 1930s were an example of unregulated free markets run amok. During that time, as Milton Friedman and Anna Schwarz pointed out in their classic, *A Monetary History of the U.S.*, the number of bank failures in Canada was exactly zero. Canada is closely linked to the United States economically and culturally, making this episode as near to a controlled experiment as any macroeconomist could wish for.

The difference? Canada had just ten nationwide banks with about 3,000 branches, while branch banking across state lines, and often within states, was *prohibited* by U.S. law. Thus smaller communities could only be served by relatively weak, poorly capitalized banks. A hailstorm might be enough to topple the local bank in a small farming community as surely as if it were built from straw.

The banking system was also caught in the downdraft of a plummeting money supply. When banks hold only a fraction of their liabilities as reserves, deposit

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inflows cause the money supply to multiply, but the reverse happened during the Depression as worried depositors began to cash out their accounts. The economy could have adjusted to a declining money supply in one of two ways: either by lowering prices and wages or by Federal Reserve injection of new money. Hoover's jawboning and Roosevelt's New Deal legislation precluded the first solution, while the Fed, out of ignorance or confusion, failed to inject new money. With economic adjustment prevented by government policies, a vicious cycle of souring bank loans, liquidation of deposits, further declines in the money supply, and more business failures took hold.

Interestingly, Milton Friedman and Murray Rothbard, both free-market economists, reached opposite conclusions about the declining money supply. While Friedman blamed the Fed, Rothbard celebrated what he saw as the people's attempt to overturn fractional-reserve banking, which he believed is inherently fraudulent. Either way, the fingerprints of government were all over the bank failures of the 1930s and the Great Depression generally.

With the failure of so many banks, U.S. Representative Henry Steagall vigorously pushed deposit insurance legislation. Franklin Roosevelt was among his opponents. Indeed, when asked about guaranteeing bank deposits four days after his inauguration in March 1933, Roosevelt said he agreed with Herbert Hoover: "I can tell you as to guaranteeing bank deposits my own views, and I think those of the old Administration. The general underlying thought behind the use of the word 'guarantee' with respect to bank deposits is that you guarantee bad banks as well as good banks. The minute the Government starts to do that the Government runs into a probable loss. . . . We do not wish to make the United States Government liable for the mistakes and errors of individual banks, and put a premium on unsound banking in the future."

> Four days after taking office, FDR endorsed Hoover's view and said, "We do not wish to make the United States Government liable for the mistakes and errors of individual banks, and put a premium on unsound banking in the future."

FDR was right. Deposit insurance generates moral hazard: an incentive to engage in more reckless behavior when one's misdeeds are covered by someone else. Bank managers tend to make riskier loans than they would without insurance, and depositors don't worry about the lending practices of the banks they patronize. Currently many people, including me, buy bank certificates of deposit through online brokers, perhaps not even learning the name of the bank that got our money. The magic letters FDIC are all we look for.

Savings & Loan and Moral Hazard

The savings and loan crisis of the late 1980s saw a catastrophic explosion of moral hazard. Deregulation had lifted interest rate caps for S&Ls and allowed them to expand from residential mortgages into commercial and consumer lending. Competitive pressures sent managers scrambling into these markets, which were mostly unfamiliar to them, while at the same time they had to compete vigorously for deposits. With deposit insurance offered to all chartered institutions regardless of risk, S&Ls made many preposterous loans. When the dust settled, roughly half had failed. A massive taxpayer bailout followed and, as very rarely happens to failing government agencies, the Federal Savings and Loan Insurance Corporation was abolished in 1989—though its responsibilities were shifted to the FDIC.

Moral hazard is an aspect of all insurance, public or private. But private insurance companies, if they wish to survive and prosper, must find ways to limit policyholders' risky behavior. Deductibles, copays, threats of cancellation, and rewards for prudent behavior return some monetary incentive to policyholders. In addition, insurance companies try to educate policyholders about prudent behavior. Crucially, in a free market private insurance companies' profit-and-loss statements tell whether they're getting it right. Government agencies lack

profit-and-loss discipline and are inevitably subject to political pressure. The FDIC's legally mandated requirement to hold reserves to back its liabilities may resemble market discipline, but as we shall see, when the mandate was violated, no one lost his job and no investors lost any capital.

Private insurance companies invest most of their reserves in productive activities such as corporate securities or real estate. They count on earnings from these investments to balance low or even negative returns on their pure underwriting activities. The FDIC, by law, holds its reserves in the form of Treasury securities. Any alternative would certainly be riskier and more politically charged. Yet we must recognize that this arrangement, as with the Social Security Trust Fund, is merely a pass-through of the FDIC's liabilities to U.S. taxpayers.

Ken Yee [flickr]

The FDIC reserve fund is called the Deposit Insurance Fund (DIF). For most of its history, the DIF was kept within its statutory limit, which has varied over time but is currently a range of 1.15 to 1.25 percent of insured deposits. At least, that's the statutory range. It's actually essentially zero. But are the statutory numbers the right ones? No one can be sure, but again, the FDIC lacks a profit motive to help get it right.

A spate of bank failures in 2008 and 2009, while far less severe in number and magnitude than in the 1930s, left the DIF with no unencumbered assets at all. The pace of bank failures continued during the first three months of 2010, while the number of problem banks on the FDIC's secret list jumped 27 percent in the fourth quarter of 2009, to 702. In short, the FDIC is in trouble.

A restoration plan has been proposed to get the DIF back to 1.15 percent of insured deposits by about 2017, a date that has been pushed back more than once. The plan relies heavily on an assumption that the economy will soon resume robust growth and that "only" about $100 billion in failure costs will be incurred between 2009 and 2013, with most of those costs coming in 2010. For the shorter term, the proposal calls on commercial banks to prepay their deposit insurance premiums through 2011. When they do so, a new asset will appear on their balance sheets: a prepaid expense. To gain their acceptance and cooperation, the FDIC proposes that this prepaid expense be counted as an asset that is just as safe as U.S. government securities and therefore does not require additional capital backing. This shuffle will be pretty much a wash for the commercial banks, and the upshot is that the FDIC will indirectly borrow its own future premium income, hoping that income will materialize in amounts sufficient not only to cover future bank failures but also to rebuild the DIF. We shall see.

The DIF is not the FDIC's only problem. When closing a failed bank, the agency tries to sell as many of the bank's assets as possible, including branches, loans, and securities holdings. The FDIC's goal is usually to make all depositors whole, not just insured depositors. It sometimes takes possession of assets for which it can't get an acceptable bid. In doing so it acquires assets that are difficult to evaluate and thus greatly complicate estimates of future liabilities.

Disguised Risk

Now let's take a longer look at the business of banking. The very words we use, like "bank" and "deposit," can distort our thinking. The word "bank" comes from the bench or counter where medieval money changers did business. The word "deposit" suggests something like an ore deposit in the ground: the minerals are there and can be gotten out. We think of banks as custodians of our money, keeping it safe for us and making it available whenever we need it. But present-day banks are not deposit banks, locking our money away in a vault as the term would suggest, but rather loan banks. Most of our deposits are loaned out and not all of them could be redeemed on short notice. This works

fine as long as there is no large and sudden short-term demand for withdrawals. But we have come to believe, in part due to misleading terminology, that we can have rewards without risk. Interest paid on bank deposits is now essentially zero but as depositors, we still reap benefits such as ATMs and online banking with no fee and no apparent risk. In short, as in so many areas of contemporary life, we have been led to expect something for nothing.

Thus proper labeling could help rationalize banking. Those who want utmost safety in the form of true deposit banking should be free to pay for it with fees for storage of their currency or gold. Liability insurance for true custodial service should be very cheap. Those who wish to entrust their money to loan banking should accept the risk, and if they want insured accounts, they—not taxpayers—should be prepared to pay for the insurance, at least indirectly.

While there is nothing inherently wrong with loan banking, we get too much of it when it is disguised as deposit banking and backed by mispriced and politically motivated government insurance. The result is a banking system that is more highly leveraged than it otherwise would be. This in turn increases the severity of business cycles—booms and busts.

Make no mistake, our current banking system is, and has long been, a cartel run for the mutual benefit of Wall Street financiers and their regulators in Washington.

FDIC Incentives

Back to the FDIC. As we have seen, banks pay for its service in the form of insurance premiums. Coverage is not mandatory, so the organization looks somewhat like a private business. But in fact it is a monopoly supplier to banks (with a parallel institution serving credit unions). Private competitors are locked out, perhaps not by statute, but by the FDIC's implicit and explicit backing by the Treasury (explicit in the form of a line of credit). Without a profit motive, the FDIC lacks the incentive to serve its bank customers and its indirect depositor customers by offering innovative services with effective moral-hazard controls.

Though the FDIC lacks market incentives, it is awash in political incentives. Thus in 2008 Congress voted for an increase in deposit coverage from $100,000 to $250,000 with little or no discussion of the costs of this move. This "temporary" increase has been extended once and will likely become permanent. Members of Congress are of course motivated by the campaign contributions of bankers and others, and may not know or care about the long-term consequences of such actions.

Private Options

How might private firms handle bank deposit insurance? Before the government takeover of the banking system, private clearinghouses sometimes provided mutual aid among member banks. The Suffolk Bank in Boston was a notable example in the early 1800s. It supported country banks in New England for many years by clearing their transactions and accepting their currency at par. It earned a profit doing so.

But could private firms ever be big enough to provide bank deposit insurance in today's multitrillion dollar economy? Reinsurance firms offer evidence that they could. As their name indicates, General Re and other such firms insure insurance companies. Who insures the reinsurance companies? No one. Absent government intervention, these firms would experience diseconomies of scale when they grow too large, provided it is clear that they would not be in line for a government bailout should they get into difficulty.

Failure is an important aspect of the free market. Economist Joseph Schumpeter's pithy phrase "creative destruction" captures this notion and reminds us that failures, which will always be with us, should be liquidated so that others can pick up the remains and apply them to more promising enterprises. Shouldn't this idea apply to banks as well? Rothbard actually celebrated occasional bank runs as a way of putting the fear of God into bank managers and depositors alike. Amazingly, Roosevelt's initial response to the deposit insurance proposal echoed Rothbard's: "There are

undoubtedly some banks that are not going to pay one hundred cents on the dollar. We all know it is better to have that loss taken than to jeopardize the credit of the United States Government. . . .”

Washington-Wall Street Banking Cartel

Make no mistake, our current banking system is, and has long been, a cartel run for the mutual benefit of Wall Street financiers and their regulator friends in Washington. Case in point: Goldman Sachs and Morgan Stanley were allowed to convert to bank holding companies so that they could receive federal bailout money. The $180 billion AIG bailout provided Goldman with 100 cents on the dollar for its holdings of AIG credit default swaps.

Let us not be so naive as to believe that government deposit insurance is any different. Any benefit this system provides to small depositors is incidental to its real objective: to serve the cartel.

The banking system is in need of real reform. More regulation? More virtuous regulators? Only the naive, the ignorant, or the disingenuous can believe these answers in the face of regulation’s long history of failure, the practical impossibility of detailed oversight, and the perverse political incentives that always operate. The solution lies not in wiping out risk—there can be no real economic growth without risk. Instead, we need rational incentives: Let risks be borne by those best able and willing to take them. FEE

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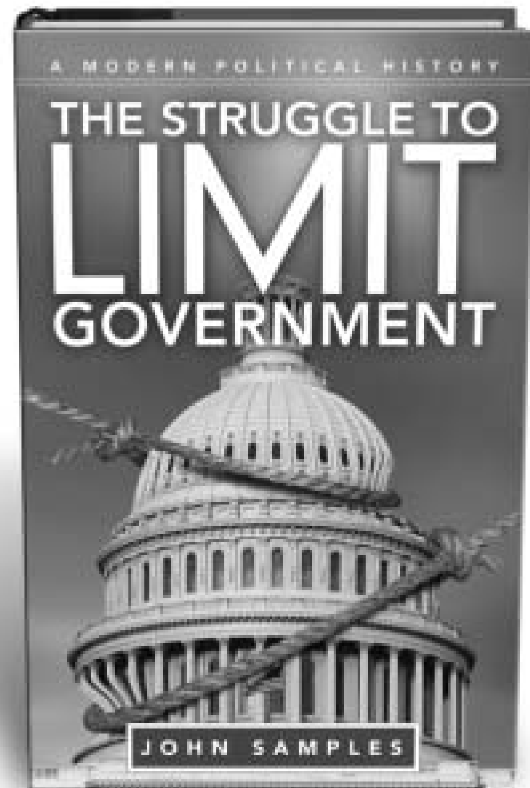

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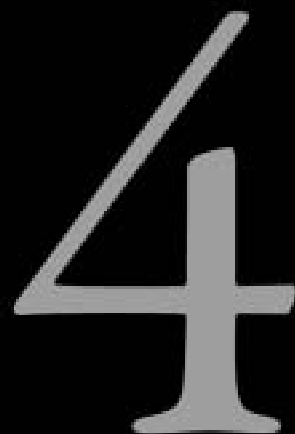

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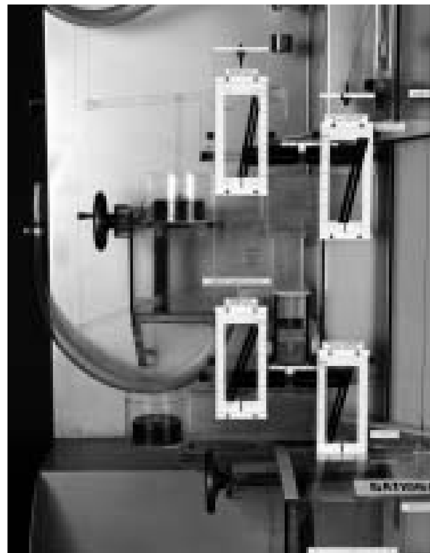
The Myth of the Model

BY MAX BORDERS

Most people don't notice it, but "model" may be the most dangerous word in the English language right now. Models justify a lot of the bad policies that have been, or soon will be, foisted on us. For example, what was used to justify the fiscal policy of the big "stimulus"? That's right. And as I wrote this, "experts" were using models to gear us up for another one.

