THE FREEMAN
IDEAS ON LIBERTY
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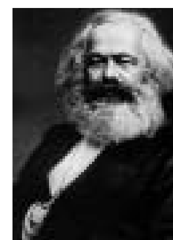

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IDEAS ON LIBERTY

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President Lawrence W. Reed
Editor Sheldon Richman
Managing Editor Michael Nolan
Book Review Editor George C. Leef

Columnists
Charles Baird, David R. Henderson, Donald J. Boudreaux, Robert Higgs, Stephen Davies, John Stossel, Burton W. Folsom, Jr., Thomas Szasz, Walter E. Williams

Contributing Editors
Peter J. Boettke, Dwight R. Lee, James Bovard, Wendy McElroy, Thomas J. DiLorenzo, Tibor Machan, Joseph S. Fulda, Andrew P. Morriss, Bettina Bien Greaves, James L. Payne, Steven Horwitz, William H. Peterson, John Hospers, Jane S. Shaw, Raymond J. Keating, Richard H. Timberlake, Daniel B. Klein, Lawrence H. White

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Perspective

The Function of *The Freeman*

Editor's Note: The Freeman *began publication before it became part of the Foundation for Economic Education in 1956. Its first issue was published in 1950, with Henry Hazlitt, author of* Economics in One Lesson*, as an editor and FEE founder Leonard E. Read a member of the board of directors. What follows was originally part of a first-anniversary (1951) editorial in which Hazlitt explained the role of* The Freeman *in the freedom movement. It is still relevant today.*

In our first issue, on October 2, 1950, we published an editorial called "The Faith of the *Freeman*," in which we outlined our fundamental economic, political and moral philosophy. In the fifteen months since then our articles and editorials, we trust, have made that basic philosophy and its practical application increasingly clear.

Now, at the completion of our first full calendar year of existence, we think it appropriate to say something about our function. That function is in one respect obvious. It is to propagate our announced philosophy, and to apply it, as we have been doing, to current issues as they arise. On the constructive and positive side, in other words, our function is to expound and apply the principles of traditional liberalism and individual freedom. On the negative side, it is to expose the errors of collectivism of all shades—of statism, "planning," controllism, socialism, fascism and communism. One of our central aims is, on the one hand, to hearten and strengthen those who already accept most of the philosophy of individual freedom and to help them to clarify their own thinking; and, on the other hand, to convert open-minded collectivists to the philosophy of freedom.

The mere announcement of such an aim is likely to be followed by immediate expressions of skepticism or incredulity. Some of our correspondents tell us, for example, that a magazine like *The Freeman* is read only by those who already believe in its aims, and therefore we are doing nothing more than "talking to ourselves." But even if this were true, which we do not believe, we

would still be performing a very important function. It is imperative that those who already believe in a market economy, limited government and individual freedom should have the constant encouragement of knowing that they do not stand alone, that there is high hope for their cause. It is imperative that all such people keep abreast of current developments and know their correct interpretation, and that, through constant restatement and mutual criticism of each other's ideas; they continue to clarify, improve, and perfect their understanding. Only if they do this can they be counted upon to remain true to a libertarian philosophy, and be proof against collectivist fallacies. Only if those on "our side" do this can we even hope to hold our ranks together and cease constantly to lose converts, as in the past, to collectivism.

But the function of a journal of opinion like *The Freeman* only begins here; it does not stop here. It is necessary for the believers in a free system to do far more than hold their present thin ranks together. If they hope to see their ideas triumph, it is imperative that they make converts themselves from the philosophy of collectivism, "security" and serfdom that dominates the world today.

They can do this only if they themselves have a deeper understanding than the collectivists, and are able not only to recognize the collectivist errors, but to refute them in such a way that the more intelligent and well-meaning collectivists themselves will recognize, acknowledge and renounce them as errors. And those on "our side" cannot do this, cannot live up to their responsibilities, unless they have troubled to keep themselves informed to make their ideas clearer and their understanding deeper than those of the collectivists. For our side can hope to grow only if it attracts and keeps adherents who in turn will become, not blind or one-eyed partisans, but enlightened and able expositors, teachers, disseminators, proselytizers.

To make this possible, it is essential that there should exist a prospering periodical with the aims of *The Freeman*.

⋆ ⋆ ⋆

Children's books about the environment are so dull and devoid of active people that Andrew Morriss hopes kids are playing video games rather than reading that stuff.

A report claiming that the tax burden is the lightest since the Truman administration gave Progressive talk-show hosts something to beat the tax-cutters over the head with—until the report was debunked. As D. W. MacKenzie points out, it's easy to make the tax burden look small if you don't count all the taxes.

Government schooling has been subjected to all kinds of criticisms. Michael Bors shows that Public Choice arguments shed further light on why the schools are bad and don't improve.

This sounds like a bad dream, but people inside and outside of government are actually proposing that the failing newspaper business be bailed out by the taxpayers. Edward López shows why that's a terrible idea.

The Glass-Steagall Act was the major banking regulation of the New Deal. In 1999 a key part was repealed. Was that repeal responsible for the recent financial debacle? Warren Gibson and Jeffrey Rogers Hummel have the skinny.

The welfare state isn't just wasteful and larcenous. It's morally corrupting. Richard Fulmer tells why.

Police departments have ways to keep abusive officers' names out of the papers. Wendy McElroy says that denies citizens one of their greatest protections against police misconduct.

Contrary to Lord Keynes's maxim that in the long run we're all dead, his spirit is alive and well more than 64 years after his death. Richard McKenzie looks into this curiosity.

Our columnists have plenty to talk about: Lawrence Reed reveals his sympathies for Marxism. Thomas Szasz scrutinizes the medicalization of suicide. Burton Folsom has a few choice words about Theodore Roosevelt. John Stossel catalogues attacks on our freedom. Walter Williams exposes some Washington lies. And Mark Skousen, hearing for the nth time that consumer spending drives the economy, objects, "It Just Ain't So!"

Our reviewers dissect books on the financial mess, British libertarian Arthur Seldon, antipsychiatry, and public schooling.

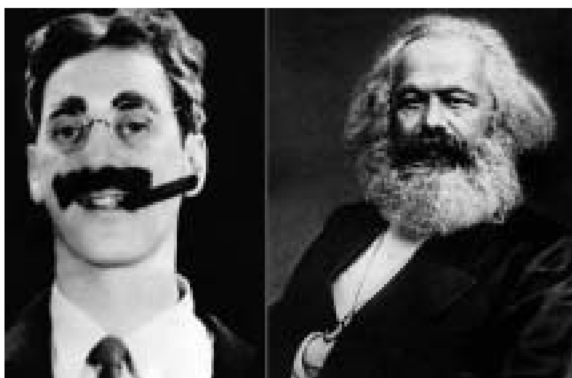
—Sheldon Richman
srichman@fee.org

Confessions of a Secret Marxist

BY LAWRENCE W. REED

After 33 years of writing articles and columns about capitalism and freedom for *The Freeman*, I've decided to confess. I'm a Marxist, and have been from a very early age.

I'm not the kind of Marxist that you normally think of when that term is used. I have nothing in common with Karl. I am a *Groucho* Marxist. As the great funny man himself might say, he and Karl were unrelated to each other in many ways. While Karl left a legacy of death and destruction (there was nothing funny about him or his communist nonsense), Groucho still has millions of adoring fans the world over, a third of a century after he passed away.



A lot more Groucho and a lot less Karl would have averted the massive tragedies of the twentieth century.

Count me among those many fans of Julius Henry "Groucho" Marx, born 120 years ago this very month, on October 2, 1890, on the upper east side of Manhattan. But don't put me anywhere near Karl's fan club.

The contrast between these two men with the same last name led the American composer Irving Berlin to pen this couplet many years ago:

The world wouldn't be
In such a snarl
If Marx had been Groucho
Instead of Karl.

What an understatement! No other human being ever concocted a set of ideas that produced more mayhem than Karl Marx, and few were as reprehensible in the way they lived their personal lives. In his book *Intellectuals* historian Paul Johnson devotes a revealing chapter to the man who wrote *Capital* and *The Communist Manifesto*. Karl was an angry, hate-filled man—quarrelsome, neglectful of his family, lazy, and violent. He suffered from hideous carbuncles in part because he almost never bathed. Some of the most memorable phrases from his two books were lifted from others without appropriate credit. He spent almost all his time at home or in libraries, and almost none where the workers he fumed about actually worked. He mooched off of others all his life, prompting his mother to say that she wished Karl would "accumulate capital instead of just writing about it."

But the worst thing about Karl Marx was not his personality or his hygiene. It was the evil web he spun with deceitful bait that snared and doomed millions. He called the workers of the world to revolution, but, as the Italian writer Ignazio Silone put it, "Revolutions, like trees, must be judged by their fruit." Without exception, wherever Marxist ideology found root, it grew into monstrous depravity. Some of Karl's disciples have attempted to explain this away with the old phrase, "To make an omelet, you have to break a few eggs." The problem is, communists (and socialists and fascists, their kissin' cousins) only break eggs; they never, ever, make an omelet.

Groucho, on the other hand, did honor to his family's name and to society at large. In contrast to the loafer Karl, he actually worked at real jobs, enduring many exhausting days for 20 years performing in

Lawrence Reed (lreed@fee.org) is the president of FEE. Portions of this column originally appeared in an op-ed by the author in the August 19, 2002, issue of USA Today.

Vaudeville and in small towns. Early in his show business career, he picked up the nickname Groucho, though he privately chafed at its negative connotation.

After a big break on Broadway in 1924, the Marx brothers team of Groucho, Chico, and Harpo did 13 feature films—including *Animal Crackers*, *Cocoanuts*, and *Duck Soup*. A fourth brother, Zeppo, appeared in five of them. With his trademark cigar, greasepaint mustache and eyebrows, chicken-like gait, zany one-liners, and clever put-downs, Groucho usually stole the show. In later years, he hosted a popular television program, "You Bet Your Life." His performances are best remembered for pithy wisecracks like these:

- "Please accept my resignation. I don't want to belong to any club that would have me as a member."
- "Those are my principles. If you don't like them, I have others."
- "Last night I shot an elephant in my pajamas. How he got in my pajamas I'll never know."
- "Either this man is dead or my watch has stopped."
- "I've had a perfectly wonderful evening, but this wasn't it."
- "He's honest—but you gotta watch him."
- "I was married by a judge. I should have asked for a jury."

Groucho once said, "Politics is the art of looking for trouble, finding it, diagnosing it incorrectly and then applying the wrong remedies."

Though Groucho in real life called himself a liberal Democrat, he never harbored a blind faith in State power that characterized the warped thinking of Karl. In fact he once opined, "Politics is the art of looking for trouble, finding it, diagnosing it incorrectly and then applying the wrong remedies." That description of politics was on full display in *Duck Soup*, regarded by many, including me, as the Marx Brothers' best film.

Duck Soup, released in 1933, takes place in the fictional, bankrupt country of Freedonia ("Land of the Spree, and the Home of the Knave"). On becoming its leader, Groucho's character, Rufus T. Firefly, literally sings what a lot of politicians do but never admit: "The last man nearly ruined this place. He didn't know what to do with it. If you think this country's bad off now, just wait 'til I get through with it." A mere trifle leads Freedonia and neighboring Sylvania to go to war, a clear spoof of the insanity of World War I. In *Groucho: The Life and Times of Julius Henry Marx*, Stefan Kanfer writes that the satirical depiction of Freedonia's government didn't sit well with Benito Mussolini, who banned the film in Italy.

Government was also the object of Groucho's irreverence outside the movies. His son Arthur once published an account of the time his father got in trouble with airport customs by listing his occupation as "smuggler."

Groucho once quipped that he had worked himself up "from nothing to a state of extreme poverty." But actually, his talent and hard work earned him a very good living. He accumulated the capital that Karl only wrote about and left behind a legacy of some of the most original and hilarious comedy ever performed on the stage or silver screen.

The very persona of Groucho Marx is still imitated by comedians the world over. Almost nobody, however, deliberately imitates Karl outside of Pyongyang and Havana. And thankfully, a dwindling number of people remain devoted to his philosophy or what it wrought. In his introduction to *The Black Book of Communism: Crimes, Terror, Repression*, the definitive catalogue of Marxist-inspired atrocities, editor Stéphane Courtois revealed that communism's twentieth century death toll of 94 million people was far greater than that of any other political movement.

Karl and Groucho. Two men named Marx. Both brought tears to the eyes of millions but for very, very different reasons. FEE

Consumer Spending Drives the Economy? It Just Ain't So!

BY MARK SKOUSEN

Consumer spending makes up more than 70 percent of the economy, and it usually drives growth during economic recoveries."

—"Consumers Give Boost to Economy," *New York Times*, May 1

Every quarter, when the government releases its latest GDP figures, we hear the familiar refrain:

"What the consumer does is vital for economic growth."

"If the consumer starts saving and stops spending, we're in big trouble."

"Consumer spending accounts for 70 percent of the economy."

The latter "fact" crops up regularly in the news reports from the Associated Press, the *Wall Street Journal*, and the *New York Times*.

The truth is that consumer spending is not the mainstay of the U. S. economy. Investment is. Business spending on capital goods, new technology, entrepreneurship, and productivity is more significant than consumer spending in sustaining the economy and a higher standard of living. In the business cycle, production and investment lead the economy into and out of a recession; retail demand is the most stable component of economic activity.

Granted, personal consumption expenditures represent 70 percent of gross domestic product, but journalists should know from Econ 101 that GDP only measures the value of *final* output. It deliberately leaves out a big chunk of the economy—intermediate production or goods-in-process at the commodity, manufacturing, and wholesale stages—to avoid double counting. I calculated total spending (sales or receipts) in the economy at all stages to be more than double GDP (using gross business receipts compiled annually by the IRS). By this measure—which I have dubbed gross domestic expenditures, or GDE—consumption represents only about 30 percent of the economy, while business investment (including intermediate output) represents over 50 percent.

Thus the truth is just the opposite: Consumer spending is the effect, not the cause, of a productive healthy economy.

This truth prevails in the marketplace: It's supply—not demand—that drives the economy. Savings, productivity, and technological advances are the keys to economic growth. This principle was discovered and developed by the brilliant French economist Jean-Baptiste Say in the early nineteenth century and is known as Say's Law. In fact, he invented the word "entrepreneur" to describe the primary catalyst of economic performance.

Is retail sales a leading economic indicator? Each month the Conference Board releases its Leading Economic Indicators for the United States and nine other countries. The ten U.S. leading indicators are:

- manufacturers' new orders
- building permits
- unemployment claims
- average weekly manufacturing hours
- real money supply
- stock prices
- the yield curve

Mark Skousen (editor@markskousen.com) is the editor of Forecasts & Strategies *and author of* The Making of Modern Economics, *winner of the Choice Book Award of 2009.*

- new orders for nondefense capital goods
- vendor performance
- index of consumer expectations

As you can see, almost all the indicators are linked to the early stages of production and business activity.

What about the Consumer Confidence Index that the media highlights every month? It turns out that the title is misleading. The questions asked consumers are more about business conditions than spending attitudes. Here are the questions consumers are asked to determine their "expectations":

1. Are current business conditions good, bad, or normal?
2. Do you expect business conditions to be good, bad, or normal over the next six months?
3. Are jobs currently plentiful, not so plentiful, or hard to get?
4. Do you expect jobs to be more plentiful, not so plentiful, or hard to get over the next six months?
5. Do you plan to buy a new/used automobile/home/major appliance [note: these are all *durable* consumer goods, not unlike durable capital goods] within the next six months?
6. Are you planning a U.S. or foreign vacation within the next six months?

In other words, the much-touted "consumer" confidence index is more a forecast by consumers for business, employment, and durable goods than "retail sales" and consumer spending. It does not ask any questions about food, clothing, entertainment, and other short-term buying, because these expenditures seldom change from month to month.

The reality is that business and investment spending are the true leading indicators of the economy and the stock market. If you want to know where the stock market is headed, forget about consumer spending and retail sales figures. Look to manufacturing, capital expenditures, corporate profits, and productivity gains.

We hear so much about the consumer because the media and political pundits still live under the spell of Keynesian economics, which teaches that demand creates supply. Keynes's law is just the opposite of Say's law (supply creates demand). According to Keynesians, consumer spending drives the economy and saving is bad when the economy is in a short-term contraction.

In reality, increased savings can actually stimulate the economy, even if consumer spending is anemic. A recent study by the St. Louis Fed concluded that in the short run, "a higher saving rate in the current quarter is associated with faster (not slower) economic growth in the current and next few quarters" (Daniel L. Thornton, "Personal Saving and Economic Growth," *Economic Synopses*, St. Louis Fed, December 17, 2009).