More than a year after the original "stimulus," not only are economists nowhere near consensus about its effects but few if any of the models used to justify it have turned out to be right. Obamanomic adviser Christina Romer, for example, has come under heavy criticism because her team's plan has performed abysmally. The model behind the plan predicted unemployment would peak at 8.3 percent. It exceeded 10 percent before dropping back slightly. In defending her plan she appealed to counterfactuals—that is, how bad things *could have* been without it. That her team failed to reach its rosy targets, she says, "prevents people from focusing on the positive impact." But did Romer ever consider the possibility that her model was just wrong?



In 1949, Bill Phillips tried to model the economy using this hydraulic contraption.
Science Museum / Science & Society Picture Library

When it comes to prediction and explanation, macroeconomic models are often just as bad after the fact as before it. There are just as many debates raging about the effects of the "stimulus" as explanations of the crisis used to justify it. Consensus consistently eludes us. Almost all the arguments presuppose models. There are Keynesian models, "new" Keynesian models, and unbranded models proffered by leading economic lights like Harvard's Robert Barro. Comparative analyses of these positions offer little except further evidence that, as Stanford's John Taylor writes, "[T]here is no consensus."

But why? These people aren't stupid. I'd like to suggest in nontechnical terms why the problem might be with the models themselves.

"Mainstream macroeconomics is 'hydraulic,'" writes recovering macroeconomist Arnold Kling at EconLog. "There is something called 'aggregate demand' which you adjust by pumping in fiscal and monetary expansion. I wish to reject this whole concept of macroeconomics." I think he's right. In fact, as I've argued in these pages before, economies are not pumps to be primed, but economic ecosystems ("Black Swans, Butterflies, and the Economy," March 2009; www.tinyurl.com/crea2y). Economists are thus notoriously bad at predicting, much less planning, economies. That's why next-generation economics must focus on the fundamentals—namely, the rules that give rise to successful entrepreneurship and sustainable growth. Not aggregates. Not models. Rules.

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"Institutions form the incentive structure of a society and the political and economic institutions, in consequence, are the underlying determinant of economic performance," said Douglass North in his Nobel Prize lecture. And he's not alone in the wilderness. James Buchanan, another Nobel Prize winner, says economists are simply asking the wrong questions:

> How do markets work? Standing alone, this is an inappropriate and unanswerable question. It must be replaced by the question: How do markets work under this or that set of constitutional and institutional constraints? Economists' scientific expertise can be brought to bear on the predicted effects of alternative sets of constraints. The relevant question is not how this or that outcome may be put in place through possible collective or political action. The question becomes instead, how can this or that set of constraints be predicted to operate so as to allow the generation of an order that meets certain criteria of desirability? The difference between the two methodological stances may appear minor, but much ill-advised effort might be avoided if economists would recognize the limits of their own discipline. ["Economists Have No Clothes"; www.tinyurl.com/yd3tmab]

At the end of macroeconomists' yellow-brick road? A curtain, behind which lies a model, behind which lies an agenda.

Buchanan not only laments the poor framing of economic questions, but also says that even those attempting postmortems of the 2008-09 financial crisis have been "embarrassed by their inability to offer 'scientific' explanations." Those who've dared to come forward have offered little more than warmed-over Keynesian nostrums. Just think of folks like Romer, Paul Krugman, and Joseph Stiglitz—all of whom have recommended various versions of doubling down on the failed policy. At the end of their yellow-brick road? A curtain, behind which lies a model, behind which lies an agenda.

So what do all these macroeconomic models have in common?

- They're rendered either in impenetrable math or with sophisticated computers, requiring a lot of popular (and political) faith.
- Politicians and policy wizards hide behind this impenetrability, both to evade public scrutiny and to secure their status as elites.
- Models vaguely resemble the real-world phenomena they're meant to explain but often fail to track with reality when the evidence comes in.
- They're meant to model complex systems, but such systems resist modeling. Complexity makes things inherently hard to predict and forecast.
- They're used by people who fancy themselves *planners*—not just predictors or describers—of complex phenomena.

None of this is to argue we should do away with measurement. Temperature, blood pressure, and other indicators are all useful data for telling whether you're healthy. But using proxy measures to determine an economy's health is a far cry from using models to reduce dynamic systems to steady-state snapshots.

What does this mean for economics as a discipline? I think it's time we admit many economists are just soothsayers. They keep their jobs for a host of reasons that have less to do with accuracy and more to do with politics and obscurantism. Indeed, where do you find them but in bureaucracies—those great shelters from reality's storms? Governments and universities are places where big brains go to be grand and weave speculative webs for the benefit of the few.

And yet "ideas have consequences." Bureaucracies are power centers. So we have a big job ahead of us. We've got to do a seemingly contradictory thing and make the very idea of complex systems simple. How best to say it? Economists aren't oracles? Soothsaying is not science? Ecosystems can't be designed?

"The very term 'model' is a pretentious borrowing of the architect's or engineer's replica, down-to-scale of something physical," says *Barron's* economics editor,

Gene Epstein. "These are not models at all, but just equations that link various numbers, maybe occasionally shedding light, but often not."

Take this as a throwing down of the gauntlet. Macroeconomic wizards owe us more than the circular justifications for cushy jobs.

Likewise, we have to explain that a scientist's model, while useful in limited circumstances, is little better than a crystal ball for predicting big phenomena like markets and climate. It is an offshoot of what F. A. Hayek called the "pretence of knowledge." In other words, modeling is a form of scientism, which is "decidedly unscientific in the true sense of the word, since it involves a mechanical and uncritical application of habits of thought to fields different from those in which they have been formed" (www.tinyurl.com/ybjtur2). A model is thus a cognitive shortcut for both the wonk and the journalist, the latter of whom wants to peg his story to something authoritative the wonk has to provide. At the receiving end of this wonk-writer alliance are the rest of us—with little besides common sense as a shield. And I don't mean this as populism. It is rather a defense against scientism launched from the turf of Austrian economics.

> A model is a cognitive shortcut for both the wonk and the journalist, the latter of whom wants to peg his story to something authoritative.

Complex phenomena can be counterintuitive. Sometimes they require scrutiny by experts to make sense of them. Notwithstanding their expertise, experts are just as often wrong as right. Can we base policy decisions on what amounts to coin flips? Models are a means of making the most fragile of hypotheses seem strong and substantive. But the only thing we can really predict is that they'll eventually shatter. FEE

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The Private Provision of Public Goods

BY DONALD J. BOUDREAUX

Nobel laureate economist Elinor Ostrom's important work shows that people are very good at using voluntary action to solve problems that economics textbooks insist require the forceful hand of government. Producing "public goods" (such as irrigation systems for a community of farmers) often promises large enough gains to stir the creative juices of people—who, given enough freedom of action and security of rights, then figure out how to cooperate to provide them. This cooperation often takes different forms from what we witness in markets for typical private goods (such as shoes).

Along similar lines other scholars over the years have discovered countless historical examples of the successful private provision of public goods. Sometimes it is achieved by firms seeking monetary profit, while other times it is achieved by people cooperating for gains that are real but not monetized or exchanged in conventional markets.

Reston, Virginia's public services are delivered by a private company and governed by the consent of homeowners.
Joshua Davis

The discovery of any such instance always surprises the typical economist, whose thinking is stymied by too many wrongheaded models of economic interaction.

Perhaps the most surprising of these discoveries is the issue of private currencies (or "free banking"). F. A. Hayek, George Selgin, and my George Mason University colleague Larry White led the way in showing not only that sound money *can* be supplied privately but that it *has* been supplied privately—most notably in Scotland from 1716 until 1844.

What about roads?

Limited-access highways are no problem. Private highway builders can erect tollbooths at entrances and exits and charge for use of their roads. No free riders will thwart builders' efforts to collect payment from willing customers.

Local city streets are different. Having tolls at each intersection seems awfully inconvenient.

One way of solving the problem of privately supplying local city streets was seen in St. Louis. As reported by historian David Beito:

"In 1867, property on Benton Place, the first private street in St. Louis, went on the market. The street had been subdivided a year earlier by Montgomery Blair, who had been Postmaster General under Abraham Lincoln. Blair entrusted design of the street to Julius Pitzman. By the 1870s, at least four other private streets ringed Lafayette Park. Pitzman laid a park median on the street, a feature emulated by later private places. Every lot extended to the center of the median. Following the pattern of Lucas Place [a St. Louis street with some private characteristics], each deed carried restrictions, including a setback from the street of twenty-five feet. Business use and multifamily housing were not prohibited, however. The restrictions provided for the annual election of

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three commissioners by the lot owners. The commissioners had authority to maintain the street, street lighting, the park median, sewers, and the alley by levying an annual assessment of fifty cents per front foot on each property. Armed with private-street ownership, Benton Place's residents enjoyed a range of powers not possessed [by residents of nonprivate streets]. The commissioners, exercising their proprietary rights, erected a gate at one end of the street and a retaining wall at the other. They could deny access to the alley or park median to residents delinquent in their assessments to the street association."

Note that the private payments for this private street were simultaneously also payments for several other public goods that people value: sewerage, a park, and street-cleaning services, among others. By bundling these public amenities into a single package—namely, title to property on Benton Place—the developer was paid for providing this range of public goods. Persons who didn't buy property on Benton Place and live up to their express agreement to pay annual assessments got no residential rights to live there.

Note, too, that Beito does not call the assessments "taxes." He's right not to do so. Everyone who bought property on Benton Place expressly agreed to pay the assessments according to the contractual agreements they signed with the developer. These payments, therefore, were made voluntarily.

Modern Examples

Columbia, Maryland, and Reston, Virginia, provide more recent examples of cities whose infrastructures were built and supplied privately. In both cases, private developers—James Rouse in Columbia and Robert Simon in Reston—planned and constructed the streets, sewer lines, and parks. They then sold real estate that included a prorated portion of the infrastructure's cost.

Obviously these developers also had incentives to provide high-quality infrastructure. Were the streets too few, the park too small, the sewer lines too narrow, the maximum prices that buyers would pay for homes in these towns would have been lower.

Interestingly, not only was physical infrastructure provided privately in Reston and Columbia, so, too, was perhaps the most important public good of all: law. By buying real estate in Reston or Columbia, a buyer also expressly agreed to abide by the town's bylaws, which serve as constitutions. They specify limits on property use (for example, no old cars on cinder blocks in front yards) as well as procedures for making future collective decisions that affect all residents. Unlike constitutions and statutes chosen by majoritarian voting, *these* rules have the actual unanimous consent of the people they govern.

Unlike constitutions and statutes chosen by majoritarian voting, *these* rules have the actual unanimous consent of the people they govern.

In our 2002 paper, "Contractual Governments in Theory and Practice," Randy Holcombe and I called the rule-making procedures and agencies formed by such constitutions "contractual governments." We explained:

> A single owner who intends to subdivide property and sell individual parcels forms the typical contractual government. The owner's motivation is to increase the value of the parcels. As such, the creator of the contractual government has an incentive to create constitutional rules with the highest value. . . . The entrepreneur who forms a contractual government is a residual claimant whose income depends on the production of efficient constitutional rules. In municipal government, in contrast, there is no residual claimant. Mayors, city managers, and town-council members may have some incentive for making efficient decisions, but not the direct incentive that they would have if they were able to capture the profit from efficient decisions directly, as is the case with contractual governments. Thus, a direct incentive exists to produce efficient constitutional rules under which a contractual government will operate, unlike the situation that exists with municipal governments.

Sounds like a pretty good system. FEE

The New Financial Imperialism

BY ROBERT STEWART

The *Britannica Concise Encyclopedia* defines *imperialism* as "the policy of extending a nation's authority by territorial acquisition or by the establishment of economic and political hegemony over other nations. Because imperialism always involves the use of power, often in the form of military force, it is widely considered morally objectionable, and the term accordingly has been used by states to denounce and discredit the foreign policies of their opponents."

For example, Britain colonized North America, and what now constitutes the United States, until 1783 when the Brits were kicked out because out they imposed high taxes. The Declaration of Independence had it exactly right: "He [King George III] has erected a multitude of New Offices, and sent hither swarms of Officers to harass our people, and eat out their substance."

New Napoleon: Jeffrey Owens leads OECD's attempt to foist high-tax policies on low-tax jurisdictions.
OECD.org

Today, the United States makes George III look like a piker. It is amazing how, with respect to taxes and freedom, the U.S. government has copied and often been more ruthless than the British Empire. As a consequence, the extent to which economic liberty has been destroyed in America and what is now the EU is almost beyond belief. It is as if the American and French revolutions never took place, or took place to provide cradle-to-grave management by government over our lives.

The U.S. governments—federal, state, and local—find that extracting 35–40 percent of incomes is not sufficient. They need more to continue their march toward the perfect welfare state and, in the case of the national government, military dominance of the world. As a result the tax burden under which the average American suffers is now about 20 times higher than under George III.

The EU countries are even worse, with governments raking in around 50 percent of national output. Even Louis IV of France would now be viewed as a benevolent uncle compared to that. The U.S. and EU governments intrude on the financial lives of citizens in every conceivable way, from taxes to regulations to absurd laws that shape and control their citizens.

Empire of the Welfare State

The welfare state, even more than the war on drugs or organized crime, drives the financial imperialism of the U.S. and Europe. Financing the welfare states—most of them are technically bankrupt because of the huge costs of Social Security, public-sector pensions, medical care, and aging populations—creates massive problems, so the United States and Europe look hungrily abroad for more money.

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Thomas Paine, who wrote of "the greedy hand of government, thrusting itself into every corner and crevice of industry," would be astounded at today's situation. Some taxpayers subsidize other taxpayers, or pay taxes that they later themselves get back as subventions, or pay for services they do not want or even positively oppose. Industry after industry is regulated by millions of bureaucrats and thousands of pages of regulations.

Not content with levying excessive taxes on their citizens at home, large governments using the Organisation for Economic Co-operation and Development (OECD) have in their sights the tax policies of small and less-influential countries whose cardinal sin is to siphon off revenues or poach wealthy taxpayers.

Instead of fighting Britain, the United States has now joined hands with its former colonial oppressor and several other European countries in seeking to prevent a major threat to their treasuries. (For some examples see Daniel Mitchell's July/August 2009 *Freeman* article, "In Praise of Tax Havens," www.tinyurl.com/l2crab.) What is the nature of this threat?

> The greatest enemy of the modern State is not the terrorist, but the citizen who simply wants to keep his own income or to protect his own wealth.

There are a number of countries, disparagingly called tax havens (or offshore financial centers), most of them small and insignificant, such as Bermuda, Monaco, Liechtenstein, and Cayman, that are allegedly sabotaging the grandiose plans of the United States and the European Union to create their utopian welfare states and undermining expensive military ventures in obscure places like Iraq and Afghanistan.

What on earth can these toe-holds on the world atlas be up to?

According to a March 2, 2009, floor statement of Senator Carl Levin of Michigan on the introduction of the "Stop Tax Haven Abuse Act," (an earlier version of which was supported by then-Senator Obama) a tax haven is a foreign jurisdiction that maintains corporate, bank, and tax secrecy laws and industry practices that make it difficult for other countries to find out whether their citizens are using the tax haven to cheat on their taxes. He went on to say "that secrecy breeds tax evasion. Tax evasion eats at the fabric of society, not only by starving health care, education, and other needed government services of resources, but also by undermining trust—making honest folks feel like they are being taken advantage of when they pay their fair share."

It is dubiously alleged that offshore tax abuses cost the U.S. treasury an estimated $100 billion each year in lost tax revenues. (As Mitchell says, "That number is phony.") "Tax havens are engaged in economic warfare against the United States, and honest, hardworking Americans," Levin said. The implication is that no country should derive a comparative economic advantage from its fiscal policies and that such policies should be harmonized with countries like the United States.

An appropriate response might be that this $100 billion is channeled from tax havens into productive investment that creates jobs, wealth, and opportunities for Americans rather than disappearing into the rat-hole of government spending. Or that tax policy should not be decided by OECD bureaucrats.

Truly in many ways the world has changed—and not always for the better—during the past two centuries. High taxes are good, and low taxes are bad now. Freedom to spend your money in the way you deem best is no longer a virtue but a sin. Diversity is out, homogeneity in. Millions of people in the United States and Europe now depend on taxing others in order to enjoy income, medical care, and unemployment and other benefits.

The greatest enemy of the modern State is not the terrorist, criminal, hoodlum, or even the foreign aggressor; it is the citizen who simply wants to keep his own income or to protect his own wealth. "Need" is defined as getting your hands on other people's money, and greed has come to mean the natural desire to protect your own property and assets from sequestration by governments.

The jihad against low-tax jurisdictions and the imperialist tax policies being implemented by the

United States and the European Union have at least four adverse consequences.

Privacy is reduced. Increasingly, the right to be left alone or to tell the government, "Mind your own business," is seen as a quaint throwback to the eighteenth century. But is not the principle a fundamental part of privacy and liberty?

The enjoyment of financial and personal privacy is the essence of a free and civilized society. Freedom means the right to spend your own money as you like and to talk to your lawyer or banker without fear he is a government agent.

Government power is increased. The tax laws of most countries are voluminous, so much so that even tax lawyers and accountants have trouble interpreting them. Everyone breaks them inadvertently. The more laws, the greater is the power of government, and proportionately the freedom of the individual is diminished. John Mitchell, the attorney general under President Nixon, is alleged to have said to his boss, "Let me know who you wish to be arrested, and I will find a law he has broken." He likely wouldn't have to look further than the tax code. For anyone.

The sorry and tragic history of government power is that it is likely to be abused, and the likelihood, or even the certainty, of abuse grows along with that power. This point was made early on after the creation of the income tax, when Richard E. Byrd, speaker of the Virginia House of Delegates, predicted, "[A] hand from Washington will be stretched out and placed upon every man's business. . . . Heavy fines imposed by distant and unfamiliar tribunals will constantly menace the taxpayer. An army of Federal officials, spies and detectives will descend upon the state."

The income tax changed the relationship between the taxpayer and government. Taxpayers are allowed to retain a portion of their earnings as pocket money while the government filches the rest. Freedom to spend hard-earned wages is at the discretion of the tax authorities.

Capital investment is reduced. One of the fundamental and settled propositions of sound economics is that the standard of living of everyone depends on capital investment, which today is not only tools, factories, and equipment, but human capital. Capital investment requires resources not consumed but saved. Ludwig von Mises said it best: "The confiscation of business profits does not benefit the masses. It prevents the efficient entrepreneur from expanding his efforts to supply the consumers in a better and cheaper way, and it shelters the less efficient against the competition of more efficient newcomers. It substitutes rigidity and immutability for progress and continuous improvement."

Inhibiting, through punitive taxation, the production of wealth in order to create the impression of equality is not humanitarianism but simply stupidity because it makes everyone less well-off—especially the poor.

Tax policy is "harmonized," that is, "cartelized." Tax harmonization is the equivalent of tax bullying. The hypocrisy of governments' bullying tax havens is appalling. If the OECD tax systems were mild, most people who now use tax havens wouldn't bother.

The belief that tax harmonization is sound public policy has its genesis in the mistaken belief that government spending is good and private spending is bad. This is the private affluence/public squalor argument sanctified by the 1958 publication of *The Affluent Society* by the late John Kenneth Galbraith—patron saint of political big spenders. However, history tells us that when you leave people alone and keep taxes low, economies flourish and people prosper. If the ability to avoid taxes were impossible, a tyrannical regime could squeeze the taxpayer orange until the pips squeaked.

If the ability to avoid taxes were impossible, a tyrannical regime could squeeze the taxpayer orange until the pips squeaked.

Guilt by Lack of Association

One of the latest stunts of the OECD is to compel offshore financial centers to sign tax information exchange agreements (TIEA), under which authorities in these centers can be forced to provide information. Failure to sign a sufficient number of TIEAs can place a jurisdiction on a blacklist. This is a bully-boy tactic.

Appearing on the blacklist means that there is a strong suspicion that monkey business is going on, and that the low-tax jurisdiction is using improper secrecy to shelter potential money launderers, terrorists, tax evaders, and other assorted financial riffraff. However, the pristine reputation of the United States has been undermined lately by research conducted by Jason Sharman of Griffith University on Australia's Gold Coast. Sharman tested the difficulty in setting up anonymous bank accounts in various places around the world, including tax havens. The highest standards of probity were small island tax havens, while the lowest standards arose in Somalia and the United States, where service providers were prepared to set up anonymous bank accounts without proper identification. This led Jean-Claude Juncker, prime minister of Luxembourg, to state, "If there must be a blacklist, then America should have its place on it."

> Tax competition compels governments to think more carefully before spending the public's money.

Tax competition compels governments to think more carefully before spending the public's money and frees entrepreneurs for greater access to investment funds. Contrary to common belief, low-tax jurisdictions do not siphon off capital from high-tax areas, but allow a better and more effective means of making investment decisions.

The Bible established a tax rate of 10 percent, known as the tithe. That should be enough for governments. There is little hope for optimism on that score.

Low-tax countries are an affront to high-tax countries that believe they have a right to tell the rest of the world how to live. So high-tax countries try to force their tax regimes on everyone else. That is financial imperialism. FEE

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Producing Jobs: Thoughts on Obama's Plan for Small Businesses

BY BRUCE YANDLE

The ears of small business America must have perked up when President Obama spoke about that critically important sector in his State of the Union address. Mine certainly did. Here's when it really got interesting: "I'm . . . proposing a new small business tax credit—one that will go to over one million small businesses who hire new workers or raise wages. While we're at it, let's also eliminate all capital gains taxes on small business investment, and provide a tax incentive for all large businesses and all small businesses to invest in new plants and equipment."

Later the President explained there would be a $5,000 tax credit for employing an additional worker, forgiveness of the employer's 6.2 percent portion of Social Security payroll taxes for newly added salaries and other salary increases, an end to capital gains on investment, and continuation of rapid write-offs for new capital investment, all to be targeted to businesses with 50 or fewer workers.

Mr. Obama was right to be concerned about small businesses. According to ADP's latest report, firms with fewer than 50 workers employed some 48 million people in December 2009; those with more than 50 had 60 million on the payroll. So America's small businesses employ close to half the workers in the economy. But their hiring plans have been decidedly bleak.

On first hearing the President's message, and captured by the moment, I shouted out, "Right on! Now we are getting somewhere." According to press reports, I was not alone in my enthusiastic reaction. John Arensmeyer, CEO of Small Business Majority, happily said, "These tax credits are simple and straightforward, and will support small businesses to generate the jobs Americans so desperately need. And they'll start doing it now."

My response must have come from a stored-up love for small businesses that goes back more than 40 years. But after settling back in my chair, I had other thoughts on the matter. Let me explain.

For some 15 years, starting when I was still a college student in 1952, I was a part-owner of a small business enterprise, which in 1967 had about 50 employees. As corny as it may sound, I still remember what it takes to make a payroll on Friday night. I understand how hard it is to generate enough additional dependable business to add just one more employee. And I know how great it feels to bring one on and to introduce the new employee to the team members he or she will join. I also know how much it hurts everyone in the firm to cut back, to have to fire a good worker because business has fallen off. Because of the pain that goes with layoffs, I know how careful one will be before hiring another worker. In the case of small business, that person is likely to be a friend, former colleague, or family member. Also, if the firm employs ten people, which is common, adding one more amounts to a 10 percent increase in personnel.

America's small businesses employ close to half the workers in the economy.

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And that ain't hay, especially in a recession when you are not sure if the next month will be your last.

I hope that some of Mr. Obama's close advisers know these things as well as, if not better than, I do. I am betting they do.

No one in his right mind wants to bring on a new employee only to face the plight of having to pass out more pink slips. Before hiring that one person I would want to see a lot of black ink on the operating statement, not just one or two profitable months. Because of this, I don't think a $5,000 tax credit will get the job done. What we need is some certainty.

This seemed to be a base concern when Susan Eckerly, senior vice president, federal public policy, of the National Federation of Independent Business, was asked about the Obama tax credit. She indicated that small businesses wouldn't start hiring until earnings improved. "An employer is unlikely to hire someone just to get a $5,000 credit," she said. When I read Eckerly's comments I was reminded of a wise guy's response to tax incentives that allowed a firm to "to take it off your income tax." The response: "First off, I've got to have income."

Adding just one new full-time hire when your toes can barely touch the bottom in a recession's deep end is risky business.

Obama wants to see one million new employees added to the ranks of America's small businesses. I do as well. But adding just one new full-time hire when your toes can barely touch the bottom in a recession's deep end is risky business, and for one major reason. At this point there is no way to know what really lies ahead; there is no way to distinguish between stimulus and the real economy. Too many policy boulders are being dropped in the water. One can hardly determine the effects of one before another one is thrown in the pool.

There was stimulus one. Then stimulus two. And now talk of stimulus three. There was TARP. Cash for Clunkers. Cash for Appliances. First-Time Homebuyer tax credits. Health care revision. Copenhagen. Cap and trade. Jobs programs. Financial reform. Each announced in short succession. The effects of some of these programs are so large that they are readily seen in GDP and construction data. By some counts, about half of 2009's fourth quarter 5.7 percent GDP growth is explained by Cash for Clunkers, a program that came on like gangbusters and then faded into oblivion.

Imagine yourself as owner of a small business with 20 employees who's trying to decide if you should build up inventories again, hire one or two people, and lease another pickup truck. Would you make your decision on the basis of the fourth-quarter GDP numbers? Would you base your plans on the explosion of existing home sales that followed the First-Time Homebuyer stimulus? Most likely not. I'll bet you would wait so that you could get a better fix on the real economy.

Perhaps we need six months of political silence.

When I think about the situation and Mr. Obama's proposal, I wonder if it might be better to expand the noble elements of his idea to all businesses, small and large, and do so permanently. Instead of having a complicated jobs-based tax system, why not just cut the marginal tax rate? And instead of allowing a temporary moratorium on capital gains taxes for small businesses, why not just abolish capital gains taxes for all businesses? Doing this would put an end to trying to determine what is stimulus and what is real and what may change at the end of the year.