How is this possible? When people save more, interest rates fall and businesses can afford to replace their old equipment with new tools, spend more on research and development, or develop new production processes. So while consumer spending may stay low, business spending can pick up the slack. Remember, in a dynamic economy the decision by businesses to spend more investment funds and hire more workers is a function of both current consumer demand and future consumer demand. And don't forget, during a recession corporate profits often recover first, without an increase in customer demand, because companies can boost profits by cutting costs and downsizing.

In the long run new business strategies and spending patterns increase productivity and lower prices to consumers, which in turn means the consumers' purchasing power increases. As the St. Louis Fed concludes, "A higher saving rate does mean less consumption [in the short run], but it could also result in more capital investment and, ultimately, a higher rate of economic growth. . . . [T]he growth rate of real GDP has been higher on average when the personal saving rate is rising than when it is falling."

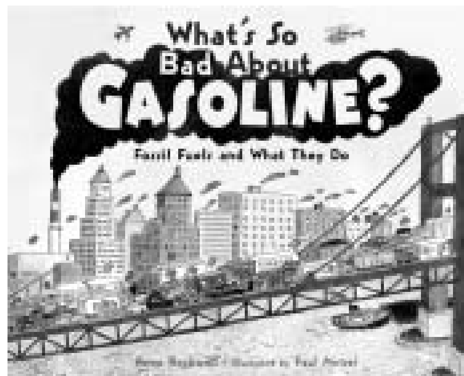
Granted, the ultimate function of business activity and entrepreneurship is to fulfill the needs of consumers, and the most successful firms are those that satisfy their customers. But more important, who discovers the new, improved products that consumers desire? Who is the catalyst that determines the quantity, quality, and variety of goods and services? Did the consumer come up with the idea of personal computers, SUVs, fax machines, cell phones, the Internet, and the iPhone? No, these technological breakthroughs came from the genius of creative entrepreneurs and the savers/capitalists who funded their inventions. FEE

What's So Bad about Eco-Propaganda for Kids?

BY ANDREW P. MORRISS

Although my own children have long outgrown picture books, I still have nephews and nieces young enough to enjoy them. So I buy them from time to time. I also buy books on energy. Perhaps it was that combination that prompted Amazon to recommend *What's So Bad About Gasoline?* by Anne Rockwell, engagingly illustrated by Paul Meisel.

Curious about what is so bad about gasoline that it was necessary to warn children, I bought it and found myself in an alternative universe of dreary ecological disasters. This was a far cry from the world of the classic picture books, such as what is undoubtedly today considered the criminally polluting tale of *Mike Mulligan and His Steam Shovel* by Virginia Lee Burton. Nor did it resemble the brightly colored and fantastic world in the books I read to my kids in the early 1990s. Even more depressing, when I dug further it turned out that *What's So Bad About Gasoline?* is part of a series of "science" books aimed at elementary school kids that tell a tale of ecological catastrophe. These include *Oil Spill!* by Melvin Berger and *Where Does the Garbage Go?* by Paul Showers.



"Green" kids' books ignore the individual dynamism that improves life and solves problems.

If these books are what kids grow up with today, we should hope they spend their time on video games instead of reading. The books are troubling because by ignoring economics and by focusing on eco-politics, they get the solutions to environmental problems wrong.

Worse, in the world these books present things don't get better. We must always do more to repent for our environmental sins. As economist Robert Nelson observes, environmentalism in America has evolved into "environmental Calvinism." Even worse, Nelson notes, it is "Calvinism without God," as bleak a vision as one can imagine since we're left only with an impersonal environment as the object of veneration. (Nelson's *The New Holy Wars: Economic vs. Environmental Religion* is a great read.) Presenting consumption as ecological sin without showing the vast improvements in people's lives produced by growing wealth ignores the great success of market economies and entrepreneurs.

Finally, the vision of the world these books present lacks human agency as anything other than motivating the mindless consumption that leads to ecological catastrophes. Not only is this a world missing entrepreneurs and inventors, there's also no excitement to its vision of the future. Although I am still waiting for my personal jetpack, the world of the *The Jetsons* promised a future of excitement and fun rather than a grim time in which we merely replace our cars with hybrids. The optimism that prompted Julian Simon to term humanity "the ultimate resource" is missing from this literature.

Oil Spill! was first published after the *Exxon Valdez* event. It opens with a dramatic scene of the tanker hitting the reef in Prince William Sound. Missing from the story are the broken sonar system that should have

Andrew Morriss (amorriss@law.ua.edu) is D. Paul Jones, Jr., Chair in Law at the University of Alabama, where he still likes to read children's books from time to time.

alerted the crew to the impending collision, the overtired third mate in the wheelhouse because the union-protected captain was sleeping off a drinking binge, and the lack of sufficient crew. The spill just happens. Indeed, humans are a minor presence in the book—appearing on just eight of 29 pages of illustrations, only as a cleanup crew hosing down a beach, a family on a beach, people using energy, and a child writing her congressman. *Oil Spill!*'s solution to the devastation of nature is political action.

Kids reading *Oil Spill!* aren't likely to be ready for a fact-heavy discussion of oil-transportation risks versus the benefits of energy consumption, the natural underwater oil seeps that could be reduced by offshore drilling, or whether using less electricity will really reduce oil spills, as the book suggests (oil-fueled sources account for under 2 percent of U.S. electrical generation).

Children do not learn that the profit motive is what drives inventors and manufacturers to improve products to reduce energy consumption. The U.S. economy has steadily become more energy-efficient: Per dollar of real GDP, energy use dropped by more than a third from the late 1970s to 2000. Compared to 1900 each unit of energy input in 2000 could provide four times as much useful heat, move a person 550 times farther, provide 50 times more illumination, and produce 12 times as much electricity. Moreover, oil spills like the *Exxon Valdez* or the BP disaster are exceptions rather than the rule and are more likely due to failures in regulatory schemes than to a lack of laws.

> Consumption isn't bad—it's how we are made better off.

Where Does the Garbage Go? isn't a new book, first appearing in 1974. Comparing the 1974 and 1994 editions reveals an interesting shift in environmental thinking. Originally, *Where Does the Garbage Go?* centered on a girl who went through her own trash to see what her family threw away. She found worn sneakers, potato peels, cans, bottles, and her old yoyo. She then visited her uncle on a farm, discovering that food scraps could be fed to pigs. The book generalized to the collection of garbage and its disposal in the ocean (showing children swimming in a polluted ocean), incinerators (children grimacing and rubbing their eyes from the smoke), and dumps ("a dirty place," "a great big mess" with rats and "millions of flies"). After explaining recycling and showing crowds making more trash, the 1974 book concluded with the child narrator asking what the reader thought "we should do" about trash as she took her old yoyo from the trash and fixed it.

By 1994, however, the narrator was gone and the story was now presented as a school lesson. Dumps and ocean dumping were history. But, just as in 1974, "Waste never stops piling up." Recycling and waste-to-energy plants could handle some of our trash, but "we must do more. We must stop throwing so many things away." By the end children are depicted walking home from the grocery store holding string bags that "we never throw away" and use "over and over again."

Set aside whether or not recycling makes economic sense, particularly in the forms advocated in *Where Does the Garbage Go?* No second-grader wants to read a cost-benefit analysis of curbside recycling programs. Let's even forget whether there is a market for recycled products large enough to absorb our trash. The big problem in this book—and in the others as well—is the focus on making people feel bad about consuming goods because it creates "waste."

Conspicuous Underconsumption

Consumption isn't bad—it is how we are made better off by the goods and services we purchase. The great success of market societies is precisely that they make it possible for virtually everyone in them to consume at a rate greater than even kings and emperors did in even the recent past. It was Boris Yeltsin's 1989 visit to a Houston supermarket, not a visit to a recycling center, that convinced him of the superiority of free markets.

Moreover, the bounty of a market economy is a relatively recent discovery. There was little change in consumption of calories anywhere in the world until about 1800 in western Europe. Only after the Industrial Revolution did the human condition experience a dramatic change for the better. The world's most pressing prob-

lem is that there is too little consumption not too much. People living in poverty in societies that lack basic market institutions across the developing world need to increase their consumption not reduce it.

Simultaneously the worst and best thing about *What's So Bad About Gasoline?* and its ilk is that they are excruciatingly boring. Boring is bad because energy isn't a boring topic, and making it boring turns kids off to thinking about science and technology. To their credit the book's author and illustrator try hard to make it interesting. The pictures are lively: glaciers melt and houses tumble into the ocean. But they aren't enough because the eco-catastrophist version of energy is one in which people are passive and events inevitable.

That's not how the world actually works, of course. Energy isn't boring even for elementary school kids because it is crammed full of interesting discoveries, larger-than-life characters, and exciting events. The transformation of gasoline from a waste product into a valuable commodity is a series of exciting discoveries made by entrepreneurs and scientists who raised our standards of living and health. In transforming oil into gasoline, scientists repeatedly accomplished tasks no one believed they could—turning crude oil into hundreds of different products. Brilliant and interesting characters abound.

Active beats passive for almost everyone, and free markets are active.

Unfortunately *What's So Bad About Gasoline?* misses all this. There are no individuals in the story. A cast of anonymous people from the Middle East to China to the United States finds things to do with petroleum and gasoline, and then bad things happen because we're using too much carbon-based fuel.

Presumably HarperCollins publishes books like *Where Does the Garbage Go?*, *Oil Spill!*, and *What's So Bad About Gasoline?* because earnest parents want their kids to grow up with green values. They are just a small part of a large series from one publisher, and my search for these books soon had Amazon recommending dozens of other similar titles. Worse, it is not just in these books that a future of ecological gloom and doom is being taught. Michael Sanera and Jane Shaw's *Facts Not Fear: A Parent's Guide to Teaching Children About the Environment* documented the extent of the problem of teaching children to fear the future environmental catastrophe. For kids between kindergarten and 12th grade the dominant message in schools is: "The earth is badly polluted, the rain forest is about to disappear, and global warming will submerge New York City with floods—to name a few of the imminent catastrophes," all problems caused by their parents, who "have brought the earth to the edge of doom." Scientists and engineers are not problem solvers who make life better but evil exploiters of the environment. Congressmen solve problems.

How do people who believe humanity is indeed the ultimate resource rescue the future? We've got two key advantages over the prophets of doom. First, our stories are more interesting. Free societies have room for people to do things—to discover new ideas and invent new products. Children are engaged in a process of discovery about the world around them and the narrative of discovery is more exciting than one of catastrophes. Active beats passive for almost everyone, and free markets are active. Freedom and free enterprise are just much more interesting than the alternatives.

Second, "environmental Calvinism" is even less fun than the original Swiss version. Given a choice, kids' dreams are not going to be about sorting trash into recycling bins but about personal jetpacks. Because we've got a more interesting story, we've got a chance to capture young people's attention. If you spot a neighbor's or relative's young kids glumly reading *Oil Spill!,* slip them a life of Thomas Edison or a even *Mike Mulligan and His Steam Shovel* (still in print!) and most will opt for the excitement of markets, invention, and action over the gloom of environmental pessimism. If parents read stories of action, invention, and excitement, they might even think twice about their own gloomy outlooks. FEE

How to Create the Illusion of Low Taxes

BY D. W. MACKENZIE

To the surprise of opponents of big government, the U.S. Bureau of Economic Analysis (BEA) estimates that taxes at all levels of government take *only 9.2 percent of our income*, the lowest rate since Harry Truman was president. *USA Today* and various news-media personalities, like Chris Matthews of MSNBC, have used this statistic to hammer those who complain about President Obama's profligate fiscal policies.

If this all seems too amazing to be true, you are on the right track. It's obviously not the whole story. In fact, major taxes were simply left out of the account.

Most egregiously, Social Security "contributions" were treated as insurance payments not taxes. (This is improper since the government does not think of Social Security as insurance; no citizen has contractual rights in the matter.) BEA also left out state sales taxes. Inclusion of these additional taxes pushes the total tax burden to over 20 percent, which is quite a bit more than 9.2 percent. Federal, state, and local tax receipts added up to $3.3 trillion in 2009, 27.5 percent of personal income, as Kevin Drum of *Mother Jones* points out.

But that is not the largest problem with the BEA estimate.

Last year's Recovery and Reinvestment Act (the "stimulus") included tax credits that temporarily reduced the amount of money Americans pay in taxes. However, spending increased by over $500 billion, and this has been financed by record deficits. The deficit for 2009 was $1.6 trillion, and the one for 2010 is projected at $1.88 trillion. Deficits are deferred taxation. Taxpayers will pay interest on the additional debt the Obama administration has run up until we pay off the principal. The claim that the tax burden has fallen is, to say the least, disingenuous. Increased government spending is being financed in a way that will make its true burden apparent only at some later date.

Further difficulties arise with the BEA estimate of the tax burden when you recognize that business taxes ultimately get passed on to some group of consumers.

Real Resource Costs

Moreover, this account fails to include government's real resource costs. The true costs of the State include not only money taxed and spent on resources, but the effects of increased regulation. In economic terms regulation is de facto taxation. There is no economic difference between the State controlling resources through tax-financed spending and its taking effective control of resources by regulation. There was already heavy regulation of American industry before Barack Obama entered office, and regulation has increased since then. (The cost of all regulation was estimated to have exceeded $600 billion in the 1990s.) The Omnibus Land Management Act of 2009 added over two million acres to the National Wilderness Preservation System. The Fraud Enforcement and Recovery Act and the Credit Card Accountability Act increased regulation over banking. We must also add in the takeover of GM by the Treasury, leaving out the part that went to the UAW.

In economic terms regulation is de facto taxation.

D. W. MacKenzie (dmackenz_2000@yahoo.com) teaches economics at the Coast Guard Academy. *This article first appeared at TheFreemanOnline.org.*

More to Come

Obama's policies will increase taxes even more in the future. So-called health care reform will result in heavier explicit and implicit taxes. High rates of taxation and regulation correlate with slower economic growth. Increased government borrowing deprives private investors of capital for projects. Since government borrowing crowds out private investment, deficits amount to a tax on future economic growth in private industry. Of course, Obama expects the Recovery and *Reinvestment* Act to propel America's economy forward but his expectations are wholly unwarranted. Government has an extremely poor track record of investing money productively. One need only look at the record of countries like Sweden and West Germany after World War II to see how taxes stunt economic growth. They grew rapidly when they had low effective tax rates. Then expansion of the tax burden in the 1960s and 1970s corresponded with slower economic growth. The Swedes enjoyed improved economic performance during the 1990s but only after tax and welfare reform lessened the load.

The BEA staff itself estimates that the tax burden was 30.2 percent of national income in 2009 (as opposed to personal income). Taxes were 23.8 percent of national income during Truman's presidency. Summing up all the aforementioned figures on spending and regulation leads to the conclusion that the real economic burden of government in America is over 50 percent, and rising.

The BEA is playing statistical games. In real economic terms the costs of spending and regulation have gone up substantially since Obama entered office. Worse still, Americans can expect to bear even higher burdens in the future. Concern over rising taxes is justified not merely because taxes are actually higher, but because higher taxes mean less prosperity and less freedom. Increased federal spending and regulation constitute real and unnecessary burdens for the American public. These burdens can and should be reduced. It might first, however, be necessary to educate more Americans as to the true nature of taxation. FEE

What Accounts for Government's Growth?

Politicians and the public succumb to illusions about government's abilities, says political scientist James L. Payne. These fallacies lead them to suppose government can solve problems even when the evidence keeps demonstrating that it can't.

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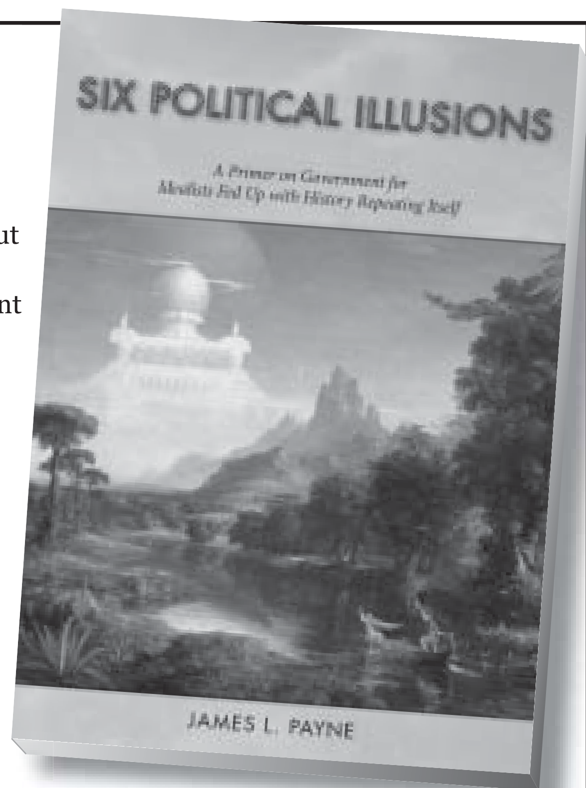
"I wish someone had put such a book into my hands at age 20. It would have advanced my political sophistication by decades," says Payne, age 71, author of 15 books on government and politics.