There is a supply side to the economy that wants to spring forward. A growing economy will produce more jobs. This is the time to give a nudge and then stand back and let the real economy recover. FEE

Comparing the Great Depression to the Great Recession

BY BURTON W. FOLSOM, JR.

President Obama has often remarked that the Great Recession (2008–10) is the greatest economic crisis since the Great Depression. It's interesting to study the many parallels between the Great Recession and the Great Depression.

Causation. The main causes of both crises lie in actions of the federal government. In the case of the Great Depression, the Federal Reserve, after keeping interest rates artificially low in the 1920s, raised interest rates in 1929 to halt the resulting boom. That helped choke off investment. Also, President Hoover signed into law the sky-high Smoot-Hawley Tariff, which stifled trade and damaged American exports throughout the 1930s. Finally, the President signed a large tax increase into law in 1932, which halted entrepreneurship.

The seeds of the Great Recession were planted when the government in the 1990s began pushing homeownership, even for uncreditworthy people, with a vengeance. Mortgage-backed securities built on dubious mortgage loans became "toxic" when the housing market took a downturn, and many American banks verged on collapse. The government's urgent desire to bail out various banks and corporations created uncertainty and instability, and this may have widened the recession.

Massive federal spending. Presidents Roosevelt and Obama responded similarly to the crises. They talked about balancing the federal budget, but instead resorted to massive spending. Earlier presidents, like Cleveland and Harding, cut spending when the nation was threatened with economic hardship. Hoover was the transition president, running deficits with record spending on public works, the first federal welfare program, and the first large-scale federal farm program. The results were budget deficits and 25 percent unemployment.

President Roosevelt became Hoover on steroids. FDR and his advisers, despite some early moves to cut spending and control the deficit that Hoover left behind, decided that ever-larger federal spending would trigger economic expansion and pull the country out of its economic slump. Thus Roosevelt began the Agricultural Adjustment Act (AAA), which paid farmers not to produce, and then expanded Hoover's Reconstruction Finance Corporation, which provided bailout money to large banks and corporations. He also expanded spending on public works and targeted large subsidies to various special interests.

President Obama, who often cites FDR, followed his example of targeting spending to interest groups. He signed into law a $787 billion stimulus package that sent tax dollars to various cities and voting groups across the nation. He later supported an expensive "jobs bill" that would send money into key congressional districts. The President also campaigned for a cap-and-trade bill and universal health coverage, both of which promised to increase the federal debt substantially. In fact, the increase in federal debt under Obama and Roosevelt is similar. The national debt more than doubled in Roosevelt's first two terms, and it is projected to double again in eight to ten years.

President Roosevelt became Hoover on steroids.

Spending fails. After the large increases in federal spending under Roosevelt and Obama, unemployment remained high. In the 1930s unemployment fluctuated, but recovery never occurred. In April 1939, toward the end of Roosevelt's second term, unemployment was almost 21 percent. Treasury Secretary Henry Morgenthau complained, "We are spending more than we have

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ever spent before and it does not work." Nonetheless, almost all of FDR's programs continued—usually with annual budget increases.

When Obama took office unemployment was at 8 percent, and in the next year it steadily increased to over 10 percent before falling back just under that mark. He and his advisers were puzzled that large spending increases did not slash unemployment, and he argued that his spending was saving jobs that would otherwise have been lost.

Critics of Roosevelt and Obama insisted that it was impossible to spend our way out of a recession. During the New Deal, economics writer Henry Hazlitt observed that public-works spending destroyed as many jobs as it created. "Every dollar of government spending must be raised through a dollar of taxation," Hazlitt emphasized. If the Works Progress Administration builds a $10 million bridge, for example, "the bridge has to be paid for out of taxes. . . . Therefore for every public job created by the bridge project a private job has been destroyed somewhere else."

Tax rates raised. During the Great Depression Roosevelt raised both income and excise taxes. In 1935, with FDR's push, the top marginal tax rate hit 79 percent. Few paid that rate, but thousands of Americans were in the 50-percent bracket. Entrepreneurs had to hand over more than half of any income above a certain level. Facing disincentives to make capital investments, many entrepreneurs used their wealth cautiously—investing in tax-exempt bonds, art collections, and foreign banks. Little wealth went into creating jobs, so high unemployment persisted. During World War II FDR raised taxes further, to 94 percent on all income over $200,000.

Most of the tax hikes under Obama are planned for the future. Thus far we have seen proposed tax hikes on products such as cigarettes, liquor, plane tickets, and soft drinks. He wants the tax cuts enacted under President Bush to expire. That will mean a spike in the capital gains tax, the income tax, and the estate tax. As FDR showed, tax hikes eventually follow large spending increases.

Scapegoats. The sequence of massive federal spending followed by a lack of recovery plus tax hikes is poison for a politician. Therefore Roosevelt sought scapegoats to explain his failure. Wall Street bankers were his favorites. He called them "economic royalists" and blamed them for causing the Great Depression. He also blamed America's top businessmen for instigating a "capital strike"—they were refusing to invest in order to make him look bad. FDR then launched IRS investigations of key Republicans and used the newspapers to encourage hostility toward these targets.

Obama has followed FDR's playbook of attacking Wall Street bankers and various corporate leaders. He condemns the raises these bankers sometimes receive and the profits earned by some large oil companies and health insurance companies.

Obama has followed FDR's playbook.

Such emphasis on "class warfare" may be an inevitable part of redistributing wealth from one group to another. Perhaps Roosevelt and Obama believed that by increasing envy and resentment toward some Americans, they could capture the votes of larger groups of Americans and thereby win reelection (in FDR's case there is evidence of this). True, this strategy guarantees that many wealthy Americans will attack any president who uses class warfare, but the campaign for redistribution will always supply large amounts of money to subsidize favored groups.

When Roosevelt was reelected in 1936 Senator Carter Glass, Virginia Democrat, admitted, "The 1936 elections would have been much closer had my party not had a 4 billion 800 million dollar relief bill as campaign fodder."

Obama may be hoping his "stimulus" package and his health insurance bill will generate similarly large support among Americans receiving federal benefits and that these voters will go to the polls to overwhelm those who are paying the bills. FEE

Are Welfare State Orphans in Good Hands?

BY JAMES L. PAYNE

On February 22, a court in suburban Washington, D.C., passed judgment in one of the most horrendous cases of child abuse in modern times. Renee Bowman, the adopting parent of three girls, had for years starved, neglected, and beaten them, while keeping them locked night and day in their bedroom. She choked two of the girls to death, put their bodies in plastic bags, and stored them in the freezer. The third girl escaped by jumping from a window.

At first glance, these child murders may seem an inexplicable, isolated tragedy; a closer look reveals that this outrage was constructed, piece by thoughtless piece, by the modern welfare state.

In It for the Money

The first error came with the selection of Bowman as the adoptive parent. She was obviously a negligent and seriously deranged person who never should have been approved for adoption. Well, who approved her? The adoption had been supervised from start to finish by a government agency, the District of Columbia's Child and Family Services. In theory, it was supposed to establish that Renee Bowman was a suitable parent. In practice it didn't even notice, or care, that she had a criminal record—she threatened a 72-year-old with bodily harm—a rather glaring instance of "government failure" by this notoriously incompetent agency.

The next link in the tragedy concerns Bowman's motivation for adopting the children. If she did not love children, if she saw them as a burden, why had she bothered with the expense and effort of adopting them? The answer is money. In 1980 Congress approved a subsidy program to provide payments to parents who adopt children from foster care. I'm sure lawmakers thought it was a useful idea. If the federal government can buy tanks and bombs, after all, why can't it buy adoptions?

> Worthy parents adopt out of love, conviction, enthusiasm, and dedication. Putting money on the table changes the mix of motivations.

Well, it does buy adoptions, but not high-quality ones. Worthy parents adopt out of love, conviction, enthusiasm, and dedication. They are willing to make real sacrifices for their children. Putting money on the table changes the mix of motivations. Yes, loving parents will still appear, but insensitive people who view children as an economic commodity also come forth. Renee Bowman was one of these insensitive, grasping types. She was being paid $2,400 a month by the federal government to be listed as the mother of these three girls; altogether she collected $152,000. "This woman was in it for the money," said the prosecutor at the trial. "And by killing the children, keeping them literally on ice, the money continued to flow."

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Keeping Adoptions Low, Abuse High

Officials point out that without adoption subsidies to attract parents, children would languish in the state foster care systems. There's some truth to this, but it exposes another flaw in the state system of handling orphans. A survey by the National Center for Health Statistics found there were nearly 600,000 women seeking to adopt children, a figure over four times the total of 129,000 children in foster care available for adoption. The oversupply of willing parents holds for all categories of children, including older children, black children, and children with disabilities. But under government management, adoption from foster care has become a tortuous, burdensome process demeaning to prospective parents. The government agencies are so focused on trying to apply a host of bureaucratic regulations that they repel many, especially independent-minded individuals critical of silly red tape and micromanagement. The result is that children remain stuck in foster care. Even so, hundreds of thousands of people would like to adopt them.

Even after the murders were revealed, officials did nothing.

The severity of government impediments to adoption was documented by a study undertaken in 2005 by Listening to Parents, a nonprofit research group. It followed 1,000 prospective parents who called a public child-welfare agency seeking to adopt. Out of this initial group, only 36 adoptions occurred.

Having inadvertently contrived a deplorably low adoption rate, government sought to correct the problem by applying government's inevitable fix-all: throwing more money at the problem, in the form of adoption subsidies. They created a situation of moral hazard where a person like Renee Bowman might adopt children primarily for the money, and, lacking love and a sense of responsibility, might neglect and abuse them.

Bowman's was not an isolated case. *Washington Post* columnist Courtland Milloy reported in February 2009 that in the previous eight months at least seven adopted children in D. C. had been killed, their adoptive parents charged or suspected in the homicides. And those are just the murder cases—that we know about. Given the number of children in Washington, D. C.'s adoption subsidy program, it's fair to wonder if neglect and abuse short of murder are far more widespread than anyone would like to imagine

This brings us to the most shocking failure in this sorry episode. After the deadly consequences of the misguided adoption subsidy became screaming headlines, officials did nothing! They didn't close down the program. They didn't fire, fine, or imprison employees responsible for the miscues. They didn't resign in shame and embarrassment. Jobs and careers depend on this program: It's in officials' economic self-interest to downplay its problems. The same is true of the pressure groups that represent parents taking the subsidy. Their attitude was captured by a *Washington Post* reporter: "Even with limited oversight, most children end up in safe and supportive families, advocates said."

In the old days, before we got hardened to welfare-state abuses, we would have said that a system that resulted in even one murdered child was unacceptable. Today, the self-interested participants of the welfare state are content with a program where "most" of the children aren't slain.

The solution to the travesties being committed by government child welfare agencies lies right before us: Move away from the welfare state as fast as we can. Turn the problems of orphans, foster care, and adoption back to private charitable and commercial entities, unsubsidized by tax money and largely unregulated.

Will errors occur in this voluntary system? Undoubtedly they will, but they wouldn't be met with institutional shrugs of the shoulders. The voluntary system would have this advantage: If a private agency was implicated in a tragic malfunction, donors and customers would be free to turn away from it and the agency would disappear. FEE

Jefferson's Economist

BY SHELDON RICHMAN

In 1817 the Frenchman Destutt de Tracy (1754–1836) published his *Treatise on the Will and Its Effects*. Thomas Jefferson was so enthusiastic about Tracy's book that he had it translated, then edited and revised the translation himself. He renamed it *A Treatise on Political Economy*.

Why was Jefferson so excited about the work? It contains a clear appreciation of the free society that would have excited anyone with Jefferson's philosophical and political proclivities. Let's have a look at some of what Tracy had to say.

We should first note that Tracy anticipated (though imperfectly) key insights of the Austrian school of economics, which would come into being a little more than half a century later at the University of Vienna under Carl Menger. The classical school of economics associated with Adam Smith's *The Wealth of Nations* (1776) leaned on an objective theory of value; the value of goods was said to be determined by the amount of labor embodied in them. Exchange for Smith consists of the trading of equivalents (measured in labor time). But here's Tracy, four decades later, stating something very close to the subjective utility theory of value that would mark the Austrian school's revolutionary approach to economics:

> In general we may say that whatever is capable of procuring any advantage, even a frivolous pleasure, is useful. . . . [T]he measure of the utility of a thing, real or supposed, is the vivacity with which it is generally desired. . . . Now, how are we to fix the degrees of a thing so inappreciable as the vivacity of our desires? We have, however, a very sure manner of arriving at it. It is to observe the sacrifices to which these desires determine us. . . . [A]n exchange is a transaction in which the two contracting parties both gain. Whenever I make an exchange freely, and without constraint, it is because I desire the thing I receive more than that I give; and, on the contrary, he with whom I bargain desires what I offer more than that which he renders me.

Destutt de Tracy's treatise contains a clear appreciation of the free society.

Thus, contra Smith, Tracy understood that people exchange *unequal* things on the basis of differing assessments of their utility, or usefulness.

And like a good proto-Austrian who understands that the future is uncertain, Tracy hastens to add:

> In truth it is possible that, in an exchange, one of the contractors, or even both, may have been wrong to desire the bargain which they conclude. It is possible they may give a thing, which they will soon regret, for a thing which they will soon cease to value. It is possible, also, that one of the two may not have obtained for that which he sacrifices as much as he might have asked, so that he will suffer a relative loss while the other makes an exaggerated gain. But these are particular cases which do not belong to the nature of the transaction.