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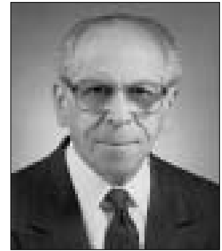
The Medicalization of Suicide



BY THOMAS SZASZ

Everyone now knows that suicide is a medical problem. Not long ago everyone knew that it was a religious and criminal problem. Bereft of the power of critical thinking and lacking historical knowledge, the human mind is a sponge for absorbing and magnifying error. The great American humorist Josh Billings (Henry Wheeler Shaw, 1818–1885) said a mouthful when he opined, "The trouble ain't that people are ignorant: it's that they know so much that ain't so."

In the medieval world Saint Augustine and Saint Thomas Aquinas had declared that whoever deliberately took the life given to him by his Creator showed disregard for the will and authority of God and was guilty of a mortal sin. In the modern world "self-slaughter" was declared a crime. In Great Britain the crime of suicide was repealed by the Suicide Act of 1961; those who failed in the attempt would no longer be prosecuted.

After 1776 the United States adopted English criminal penalties against suicide, but American courts never enforced them. Nevertheless, as late as 1963 attempted suicide still was a felony in six states—North and South Dakota, New Jersey, Nevada, Oklahoma, and Washington. Today, everyone "knows" that suicide is a mental illness, proving the wisdom of Johann Wolfgang von Goethe's (1749–1832) observation, "In the newspapers and encyclopedias, in schools and universities, everywhere error rides high and basks in the consciousness of having the majority on its side."

Coercion stands behind State talk of suicide prevention.
J.I. Bryant (flickr.com/jibryant)

Because medicalization suffuses our thinking about all manner of human problems, we bracket the term "suicide" with "prevention," implying a claim for which there is no evidence—namely, that suicide is a "medical problem." We prevent diseases but prohibit crimes. Disease is said to be prevented, not prohibited, even when a State mandate is involved, as with vaccination. Driving while intoxicated is a crime though the purpose of the law is to prevent accidents committed by drunk drivers.

Suicide prevention ought to be called "suicide prohibition." Why is this important? Because suicide is action-doing, not disease-enduring, and because the basic tool of the State is coercion not therapy. Preventive measures are aimed at keeping undesirable events from happening, prohibitions at preventing persons from engaging in behaviors defined as "dangerous" to themselves or others. The differences between these two modes of influencing/controlling the conduct of others are illustrated by the differences between the "war on cancer" and the "war on drugs." The former is fought with money and medical technology, the latter with laws and prisons.

The psychiatric perspective on life began to seep into the zeitgeist of modern Western culture in the nineteenth century and was ripe when Freud arrived on the scene in the 1880s. His influence lay mainly in his successful elaboration and popularization of the language of psychopathology and psychotherapy. By the time he died, in 1939, Wystan Auden was moved to offer this mar-

Thomas Szasz (tszasz@aol.com) is professor of psychiatry emeritus at SUNY Upstate Medical University in Syracuse. His latest book is Antipsychiatry: Quackery Squared.

velously perceptive memorial tribute to him: ". . . if often he was wrong and, at times, absurd, / to us he is no more a person / now but a whole climate of opinion / under whom we conduct our different lives."

"Mental Illness" and the Loss of Credibility

People know but do not experience that our everyday language refracts social reality in accordance with prevailing cultural beliefs. As long as a person remains unentangled in the State's psychiatric control system, he is not likely to understand its actual functioning and its threat to basic human rights. Once he becomes a "mental health consumer," he is considered credible only when he praises the system. When he criticizes it he is dismissed as lacking insight into his illness. (Psychiatric critics who are not mental health consumers are also likely to be dismissed.)

Today, suicide prohibition is a vast, bureaucratic legal-psychiatric enterprise. From the lawyer's and psychiatrist's point of view, it is medical treatment. From the would-be suicide's point of view, it is deprivation of liberty. The following excerpt from an email I received some time ago is a typical example of a "suicide prevention intervention" presented by and from the point of view of a "prevented" subject:

> Today, suicide prohibition is a vast, bureaucratic legal-psychiatric enterprise. From the would-be suicide's point of view, it is deprivation of liberty.

"I am a doctoral student in psychology. . . . I was depressed and, seeking support, had called my parents and told them that I was suicidal. They promptly called the police, who arrived at my apartment, handcuffed me, and transported me to the local psychiatric center." After many hours of waiting, the student—now called a "patient"—was "evaluated." The psychiatrist "spoke to me for approximately 10 minutes before she decided that it was in my 'best interest' for me to be committed to a psychiatric ward. I protested, of course, believing that wrenching me away from life would cause far more harm than good. She expressed no empathy, however. . . . I was finally released from the hospital five days after my arrival. I can certainly say that I received no benefit from my stay in the psychiatric ward. I am more depressed than I was before, having been traumatized by my experience with the mental health care system."

Educational authorities deny the real consequences of suicide prevention for college and university students and persist instead in restating their medicalized mendacities. Following three suicides within a period of a few months, Cornell University President David J. Skorton basks in his own platitudes: "On and off campus, there is an epidemic of suicide among young people. . . . As a father, teacher, physician and president of a university where we have recently experienced the horror of multiple suicides, I have long been concerned about this national public health crisis."

Every death is a crisis for the affected family, but three deaths, or 30 deaths, do not constitute an "epidemic" or a "national public health crisis" in a nation of 300 million people.

"What is the way ahead?" Skorton asks. His answer: "[W]e need more research into the factors that lead to suicide in this age group and how to identify those at greatest risk. . . . [S]tudents must learn that it is smart to ask for help."

This is a lie. The college student who trusts college mental health personnel is misguided. The psychiatrist, psychologist, or social worker employed by the college serves the interests of the college not the student: The student who seeks such a professional's "help" is more likely to be entrapped and harmed than empowered and helped.

So what can the parents of young-adult children, struggling with the hazards inherent to that period of life, do to protect them? They can avoid defining them as "mentally ill," enlighten them about the true function of school mental health services, and thus shield them from their "care." And they can continue to fulfill their responsibilities, as the parents of nearly grown-up children, to demonstrate their love by listening, advising, and supporting them in their struggle. FEE

Public Schools through the Public Choice Lens

BY MICHAEL BORS

Regarding the state of government ("public") schooling in the United States today, two facts stand out. The first is that the average amount of money spent per pupil has dramatically increased during the past 35 years and is now one of the highest in the world, and the second is that student achievement, by both historical and international standards, is among the lowest of industrialized countries. In conjunction with the spending increase, the current situation is surprising.

Why is it that spending larger sums for public education does not lead to better results while a higher price purchases a higher-quality service nearly everywhere in the private sector? And why haven't fundamental changes to the schools been made through the political system despite long-falling student achievement? Public Choice theory and economic reasoning make it clear that, far from being contradictory, the current state of affairs in American public schools is the logical result of the processes by which they are run and funded, and that the continuance of the status quo is the result of rational choices by voters within the current democratic system.

Why is it that spending larger sums for public education does not lead to better results?

Just how much is spent on schooling in the United States? In 2004–2005, the average expenditure per pupil was $9,266, the National Center for Education Statistics says, while the average expenditures in 1984 and 1994 were $6,219 and $7,504, respectively. This represents a 23.5 percent increase over ten years and a 49 percent increase over 20. It's also 52 percent more than what 29 other countries spent in 2003, according to the Organization for Economic Cooperation and Development.

Yet despite the vast spending increases, the average combined SAT score dropped from 1060 in 1967 to 990 in 1980, after which it rose modestly to around 1028 in 2005. Fifteen-year-old U.S. students scored 483 on the 2003 Program of International Student Assessment, 17 points below the average of all the countries that participated. Thus by the dual standard of cost and benefit, the public school system is doing poorly.

One great difference between government-run operations (such as the public schools) and all organizations on a free market, whether for-profit or nonprofit, is that government agencies are *allocated* funds by political decisions, while free-market organizations must *earn* their revenue either through voluntary gifts or voluntary exchange. This distinction has important implications for the actions of these two groups. Free-market organizations strive to maximize profit by increasing revenue and reducing costs; these profits are then either distributed to owners or shareholders or are used to further the goals of the organization. Organizations in which costs exceed revenue earned close or go bankrupt. Thus they constantly strive to become more efficient and productive, and the inefficient producers are driven out.

As Public Choice theory tells us, however, the people who run government agencies have no such incen-

Michael Bors (mbors1@gmu.edu) is a student in the Class of 2013 at George Mason University. He attended FEE's History and Liberty seminar this year.

tive to decrease costs and increase revenue because they are not subject to market competition and do not stand to benefit from any profits made. In fact, through a perverse process exactly opposite to the market process, *failing* schools and districts are often given more money in the desperate hope that the problem will be solved. Public Choice theory also demonstrates that for any public school or school system it is rational to waste resources because of the "use it or lose it" phenomenon. If a school were to have a budget surplus, its budget for the next period might be curtailed—something its administrators would abhor. Thus the public education system typically does not provide incentives for cost-cutting and quality-improving measures. In fact, it does the opposite.

Cost and Quality at Private Schools

Based on this reasoning, and other things equal, one would expect to see, on average, private schools providing better-quality education at lower cost (per pupil) than public schools. Indeed this is exactly what we find. Adam Schaeffer of the Cato Institute, in his policy analysis, "They Spend WHAT? The Real Cost of Public Schools," found that in the five metro areas studied, public schools spend nearly twice the amount of money per pupil (93 percent more) than the estimated median private school does. That students were sent to these tuition-charging schools instead of to "free public" schools is further evidence the private schools were providing a higher-quality education even at lower total cost.

> Through a perverse process exactly opposite to the market process, failing schools and districts are often given more money.

Instead of competing for students and donations, public schools and school systems compete for allocations from legislatures and bureaucracies. One factor in making these allocations is student performance on standardized tests. This artificial substitute for competition creates perverse incentives for all levels of the education apparatus. Individual teachers and schools, for example, knowing that funding is dependent not on general student knowledge and sharp critical thinking skills, but rather on one test, are induced to teach students only those skills which will be tested (a process known as "teaching to the test"). When schools receive money according to how many students enroll in upper-level classes, they have an incentive to spur more students to take those classes, resulting in unqualified students falling behind and advanced students being held back. In addition, states have an incentive to make standardized tests easier rather than harder so that more students will pass. Thus the perverse results are seen at all levels: individual schools, districts, and state governments.

Rational Ignorance and Bundle Purchases

Public Choice also explains why voters don't show up en masse on election day to vote for candidates who will change the educational system. Although many citizens agree that the schools could and should be run better, few have a detailed plan of how that could best be done, and therefore few have a standard by which to judge the education proposals of candidates. This is a result of *rational ignorance*. To cast the smartest vote regarding education policy, a parent (for example) would have to devote an enormous amount of time to learning about the various issues related to education: the inner workings of the local school system, the broader laws of economics, Public Choice theory, the structure of the teachers' unions, the fine print of the No Child Left Behind Act, and more. Yet after all this work, the parent would still only have one vote to cast. Thus the cost to the parent of learning about this political issue far outweighs the potential benefit of one well-informed vote.

Even more, an informed parent might *still* not vote for the candidate with the better schooling plan because political decisions, unlike market decisions, are "bundle purchases." While one chooses any variety of individual goods and services on the market, one must choose a single politician with all of his policy positions. Stuck with a choice of two candidates, each of whom has some agreeable and some disagreeable views, voters are very often forced to choose the lesser

of two evils. Note that such language is rarely used to describe market purchases.

Even if a parent voted for the politician who advertised the best plan for educational reform, the politician might fail to live up to his campaign promises. Candidates compete for votes and have an incentive to say or promise whatever is necessary to be elected. But dishonest campaigning is not illegal—no politician ever went to jail for breaking a campaign promise. In addition, politicians generally cannot be ejected from office during their terms; thus in the case of a lying candidate, the voter would be stuck with a representative committed to the status quo until the next election, at which time entirely new issues (apart from education) might take priority. This is the opposite of the market, where many goods can be returned immediately for full refunds, and where false advertising is punished both by the law and by consumers who withdraw their patronage. So widespread public dissatisfaction persists but the education system does not change.

A few alternatives to the current public system have been proposed, including school vouchers and charter schools. While both options stimulate a limited sort of competition on the supply side of schooling, they too are fundamentally flawed. First, the requirements and mandates that the government would impose on all schools accepting vouchers (in terms of curricula, standardized tests, and hiring policies) could create even more State control over education than already exists. Second, these proposed solutions would do nothing to address the abnormally large quantity of education that is demanded under a system of taxpayer-financed schooling.

In the final analysis, the only solution that solves all these problems is the complete separation of state and school. Only in this way can a high-quality, low-cost, diverse, and voluntary educational system be achieved. FEE

The only solution that solves all these problems is the complete separation of state and school.

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Is the Decline of Newspapers a Market Failure?

BY EDWARD J. LÓPEZ

Over the past year there has been a flurry of government-related activity aimed at stopping the decline of the newspaper business. The Federal Trade Commission (FTC) has held three series of workshops on the subject, drawing dozens of top academics, national politicians, business leaders from companies like Google and News Corporation, and the FTC commissioners themselves. On June 7 the agency released a discussion paper titled "Potential Policy Recommendations to Support the Reinvention of Journalism," and a week later it held a workshop at the National Press Club, "How Will Journalism Survive?" to discuss its proposals.

The FTC thinks this is how news should be delivered.
Adam Bowie (flickr.com/adambowie)

This activity has focused on the fact that traditional news-producing businesses aren't making the money they used to make because of competition from new kinds of outlets.

This, allegedly, is a market failure.

Print journalism lost income to television, then the Internet, and now from the expanding capabilities of mobile handsets. In this new and still rapidly evolving order, print news media are increasingly discovering they are at a comparative disadvantage in attracting advertising dollars. Like dial-up Internet access, the newspaper is getting left behind.

But is this a market failure? The FTC argues that journalism is a public good, that the severe contraction of the industry proves that the market has failed, and thus that even tirelessly experimenting entrepreneurs have been unable to find new and sustainable streams of revenues for news organizations, especially for traditional newspapers and their online extensions. As paragraphs 14 and 15 of the FTC paper argue:

> 14. There are reasons for concern that experimentation may not produce a robust and sustainable business model for commercial journalism. History in the United States shows that readers of the news have never paid anywhere close to the full cost of providing the news. Rather, journalism always has been subsidized to a large extent by, for example, the federal government, political parties, or advertising.
>
> 15. Economics provides insight into why this has been the case. The news is a "public good" in economic terms. That is, it is non-rivalrous (one person's consumption of the news does not preclude another person's consumption of the same news)

Edward López (edward.lopez@sjsu.edu) is an associate professor of law and economics at San José State University. This article originally appeared at TheFreemanOnline.org.

and non-excludable (once the news producer supplies anyone, it cannot exclude anyone). Because free riding is usually easy in these circumstances, it is often difficult to ensure that producers of public goods are appropriately compensated.

The policy recommendations, in turn, are intended to raise revenues and decrease costs to news-producing organizations, while making life more difficult for online news aggregators and other new media "free riders."

Major New Programs

By my count the FTC report contains 30 potential policy proposals, ranging from major new programs to tweaks of existing interventions. I have categorized most of the proposals into six broad areas:

- Raise revenues to news organizations by: amending the Copyright Act to allow licensing of news content and expand protections of "hot news" while also narrowing the scope of fair use; and exempting news organizations from federal antitrust laws to encourage collusion in charging end users and online news aggregators.
- Reduce costs to news organizations by: granting free access to government computing centers; expanding R&D subsidies to information technologies that journalists use; and standardizing the way governments issue electronic information as fodder for what journalists report.
- Increase current funding of journalism by: increasing subsidies to the Corporation for Public Broadcasting; increasing postal subsidies for mailing of print media; and funding newly created domestic counterparts to international radio broadcasting like Voice of America and Radio Free Europe.
- Create new federally funded programs including: a new journalism division of AmeriCorps; a national fund for local news in "places the market has failed to serve"; and grants to universities for student-produced investigative journalism.
- Offer tax preferences to news organizations including: credits for hiring journalists to "help pay the salary of every journalist"; tax-exempt status for news organizations that convert from commercial to nonprofit news organizations; and a newly created IRS status of news organizations as "for benefit" organizations that are tax-exempt.
- Harvest new funding mechanisms for earmarked spending on news organizations, including: a tax return checkbox for up to $200 to distribute to nonprofit news organizations; new Federal Communications Commission surcharges on new-media content; new taxes on spectrum use and spectrum auctions; a new 5 percent tax on consumer electronics; a new 2 percent tax on online advertising; a new 3 percent tax on wireless and Internet phone bills; and more.