As a result of his insights, Tracy has a distinctive way of describing society:

> Society is purely and solely a continual series of exchanges. It is never anything else, in any epoch of its duration, from its commencement the most unformed, to its greatest perfection. And this is the

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greatest eulogy we can give to it, for exchange is an admirable transaction, in which the two contracting parties always both gain; consequently society is an uninterrupted succession of advantages, unceasingly renewed for all its members. . . .

It is this innumerable crowd of small particular advantages, unceasingly arising, which composes the general good, and which produces at length the wonders of perfected society.

Those are some of the fundamentals of Tracy's positive economics. From there he moves on to normative economics, or political economy. Given what he has said already, we should not be surprised that he embraces freedom and property: "[S]ociety should have for its basis, the free disposition of the faculties of the individual, and the guarantee of whatever he may acquire by their means; then every one exerts himself. One possesses himself of a field by cultivating it, another builds a house, a third invents some useful process, another manufactures, another transports; all make exchanges; the most skilful gain, the most economical amass."

Tracy points out that land is a key source of income that in a free society competes with employers for labor, maximizing workers' bargaining power.

Tracy points out that land is a key source of income that in a free society competes with employers for labor, maximizing workers' bargaining power by providing an alternative to wage employment.

[S]o long as society has not occupied all the space of which it may dispose, all still prosper with care; for those who have nothing but their hands, and who do not find a sufficiently advantageous employment for their labour, can go and possess themselves of some of those lands which have no owners, and derive from them a profit so much the more considerable, as they are not obliged to lease or buy them. Accordingly care is general in new and industrious nations. But when once all the country is filled, when there no longer remains a field, which belongs to nobody, it is then that pression begins. Then those who have nothing in advance, or who have too little, can do no otherwise than put themselves in the pay of those who have a sufficiency. They offer their labour every where, it falls in price.

Curiously, Tracy does not acknowledge that land may become unavailable not because of population density but because the government has seized it and given it to the nobles or cronies. In fact, this happened repeatedly in England. State-sponsored "land monopoly" and the exploitation it made possible were deep concerns of libertarians from the early nineteenth century into the twentieth century.

Tracy understood that through government intervention class conflict emerges, as owners of land and capital seek advantage over those who labor for them:

After the free disposition of his labour, the greatest interest of the poor man is that this labour should be dearly paid. Against this I hear violent outcries. All the superior classes of society—and in this view I even comprehend the smallest chief of a workshop—desire that the wages should be very low, in order that they may procure more labour for the same sum of money; and they desire it with so much fury, that *when they can, and the laws permit them, they employ even violence to attain this end*,—and they prefer the labour of slaves, or serfs, because it is still at a lower rate. These men do not fail to say, and persuade, that what they think is their interest, is the general interest; and that the low price of wages is absolutely necessary to the development of industry, to the extension of manufactures and commerce,—in a word, to the property of the state. [Emphasis added.]

Thus the State is implicated in class conflict, a theme that originated not with Marx but with early libertarians.

In future columns, I'll examine Tracy's views on government spending and borrowing. FEE

Orient Express to Hell

BY JAMES BOVARD

In 1986 and 1987 I slipped behind the Iron Curtain a few times to study economic perversity and political slavery. In November 1987 I flew into Hungary before heading on to the most repressive regime in Europe.

The train from Budapest to Bucharest, Romania, was called the Orient Express. The original Orient Express began in the 1880s and connected Paris to Constantinople. The menu on the train's first run included oysters, turbot with green sauce, chicken "à la chasseur," fillet of beef with "château" potatoes, and a buffet of desserts. In the communist rendition of the Orient Express, there was no food on the train in Romania, though a few morsels may have been available in Hungary.

I had a cabin to myself as the train rolled southeast from Budapest. I had been told that if border guards found a map of Romania or any other dubious papers, I could be arrested or denied entry. So late at night, nearing the Romanian border, I studied the documents one more time, drilling into my head the things that I should be looking for. Then I tore everything up and threw it out the train window, piece by piece.

Ceauşescu, the World Bank's darling, had to flee his former subjects by helicopter when his government broke down.
Denoel Paris

Shortly after midnight the train lumbered to a stop in Transylvania, at the Hungary-Romania border. The scene had all the ambience of the original 1932 Dracula movie. I didn't hear wolves howling, but the mountain terrain, low-hanging fog, and military guards with German shepherds circling the train time and again sufficed.

My cabin was searched four times, with each team outdoing its predecessors. The mattresses on the bunk beds were jostled, and practically every cubic inch of space was poked or prodded.

The final inspection was supervised by a cute (by socialist standards) military officer. Perhaps the authorities thought I would confess my perfidy to the opposite sex. Nope: I was just another tourist heading to the "Paris of East Europe," as Bucharest preened in pre-communist times. Except that there were almost zero tourists in a land renamed "the Ethiopia of Europe." (I entered the country illegally—relying on an easily acquired tourist visa, instead of enduring the hassles and delays for a journalist visa.)

After the final search, guards bolted my cabin shut from the outside. The pseudo-luxury train had officially been converted into a traveling jail. But at least the intellectual-political virus was quarantined. My American passport had earned me special treatment. I just leaned back and counted my bless

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ings: In Western Europe they charged double for a private cabin.

The Orient Express was no longer an express after it entered Romania, taking 13 hours to go roughly 400 miles and running far behind schedule.

Everywhere were signs of a government increasingly fearful of its people. Throughout Transylvania radio towers were surrounded by military guards and barbed wire. The train stopped at Brasov, a medieval city renamed Stalin City in 1950. A dozen years later, as friction rose with Moscow, Brasov regained its old name. Shortly before I passed through, thousands of workers responded to wage cuts by ransacking communist party offices and killing two government militia men.

Romania looked double-damned by government planning and political meddling. There were horse-drawn wagons next to spewing factories and huge apartment complexes. Many people had abandoned their slipshod cars after government sporadically banned the sale of gasoline for private vehicles.

> Everywhere were signs of a government increasingly fearful of its people.

Around nine the next morning, there was a rapping on my cabin door—like someone sending a secret message. I heard someone struggling with the bolted lock. The door popped open, and half a dozen ragtag Romanian workers poured in. They had heard there was a foreigner—perhaps an American—confined on the train. They obviously knew how to overturn the bolt that sealed the door. The workers stared at me like I was E.T., and it probably wasn't just because of the old canvas hat I was wearing. Two of them leaned over and pawed/stroked my leather boots—eyes wide in amazement. Leather boots had apparently become the same type of luxury there that full-length mink coats were in America. Yet, in the pre-communist era, leather boots were probably routine for factory and farm workers. We communicated with simple gestures since I did not speak Romanian and they spoke no English. They seemed full of goodwill, but vanished after a few minutes—perhaps fearful of being caught talking to a foreigner.

Starved Into Submission

The workers were likely no fans of Nicolae Ceaușescu, the communist dictator who made Romania the most barbaric and repressive regime in Europe. Though Romania had been a breadbasket of Europe before World War I, food had become as rare as honest economic statistics. The communists destroyed hundreds of square miles of prime farmland to erect factories and open-pit mines. The government responded to food shortages with a publicity campaign on the danger of overeating. The government also revved up advertising in western nations touting Romania's "world famous" weight-loss clinics.

Ceaușescu seemed determined to starve the people into submission. Romanians were forbidden to receive food shipments from foreigners. Visitors were stopped at the Romanian border and denied entry if they attempted to bring in a chocolate cake or bubble gum.

The government put almost all investments into heavy industry—the ultimate source of bragging rights for communist leaders. But roughly half of Romanian factory output was so shoddy it was ready for the junk heap as soon as it left the gate.

Romanian industry was also extremely inefficient, consuming up to five times as much energy per unit of output as western factories. The government compensated by cutting off electricity to people's homes for up to six hours during the winter and permitting only one 25-watt light bulb per room.

The health system was collapsing, and the infant-mortality rate was so high the government refused to "register" children as being born until they survived their first month. The government also routinely cut off power to hospitals, which had caused a thousand deaths the previous winter.

The Darling of the World Bank

Yet some western experts thought Ceaușescu was the greatest thing since sliced bread. A 1979 World Bank report, the "Importance of Centralized Economic Control," praised the Romanian regime for pursuing

"policies to make better use of the population as a factor of production [by] stimulating an increase in birth rates."

And how did the benevolent ruler do this? By prohibiting distribution of contraceptives and banning abortions. These policies turned Romania into the world capital of abandoned babies.

Finally arriving in Bucharest, I learned that the Hotel Intercontinental was the only place westerners were allowed to stay. After I checked in, a beefy thirty-ish woman came up and asked in a gravely three-pack-a-day voice: "Would you like to have some company?"

I said no, and got away from her quick. The Romanian government was famous for using its intelligence agents as prostitutes. The woman had the hotel staked out, hoping to gather information from visitors or to entice them into behavior that could be videotaped and used to betray them.

I checked into my room, which looked like it was custom-designed for surveillance. I flipped on the TV set and saw choruses of peasants and workers in overalls listlessly waving flags and singing the praises of Ceauşescu, the self-proclaimed "Genius of the Carpathians," as the camera zoomed in for close-ups of the great man's face.

The only things with value were western goods, such as packs of Kent cigarettes.

Fascinating stuff, but the plot line was a bit flat, so I sought entertainment elsewhere.

When I visit a new city I love to spend hours walking around—getting a feel for the turf. I stopped at the concierge desk at the Hilton and asked for a street map of downtown Bucharest. I figured it might have a walking guide to the Greatest Triumphs of Ceauşescu-ism within an eight-block radius of Communist Party headquarters.

The guy grimaced and eyed me like I had asked for a detonator for a bomb strapped underneath my overcoat.

"For what do you need a map?"

"Because I want to see the city's landmarks."

"We have no maps. If there is some place you want to go, you tell me what it is and I will tell you how to get there."

"Where is the old part of the city?" I asked, knowing that most of it had been razed to make room for the ugliest "socialist realism" monoliths outside of North Korea.

The concierge scowled and muttered something—perhaps the Romanian slur for vexatious foreigners. My hunch was this guy didn't make a living from tips.

On the street many people darted their eyes away—as if looking at foreigners might cause leprosy. I had heard that it was a crime for Romanians to talk to strangers. But a few people summoned up a hodgepodge of broken English, pleading for a pack of Kent cigarettes to bribe doctors to treat their sick children. The Romanian currency was practically worthless. The only things with value were western goods, like those Kents, which circulated as a black-market currency.

I stepped into the largest department store in Bucharest; it was dark, dank, and miserable. Sales clerks lounged on piles of new clothing heaped on the floor. One of the main attractions in the store: incredibly rickety baby carriages—the kind to use when you want to kill your kid and sue the pants off somebody. Except that this government never had any liability to its victims, no matter how many perished from its products or policies.

I passed by the boarded-up front door of an ancient church, standing naked amidst construction projects that had razed its surroundings. Many Romanians fretfully crossed themselves as they passed the church.

The U.S. embassy was surrounded by Romanian troops with machine guns to prevent Romanians from entering and asking for asylum.

Like other communist regimes, Romania was an economic theocracy. The government used its iron fist to make sure everything happened according to the Plan. For instance, the 1986-90 five-year plan decreed that Romanian scientists would make 4,015 discoveries, of which 2,423 would result in new products by Romanian businesses. It's not surprising that the regime "planned" creativity, since it considered itself omniscient.

Romania was one of the World Bank's favorite regimes, receiving more than $2 billion between 1974 and 1982. It predicted in 1979 that Romania would "continue to enjoy one of the highest growth rates among developing countries over the next decade . . . and become an industrialized economy by 1990." But much of Romania's apparent economic growth was the result of World Bank aid. The more handouts it gives a country, the easier it becomes to portray the nation as a success story. Then-World Bank president Robert McNamara cited Romania to tout his own "faith in the financial morality of socialist countries."

Human Resources

The World Bank also praised the Romanian regime for its ability to "mobilize the resources" required to boost economic growth. In reality this merely meant that the government could brutalize its subjects to squeeze out "surpluses" to lavish funds on World Bank-approved industrial enterprises. Ceaușescu was doing the same thing Stalin did in the 1930s, when he starved up to ten million peasants to squeeze farmers to generate surpluses to build new factories.

> Romania was one of the World Bank's favorite regimes.

The Romanian regime also "mobilized resources" by pawning its ethnic German and Jewish inhabitants. (West Germany would pay money for each ethnic German released from Romania). International agreements banned slave trading in the nineteenth century, but selling human beings in the twentieth century was okay if the receipts went for progressive purposes.

The World Bank never cut Ceaușescu off; instead, he ceased borrowing after he became convinced that western debt was a curse on his country.

As I knocked around Bucharest I assumed I was being followed. Roughly one in 15 Romanians was working as a government informant.

From my experience elsewhere in the East Bloc, I knew that pulling out a notebook set off the alarm bells. Instead, I jotted down notes on the palm of my hand. Such behavior was likely to be seen as merely weird not menacing. Single words served me as pegs to later pull up a strand of facts and thoughts.

Late the next afternoon I arrived at Bucharest's main airport to fly to Frankfurt. I noticed that most of the businessmen ahead of me were openly giving a pack of Kents to each guard or other dreg at the four different security checkpoints.

I had bought a couple cartons of Kents before going to Romania, and I was soon passing out cigarette packs to airport guards like an old widow tossing candy to kids on Halloween.

I saw one or two German businessmen yanked aside for more invasive searches. As I passed the last checkpoint, I thanked my lucky stars that I had avoided such depredations.