The old business model is dying. That doesn't make journalism a public good. It makes the traditional business model obsolete.

This is what the best and the brightest have been up to.

Now just to be clear, the FTC authors are careful to state that these are merely potential proposals that are intended for discussion only. Yet after a year of workshops and dozens of studies, these are the ideas on the table—a thoroughgoing commitment to the coddling of a dying business model coupled with a seemingly wholesale disregard for freedom of speech.

Since there isn't enough space here to talk about all the implications of the FTC report, I will focus on the economic argument that lies at the core of these proposals.

First, you might wonder what the FTC refers to in saying that journalism has always been subsidized by the federal government. Well, consider postal subsidies for shipping print news, first enacted in 1792. Then there are tax breaks to newspapers for costs incurred to increase circulation. Finally, there is direct funding of public radio and television. In light of these examples, it seems apparent that there is a long history of federal subsidies to print journalism.

But precedent does not a market failure make.

In fact, even if a good does have the properties of being non-exclusive and non-rival, as the FTC characterizes journalism, this still does not make the decline of newspapers a market failure. Voluntary provision of public goods tends to work when the supplier of a good can find indirect ways to charge users of a good, thus converting it from non-exclusive to exclusive.

Voluntary Provision of Public Goods

History shows us repeatedly that public goods are often and perhaps even usually provided voluntarily—without mandate or subsidy from government. Toll charges have been sufficient incentives to build roads and bridges for centuries. Beekeepers and orchard growers have found ways to contract and cooperate with each other to provide more of two goods—honey and flowers—that have classic potential free-rider problems. Casino hotels in Las Vegas provide free self-parking and security. Even law enforcement itself is not a public good. Neighborhood police forces have survived on a fee-for-service basis in San Francisco, of all places, for over 150 years.

The question of whether that classic public good, the lighthouse, was provided privately in England has been a matter of some controversy. But of course, ships don't rely on lighthouses any longer. When navigation tools enabled precise longitudinal calculations, those tools began displacing lighthouses. More recently, GPS has made lighthouses obsolete. The lighthouse is now a dead business model. That doesn't make a lighthouse a public good, though. It makes it no longer a good.

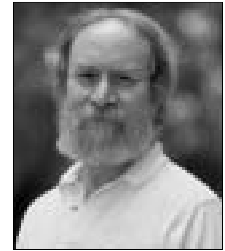
The same dynamics are true of journalism. Producers of journalism charge consumers of journalism indirectly through advertising. But the old business model is dying. That doesn't make journalism a public good. It makes the traditional business model obsolete.

Forgotten Consumer

But what about the losses to news producers? This is not pleasant to see unfold, but it is not a market failure. A policy-relevant market failure is the experience of real net losses in society as a result of purely self-regulated voluntary action. When people stop using lighthouses and newspapers, it's because they've turned to new and better substitutes. The lighthouse's loss has been society's gain. Similarly, as news producers' revenue streams have dried up, this has created more than offsetting opportunities for new-media producers and consumers of information. It has also spurred innovation in new forms of journalism. To its discredit, the FTC report barely mentions news consumers in its litany of industry-enhancing proposals. And it treats new-media competitors as the bad guys. As a society, we wouldn't want to go back to horse-drawn buggies unless we were fixing our focus entirely on the welfare of buggy-whip makers to the neglect of carmakers, consumers, and the rest of us. The authors of the FTC report do not seem to get this point.

> When people stop using newspapers, it's because they've turned to new and better substitutes. That is not a market failure.

Market-failure theory is of little help in understanding how markets really work and what is happening to journalism. A better framework is creative destruction. Old journalism is failing not because it is a public good that government has not adequately funded. It's failing because it is being replaced with more innovative alternatives. FEE



Can America Afford an Empire?

BY SHELDON RICHMAN

Fiscally speaking, the U.S. government has been running a disorderly house for some time. That makes the fiscal crisis in Greece an uneasy portent for Americans (as Steven Horwitz points out in our July/August issue, www.tinyurl.com/3yfqqlg).

Just contemplate some of the numbers. The total federal debt is nearly $13 trillion, $8.6 trillion of which is held by the public, with the rest held by government entities. (These are conservative estimates, since many government obligations are not counted.) GDP is something over $14 trillion. That ratio of debt to GDP isn't pretty. "The CBO estimates that at the end of 2020 publicly held debt will be a staggering $20.3 trillion—90 percent of GDP—with total debt being notably higher than that," Horwitz writes.

As for the budget deficit, the Congressional Budget Office projects it to exceed a trillion dollars this year and next, bringing it into the neighborhood of 10 percent of GDP. This comes on top of a 2009 deficit of $1.88 trillion—the government spent a buck-ninety for every dollar it collected. The deficit is projected to fall in the years following 2011, before resuming its growth in 2015 and beyond. By 2018 it will be back over $1 trillion, assuming these estimates are not wildly optimistic. Remember, ObamaCare has not kicked in yet.

According to the CBO, the Obama administration will create $9.75 trillion in deficits over the next decade.

Compare this with Greece: Its accumulated debt is 113 percent of GDP, and its budget deficit last year was 12.7 percent of GDP. Greece needed to sell bonds to obtain the money to pay debts come due, but lenders were too nervous to lend the money at rates the Greek government can handle. So Greece needed a bailout in the form of cheaper loans from the European Union and International Monetary Fund (a.k.a. American taxpayers), conditioned on budget austerity (spending cuts and tax increases), which in turn incited violent street demonstrations by government employees, who have benefited from high deficit spending for years.

> The Department of Defense consumes nearly 19 percent of the budget.

The Need for Cuts

If we want to avoid the Greek experience, which could spread to other EU countries in the future, the U.S. fiscal house will have to be put in order. Contrary to what the policy elite is thinking, this does not mean raising taxes, which would impede economic activity and make conditions worse.

So if the deficit is to be eliminated it will have to be through dramatic budget cutting. In the current fiscal year the federal government is planning to spend $3.55 trillion. Among the largest categories of spending are Social Security (19.63 percent); unemployment/welfare/other "mandatory" spending (16.13 percent); Medicare (12.79 percent); Medicaid and the State Children's Health Insurance Program (8.19 percent); and interest on the national debt (4.63 percent).

Of course I've left out a category, but deficit hawks often ignore it: the Department of Defense. It comes in at 18.74 percent of the budget, or $663.7 billion. (More about this number below.) For some context, the 2009 Pentagon budget was almost as much as the rest of the world's military spending combined.

For fiscal 2011 President Obama has asked Congress to appropriate $719 billion for the Pentagon, a 4.5 per-

Sheldon Richman (srichman@fee.org) is the editor of The Freeman *and TheFreemanOnline.org.*

cent increase over the current year. But as Robert Higgs points out, "few appreciate that the total amount of all defense-related spending greatly exceeds the amount budgeted for the Department of Defense."

Writing about the 2009 Defense Department budget of $636.5 billion, Higgs states: "Lodged elsewhere in the budget, however, other lines identify funding that serves defense purposes just as surely as—sometimes even more surely than—the money allocated to the Department of Defense. On occasion, commentators take note of some of these additional defense-related budget items, such as the Department of Energy's nuclear-weapons program, but many such items, including some extremely large ones, remain generally unrecognized."

Those other items include the departments of Homeland Security and Veterans Affairs, and programs within the Energy, Justice, and State departments. Higgs also calculated the share of the interest on the debt attributable to past Pentagon spending: "Adding this interest component to the previous all-agency total, the grand total comes to $1,027.8 billion, which is 61.5 percent greater than the Pentagon's outlays alone."

The grand total will be well above a trillion dollars in the current fiscal year also.

Guns and Gravy

"Owing to the financial debacle and the ongoing recession," Higgs sums up, "millions are out of work, millions are losing their homes, and private earnings remain well below their previous peak, but in the military-industrial complex, the gravy train speeds along the track faster and faster."

It's no mystery why so much is spent on the military. The U.S. government maintains close to a thousand military bases around the world and is engaging in two foreign occupations, not to mention less formal campaigns in Pakistan and elsewhere, including covert operations that never make the papers. Intervention has gone on at least since World War II. This costs money. The Iraq and Afghan occupations consume over $12 billion *a month*. *USA Today* reported recently that the Pentagon had spent $620 billion on the Iraq invasion and occupation and more than $190 billion on the operation in Afghanistan, America's longest military adventure ever. Other estimates last summer were higher, as much as $300 billion for Afghanistan, according to *U.S. News and World Report*. Last summer, more spending was approved in Congress. It's safe to say the combined price tag is over $1 trillion.

> The fiscal question is whether, in the face of the huge national debt and trillion-dollar deficits, we can afford a "defense" establishment more befitting an empire than a republic.

The fiscal question is whether, in the face of the huge national debt and multiyear trillion-dollar budget deficits, we can afford a "defense" establishment more befitting an empire than a republic. That's not the only question, however. We must also ask if a society that claims to value free enterprise can long endure the economic disfigurement that inevitably accompanies a large military-industrial complex, as President Eisenhower warned of as he left office.

Small-government men from Richard Cobden to William Graham Sumner to Robert Taft would have said no, as does their political heir, Ron Paul, today. As for whether slashing military spending would deny us needed protection, one could as well ask whether we are safe today with policies that risk "blowback," bankruptcy, and monetary disarray.

One cannot help but conclude that James Madison had it right:

"Of all the enemies to public liberty war is, perhaps, the most to be dreaded, because it comprises and develops the germ of every other. War is the parent of armies; from these proceed debts and taxes; and armies, and debts, and taxes are the known instruments for bringing the many under the domination of the few. . . . No nation could preserve its freedom in the midst of continual warfare." FEE

The Rise and Fall of Glass-Steagall

BY WARREN C. GIBSON AND JEFFREY ROGERS HUMMEL

The ongoing financial crisis has pundits, bloggers, academics, and politicians scrambling for explanations. Deregulation gets a major share of their attention, specifically the 1999 repeal of the Glass-Steagall Act of 1933. Just what was Glass-Steagall and how did it come about?

Bank failures were among the most dramatic and devastating aspects of the Great Depression. A wave of failures swept the country in 1930. A second and stronger wave followed in 1933. In all some 9,000 banks failed, taking with them all or part of the savings of millions of individuals and businesses. Perhaps the most significant response to this crisis was the Glass-Steagall Act, officially known as the Banking Act of 1933. (Glass-Steagall originally referred to a measure enacted in 1931 that was concerned mainly with powers of the Federal Reserve System, but that name now generally refers to the 1933 act.)

Roosevelt with, to his right and left, respectively, Glass and Steagall.

Glass-Steagall was a far-reaching measure that established federal deposit insurance (see *The Freeman*, June 2010; www.tinyurl.com/2v5u9cf) as well as separation of investment banking from deposit, or commercial, banking. Although it is rightly classed as one of the New Deal reforms, the bill had been debated before Roosevelt's assumption of the presidency in March 1933 and the bank holiday the same month. In fact, Senator Carter Glass had long made known his opposition to "universal banking," in which single firms could conduct deposit banking, investment banking, and other financial activities. Glass had been a sponsor of the Federal Reserve Act of 1913 and by 1933 was without doubt the most respected and powerful politician on matters related to banking.

The Glass-Steagall separation of investment and deposit banking was generally repealed by the Gramm-Leach-Bliley Act of 1999, during the administration of Bill Clinton. However, in response to the financial crisis of 2008, there has been much discussion of whether repeal was a mistake and whether some or all of its restrictions should be reinstated. We can gain valuable perspective on the current situation and calls for reform if we know a little about Glass-Steagall. What problems was it supposed to solve? What political incentives were at work? What new problems might it have caused?

Investment banking seems quite different from commercial banking. We might even wonder why both are called banking. Deposit banks accept deposits and make loans. They provide benefits to savers who couldn't reasonably find and assess borrowers on their own, and to borrowers who would have a hard time finding lenders. Investment banks underwrite securities, meaning they help companies issue new equity (shares of stock) or debt securities (bonds). They perform similar services for state and local governments that wish to issue bonds.

Warren Gibson (warren@gibson2.com) teaches engineering at Santa Clara University and economics at San Jose State University. Jeffrey Rogers Hummel (jeff@jrhummel.com) is an associate professor of economics at San Jose State University.

They set an offering price, line up buyers, and sometimes guarantee to absorb the securities themselves should any remain unsold. Unless they keep some of the new securities on their books, their work is finished once the securities are sold.

Some of the skills and practices of investment bankers are quite similar to those of bank-lending officers. Lenders must investigate the creditworthiness of prospective borrowers. Investment bankers must perform the same sort of due diligence in deciding whether to underwrite a proposed security offering and if so, how to price it. Firms that combine commercial and investment banking under one roof thus tend to be more efficient, a situation that economists call "economies of scope." If they successfully exploit economies of scope, combined firms provide lasting benefits to their corporate clients and indirectly to consumers, as well as higher profits to themselves—at least until competing firms bid away those profits.

Pecora Hearings

The main impetus for the separation aspect of Glass-Steagall was a series of congressional hearings known as the Pecora hearings, named for the chief counsel of the Senate Committee on Banking and Currency. The hearings took place in 1933 and 1934 and generated some 11,000 pages of testimony. Ever since that time the Pecora hearings have been cited as firmly establishing the abuses that can and did arise when a single firm is allowed to engage in both deposit banking and investment banking, and as justifying government intervention to curb those abuses. This belief, by now something of an urban legend in financial and regulatory circles, is summarized in the following congressional testimony given in 1986:

> [The Pecora hearings] on the securities practices of banks disclosed that bank affiliates had underwritten and sold unsound and speculative securities, published deliberately misleading prospectuses, manipulated the price of particular securities, misappropriated corporate opportunities to bank officers, engaged in insider lending practices and unsound transactions with affiliates. Evidence also pointed to cases where banks had made unsound loans to assist their affiliates and to protect the securities underwritten by the affiliates. Confusion by the public as to whether they were dealing with a bank or its securities affiliate and loss of confidence were also cited as adverse consequences of the securities affiliate system.

Who said that? None other than Paul Volcker, former chairman of the Federal Reserve System, who was given credit (perhaps exaggerated) for stopping the inflation of the late 1970s and who has reentered public life as an adviser to President Obama. (More about Volcker and the proposed Volcker Rule below.)

> One senator said the government should "treat [bank presidents] the same as they treated Al Capone."

For years Glass had been frustrated in his attempts to legislate separation of commercial and investment banking. Revelations of supposed abuses by National City Bank (NCB) of New York and its president, disclosed in the Pecora hearings, provided the spark to ignite the issue and give Glass his victory. Senator Burton Wheeler thundered, "The best way to restore confidence in our banks, is to take these crooked presidents out of the banks and treat them the same as they treated Al Capone when Capone avoided payment of his tax."

The Witch Hunt

The press got on board to the point where the *Literary Digest* reported that "Apologies, even resignations, do not satisfy listening editors." Heywood Broun, a leading columnist and perhaps the Paul Krugman of his day, piled on with, "The only thing that some of our great financial institutions overlooked during the years of boom was the installation of a roulette-wheel for the convenience of depositors." The hearings and their aftermath, it is fair to say, had become a witch hunt.

NCB was a leading New York bank, restrained by law to operate only within the city. Its subsidiary,

National City Company (NCC), had become the largest and most prominent commercial-bank-related securities underwriter, with offices in many cities besides New York. National City and its president, Charles Mitchell, were charged with numerous misdeeds. Mitchell allegedly arranged his affairs so as to avoid income tax. It was also alleged that the bank paid high salaries and bonuses and made special lending facilities available to executives.

These are scarcely criminal offenses. But among the more serious charges, executives allegedly profited from the firm's own securities underwritings. For example, National City bought a large block of stock in the new Boeing Corporation. Rather than sell this stock to the public, Pecora charged that NCC "retained a large block for itself and allotted the remainder to Mr. Mitchell and a select list of officers, directors, key men, and special friends." But an internal NCC memorandum concerning this stock says, "[O]n account of the fact this industry is still somewhat unseasoned, even though we regard this particular company as sound and having a very bright future, we were not quite ready to make a general offering to our customers. It would have been next to impossible to avoid taking orders from the type of investor who should not buy this stock. Therefore, our own family and certain officers and employees of the Boeing Co. and affiliations have taken the entire issue."