That Lufthansa jet on the tarmac was the prettiest thing I had seen since the Orient Express crossed the Romanian border.

There was one graying soldier standing about 20 yards from the plane. I held up my passport, and he waved me on.

I had almost reached the gangway when I heard: HALT!

I turned and saw the guard running toward me, his submachine gun bouncing off his ample belly.

Puffing a bit, he caught up to me, grabbed my left arm, yanked it back, and pointing at my palm, demanded to know:

"WHAT IS THIS?!!!?"

I looked at my hand, then I looked at the guard.

"It's ink."

He paused, squinted, nodded his head knowingly, and then waved me on to the plane.

Two years later, 5,000 Romanians were killed during an uprising that overthrew the government. When Ceaușescu and his wife were summarily executed on December 25, 1989, it was probably the best Christmas present Romanians ever received. FEE

R.C. Hoiles and Public Schooling

BY WENDY MCELROY

In a letter dated May 23, 1946, the libertarian publisher R.C. Hoiles wrote to Leonard E. Read, who would establish the Foundation for Economic Education later that same year. Hoiles advised Read on what he believed was the underlying cause of America's alarming shift from individual liberty toward socialism:

> I am inclined to think that the grass roots of our trouble is our tax-supported school system. It is teaching by example that might makes right; that the end justifies the means; that there is no law superior to the will of the majority. How can we expect the youth of the land, when the public generally believes in tax-supported schools, to believe in freedom, the American way, or a definite limited government?

R. C. Hoiles
Photo courtesy *Orange County Register*

In place of a tax-funded and compulsory school monopoly, Hoiles argued passionately for a voluntary, private system. It was an argument he sustained throughout his long, remarkable life.

Raymond Cyrus Hoiles (1878–1970) epitomizes the American dream. Born into comfortable but modest circumstances, he rose through hard work and merit. At his death at the age of 91, his corporation, Freedom Newspapers, Inc., owned 16 daily newspapers, including the influential *Orange County Register* (originally the *Santa Ana Register*), with a collective circulation of over half a million. The California Press Association honored him posthumously as a "Great Crusader for Individual Freedom" who was respected for "his conservatism."

Hoiles is often mischaracterized as conservative. At a quick glance the confusion is understandable. For one thing, Orange County, California, became a center of conservatism in the decades following World War II. As the county's foremost newspaper, the *Register* often ran conservative columnists and letters to the editor. But it was Hoiles's libertarian voice that dominated through editorials.

Hoiles insisted the editorial page was "a daily school room made available to its subscribers." In that schoolroom Hoiles taught what he called "voluntaryism." A November 1953 editorial, "Articles of Faith," distilled its essence: "[A] government is a good government that only does what each and every individual has the moral and ethical and just right to do." If it was not right for an individual to take money by force, then it was not right for a government to do so in the name of "taxation." Another of the "Articles" stated, "I have faith that our government would better protect every person's inalienable rights if it was supported on a voluntary basis rather than by taxes."

Contributing editor Wendy McElroy (wendy@wendymcelroy.com) is an author, the editor of ifeminists.com, and a research fellow for the Independent Institute in Oakland, California.

Perhaps no single issue better captures the libertarian spirit of Hoiles than his feisty stand on education. The "Articles" declared, "I have faith that we will be better educated by voluntary, competitive schools than by government schools." This statement must have startled conservatives who viewed the public schools as a success story. Indeed, a then-favored conservative strategy was to enter school board races. By contrast, Hoiles insisted he had no more right to vote for a school official than he did to vote for a trustee within a government-owned brothel. (Perhaps for shock value, Hoiles repeatedly compared public schooling to prostitution; he once declared, "A house of prostitution is voluntary, grade school is not.")

Opposition to tax-supported schools became a dominant theme in Hoiles's writing; his last editorial in the *Register* dealt with "something-for-nothing schools that have had a great influence in conditioning pupils to believe in something for nothing." On occasion, Hoiles even found it necessary to defend the considerable amount of space school issues occupied in his paper. On October 15, 1945, he wrote, "The amount of space the *Register* is devoting to the junior college bond issue might cause some to think we are overestimating the importance of the issue. There is nothing more important than the principles back of the issue."

Hoiles repeatedly compared public schooling to prostitution; he once declared, "A house of prostitution is voluntary, grade school is not."

An Integrated System of Belief

The "principles back of the issue" involved an integrated system of beliefs about government, society, morality, and human nature.

Hoiles rooted his theory of government in the Declaration of Independence—a document he quoted frequently—namely, that government derives its just power from the consent of the people and ultimately from the consent of the individual himself, who possesses inalienable rights.

"Articles of Faith" expressed this theory of society: "[G]aining understanding of nature's laws is the best way to be useful to one's self and to his fellow man." One of nature's fundamental laws was "the superiority of voluntary, competitive human endeavor over compulsory activity." Freedom of association, including a free market, fueled the goodwill that civil society depended on; forced association destroyed it.

Hoiles based his morality largely on the Ten Commandments and insisted on "a single standard": Everyone without exception should act according to the same moral code. What was wrong for a private individual was equally wrong for a government official. In a later policy statement, Hoiles offered the essence of this universal code: the Ten Commandments, the Golden Rule, and the Declaration of Independence.

His theory of human nature stressed the perfectibility of man through effort and the exercise of moral character. He believed this perfectibility resided in each human being, which seemed to make him somewhat blind to differences of race, gender, and social status. Former employees often commented on how he would engage a janitor in intellectual discussion as quickly as he would a writer.

Hoiles's evolution on education began in a "little red schoolhouse" across from his family's large farmhouse in Alliance, Ohio, where, he later explained, he learned "that the State, or a majority of citizens, had the right to use taxation to support the public school system." His school texts exposed the political "error" of the divine right of kings but "they never explained the error in the divine right of the majority. It simply substituted the divine right of the majority for the divine right of kings." Nor did his school books explain "the basic principle that governments derive their just powers from the consent of the individual; that the government had no right to do anything that each and every individual did not have the right to do. Instead, they had to teach that the government or the local school district, if the majority so willed, had a right to force a Catholic parent, or a childless person, or an old maid, or an old bachelor to help pay for government schools. . . ."

At the same time as they legitimized taxation, however, Hoiles's teachers spoke of the Ten Commandments, including "Thou shalt not steal" and "Thou shalt not covet." He observed wryly, "[T]he government school I attended made no attempt to be consistent and teach me to recognize contradictions." The contradictions did not surprise Hoiles, who explained, "They cannot teach the single standard of rightness because they are practicing a double standard." They could not teach moral values "any more than a robber can teach honesty."

Hoiles's higher education must have also imbued him with skepticism about government education. The knowledge he valued most had been self-taught and came from experience. While studying electrical engineering at the Methodist Mt. Union College (Alliance), Hoiles worked part time at his brother Frank's daily paper, the *Alliance Review*, and discovered what became a lifelong passion for the newspaper business. Hoiles must have wondered if his college education had been wasted. Later in life he complained of the common perception that "going through the public schools and colleges is education."

In 1932 Hoiles temporarily left the newspaper business and began to read insatiably. Even though he had shown little interest in philosophy to date, he acquired the background to sprinkle future writing with quotations from an amazing range of authors: from Frédéric Bastiat to Ayn Rand, from John Locke to Spinoza.

The most influential was Bastiat. In a 1955 editorial Hoiles wrote, "He was the first man who awakened me to the errors, taught in government schools and more Protestant colleges, that the state doing things that were immoral if done by an individual made these acts become moral. In other words, he was the first man that pointed out that there was only one standard of right and wrong."

In 1935, at 56, Hoiles arrived in Orange County, where he had purchased an established newspaper. With him, Hoiles brought not only his family but also an evolved philosophy of freedom, which he aggressively applied, especially to public education.

> Modern teachers need only to satisfy the government, their source of income.

A September 3, 1946, editorial in the *Register* titled "Most Sacred of All Popular Idols, Government Education," typifies both Hoiles's style and content in approaching the issue. The editorial is clearly answering critics who argued that public education is a necessary good because it leads to a literate population.

Hoiles opened by quoting an anonymous "lover of freedom" (Leonard Read) who defined the proper role of government as a "restraining force rather than a force to compel people to do good." Considering government education from this angle, the "lover of freedom" concluded "it has all the characteristics of other forms of socialism."

Some people, Hoiles continued, may see little difference between the earliest "red schoolhouses" that were voluntarily supported and the subsequent tax-funded ones. "True," he stated, "the socialism incident to the 'little red school' was only a slight departure from the procedure of a few neighbors pooling their resources, voluntarily, to employ a teacher to instruct their children. But once the socialistic principle is admitted, once the idea is sanctioned of using government's powers of coercion to take the fruits of the individual's labor for the 'collective good,' there is no logical stopping point."

Hoiles went on to quote Isabel Paterson's *The God of the Machine*: "There can be no greater stretch of arbitrary power than is required to seize children from their parents, teach them whatever the authorities decree they shall be taught, and expropriate from the parents the funds to pay for the procedure." Thus, continuing the quote, "[n]eighborly, small-scale socialism in education has expanded and developed until today we are faced with the disaster of national socialism in education."

The "disaster" was partly economic. Hoiles cited statistics showing how the costs of educating one individual had increased more than ten times from 1880 to 1940, with no corresponding increase in quality. Indeed, quality had declined—partly due to increased bureaucratization, partly to the severing of connection between a teacher's wages and his or her need to satisfy

customers (the parents and children). Modern teachers needed only to satisfy the government, their new source of income.

"Government educators are becoming less and less servants of those from whom revenues are extracted or from whom their pupil raw material is conscripted," Hoiles wrote. "More and more they are becoming vested interests, concerned with their own employment and tenure. More and more they are allying themselves as a pressure group with other bureaucratic interests. More and more they are using their strategic position to turn the minds of the young towards statism and interventionism."

Attacking on yet another front, Hoiles explained the terrible impact that government teachers have on the character development of children. "I take the stand against tax-supported education because I believe . . . that the advantage of being able to read and write is far outweighed by the destruction of individual initiative, enterprise and responsibility brought about by government education's poison of statist psychology. Practically every youth in the land is a socialist at heart. How can he help but be unless he comes from a family that is steeped in the belief in true liberty and the dignity of man and recognizes that multiplying a robbery does not make it right?"

> "I believe that the advantage of being able to read and write is far outweighed by the destruction of individual initiative . . . brought about by government education."

It is not possible to understand the passion with which Hoiles and other advocates of individual freedom addressed public education without establishing the context. In the early twentieth century, education in America underwent a political revolution, becoming the lynchpin of the Progressive Era—a period of social reform, from the 1880s to the 1920s. A central tenet was that government needed to play a larger role in solving social problems and in promoting the "social good." "Popular," or public, education was viewed as a prerequisite and the key to reconstructing society by molding generations to come. In his watershed book, *Democracy and Education* (1916), John Dewey advocated using popular education as a conscious tool to remove social evil and promote social good. Slowly, the classical curricula that aimed at rigorous education—such as familiarity with Latin, a stress on history—were replaced by programs aimed at creating "good citizens."

Hoiles was outraged by his children's curriculum. In a 1961 editorial he reminisced about an incident involving his daughter Jane. After reviewing one of her school textbooks, he appeared before the directors of the Santa Ana Chamber of Commerce to protest against school books that "set forth the principles of Karl Marx." Hoiles's purpose was not to ban or censor but to assert a parent's right to guide his children's education. Nevertheless, the book was pulled.

Why, then, did Hoiles's children attend public school? He told a *Newsweek* reporter, "There was no place else to send them."

A particularly provocative strategy of his was spelled out in the May 23 letter to Read. Hoiles explained, "I have repeatedly offered a member of the Board of Education in Santa Ana, who is a preacher, $100 if he would publicly attempt to harmonize tax-supported schools with quotations from Jesus. He will not undertake it. I also made the offer to the superintendent of schools. He will not undertake it." Hoiles wondered if he should up the ante to $500 and construct the discussion as a debate, perhaps with Isabel Paterson, Rose Wilder Lane, or Read himself. Hoiles considered the offer a fail-proof maneuver. If the preacher accepted, the flaws in his argument would be exposed. If he refused, then the refusal would "cause the people of the community to wonder . . . whether tax-supported schools are doing what they think they are doing."

R.C. Hoiles died on October 30, 1970, at 91. Within his lifetime he made no lasting impact on public schooling. But times change. Current discontent with government education is so deep and widespread that homeschooling has become a phenomenon and others grasp at any route out. I can only imagine Hoiles's response to a revival of his moral crusade against public schooling. FEE

The Right to Work

BY JOHN STOSSEL

The people of Louisiana must sleep soundly knowing that their state protects them from . . . unlicensed florists.

That's right. In Louisiana, you can't sell flower arrangements unless you have permission from the government. How do you get permission? You must pass a test graded by a board of florists who already have licenses. To prepare for the test, you might have to spend $2,000 on a special course.

The test requires knowledge of techniques that florists rarely use anymore. One question asks the name of the state's agriculture commissioner—as though you can't be a good florist without knowing that piece of vital information.

The licensing board defends its test, claiming it protects consumers from florists who might sell them unhealthy flowers. I understand the established florists' wish to protect their profession's reputation, but in practice such licensing laws mainly serve to limit competition. Making it harder for newcomers to open florist shops lets established florists hog the business.

Hey buddy, you got a license for those begonias?
plantasyflores [flickr.com]

Other states are considering adopting Louisiana's licensing law, but before any do, I hope that the law will be stricken. The Institute for Justice, a public-interest law firm, has challenged the licensing in court, saying it violates liberty and equal protection, and so is unconstitutional.

"One of the most fundamental tenets of the American dream is the right to earn an honest living without arbitrary government interference. What could be more arbitrary than saying who can and who cannot sell flowers?" IJ President Chip Mellor says.

Other states have their own sets of ridiculous licensing rules. In Virginia, you need a license to be a yoga instructor. Florida threatened an interior designer with a $25,000 fine if she didn't do a six-year apprenticeship and pass a test, at a cost of several thousand dollars. Fortunately, the Institute for Justice got that law overturned.

I'm rooting for IJ because licensing interferes with the freedom to make a living, harms consumers by limiting competition, and protects established firms. It's an old story. Established businesses have always used government to handcuff competition. Years ago, small grocers tried to ban supermarkets. A&P was going to "destroy Main Street," the grocers cried. Minnesota legislators responded to their lobbying by passing a law that forbade supermarkets to hold sales. Consumers were hurt.

What about Doctors and Lawyers?

Okay, while licensing of florists, interior designers, and yoga teachers is ridiculous, what about more important professions, like law? Surely people need protection from people who would practice law without a license. Again, I say no. The lawyers' monopoly on helping people with wills, bankruptcies, and

John Stossel hosts Stossel *on Fox Business Network and is the author of* Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong. *Copyright 2010 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

divorces is just another expensive restraint of trade.

David Price recently spent six months in a Kansas jail because he wrote a letter on behalf of a man who was wrongly accused of practicing architecture without a license. When Price refused to promise never to "practice law" again, a judge sent him to jail.

All he did was write a letter. Price didn't misrepresent his credentials. However, he did save a man from paying $3,000 to a lawyer. Perhaps that was his real offense.

Competition is better than government at protecting consumers from shoddy work. Furthermore, licensing creates a false sense of security.

Competition is better than government at protecting consumers from shoddy work. Furthermore, licensing creates a false sense of security. Consider this: When you move to a new community, do you ask neighbors or colleagues to recommend doctors, dentists, and mechanics even though those jobs are licensed? Of course. Because you know that even with licensing laws, there is a wide range of quality and outright quackery in every occupation. You know that licensing doesn't really protect you.

A free competitive market for reputation protects consumers much more effectively than government can. Today, online services like Angie's List (www.angieslist.com) make it even easier for consumers to get better information about businesses than government licensing boards will ever provide. We do need protection from shoddy businesses. But it's freedom and competition that produce the best protection. FEE

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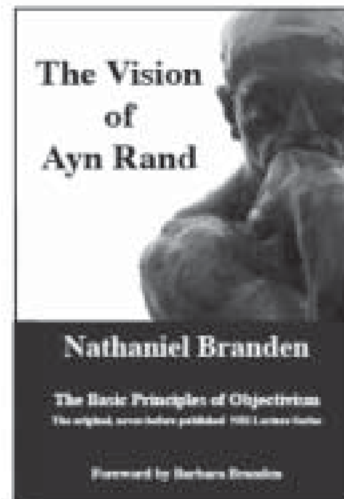
The Vision of Ayn Rand:
The Basic Principles of Objectivism



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For ten years--from 1958 to 1968--Nathaniel Branden's lectures on *Basic Principles of Objectivism* were given at Nathaniel Branden Institute in New York City and, via tape transcription, to groups in over eighty cities throughout the United States and abroad. More than 35,000 students have attended these lectures. Until now, this course has never been available in book form.

The Vision of Ayn Rand is a detailed, systematic exposition of the philosophy defined by Ayn Rand and introduced in her novels, *Atlas Shrugged* and *The Fountainhead*. The lectures are devoted to a presentation of Miss Rand's philosophy—and to Mr. Branden's application of Objectivism to his own field, psychology. Special emphasis is given to the concepts of human nature, mental health and personal development.

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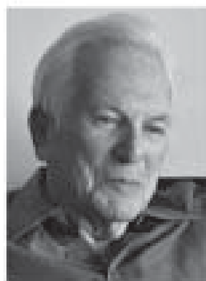


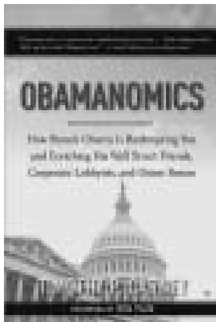
Nathaniel Branden

With a Ph.D. in psychology and a background in philosophy, Nathaniel Branden is a practicing psychotherapist and a corporate consultant, and is widely recognized as the authority on self-esteem, a field he pioneered more than four decades ago. His many books include *The Psychology of Self-Esteem*, *The Six Pillars of Self-Esteem*, *Taking Responsibility, Self-Esteem at Work*, *A Woman's Self-Esteem* and his memoir, *My Years With Ayn Rand*. He is in private practice in Los Angeles.

Book Reviews

Obamanomics: How Barack Obama Is Bankrupting You and Enriching His Wall Street Friends, Corporate Lobbyists, and Union Bosses
by Timothy P. Carney
Regnery • 2009 • 256 pages • $18.45

Reviewed by George Leef



In his previous book, *The Big Ripoff* (reviewed in the June 2007 *Freeman*), author Timothy Carney launched an attack on two of America's preeminent political myths—that the Democrats are "the party of the little guy" and the Republicans are "the party of free enterprise." Both notions are useful to candidates in the endless quest for votes, but both are overwhelmingly false. Yes, some Democrats deeply believe that all they do is helpful to Americans struggling to get by, and some Republicans really want to move towards laissez faire. Party leaders, however, are remarkably similar in their embrace of a corporative philosophy (or perhaps we should say, strategy) that trades favors to well-established institutions in exchange for campaign support.

With *Obamanomics,* Carney narrows the focus of his microscope to explain, as the book's subtitle says, "how Barack Obama is bankrupting you and enriching his Wall Street friends, corporate lobbyists, and union bosses." Under Carney's high magnification, Obama's campaign rhetoric that he would kick out the special-interest lobbyists and only listen to the voice of the people is exposed as a fantastic prevarication. Not only have the lobbyists not been kicked out, they have been welcomed in like long-lost children.

Many Americans will instinctively recoil from Carney's argument. They believe something like this: "Obama is for more government economic control and businesses want less control because they favor free markets." Carney blows that idea to smithereens, showing that big business generally does not want free markets (which are unpredictable due to competition and consumer sovereignty) and likes regulations to suppress competition and guarantee profits. The key point of the book is that big business doesn't lobby for free markets; it lobbies for government favors.

Carney produces a mountain of evidence to support his case. To begin with, campaign contributions from big businessmen (and of course other moneyed groups, including lawyers and unions) flooded into Obama's 2008 campaign far more freely than into the campaign of the ostensibly pro-business candidate, John McCain. People associated with Goldman Sachs were major campaign contributors, with their money flowing into the Obama treasury at a ratio of four to one over McCain. That was not an anomaly. Contributions from many industries went lopsidedly to the supposedly "anti-business" candidate.

The standard line from the media about this, when it was noted at all, was that these commercial giants were just buying "access" with the probable winner to ensure that they wouldn't be treated too harshly in the coming administration. Carney refutes that notion by pointing out that Obama had long been cozy with certain corporate interests (such as ethanol) and that even in their inchoate stages, Obama's policy initiatives promised steady, predictable revenues for certain businesses and industries. They weren't just buying access. They were eagerly supporting the candidate most inclined to their corporatist desires.

After his election Obama's policies suited many industries just fine. The prodigious "stimulus" package was manna from heaven for those whose lobbyists knew how to direct the flow of federal dollars. "With more than 800 lobbyists working on it," Carney writes, "the stimulus particularly benefited the tech industry and its representatives." As one corporate insider he quotes said, green lobbyists went into a "feeding frenzy."

Instead of resources flowing into businesses to produce goods and services that consumers wanted, resources were directed into politically connected firms to produce things that appeal to politicians (or *perhaps* produce; some of the "stimulus" projects have since been shown to be fraudulent). The impact of Obamanomics, Carney concludes, is to shift economic power

"from consumers, workers, and investors to politicians and bureaucrats."

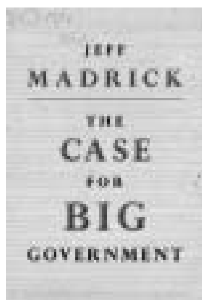
Readers will find their blood pressure rising as Carney takes us through the vast corporate welfare tucked into ObamaCare, the environmental crusade's "cap and trade" legislation, Obama's favoritism toward the United Auto Workers and the car companies it has done so much to ruin, the administration's fondness for regulations that help big business stifle competition from smaller rivals, and, perhaps most disgustingly of all, the Wall Street bailout. "Conservatives like to think of Wall Street as a bastion of capitalism, but that image ignores the ways in which our financial sector depends on government protection," Carney observes.

We are mired in recession, and mountains of government debt will soon hit us like an avalanche. Will Americans fall for the deception that returning to prosperity depends on still more of the statism that has brought us to this dire situation? If they've read *Obamanomics*, they won't. FEE

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

The Case for Big Government
by Jeff Madrick
Princeton University Press • 2008 • 224 pages • $22.95

Reviewed by Robert Batemarco



Could it be that our already immense government is still too small? That's what some people, including economic journalist Jeff Madrick, would have us believe.

The first sentence of *The Case for Big Government* reads, "It is conventional wisdom in America today that high levels of taxes and government spending diminish America's prosperity." While this is, indeed, wisdom, it is hardly conventional, at least in our national and state capitals, and that wisdom has not had a meaningful role in policy for over 80 years.

From that sentence on it's all downhill. The book's theme is that principled calls to limit government's power to benefit the few at the expense of the many are nothing but rigid ideology, which must now make way for "pragmatic solutions." Of course, such "pragmatism" has long been a cover for removing all restraints on government power and trusting that those who wield it will do the right thing. To prove my point, Madrick favorably cites Alexander Hamilton's view that laissez faire "was to be respected but to be violated when necessary." Translation: It is to be routinely violated.

The book is divided into three parts. The first recaps how well "pragmatic" government has served us in the past (according to Madrick anyway); the second avers that change is inevitable and sees more government power as the only way to deal with it; the finale lays out the specific policies the author believes will cure our ills. Naturally, all call for further expansions of government power to tax and control us.

What passes for analysis in this book is an embarrassment. Inconsistencies abound. For instance, the author correctly asserts that flexible labor markets are indispensable for economic growth, yet two pages later he endorses a higher minimum wage and the reinvigoration of labor laws to facilitate the spread of unions into new industries. He also demonstrates difficulty distinguishing free-market rhetoric from free-market policies. He correctly points out that the Reagan and Bush administrations practiced Keynesianism, yet blames their *nominally* laissez faire policies for our recent stagnation. Since Keynesian policies are the antithesis of laissez faire, one cannot logically blame problems originating from those policies on laissez faire.

Madrick invariably fails to appreciate the implications of the things he does get right. For instance, he admits that the post-World War II demobilization spurred a recovery rather than the relapse into depression unanimously expected by those who relied on Keynesian analysis, yet he doesn't acknowledge that this is strong evidence of just how mistaken that analysis is. He also admits that governments err and that the programs they create tend to live forever, but he gives them a pass since businesses too make errors and are as hard to shut down. Not only is that last statement factually inaccurate—faltering businesses are much easier to shut down than wealth-draining government programs (56 percent of new businesses fail within four

years; the number of government programs that have ever been terminated is miniscule)—but the examples he gives, such as Chrysler, are still in business only because of government bailouts. The attempt to equate business fallibility with government blundering is absurd.

In setting forth his wish list in part 3, Madrick asserts that giving the federal government control over an additional 5 percent of our GDP will do no harm—in other words, it has no opportunity cost. He offers no theoretical basis for that assertion. Much of the evidence he cites in support of particular programs is provided by some of the likely beneficiaries. Madrick sees only the nice hoped-for results and never realizes that politically connected big business and big labor groups will gain the most from mushrooming government.

Worst of all, however, Madrick is blind to the fact that expansion of government means contraction of liberty. The big-government policies he advocates won't just waste resources; they will also further whittle away at our freedom. Look at the authoritarian details of the recent "health care reform" legislation, such as the mandate for individuals to purchase insurance whether or not they want it, and you see that big government is not a kindly uncle.

I could go on, but that should suffice. The underlying problem not only of this book, but also of would-be central planners of every stripe, is the denial of the primordial fact of scarcity. Madrick's frequent denunciations of "the age of limits" can mean nothing else. Since scarcity and the human actions to deal with it are the ultimate foundations of economics, the case for big government is based not on economics but rather on special pleading devoid of principle and logic. FEE

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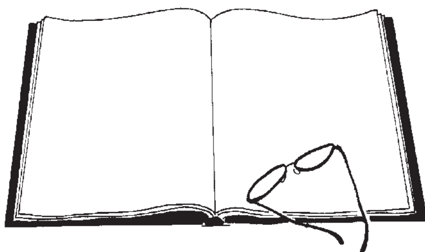

Race & Liberty in America: The Essential Reader

edited by Jonathan Bean
University Press of Kentucky/
Independent Institute • 2009 •
352 pages • $42.50 hardcover;
$21.20 paperback

Dred Scott's Revenge: A Legal History of Race and Freedom in America

by Judge Andrew Napolitano
Thomas Nelson • 2009 • 320 pages • $25.99

Reviewed by Roger Clegg

Two recent books criticize racial discrimination from a classical-liberal perspective.