> The press got on board and the hearings ultimately leading to Glass-Steagall turned into a witch hunt.

Not only does this not sound improper, but in fact it sounds like just the sort prudent regard for customers' best interests that was supposed be lacking in combined firms such as NCB/NCC.

The committee produced a Mr. Brown, a witness who claimed to have lost $100,000 as a result of an NCC salesman's bad advice. Bankrupt and in ill health, Mr. Brown was an ideally sympathetic witness, but it turned out that he had been a successful businessman and not a novice. NCB was forbidden to call rebuttal witnesses.

In his 1990 book, *The Separation of Investment and Commercial Banking*, Professor George Bentson investigated numerous other charges against NCB and showed that none had any substantial basis in fact. Similar charges were brought against the Chase Bank, its president Alfred Wiggins, and the affiliated Chase Securities Corporation. Bentson also showed that these charges were mostly unsubstantiated—and added a thorough critique of the supposed theoretical problems of universal banks such as conflicts of interest.

Caveat Emptor

But what about conflict of interest? It is certainly possible that a banker in a combined firm might steer customers into ill-suited investments or insurance products. This is a hazard we face whenever we deal with professionals, such as physicians who advise treatments and also provide them, or lawyers who advise lawsuits and offer to file them. Such hazards are manageable: We can always get a second opinion or consult a fee-based financial planner or simply rely on the professional's incentive to maintain a reputation for ethical service.

Financial institutions have widened their offerings considerably in recent years without any apparent problems. At the website of Wells Fargo Bank, for example, one finds not only traditional deposit and savings accounts and loans of all sorts, but also stock brokerage, mutual funds, automobile insurance, homeowner's insurance, and even pet insurance. (But the Wells Fargo branch in a nearby Safeway store didn't catch on and was closed.) Similarly, Charles Schwab, which began as a discount broker, now offers a full range of investment products and advice as well as banking services through its affiliated bank. Customers enjoy expanded services and lower prices as a result of the widening of competition among traditionally distinct firms. There is no sign of significant or widespread problems arising from conflicts of interest in such firms.

Combined firms are not assured success. Sears, Roebuck, for example, once decided to get into financial services. Sears as such couldn't just start accepting deposits and making loans, nor could any commercial

bank start selling underwear. But it formed a holding company, and the combination was effected. For a brief time customers in a nearby Sears, clutching their underwear purchases, could wander across the aisle into an alcove where smiling agents offered banking services through Allstate Savings and Loan, insurance policies from Allstate Insurance, and securities from Dean Witter—Sears subsidiaries all. Customers, not regulators, showed that no economies of scope were to be found in the Sears approach: The alcoves were returned to retail use, and the subsidiaries were sold. By the time Sears recovered from this excursion, Walmart was riding high and Sears was headed for the ropes.

Another failed expansion of scope was Citicorp's acquisition of The Travelers, a major insurance firm that had previously acquired the Smith Barney brokerage. The resulting combination was christened Citigroup but the hoped-for synergies never appeared and Travelers was sold. This happened long before Citigroup was rescued by a federal bailout. Citigroup, incidentally, is the successor of the National City Bank of Glass-Steagall fame.

While the Volcker rule does not seem to be a return to Glass-Steagall, it is disturbing that Volcker has bought the urban myth supporting it.

The End-Around

Sears and Citigroup aside, some firms achieved a substantial degree of financial integration in the 1980s and '90s. Banks had figured out how to dodge the Glass-Steagall prohibition on ownership of firms "engaged principally" in underwriting and securities dealings. They simply formed subsidiaries that conducted a large enough volume of other business that they could legitimately claim they escaped the "engaged principally" clause. This avenue was not available to smaller institutions that could not marshal the required volume of business to employ this dodge. Thus by the 1990s Glass-Steagall was fast becoming a dead letter. The Gramm-Leach-Bliley Act of 1999 acknowledged the situation and provided a straightforward path toward financial integration as opposed to the variety of side routes that had been taken.

Incidentally, no other developed country has ever seen fit to separate commercial banking from investment banking. Banks in Germany and Switzerland have always been free to engage in underwriting and securities holding to no obvious harm. British banks are slightly more regulated: They are not allowed to sell insurance.

Backed partly by the reputation and stature of Paul Volcker, the Dodd-Frank act is now law. A provision that at least echoes the Volcker rule prohibits "high risk" proprietary trading by banks (trading for their own account). However, the distinction between proprietary trading and similar but supposedly benign forms of trading is left to regulators. Thus the effects of this and the act's other loosely related provisions won't really be known until a passel of regulations are written and implemented. Very likely the full effects of Dodd-Frank won't be apparent until the next financial crisis. It is disturbing that the urban myths that backed Glass-Steagall have survived like a dormant virus in the person of Mr. Volcker, as his quoted testimony suggests, and have re-emerged in Dodd-Frank.

Glass-Steagall tore investment banks out of the arms of their commercial banking parents. After that they stood alone, first as partnerships and then, starting with Merrill Lynch in 1971, as corporations. More recently they began to convert themselves into bank-holding companies. In September 2008 the last two major stand-alone investment banks, Goldman Sachs and Morgan Stanley, took the plunge. At a stroke these institutions gained certain advantages such as borrowing privileges at the Fed's Discount Window, while subjecting themselves to stricter regulations on leverage and borrowing. Most important, their explicit status as banks gives them greater assurance of a future bailout should failure loom again.

Scapegoat

The timing of the repeal of Glass-Steagall makes this deregulatory move a convenient scapegoat for the financial crisis. But the crisis began with the housing collapse, a result of government encourage-

ment of unsound lending practices. Financial firms took too much risk with mortgage-backed securities, in part because of moral hazard engendered by government guarantees and partly because bond rating firms were not as independent as was once thought. The limited liability that the investment banks gained when they became corporations may also have amplified moral hazard. There is no good reason to believe that Glass-Steagall, had it remained in effect, would have prevented any of these problems.

A panoply of myths grew up around the Great Depression, many of which are only now being debunked. Sadly, the current Great Recession may spawn a new set of myths, among them the supposed role of Glass-Steagall's repeal. We have seen how 1930s congressional hearings produced scapegoats that led to Glass-Steagall's separation of investment banking from commercial banking. Is history repeating? Last April the Securities and Exchange Commission filed securities fraud charges against Goldman Sachs. The civil complaint, since settled for $550 million, contended that the firm stacked the deck on billions of dollars worth of mortgage securities in favor of insiders and at the expense of outsiders. At this writing the Manhattan U.S. Attorney's office is conducting an investigation that could lead to criminal charges. And Goldman executives were subject to some 11 hours of intensive questioning in front of a Senate committee, during which they largely stood their ground.

We do not know whether the charges against Goldman Sachs have merit, but the parallels between that firm and the National City Bank of 1933 are eerie. We may well be seeing the manufacture of another scapegoat. FEE

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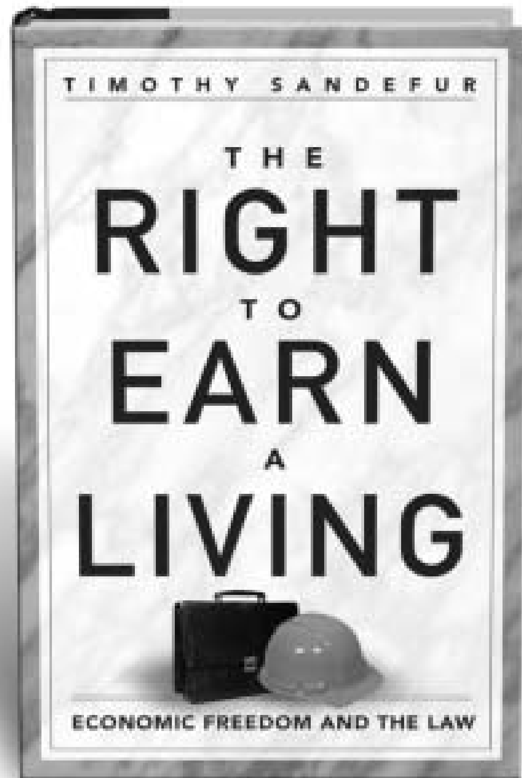

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The Paradox of the Welfare State

BY RICHARD W. FULMER

Welfare states face an inescapable paradox: The level of production needed to sustain a welfare state cannot be sustained *by* a welfare state. This paradox is created by policies that encourage the redistribution and consumption of wealth while discouraging its creation. In the face of such perverse incentives, living standards must fall even though, for a time, they may be maintained through borrowing. The paradox is not unique to Greece or California, nor is it a function of who is in charge. It is, rather, inherent in the internal contradictions of the welfare state itself.

The term "welfare state" is defined here as a polity that assumes primary responsibility for the care of a good number of its citizens, providing such benefits as public housing, health care, education, minimum wage rates, unemployment insurance, and financial support for the poor, elderly, disabled, and politically favored institutions, businesses, and industries.

> The material well-being of any society's people rests on the quantity and quality of goods and services they produce.

The material well-being of any society's people rests on the quantity and quality of goods and services they produce. All goods and services consumed by the unproductive members of society must be taken from, or paid for by, the productive. Welfare state policies ensure that the ranks of the unproductive will grow and those of the productive population will shrink, and that the productivity of the dwindling number of producers will fall. As a result, the quantity and quality of goods and services available will drop and poverty will rise. The mechanics of this decline are both straightforward and predictable.

Welfare state policies discourage saving. When government helps pay for its citizens' big-ticket items, citizens have little need to save for the future. Banks will therefore have less money to lend, leading to lower capital investment and lower economic growth.

The taxes needed to pay for public benefits reduce the ability of, and incentives for, businesses to maintain and expand production facilities. To the extent that taxes are paid by consumers, or passed on to them through higher prices, they will have less money to save, further reducing private capital.

Loss of Productivity

Minimum wage laws, unemployment insurance, employer mandates, and regulations that make it difficult to fire workers all drive up the cost of employment, resulting in less of it. High corporate taxes will drive some businesses out of the country and others into bankruptcy, further adding to unemployment rolls. Demands for protectionist legislation will become more insistent as jobless rates rise. If these demands are met, even more jobs will be lost as foreign commerce collapses amid escalating trade wars.

As benefits and benefit recipients multiply, and as the number of taxpayers declines, the latter will be less and less able to bear the ever-growing burden. Many of the most productive and adaptable will move to countries that allow them to keep more of their earnings.

Richard Fulmer (richard_w_fulmer@hotmail.com) is a freelance writer from Humble, Texas.

While productivity increases can help offset falling production due to a declining workforce, any such increase requires either capital investments or innovative process improvements. As previously explained, however, welfare states discourage capital formation by discouraging savings. Innovation is similarly discouraged by taxes that reduce or eliminate any profits that such innovation might generate.

Depleting the Ranks

As the population of unproductive citizens grows, either through job loss or through aging, government bureaucracies will also grow to meet this rising need. In addition, as more taxes are levied to pay for the bureaucracies and the programs they administer, government tax collection agencies must expand as well. This further depletes the ranks of the productive, channeling them away from producing wealth to merely redistributing it. Civil servants are typically paid more than their private-sector counterparts and are generally able to retire earlier and on more generous pensions than employees in the private sector, further adding to the burdens of productive workers. Moreover, the growing ranks of public employees form a powerful voting bloc strongly favoring increased government spending and more government control over the economy.

Institutions will grow up around the welfare state, increasing the number of people with a stake in its continuation and growth (and further decreasing the number of productive workers). For example, advocacy groups and law firms will form to help people obtain government benefits and to demand more of such benefits. Service providers, such as tax accountants, will spring up to help people deal with increasing bureaucratic complexity.

Special interest groups like AARP will funnel campaign funds and votes to pliable politicians. These private institutions will combine with government agencies in symbiotic, mutually reinforcing alliances. Elected officials can garner votes by acting as advocates for constituents forced to deal with unresponsive public agencies. Government departments, wishing to expand their "customer base," will work to make government support easier to obtain and available to more people.

Job loss, unpleasant in a free-market economy, is softened by government-provided unemployment insurance in a welfare state. Some will find paid unemployment agreeable and will delay their return to work, perhaps indefinitely. As more parents become wards of the State, more and more children will come to see this as normal, and generations of families living on welfare will become commonplace.

Advocacy groups and government agencies charged with providing benefits will work to reduce the stigma associated with receiving public aid and to justify taking from those who work to give to those who do not. Poverty must, therefore, be portrayed not as a consequence of self-defeating actions or poor choices—and certainly not of government action—but as the result of bad luck or oppression. Conversely, wealth must come to be seen not as the outcome of hard work and perseverance, but good luck or greed and exploitation. The very concept of virtue must be questioned and stood on its head as the Tenth Commandment morphs from "Thou shalt not covet thy neighbor's goods" to "Thou shalt not have goods thy neighbors covet."

The Tenth Commandment morphs from "Thou shalt not covet thy neighbor's goods" to "Thou shalt not have goods thy neighbors covet."

Feedback Loops

Imagine how dangerous the world would be for a person without the ability to feel pain (as happens with certain forms of leprosy). Such a person could hurt himself terribly by continuing to walk on a badly sprained ankle or putting his hand on a hot stove without knowing it. Government largess can create a sort of moral leprosy by weakening or even destroying feedback loops linking cause and effect. As the consequences of self-destructive actions (such as dropping out of school, having children out of wedlock, or drug and alcohol abuse) are increasingly borne by others, the incidence of such behavior will rise. At the same time,

as the benefits of hard work, perseverance, and integrity fall, such virtues can be expected to fade.

The philosophy underlying the welfare state, "From each according to his ability, to each according to his need," leads people to display minimum ability and maximum need. To the extent this philosophy is actually followed—more often, wealth flows from the politically weak to the politically strong—people will band together along ethnic, gender, religious, and other lines to compete to be seen as the most needy and therefore the most worthy of a larger share of an ever-shrinking pie. This downward spiral of competitive self-destruction may well create a permanent underclass that carefully avoids success and embraces failure—that is, which acts sensibly in the face of perverse incentives. This competition for tax dollars may create deep, irreparable fissures between recipient groups and between recipients and taxpayers.

The competition for tax dollars may create deep, irreparable fissures between recipient groups and between recipients and taxpayers.

As government grows it will increasingly be seen as the answer to any and all difficulties, and people will demand government solutions to increasingly minor inconveniences. Legislatures will respond by enacting ever-more-stringent regulations on individuals and industry, further reducing adaptability, independent and entrepreneurial thought, risk-taking, and productivity. Centralized, bureaucratic rule will erode people's self-reliance, initiative, and sense of local community.

When government begins providing people with goods and services they can provide for themselves, it launches a self-reinforcing trend that will eventually become unsustainable. Once the practice of taking from one citizen to give to another becomes established, politicians will be unable to resist the urge to bribe voters with their own tax dollars. As legislators' rewards for spending other people's money grow, spending will grow.

The time it will take a country to spend itself into bankruptcy depends on its initial economic strength and the strength of its culture. But whether it takes one generation or ten, unless the trends reverse, bankruptcy must come. Time can be gained by borrowing or printing money, but other countries will eventually stop accepting the nation's debt—whether it is in the form of government bonds or in the form of fiat currency.

In the case of the United States, the country is not yet bankrupt, but bankruptcy will soon be in sight if current policies are not changed. Social Security will go into the red this year and Medicare will shortly follow with even larger deficits. Current estimates of U.S. debt are on the order of $13–14 trillion, an amount equal to the country's entire gross domestic product. As monumental as that number is, it pales in comparison to the present value of the unfunded liabilities of Social Security and Medicare, which total $107 trillion.

Of all the changes wrought by the welfare state, a degraded, dependent culture will have the deadliest impact and will be the hardest to reverse. Yet the culture must be changed. This can occur only if government-created incentives that encourage people to live at the expense of others are replaced by market-created incentives encouraging the production of goods and services that people want. Creative marketplace competition to produce more and better products must supplant political competition for an ever-dwindling pool of tax dollars extracted from an ever-dwindling pool of productive workers. FEE

Police Misconduct and Public Accountability

BY WENDY MCELROY

Why is it difficult to prosecute police officers for criminal misconduct even when the abuse is severe and unequivocal?

A February news item from WSVN-TV in Miami/Ft. Lauderdale points to one reason:

> A homeless man's attorney said surveillance video shows deputies used excessive force in his arrest. Gerald McGovern, 58 [said he] did not attack them, as charged. Instead, they attacked him. The public defender's office said the surveillance video clears McGovern and implicates BSO [Broward Sheriff's Office]. . . . A witness, Roberto Aguilara, backed up McGovern's claim.

Note the omission. The news report names the alleged victim, the witness and (elsewhere) the lawyer but not the accused deputies. Nor do their names appear in subsequent stories about an official investigation into allegations that the deputies used excessive force.

Nondisclosure laws allow police officers to violate rights and deny victims information that may be necessary to sue.

Few people outside law enforcement are familiar with Police Disclosure Laws (PDLs), which in most states, including Florida, block the release of information about an officer's alleged misconduct until internal investigations are completed. Even then, the laws are often broadly interpreted to block such release. Some states do not make information public unless criminal charges are filed or the officer is dismissed. Other states leave the issue entirely to the police department's discretion.

The declared purpose of restrictive PDLs is to protect accused officers. With sympathetic courts ruling in favor of PDLs, police unions staunchly defend the practice of granting officers more privacy than others who are criminally accused. A news story from the New Orleans *Times-Picayune* offers a glimpse into the vigor of their defense:

> Police unions trying to block news organizations' access to internal police investigations of New Orleans officers also are waging a campaign in the civil and criminal courts to keep such records out of the hands of the city's public defender's office. Steve Singer, general counsel of the Orleans Public Defenders, said his office has filed public records requests for the New Orleans Police Department's Public Integrity Bureau files of arresting officers in the cases of more than 50 defendants. The office also has sought subpoenas through Criminal District Court to obtain some of these records.

Critics argue that PDLs obstruct justice. The laws allow police officers to violate rights because they can avoid both transparency and accountability. The laws deny victims information that may be necessary to sue or otherwise press a legal case against officers. And by shielding important aspects of accusations—for exam-

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. This article first appeared at TheFreemanOnline.org.

ple, whether the unnamed officer has been similarly accused in the past—the laws discourage the reporting of police abuse, especially by the media, for whom a significant delay in obtaining information makes a story grow cold. In turn, the lack of coverage encourages the public to believe misconduct is rare; thus those abused by police are doubly victimized by having their accounts dismissed out of hand.

On what legal basis do police departments refuse public access to information on misconduct by their officers?

Almost every state uses the federal Freedom of Information Act (FOIA) as a model for its own statutes on the public disclosure of government records. FOIA was intended to give the public a general right of access to information held by government agencies. Nevertheless, the nondisclosure about police misconduct is generally justified by reference to two common exemptions: the "investigative record" and "privacy right" exemptions. The investigative record exemption can be invoked even after an investigation is completed.

Strong arguments can be made against both exemptions.

The Investigative Records Exemption. The police units that investigate accusations of misconduct are called "internal affairs" or something similar. But are such accusations an internal, private matter rather than one of compelling public interest? The question becomes more urgent when the alleged misconduct is criminal or involves the violation of constitutional protections such as the right to due process.

When anyone is given a gun and broad authority to use it in public, that same public needs to know if the gun and the authority are being misused. The public also needs to know the particulars of how abuse accusations are being investigated. For example, has a particular police department established such a high burden of proof that virtually no accusation against an officer can be sustained?

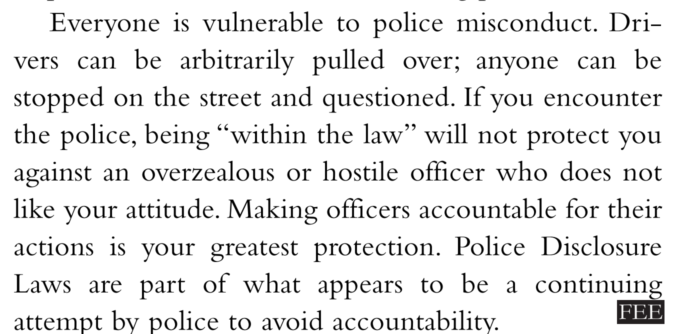
When anyone is given a gun and broad authority to use it in public, that same public needs to know if the gun and the authority are being misused.

This compelling public interest is usually overridden by the argument that releasing information would have a "chilling effect" on law enforcement. In the essay "The Public's Right of Access to Police Misconduct Files," attorney Lynne Wilson comments, "A number of federal courts have seriously questioned the empirical basis for a finding that public disclosure of internal disciplinary files causes a 'chilling effect' on law enforcement. One judge said that 'if the fear of disclosure . . . does have some real effect on officers' candor, the stronger working hypothesis is that fear of disclosure is more likely to increase candor than to chill it.'"

The Privacy Right Exemption. The police are tax-supported public servants with the authority to violate your privacy rights. As such, officers should expect to receive a public review of their performance while on duty. The intent of the privacy exemption in FOIA is the preservation of "personal" privacy, such as sexual preference, that is not of legitimate concern to the public. But in its use by police departments, the privacy exemption closes off examination of the professional behavior of public servants.

"[I]t would be difficult to imagine a subject-matter of more legitimate concern to the public than how its police departments are managed," Wilson writes. "At least one state court has held that police officers have no privacy rights in misconduct records because the records, by definition, 'involve events which occurred in the course of public service . . . matters with which the public has a right to concern itself.'"

In short, on-duty police conduct is not an internal or private matter but one of overriding public concern.



Everyone is vulnerable to police misconduct. Drivers can be arbitrarily pulled over; anyone can be stopped on the street and questioned. If you encounter the police, being "within the law" will not protect you against an overzealous or hostile officer who does not like your attitude. Making officers accountable for their actions is your greatest protection. Police Disclosure Laws are part of what appears to be a continuing attempt by police to avoid accountability. FEE

Our Economic Past

Teddy Roosevelt and the Progressive Vision of History

BY BURTON FOLSOM, JR.

Over a hundred years ago, on August 31, 1910, Teddy Roosevelt gave his famous "New Nationalism" speech in Osawatomie, Kansas. In that speech the former president projected his vision for how the federal government could regulate the American economy. He defended the government's expansion during his presidency and suggested new ways that it could promote "the triumph of a real democracy."

Roosevelt's quest for "a real democracy" and for centralizing power was a clear break with the American founders. James Madison, for example, distrusted both democracy and human nature; he believed that separating power was essential to good government. He urged in Federalist No. 51 that "those who administer each department" of government be given "the necessary constitutional means and personal motives to resist the encroachments of others. . . . Ambition must be made to check ambition." If power was dispersed, Madison concluded, liberty might prevail and the republic might endure.

> Roosevelt's quest for "a real democracy" and for centralizing power was a clear break with the American founders.

Roosevelt argued in this speech that the recent rise of corporations gave businessmen too much economic control. Madison's constitutional restraints, therefore, allowed too much wealth to be concentrated in too few hands. Redistribution of wealth by government, Roosevelt thought, would achieve "a more substantial equality of opportunity."

The economic power of railroads triggered Roosevelt's ire during his presidency. He was frustrated that railroads gave rebates to large customers. In effect, the railroads charged varying rates for carrying the same products the same distance. Roosevelt thought rates should be roughly similar for large shippers and small shippers, especially if the small shippers were far from major cities.

He posed the problem this way: "Combinations in industry are the result of an imperative economic law which cannot be repealed by political legislation. The effort at prohibiting all combination has substantially failed. The way out lies, not in attempting to prevent such combinations, but in completely controlling them in the interest of the public welfare."

In practical terms, "completely controlling" railroads in the public interest meant that the Interstate Commerce Commission (ICC) would have power to set rates so that larger shippers would not get such big discounts on their high volume of business. James J. Hill, president of the Great Northern Railroad, argued that large shippers received higher rebates because their massive business created "economies of scale" for the railroads—that is, railroads could reduce their costs best when shipping large amounts of goods over the rails. The bigger shippers contributed more to the reduced costs of shipping, so they got larger rebates.

To Roosevelt and to the smaller shippers, rebates for the bigger shippers were "unfair money-getting" and have "tended to create a small class of enormously wealthy and economically powerful men, whose chief object is to hold and increase their power." The founders may have provided a "right to life, liberty, and the pursuit of happiness," but Roosevelt believed that the pursuit of happiness and private property were not absolute. "We grudge no man a fortune which repre-

Burton Folsom, Jr. (bfolsom@hillsdale.edu) is a professor of history at Hillsdale College and author of New Deal or Raw Deal? *He blogs at BurtFolsom.com.*

sents his own power and sagacity," Roosevelt said—but then added, "when exercised with entire regard to the welfare of his fellows." If railroads were enriching themselves and larger shippers disproportionately to the smaller shippers, then Roosevelt believed such power to set rates needed to be limited: "The Hepburn Act, and the amendment [Mann-Elkins Act] to the act in the shape in which it finally passed Congress at the last session [1910], represent a long step in advance, and we must go further."

The Hepburn Act gave the ICC the power to reduce railroad rates and placed the burden on railroads to show their rates were reasonable. One intervention led to another. The railroads now had to prove that the rates they set were fair, so Congress created a Bureau of Valuation, which was empowered with a huge staff to value railroad property. According to historian Ari Hoogenboom, the bureau's "final report, issued after a twenty-year study costing the public and the railroads hundreds of millions of dollars, disproved assumptions by Progressives that railroads were . . . making fabulous returns on their true investment."

The shift from the individual rights of the founders to the community rights of the Progressives was a watershed transition.

The lesson that Roosevelt learned from passing the Hepburn Act was that federal power was needed to break up those businesses that engaged in price discrimination. "The citizens of the United States," Roosevelt said, "must effectively control the mighty commercial forces which they have called into being."

Once Roosevelt established that the federal government should regulate the prices railroads charged for shipping, the next step was to intervene in other industries as well. "In particular," Roosevelt argued in his speech, "there are strong reasons why . . . the United States Department of Agriculture and the agricultural colleges and experiment stations should extend their work to cover all phases of farm life. . . ." He added, "The man who wrongly holds that every human right is secondary to his profit must now give way to the advocate of human welfare, who rightly maintains that every man holds his property subject to the general right of the community to regulate its use to whatever degree the public welfare may require it."

The shift from the individual rights of the founders to the community rights of the Progressives was a watershed transition in American thought in the early 1900s. But Roosevelt needed a federal income tax to help him redistribute wealth in the national interest. The title "New Nationalism" reflected his view that he and other leaders could determine the national interest and redistribute wealth and power accordingly.

Of the income tax Roosevelt said, "The really big fortune, the swollen fortune, by the mere fact of its size, acquires qualities which differentiate it in kind as well as in degree from what is possessed by men of relatively small means, Therefore, I believe in a graduated income tax on big fortunes, and in another tax which is far more easily collected and far more effective—a graduated inheritance tax on big fortunes, properly safeguarded against evasion, and increasing rapidly in amount with the size of the estate."

Three years after Roosevelt's speech, the Sixteenth Amendment, authorizing a federal income tax without regard to source became law. Roosevelt had his wish—the 1913 tax was progressive: Most people paid no income tax, and the top rate was 7 percent. Roosevelt probably envisioned rates not much higher than that, but once Congress established the principle that some people could be taxed more than others, there was no way to calculate or determine what the national interest was.

Within one-third of a century after Roosevelt's speech, the United States had a top marginal income tax rate of more than 90 percent.

When the individual liberty of the founders was transformed into the national interest of Teddy Roosevelt and the Progressives, we were only one generation away from a major threat to all our personal liberties. That threat still exists today. FEE

John Maynard Keynes, R.I.P.

BY RICHARD B. MCKENZIE

The late revered British economist John Maynard Keynes, whose 1936 treatise, *The General Theory of Employment, Interest, and Money,* changed the way many economists think about recessions, once wrote that "in the long run we're all dead." Well, maybe so . . . for everyone but Keynes.

Keynes's ghost has haunted the halls of the Bush II and Obama administrations, where various "stimulus" packages were concocted. The Keynesian arguments undergirding the fiscal stimulus froth over the past two years went remarkably unrecognized in the media for their one-sidedness. The basic stimulus argument goes something like this: If the federal government engages in deficit spending during a recession, the added government expenditures (unaccompanied by tax increases) will boost "aggregate demand." Greater federal spending on a road, for instance, will create jobs for construction workers, who can be expected to spend some if not all of their additional income on, say, bread. Bakers now will have more to spend on, say, cars and so on.

National income stimulated by the initial government road project can grow by some multiple of the expenditure, the theory says. It can even be wasted on pork-barrel construction projects like bridges to nowhere, according to Keynes. He even dared to advocate that the government bury dollars in bottles. Entrepreneurs could then be expected to spend money digging up the bottles, unleashing the multiplier magic and reducing unemployment (in the same illusory way).

A stimulus package (and budget deficit) of, say, $1 trillion would morph in short order, stimulus backers have assured us, into a minimum of $1.5 trillion in additional national income—maybe even into $4 trillion or $10 trillion. Pick your multiplier, because no one in Washington or academe really knows what it is. Even the best of econometricians can't accurately assess the multiplier when the current crisis is "unprecedented," as widely claimed.

Fantastic, wouldn't you agree? Keynesianism offers the proverbial free lunch several times over.

But if it sounds too good to be true, it is. If such income growth were possible, the country and the world would now be awash in prosperity, given that the federal government increased the national debt by $1.88 trillion in fiscal 2009 and could run deficits of

Richard McKenzie (mckenzie@uci.edu) is a professor in the Merage School of Business at the University of California, Irvine. He is author most recently of Why Popcorn Costs So Much at the Movies, and Other Pricing Puzzles.

$1.6 trillion and $1.3 trillion in fiscal 2010 and 2011, respectively. Between 2012 and 2015 it will add at least another $3 trillion to the national debt. Why not go for even greater deficit spending, if Keynesian theory worked so magically? Of course, many Keynesian enthusiasts have recommended stimulus packages two and three times what the Bush and Obama administrations sought two and three years ago, with little to no recognition that an escalation in the size of the deficit can, at least beyond some point, curb any multiplier effect (if there were the prospects of a positive one) as the budget deficit rises and crowds out expenditures in private sectors of the economy.

In the 1960s Keynesianism was followed as fiscal religion, but by the 1970s economists found it to be a snare and delusion for a simple reason: The political version of Keynesianism is a one-sided theory, with almost total emphasis on what the federal government spends. It pays virtually no attention to the potential private-sector offsets to the greater deficit spending by government or to how current fiscal policies could have negative long-run real income effects that can feed the current generation's expectations of impaired futures. Keynesianism, in the form practiced in political circles, has no appreciation for how people's expectations can affect their current spending and investing plans.

The political version of Keynesianism is a one-sided theory.

The late great economist Milton Friedman frequently peppered Keynesian enthusiasts in the 1960s and 1970s with a remarkably simple question that needs to be remembered today: Where does the government get the money it spends on roads (or bridges to nowhere)? Friedman followed with an equally revealing observation: When the government engages in deficit spending, it must borrow the extra funds from someone who could have spent them on private-sector projects. An increase in government spending could be totally offset by a decrease in—or a "crowding out" of—private spending, as lendable funds are diverted from private to government uses. The net effect can be no net increase in aggregate demand—and no multiplier effect. Indeed, with the inevitable waste in government stimulus projects, the multiplier effect could as easily be negative as positive.

Okay, in a down economy some of the funds the government borrows to cover stimulus expenditures might have remained idle, which can mean that the increase in government spending is not totally offset. But Friedman still has a point: The multiplier effect of greater government spending will be muted at least somewhat and maybe in large measure. Commentators who tout the glories of stimulus packages and bemoan the difficulty that small and large businesses and consumers have been having in finding credit never seem to make the causal connection that government borrowing can dry up, and has dried up, credit for nongovernmental purposes. Why should banks loan their available funds to people for risky private projects when they can loan their funds at little risk to the government, with 300-million-plus Americans it can tax to cover the debt?

The Piper Don't Take Visa

Keynesian policy advocates rightfully assume that if the government hikes taxes along with expenditures, the stimulus effects of the added government spending will be seriously muted, maybe negated. The problem is that American taxpayers aren't the fools the Keynesian advocates would like to think they are. With the potential of a doubling of the national debt over the next ten years, many not-so-stupid Americans can anticipate that the fiscal piper will have to be paid in the future—with higher tax rates on future incomes. The anticipation today of those higher future tax rates can dampen private demand, as people set aside savings for future higher tax payments and as they refrain from making all the investments that can translate into higher future incomes—which will be taxed at higher future rates. And higher tax rates imposed currently on the rich can affect many now poor Americans' saving and investment plans because they expect to be not-so-poor, and maybe rich, in the future. In short, the anticipated future tax rates will be another offset to today's stimulus expenditures.

Then you have the threat of future inflation from today's fiscal profligacy. The anticipated higher inflation is seen as a wealth tax. If the government has little debt,

it gains little by hiking the inflation rate to lower the *real* value of its debt. However, when the debt grows to enormous levels, as already budgeted, the government's temptation to inflate away its own debt—and the wealth of bond holders—grows concomitantly. And we must not forget the lessons learned in the inflationary 1970s: Inflation, and inflationary expectations, can have debilitating effects on the real economy—in people's real income and real income expectations and, thus, on current demand.