The first, *Race & Liberty in America*, is an anthology edited by Jonathan Bean, a professor of history at Southern Illinois University. It includes dozens of selections, from 1776 to today, arguing eloquently for colorblind equality before the law and against slavery, Jim Crow, and racial preferences (affirmative action). Fittingly, Bean also includes much from the immigration context. (Bean earlier authored another important book in this area, *Big Government and Affirmative Action: The Scandalous History of the Small Business Administration*.)

In his introduction, "Civil Rights and Classical Liberalism," Bean notes that, given the domination today of "the politically correct view that left-wing liberals or radicals completely dominated the struggle for racial freedom," it is no surprise that "classical liberals are the invisible men and women of the long civil rights movement." Bean illuminates their role in the fight against government discrimination.

Some of the names and selections in the book are unsurprising. There are several pieces by Frederick Douglass, for example, and the "I Have a Dream" speech by Martin Luther King, Jr. But there are also some surprises, like the excerpts from Warren Harding, Calvin Coolidge, and Herbert Hoover. Most of the

pieces pertain to the oppression of blacks, but there are several excellent ones regarding government discrimination against Asians, especially the Chinese. The point is unmistakable: Those who hold a principled belief in liberty oppose all government oppression.

Especially useful are the selections Bean includes that show how the business community, so often accused of being in favor of racial discrimination, often opposed it. A series of letters regarding imposed segregation in trolley cars, for example, proved to be an eye-opener.

Bean balances readable and relatively short excerpts with intelligent commentary in the introductions. The big message of the book is that many of our great thinkers shared the vision that equality and progress will result from freedom, not the heavy and coercive hand of the State.

That's also the thrust of *Dred Scott's Revenge: A Legal History of Race and Freedom in America* by Andrew Napolitano, a former New Jersey state judge and frequent commentator on the Fox News Channel. Napolitano claims in his introduction, "The real culprit throughout our racial history has been the government," and his book accordingly documents and condemns a variety of bad government policies and actions from the colonial era to today.

Freeman readers will not be surprised to hear that governments, rather than the private sector, have been the most systematic and powerful purveyors of racism and discrimination. (This theme is both explicit and implicit in Bean's book as well.) Conversely, slavery, Jim Crow regulations, and our current mania for racial preferences would have been much more difficult or impossible under a system that limited government power to its proper defensive functions and maximized individual freedom.

In other ways, too, there is considerable overlap in the two books. Both Napolitano and Bean abhor racial discrimination as not only unconstitutional but deeply immoral as well.

Despite the fact that I'm sympathetic to Napolitano's instincts, I cannot recommend his book for a number of reasons. He believes courts should ignore the Constitution if it is inconsistent with the judge's view of what natural law requires, which is an endorsement of judicial activism. His historical arguments conflate the failure of federal government intervention with active discrimination. And sometimes Napolitano tries to get by with assertion where proof is called for.

So the cost-conscious libertarian (is there any other kind?) should purchase Bean's book rather than Napolitano's. To be fair, no matter how persuasive Napolitano's opinions were, they would not be as valuable as the treasury of original sources that Bean has compiled. Napolitano himself—as well as Shelby Steele, Richard Epstein, Linda Chavez, Stephan Thernstrom, and Ward Connerly, among many others—favorably blurbs Bean's book, calling it "a history buff's dream," and he's right. FEE

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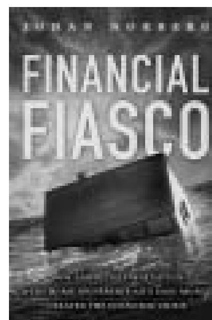
Financial Fiasco: How America's Infatuation with Homeownership and Easy Money Created the Economic Crisis

by Johan Norberg
Cato Institute • 2009 • 186 pages • $21.95

Reviewed by Waldemar Ingdahl



Free-market greed stands accused of undermining the world financial system, but that is a mistaken analysis, writes Johan Norberg. The Swedish author made famous by his book *In Defence of Global Capitalism* is back to provide an explanation for the current financial crisis.

Many factors led to the global financial fiasco, Norberg writes, including a naive policy that privatized profits and socialized losses, risk-taking based on blind faith in computer models' ability to predict the market, and a false sense of security bred by government assurances that the taxpayers would back up bad loans. This brought an unsustainable growth of assets and liabilities.

The title of the Swedish original (which I read) is *A Perfect Storm*, an expression describing an event where a rare combination of circumstances drastically aggravates

a bad situation. That certainly describes the financial implosion that began in 2007. Norberg explains the events leading to the credit crunch through one chilling example after the other. The conscious actions of financial, political, and bureaucratic decision-makers and consumers might not have been too dangerous in themselves, but in combination they proved utterly disastrous.

According to Norberg, after the dot-com bubble and 9/11, Federal Reserve Chairman Alan Greenspan acted to avoid a recession by stimulating the economy with record-low interest rates in a sort of "pre-emptive Keynesianism." But the Fed misjudged the state of the economy and kept the interest rates down far too long. Effective interest rates actually turned negative, building the momentum for another bubble.

The low rates encouraged even greater risk-taking, not to mention a mountain of debt passed on to the future. Instead of going into a recession, the global economy saw an artificial, temporary rise in prosperity. China's policy of keeping its currency undervalued to stimulate its exports while pumping its surplus of capital into U.S. bonds supported the process and hid the imbalances created by the Fed.

Predictably, artificially low interest rates inflated the real estate market. No sector of the economy is more sensitive to interest rates than real estate, and American politicians put massive pressure on two government-sponsored enterprises, Fannie Mae and Freddie Mac, to lower their standards to enable vast numbers of unsound mortgages. The resulting foreclosures will leave a terrible mark in the minds and on the credit reports of millions.

Norberg is no less critical of the actions of the Wall Street capitalists. Weak oversight of money placed in investment and pension funds, coupled with huge bonus systems, encouraged shortsighted gambling with other people's money. Lurking behind all that was the assumption that there was little risk because the mortgage-backed securities were implicitly guaranteed by the federal government.

In the public debate following the credit crunch, many argued as if the financial markets were ruled by laissez faire, but the credit-rating agencies had an oligopoly due to regulations. Such regulations break down the barriers between the government and the market. The problem was not too little regulation. Rather, it was faulty regulation upheld by a multitude of national and international agencies. Tough international bank regulations punished traditional banking, while pushing bad loans into a shadow banking system to avoid transparency.

Financial Fiasco ends on a pessimistic note, predicting that we will see extensive, long-term government involvement in the financial sector for years to come. "Create a crisis, and people will give you more power to fight it," Norberg writes. He points to the risk that politically well-connected corporations and interest groups will not only further distort competition (as in the case of TARP), but also cause new losses and crashes. Politicians in many European countries have already subtly begun to require that banks concentrate lending in their national economies. A growing financial protectionism would throw more gravel in the financial machinery. We might also see a new wave of trade protectionism.

The book's most important lesson is that the problem isn't the current recession, but the previous boom. It was during the boom that poor investments were made based on hidden inflation and far too optimistic forecasts. The recession is the cure, when labor and capital are reallocated to better uses and productivity improves.

In its brevity, the book provides an interesting, accessible explanation of the reasons for and consequences of the financial crisis. It would have benefited, however, from specific recommendations on how to get to a freer economy. What must we do—or undo—to prevent politicians from repeating the boom and bust cycle? There is a dire need for a sound policy, but unfortunately hasty and simplistic "solutions" based on populist slogans have prevailed. Norberg says that people must realize that government has its limitations, but he doesn't tell us just where we should draw the line. FEE

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Drugs, Economics, and Liberty

BY WALTER E. WILLIAMS

Only a few people would dispute that narcotics can harm people, whether that harm is in the form of damage to the body, mental and physical dependency, or threats to social relationships. However, there is not nearly as much consensus as to what the correct public response to narcotics use and sales is. Ideas range from decriminalization to the current outright prohibition.

Let's start by acknowledging that there is no question whatsoever that the sale and use of narcotics in our country could be virtually eliminated. It could be accomplished at a monetary cost far less than the hundreds of billions spent so far in the nation's "war on drugs." We could suspend habeas corpus and constitutional guarantees against unreasonable searches to more easily gather evidence on people who use or sell drugs. We could make those arrested bear the burden of proof of innocence and on conviction summarily execute them. Countries with far less wealth and far fewer police resources than ours have used that strategy to reduce drug use, and so could we. Thankfully, I think most Americans would, and should, recoil in disgust at that kind of drug-war strategy. So we have to examine less draconian measures. A few thoughts on the economics of drug trade might give us guidance.

There's no mystery why people use mind-altering drugs: It makes them feel good, at least temporarily. That's not only true of cocaine, heroin, and marijuana; it's also true of mind-altering products like cigarettes, cigars, coffee, tea, wine, and whiskey. There's considerable evidence that many people prefer their vices in a diluted form. Hence the popularity of filtered cigarettes, light beer, wine coolers, and mixed drinks. The same seems to be true, at least to some extent, about illicit drugs.

When what are seen as vices are legally prohibited, supply responses change people's behavior. Imagine there's a supplier of illegal marijuana. Government steps up its efforts to stop its supply by increasing interdiction efforts, along with stiffer fines and prison sentences. Which is easier to conceal and transport—a million dollars' worth of marijuana or a million dollars' worth of cocaine? Obviously, it's cocaine because there is far less bulk per dollar of value. Thus one effect of prohibition is the tendency toward increased sales and use of more-concentrated forms of drugs that can include products such as crack cocaine, ice, and meth.

> Prohibition increases sales and use of more concentrated forms of drugs.

Another impact of prohibition is on prices. To supply the addiction needs of those who are not able to pay the prohibition-induced higher prices of cocaine, producers will seek to find cheaper substitutes such as crack. This is borne out by the fact that crack is far more popular among poorer addicts than wealthier ones.

Invitation to Make a Killing

Illegality, high prices, and high profits, coupled with greater government drug-interdiction efforts, also encourage entry by suppliers who are more ruthless and innovative, and who have a lower regard for civility and the law. Panty-waisted, petty, and otherwise law-abiding practitioners are ousted. In addition, since the courts are unavailable to enforce agreements made among traders, as in the case of legal transactions, disputes are more likely to be settled through violence.

Yet another supply response to prohibition, largely ignored in the drug debate, is the inevitable tendency

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toward corruption of public officials. Today's drug trade, like the Prohibition liquor trade, could not flourish without official corruption. It's not difficult to see how police officers, customs inspectors, and other law-enforcement officers earning $50,000, $60,000, or $70,000 a year could succumb to the temptation of $5,000 or $10,000 bribes to look the other way. No doubt there are elected officials who are also tempted by bribes. Even otherwise law-abiding nondrug-using parents are quieted by money and expensive gifts from their children who are involved in the drug trade.

The war on drugs restricts supply and raises prices. When one drug operation is busted up, another one emerges virtually overnight to take its place. When the DEA, FBI, and local police make a big drug bust, law-abiding citizens should not be jubilant. Instead, they should expect higher prices, leading to more ruthlessness among drug users and buyers, more crime and corruption, and greater social costs.

Sanctioning Civil Rights Abuses

Another very dangerous cost of the war on drugs is that it has given respectability to the violation of our constitutional guarantees. Civil-forfeiture laws have been enacted, in clear violation of the Fifth Amendment, under which property can be confiscated without due process. A parent can have his automobile or house confiscated if, even when unbeknown to the parent, his offspring uses it in connection with drug use or sales. Anti-money-laundering laws violate our rights to privacy in our transactions. Murderers and rapists have been freed from crowded prisons to make room for nonviolent drug users.

From the demand, or personal use, side of the drug issue, what should we do? Lysander Spooner (1808–1887), one of the great American thinkers of the nineteenth century, suggested that while vices may be self-destructive or offensive, like all peaceful, voluntary activities they should remain outside the province of law and government. The vices Spooner referred to include "gluttony, drunkenness, prostitution, gambling, prize-fighting, tobacco-chewing, smoking and snuffing, opium-eating, corset-wearing, idleness, waste of property, avarice, hypocrisy, etc., etc." Spooner added that if practitioners of these and other vices cannot be reformed voluntarily, if they go on to what other men call destruction, then they must be permitted to do so. He reminds us that the maxim of law is there can be no crime without criminal intent to invade the property or person of another.

People practice vices for what they perceive as their own happiness—not to violate the rights of another. In a free society people have the right to destroy their own lives but not those of others. When government coercion is used to promote virtue, there cannot be liberty. However, there is conduct that people might engage in under the influence of narcotics, such as impaired driving, robbery and burglary to fund their habit, and other acts that threaten the rights of others. Such acts are already criminal and should be punished.

The war on drugs has given respectability to the violation of our constitutional guarantees.

We Americans have to ask ourselves if there is a better way to deal with the drug problem. I think there is. We need to focus more on the demand side of the drug problem. After all, most people don't use marijuana, cocaine, and heroin. The reason they don't has nothing to do with its price or the fact it's illegal. Their decision has much more to do with their values and common sense. Rather than near-exclusive reliance on the law and government, I believe greater and longer-lasting gains can be made through civil society, where we can cajole, admonish, and teach people about the destructive effects of narcotics—and ostracize them if necessary.

It is foolhardy to have a public policy that forces people hell-bent on destroying their own lives to become violent criminals and destroy the lives of innocents in the process. It is also foolhardy for society to create circumstances in which official integrity is compromised and our constitutional guarantees are violated. FEE