Of course, if debt holders begin to worry that the real value of their debt will depreciate due to any future orchestrated government inflationary policy, all those foreign bondholders—most notably, the Chinese and British—might lose confidence in the international value of the dollar, which can cause them to dump their dollar-denominated bonds on international money markets, which in turn can lead to a deterioration in the international value of the dollar and to a reduction in the real incomes of Americans across the board—and to contraction in private demand, yet another offset to government stimulus spending.

Perverse Politics

Even if Keynesianism had validity, we would still have to worry that the politics of the day would pervert the goal of reviving the economy as politicians fall over themselves to pack "stimulus packages" with pork, designed mainly to stimulate the private economies of their supporters and not the national economy. (Indeed, that is what happened). As economists James Buchanan and Richard Wagner argued long ago, Keynesian economics provides a grand excuse for politicians to do what they love to do: spend other people's money without having to incur the current political costs of asking them to cover the expenditures with higher taxes. Make no mistake about it, Keynesianism has the potential of transforming the United States in the not-too-distant future into a financial basket case much like Greece, Spain, and Ireland are today.

The Keynesian recovery prescription never gets sillier than when, as noted, advocates claim that the economic merit of the funded government projects is of little consequence. What counts for them is more spending. That couldn't possibly be true, given Keynesian insistence that private aggregate demand is inextricably tied to aggregate *real* income. If a bridge to nowhere is built, the bridge is obviously of no economic value, which means it adds nothing to national income. Its construction must draw resources at least some (if not all) of which could have been used to produce something of real value to people. Bridges to nowhere can only undermine any potential Keynesian multiplier effect. If anything, bridges to nowhere must have a negative multiplier effect through the effect of the impairment of long-term income growth over time through the depression of aggregate demand.

But Keynes and his followers failed to appreciate the extent to which the long-run effects of short-run policies can affect people's wealth and income expectations, which in turn can undermine their current buying decisions. If people's expected future incomes and wealth holdings are reduced (from what they would otherwise be), then surely Keynesians would, for the sake of consistency in argument, have to conclude that current private consumption and investment demand would also be suppressed, which would partially negate the so-called stimulus packages.

> What counts for Keynesians is more spending, and never mind the economic merits.

Finally, when a national economy gets seriously out of whack as happened over the last decade—with housing prices rising to unsustainable levels because of an unsustainable credit binge, with the rising housing prices fueling the demand for big-ticket consumer goods as homeowners used their houses as ATMs—then the only route to recovery is a painful one, with falling housing prices, lost jobs, and foreclosed homes. Ownership of houses, office buildings, and plants must be shifted from those who can no longer afford them to those who can afford them and can use them productively and profitably at the lower prices.

So much of what the government has done under the guise of *stimulating* the economy has been directed at retarding the required adjustments—and therefore preventing the recovery. The government has worked hard to prevent housing prices from falling as far as they

must by offering tax credits to first-time homebuyers and slowing the pace of home foreclosures. The Cash for Clunkers program has been a policy clunker in itself, given that it caused a minor boom and bust in automobile sales, just as the homebuyer tax credit distorted sales of houses over time. These are hardly the kinds of stabilizing forces the economy needs in times of instability.

Then, of course, the federal government has chosen to fight the devastating consequences of the private credit binge of the last decade with a credit binge of its own (with nearly one out of every two recent budget dollars financed with debt, or leverage). If the private credit binge gave rise to the moral hazard of excessive risk-taking in the private sector (by banks, nonbanks, homeowners, and credit card holders), should anyone not expect the same excessive risk taking in the political sphere when the government heavily leverages its current spending? Such risk-taking shows up in the government's adopting the mantra of Keynesian stimulus economics even when it has little promise of yielding the results promised and carries the nontrivial risk of damaging the future growth path of the private economy.

The recovery has been weak, contrary to the promises of Keynes's devotees.

Given all the Keynesian hype over the past two to three years, one fact stands out: The recovery has been weaker than what would have been expected from the promises of Keynes's devotees.

Nevertheless, a recovery (at this writing) appears underway, albeit more delayed than past recoveries. But, as argued here, everyone should harbor deep skepticism that the current weak signs of recovery can be traced to the stimulus packages of the last couple of years, especially since the rate at which displaced workers have been finding new jobs has been the most sluggish of all recessions since World War II. This is partially because government policies have gradually increased the long-term costs of firms hiring workers, with the most recent imposed burden being the effective nationalization of health care and health insurance.

Think the analysis here is pie-in-the-sky theory? Well, Harvard macroeconomist Robert Barro has estimated that the five-year effects of $600 billion in fiscal stimulus over the past two years will come at a cost of $900 billion in reduced private demand. That's hardly the free lunch the country has been promised.

The Obama administration has not been shy in its first year about floating a variety of tax-hike proposals, supposedly for higher-income groups. And the expected federal budget deficits harbor threats of major future tax increases, as a growing list of researchers are finding. For example, the Congressional Budget Office projects that under current law (with marginal income tax rates unchanged), the national debt will almost double, rising by more than $11 trillion, between 2009 and 2020. Researchers at the Tax Policy Center figure, optimistically, that if the annual deficits are reduced to 2 percent of GDP between now and 2020 and if all tax rates are raised proportionately for all income groups, the lowest federal income marginal tax rate would have to rise from 10 to 15 percent and the highest marginal rate would have to rise from 35 percent to 52 percent. If the deficit were lowered only by raising the top two marginal tax rates, now 33 and 35 percent, those top rates would have to go 86 and 91 percent—which of course might actually worsen the deficits, given that the current "rich" and the "rich-wannabes" would have little incentive to work, save, and invest.

The country will learn anew an old lesson: Don't count on the federal government to wave away the country's economic troubles with some refurbished fiscal wand. The wand didn't work in the 1960s and 1970s (it only contributed to "stagflation"). The wand is an illusion that should have died with Keynes long ago. We will also relearn the oft-repeated wisdom of Keynes when he wrote, "Madmen in authority, who hear voices in the air, are distilling their frenzy from some academic scribbler of a few years back."

How true, how true! Regrettably. FEE

Attacks on Freedom

BY JOHN STOSSEL

Something's happened to America, and it isn't good. It's become easier to get into trouble. We've become a nation of a million rules. Not the kind of bottom-up rules that people generate through voluntary associations. Those are fine. I mean imposed, top-down rules formed in the brains of meddling bureaucrats who think they know better than we how to manage our lives.

Cross them, and we are in trouble.

The National Marine Fishery Service (NMFS) received an anonymous fax that a seafood shipment to Alabama from David McNab contained "undersized lobster tails" and was improperly packed in clear plastic bags, rather than the cardboard boxes allegedly required under Honduran law. When the $4 million shipment arrived, NMFS agents seized it. McNab served eight years in prison, even though the Honduran government informed the court that the regulation requiring cardboard boxes had been repealed.

We've become a nation of a million rules of the sort formed in the brains of meddling bureaucrats.

The Kids Are Alright—Or Else

How about this one? Four kindergartners—yes, 5-year-old boys—played cops and robbers at Wilson Elementary in New Jersey. One yelled: "Boom! I have a bazooka, and I want to shoot you." He did not, of course, have a bazooka. Nevertheless, all four boys were suspended from school for three days for "making threats," a violation of their school district's zero-tolerance policy. School Principal Georgia Baumann said, "We cannot take any of these statements in a light manner." District Superintendent William Bauer said: "This is a no-tolerance policy. We're very firm on weapons and threats."

Give me a break. These are just some of the stories featured in a new book, *One Nation Under Arrest*, which I discussed on my show July 15 (www.tinyurl.com/2g9oxvx).

Here's another: Ansche Hedgepeth, 12, committed this heinous crime: She left school in Washington, D.C., entered a Metrorail station to head home and ate a French fry. An undercover officer arrested her, confiscating her jacket, backpack, and shoelaces. She was handcuffed and taken to the Juvenile Processing Center. Only after three hours in custody was the 12-year-old released into her mother's custody. The chief of Metro Transit Police said: "We really do believe in zero-tolerance. Anyone taken into custody has to be handcuffed for officer safety." She was sentenced to community service and now carries an arrest record. Washington's Metro has since rescinded its zero-tolerance policy.

Keith John Sampson, a student-employee at Indiana-Purdue University Indianapolis, had the temerity to read *Notre Dame Versus the Klan: How the Fighting Irish Defeated the Ku Klux Klan* during breaks on the job. One student complained because the book's cover depicted the Klan. The university then found Sampson guilty of racial harassment! Thankfully, a great organization, the Foundation for Individual Rights in Education (FIRE), came to his defense and got his school record cleared.

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.*

Palo Alto, California, ordered Kay Leibrand, a grandmother, to lower her carefully trimmed hedges. Leibrand argued that no one's vision was obstructed and asked the code officer to take a look. He refused. Then the city dispatched two police officers. They arrested her, loaded her into a patrol car in front of her neighbors, and hauled her down to the station.

In 2001, honor student Lindsay Brown parked her car in the wrong spot at her high school. A county police officer looked inside and saw a kitchen knife—a butter knife with a rounded tip. Because Lindsay was on school property, she had violated the zero-tolerance policy for knives. She was arrested, handcuffed, and hauled off to county jail, where she spent nine hours on a felony weapons possession charge. School Principal Fred Bode told a local paper, "A weapon is a weapon."

Congress creates, on average, one new crime every week. Federal agencies create thousands more.

Congress creates, on average, one new crime every week. Federal agencies create thousands more—so many, in fact, that the Congressional Research Service itself said that merely counting them would be impossible.

This is a bad trend. As Lao Tsu said, "The more laws and order are made prominent, the more thieves and robbers there will be." FEE

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Book Reviews

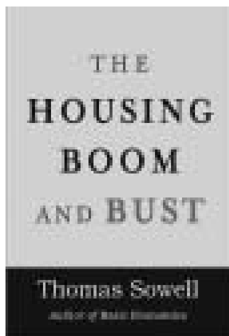
Getting Off Track: How Government Actions and Interventions Caused, Prolonged, and Worsened the Financial Crisis

by John B. Taylor
Hoover Institution Press • 2009 • 92 pages • $14.95

The Housing Boom and Bust

by Thomas Sowell
Basic Books • 2009 • 192 pages • $24.95

Reviewed by Gerald P. O'Driscoll, Jr.



These two books are must-reads for anyone wanting to have a working understanding of the economic and financial crisis. They complement each other and together form a civics lesson for an informed electorate.

Economists are prone to write turgid prose and employ a jargon-filled style. Not these two gems. Each author is a deservedly well-regarded economist, eminent in his field, but their books are written for the layman. Both draw on detailed academic research, but neither requires the reader to wade through thickets of citations.

Taylor poses these questions: "What caused the financial crisis? What prolonged it? What worsened it dramatically more than a year after it began?" His answer in each case is first and foremost "specific government actions and interventions." The heart of his argument is a criticism of Fed monetary policy under Alan Greenspan in the aftermath of the collapse of the dot-com bubble. The Fed cut interest rates and continued cutting aggressively, taking the short-term interest rate under its control (the federal funds rate) down to 1 percent. The rate stayed at 1 percent for a year. Other market interest rates fell as well. The artificially low cost of borrowing fueled the housing boom.

Taylor uses a figure to compare housing starts as they actually occurred in the boom with a counterfactual simulation—as they would have occurred had the Fed adhered to policies that began in the early 1980s and continued into the 1990s. The result: "No Boom, No Bust" in housing. Not everyone agrees that monetary policy was so benign throughout the period dubbed the "Great Moderation." But the Fed's cheap money policy after 2000–01 brought back volatility in housing and the economy last seen in the 1970s.

Taylor explains how the Fed exported its easy money to other countries (especially the European Union), drawing them into the crisis. He also examines the many other complications, including such issues as the actions of Fannie Mae and Freddie Mac, and the role of securitization. His analysis of the many policy missteps in response to the crisis is masterful. These policy errors prolonged the crisis.

While Taylor covers a broad array of issues, focusing particularly on monetary policy, Sowell focuses on the housing market itself, chronicling the "skyrocketing rise" in home prices. From 2000 to 2005 the median sales price of a single-family home rose 53 percent, from $143,600 to $219,600. In the priciest markets, like New York City, Los Angeles, and San Diego, prices escalated at an even more rapid rate (79, 110, and 127 percent, respectively). How could home prices have increased so much in such a short period, then fallen so fast?

Sowell also asks the commonsense questions. "When it comes to the home mortgage boom and bust, who was to blame? The borrowers? The lenders? The government? The financial markets?" He answers yes to all the above and notes that "economics cannot explain such things." *Politics* drove the housing boom, and he turns to the politics.

First, there is the wonderfully misnamed policy of "affordable housing." Never precisely defined, it is a complex combination of misguided policies. They

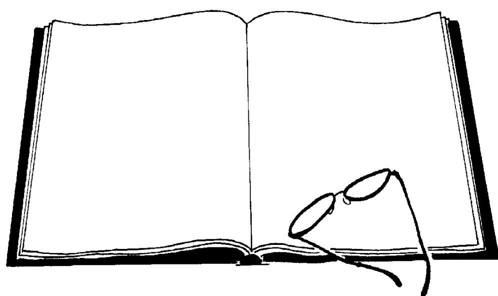
include policies to lower borrowing costs, down payments, lending standards, and, generally, costs of homeownership. Instead they have together combined to increase housing costs. As Sowell observes, it is precisely where government intervention in housing is the greatest that housing costs are highest.

Government housing policies have been at war with themselves. Sowell cites the case of housing in coastal California, now one of the highest-priced markets in the country. As late as 1969, however, home prices there were affordable by a number of measures and in line with home prices in the rest of the nation. In the 1970s California began introducing land-use restrictions that drove up costs for lots and their development. He examines alternative explanations for the rapid escalation in prices and concludes it was the land-use policies that were responsible for astronomical housing costs in coastal California.

California's land and housing policies were extreme, but not unique. So we have longstanding policies restricting the supply of land and homes meeting policies to stimulate demand. When demand is stimulated and supply restricted, prices will necessarily increase. Land-use restrictions, affordable housing, and easy credit caused the housing boom and bust.

For the full story, I recommend these two estimable books to *The Freeman's* readers. FEE

Gerald P. O'Driscoll, Jr. (gpo@ix.netcom.com) is a senior fellow at the Cato Institute and former a vice president at the Federal Reserve Bank of Dallas. With Mario Rizzo, he is coauthor of The Economics of Time and Ignorance.

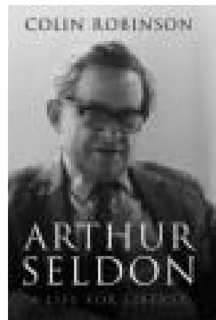


Arthur Seldon: A Life for Liberty

by Colin Robinson

Profile Books • 2009 • 256 pages • £20

Reviewed by Martin Morse Wooster



Historians who look at think tanks usually write about their presidents or scholars. But Colin Robinson's life of Arthur Seldon (1916–2005) is one of the few biographies that looks at a think-tank editor. Although Seldon was a prolific author, whose collected works fill seven volumes, his most important legacy was as cofounder and editorial director of Britain's Institute of Economic Affairs (IEA) from 1957 to 1988. While with the IEA Seldon edited over 350 books, many of which significantly influenced Margaret Thatcher and her allies in Britain's free-market reforms of the 1980s. *Arthur Seldon: A Life for Liberty* substantially adds to our knowledge of this important figure.

This biography's primary author is Colin Robinson, an emeritus professor at the University of Surrey and Seldon's successor as IEA editorial director. But the first chapter adapts an unpublished manuscript by Chris Tame, who was commissioned to write Seldon's biography but died before finishing his manuscript. In addition, Martin Anderson, Stuart Waterhouse, and Basil Yamey, who knew Seldon at various periods of his life, supply reminiscences.

Arthur Seldon was born Abraham Margolis in London in 1916. After his parents died in 1918, he was adopted by Eva and Mark Slaberdain and given the name Arthur Slaberdain. In 1939 he changed his name to Arthur Seldon.

Robinson finds several influences on Seldon's early thinking. He grew up in a Jewish ghetto whose residents believed in self-reliance and self-help organizations as the way to climb out of poverty. A history teacher in high school, E. J. Hayward, taught courses that strongly emphasized the importance of liberty in British history. In 1934 Seldon won a scholarship to the London School of Economics, where his studies with F. A. Hayek, Ronald Coase, Lionel Robbins, and

Arnold Plant enhanced his understanding of free-market economics.

After serving in the British army during the war, Seldon worked for a magazine about retail stores and for the Brewers' Society until he was recruited for the Institute of Economic Affairs in 1956. The IEA was the first British free-market think tank. Seldon's job as IEA's principal editor, Robinson writes, was to produce studies "to be written primarily by academic economists but carefully edited by him—with the specific purpose of explaining, in language that could be understood by those not technically trained in economics, the practical benefits of voluntary action in competitive markets, the virtues of self-help and the disadvantages of state intervention."

Seldon was a masterful editor, able to turn dense economic treatises into pellucid prose. He invented the idea of a series of papers, between 10,000 and 15,000 words each, which argued for a particular reform. Many economists, even those sympathetic to IEA's free-market positions, chose to limit their conclusions to what they considered "politically possible." Seldon urged his authors to pursue their analyses to their logical conclusions—even if those conclusions were quite radical.

Seldon liked to use a military metaphor to explain IEA's goal. The institute, he argued, would be like long-range artillery, launching shells into statist lines from a great distance. The IEA, he argued, "would never be the infantry, engaged in the short-term face-to-face grappling." Rather than quickly generated policy analyses, Seldon believed that the IEA should produce thoroughly researched, detailed studies to persuade a skeptical audience of the virtues of the market.

Over his career Seldon edited many great economists, including Milton Friedman and Gordon Tullock. Most of the authors respected his skills as an editor. Hayek admired Seldon's editorial work so much that he asked Seldon to complete his trilogy *Law, Legislation, and Liberty* if he passed away before he finished it (thankfully, that didn't happen). Seldon's influence shows up in surprising places; according to Martin Anderson, Seldon's assistant in the 1970s and 1980s, he "was an enthusiastic adviser" to Anthony Jay and Jonathan Lynn when they wrote the scripts for "Yes, Minister," a television comedy that remains a very funny critique of government bureaucracy.

As for Seldon's own writings, Robinson finds two works particularly significant. In 1968 Seldon nearly died because of a botched blood transfusion following an ulcer operation. Seldon's response was *The Price of Blood*, a controversial study that called for blood to be bought and sold. Another important book was *The Riddle of the Voucher* (1986), an exploration of why Britain failed to adopt educational vouchers.

How significant was Seldon? In economics, Robinson argues that Seldon was crucial both in introducing Public Choice theory to Britain and in emphasizing the importance of monetary economics, by publishing papers by Milton Friedman and Sir Alan Walters. Robinson also believes that Seldon-edited papers provided analyses used by the Thatcher administration in Britain's deregulation of the 1980s.

Arthur Seldon: A Life in Liberty is an important biography of a major libertarian figure. FEE

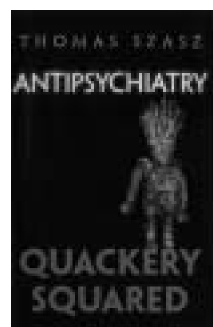
Martin Morse Wooster (mmwooster@yahoo.com) is a writer and editor living in Silver Spring, Maryland.

Antipsychiatry: Quackery Squared

by Thomas Szasz

Syracuse University Press • 2009 • 188 pages • $24.95

Reviewed by Ron Roberts



In this latest work, *Freeman* columnist Thomas Szasz fires another salvo in his continuing critique of the disasters wrought by contemporary psychiatry—specifically its penchant for coercive pseudomedical interventions that masquerade as treatment while depriving people of their liberty. Here, however, the focus is more specific, with Szasz providing the definitive critique of what has erroneously come to be known as the anti-psychiatry movement.

As is customary with Szasz's work, there is painstaking historical analysis, beginning with the term "anti-psychiatry movement." That term originated not, as

might be thought, in the 1960s, when it became synonymous with the work of Scottish psychiatrist R.D. Laing and his colleague David Cooper, but in late nineteenth-century Germany. Then as now the term was employed, Szasz writes, to "divert people's attention from the core moral-political problems of psychiatry, coercion and excuse making." In short, it was a dismissive label to prevent serious criticism of psychiatry.

The "antipsychiatry movement" was largely ignored until the late 1960s when Laing and his allies sought to draw attention to themselves by appropriating the label for their critique of conventional psychiatry. Szasz argues that despite some differences between mainline psychiatry and Laing and his followers, their actions were in fact fully in accord with psychiatry's central precepts. Laing and his allies held a core belief in the existence of mental illness as a medical entity—to be treated with drugs if necessary—and a belief in their own power to cure people of purported mental illness, with the use of force if required. As such, rather than challenging, as is usually thought, psychiatry's customary mores, Laing and his associates are described as practicing an alternative form of it and thereby reinforcing the myth of mental illness that Szasz has correctly challenged for almost 50 years now.

Readers coming to the book with some knowledge of Laing's work will be disappointed and somewhat shocked to see his inconsistencies exposed. His employment of forced "treatment" at Kingsley Hall (the antipsychiatric "residence" in the East End of London) is dissected in detail. Disconcerting though it may be, we are better and wiser for this knowledge. As is well known, Laing's behavior, often fueled by alcohol, could be particularly unpleasant. Szasz highlights his inconsistencies: While he made lucid attacks on the barbaric nature of psychiatric treatment, he was ultimately incapable of rejecting the movement that gives rise to them. Laing compromised and sacrificed the potential strength of his arguments in pursuit of establishment recognition and fame.

Szasz meticulously documents Laing's desire to work both within and outside the established system at the same time and depicts him as a "trickster"—willfully exposing psychiatric brutality at the start of his career, but subsequently endorsing the "standard of care" of modern biological psychiatry as his swan song. Laing and Cooper emerge as sad and rather disturbing people, notwithstanding the effect they had on others.

To describe Laing as a "bad person," as Szasz does, seems somewhat harsh, but that probably reflects Szasz's disappointment in him. Laing had the potential to contribute greatly by exposing the medical myth-making at the dark heart of psychiatry, but threw it away amidst a trinity of drink, abuse, and desire for celebrity.

In sum, Szasz makes a strong argument that the "antipsychiatrists" have presented only a very limited vision of liberation for the psychiatric service user. The changes that are required in society to restore freedom and dignity to those said to be "mentally ill" need a greater vision than theirs.

This is an important book, and it deserves to be read closely alongside Szasz's other works. For those with an earnest desire to support human freedom, it provides more food for thought about the damage wrought, under the guise of benevolence, by the relentless psychiatric machine. FEE

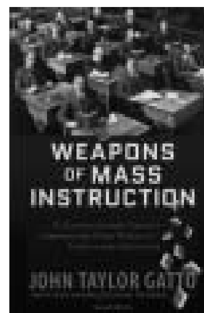
Ron Roberts (R.A.Roberts@kingston.ac.uk) is senior lecturer in psychology at Kingston University in London.

Weapons of Mass Instruction: A Schoolteacher's Journey Through the Dark World of Compulsory Schooling

by John Taylor Gatto

New Society Publishers • 2010 • 240 pages •
$24.95 hard cover; $16.95 paperback

Reviewed by George Leef



An annoying bumper sticker I have seen on occasion reads, "If you think education is costly, try ignorance." That trope is meant to break down resistance to the education establishment's desire to shop-vac in as much taxpayer money as possible. The trickery is subtle—deceive people into equating *schooling* with *education*. What the education establishment does is the former. It absorbs prodigious amounts of money to keep children

in a building called school. Whether the children actually acquire any education is immaterial.

Most Americans are suckers for this hokum because many generations of us have been told that the alternative to schooling as we know it (classrooms, teachers, textbooks, tests, grades, school days, semesters, and so on, organized and mandated by the government) is ignorance. That idea is supported by an enormous and ceaseless propaganda campaign. But what if the idea is false? What if officially approved schooling actually inhibits a young person's education? What if it crowds out more effective forms of learning, much as government welfare tends to crowd out more effective voluntary charity?

That is precisely what John Taylor Gatto argues in this incendiary book.

Gatto, who was the New York State Teacher of the Year decades ago, came to realize that the schooling he helped provide was at best useless and often detrimental to the children the state's system was supposed to serve. Since leaving the teaching ranks, Gatto has made himself the most *non grata* of *persona* by speaking his mind on the disconnect between the purported aims of schooling and its true effects.

How much his message upsets the educrats is revealed in one incident he recounts. Gatto had been invited to speak to the students at a high school in a wealthy New York City suburb. (Later in the day, he was going to address their parents.) He was proceeding along with his polite, low-key discussion with the students when he was suddenly interrupted by police officers storming into the assembly room. The officers barked orders for everyone to remain calm (which they had been until then) and yelled that the assembly was over and everyone must leave immediately. Gatto was naturally shaken and sought an explanation. The school's superintendent had been monitoring the assembly and decided that Gatto's ideas were too dangerous to expose his students to. Imagine the devastation if any of them should take Gatto seriously! (The planned talk to parents was also called off, naturally.)

Fortunately, the education establishment can't yet suppress published books, and people are (still, for now) free to read contrarian ideas.

Part of the book is a look at our history. Early America, Gatto observes, was wonderfully free of the schooling mania. There certainly were some schools, but no one had to attend. Overwhelmingly, people learned in the home and by doing, Benjamin Franklin being a good example. Sources of knowledge and skills were everywhere. Schools were not treated as *the place* for learning, and many brilliant, successful people didn't go to school at all. Individuals were in charge of their own education rather than passively waiting for it to be poured into them.

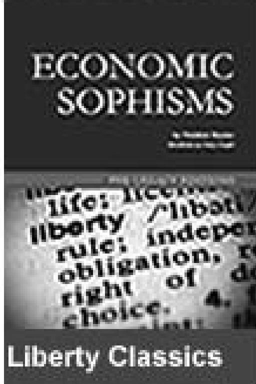
Here's how Gatto puts it: "In 1790 it was still possible to become educated in America because school didn't preempt all the time of the young, nor did it act as a leech upon family life then; it didn't impose servile habits on the growing up time; it didn't indoctrinate young minds with a burden of too many pre-thought thoughts."

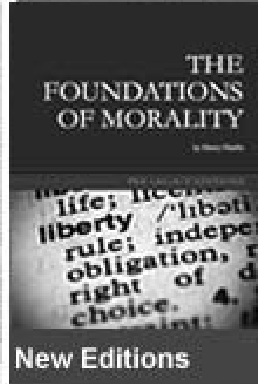
That began to change in the mid-1800s. Social elitists imbued with admiration for the order and efficiency of Germany joined with industrialists who knew that a labor force composed of cookie-cutter workers would be easier to manage than one composed of an assortment of free-thinking individuals. America's traditional "open source" nonsystem of education was therefore replaced by a system of schooling meant to homogenize young people, who would all think the right things.

The consequences have been disastrous. Gatto points to pathetically low educational levels (we now find college graduates who read less well than most grade schoolers used to) and the extended immaturity of many young Americans who remain in a state of trance-like dependency long into their teens and twenties, an age when Americans of centuries past were active, energized, and independent adults, not to mention the problem of violence that periodically erupts in public schools when young people who don't want to be there just snap.

Is there any escape from the grip of our schooling establishment? Gatto suggests what he calls "The Bartleby Project," named after the main character in Herman Melville's story "Bartleby the Scrivener." After many years of obediently doing just what he was told, Bartleby starts to say, "I'd prefer not to." That's what Americans need to tell the schooling authoritarians. FEE

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





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Washington's Lies

BY WALTER E. WILLIAMS

During his campaign President Obama and his congressional supporters estimated that overhauling the nation's health care system would cost $50–$65 billion a year. On June 15 the Congressional Budget Office (CBO) reported that Obama's overhaul would cost at least $1 trillion. It's clear that Obama's cost estimates are untrue, and over ten years, it's likely the recent CBO's numbers will turn out to be untrue as well. Government estimates of what a spending program will cost are always lies whether they come from a Democratic or Republican president or Congress. You say, "Williams, you don't show much trust in the White House and Congress." Let's check out some of their past dishonesty.

> Government estimates of what a spending program will cost are always lies whether they come from Democrats or Republicans.

At its start in 1966, Medicare cost $3 billion. The House Ways and Means Committee, along with President Johnson, estimated that Medicare would cost an inflation-adjusted $12 billion by 1990; however, by 1990 Medicare costs topped $107 billion. That's nearly nine times greater than Congress's prediction. Today's Medicare tab comes to $420 billion with no signs of leveling off. How much confidence should we have in any cost estimates by the White House or Congress?

Another part of the Medicare lie is found in Section 1801 of the 1965 Medicare Act, which reads: "Nothing in this title shall be construed to authorize any federal officer or employee to exercise any supervision or control over the practice of medicine, or the manner in which medical services are provided, or over the selection, tenure, or compensation of any officer, or employee, or any institution, agency or person providing health care services." Ask your doctor or hospital whether this statement contains even one iota of the truth.

Washington's lies and deception are by no means restricted to modern times. During the legislative debate before ratification of the Sixteenth Amendment, President Howard Taft and congressional supporters said that only the rich would ever pay federal income taxes. In 1916 only one half of 1 percent of income earners were affected. Those earning $250,000 a year in today's dollars paid 1 percent, and those earning $6 million in today's dollars paid 7 percent. The promise that only the rich would pay was simply a lie to exploit the politics of envy and dupe Americans into ratifying the Sixteenth Amendment.

The Social Security Lie

Another big congressional lie is Social Security. Here's what a 1936 government Social Security pamphlet said: "After the first 3 years—that is to say, beginning in 1940—you will pay, and your employer will pay, 1.5 cents for each dollar you earn, up to $3,000 a year. . . . [B]eginning in 1943, you will pay 2 cents, and so will your employer, for every dollar you earn for the next 3 years. . . . And finally, beginning in 1949, twelve years from now, you and your employer will each pay 3 cents on each dollar you earn, up to $3,000 a year" (www.tinyurl.com/2c8d4p2).

Here's Congress's lying promise: "That is the most you will ever pay." Let's repeat that last sentence: "That is the most you will ever pay." That was a maximum of $90 a year. Compare that to today's reality, which is

Walter Williams is the John M. Olin Distinguished Professor of Economics at George Mason University.

6.2 cents on each dollar that you earn up to nearly $107,000, which comes to $6,621. That's $432 in inflation-adjusted 1936 dollars. And that does not include the fictional so-called employer's share.

The Social Security pamphlet adds another lie: "Beginning November 24, 1936, the United States government will set up a Social Security account for you. . . . The checks will come to you as a right. You will get them regardless of the amount of property or income you may have." That's another lie. First, there's no Social Security account for you, but more important, in *Helvering v. Davis* (1937) the Supreme Court held that Social Security was not an insurance program, saying, "The proceeds of both (employee and employer) taxes are to be paid into the Treasury like internal-revenue taxes generally, and are not earmarked in any way." In a later decision, *Flemming v. Nestor* (1960), the Court said, "To engraft upon Social Security system a concept of 'accrued property rights' would deprive it of the flexibility and boldness in adjustment to ever-changing conditions which it demands. . . ." That ruling established the principle that entitlement to Social Security benefits is not a contractual right. "Flexibility and boldness" means Congress can constitutionally do anything it wishes, including cutting benefits, raising retirement age, increasing Social Security taxes, and ultimately eliminating payments for some or all Americans.

The Supreme Court ruled that Social Security taxes were to be treated like any other revenue, and that you don't have any right to payments.

The 1936 Social Security pamphlet closes with this promise from the government: "You will always get more back from this program than you pay into it, and you will always get more with this program than you could have possibly gotten on your own by saving and investing." That's a lie. According to a report by Boston University Professor Laurence J. Kotlikoff, "Privatizing Social Security," baby boomers will get a real rate of return of less than 2 percent. Generation Xers will get less than 1 percent, and today's newborns will get a rate of return close to zero (www.tinyurl.com/2brx2ss [PDF]). Almost any private retirement plan yields higher returns.

Coupled with Medicare, Social Security is a disaster waiting in the wings. As the NCPA's Pamela Villarreal writes, "The 2009 Social Security and Medicare Trustees Reports show the combined unfunded liability of these two programs has reached nearly $107 trillion in today's dollars! That is about seven times the U.S. economy and 10 times the national debt. Unfunded liability is the difference between the benefits that have been promised to current and future retirees and what will be collected in dedicated taxes and Medicare premiums. . . . If no other reform is enacted, this funding gap can only be closed in future years by substantial tax increases, large benefit cuts," increases in retirement age eligibility, or some combination thereof.

Why We Believe

Here's my question: Why are so many Americans taken in by Washington's lies? I think there are several likely answers. Man is tempted by what looks like a free lunch. He is also tempted by government's promise to permit him to live at the expense of someone else. Some people are totally ignorant of the effects of government programs on the socioeconomic fabric of our country. There are many Americans who do understand the problem but what do they care? The primary beneficiaries of massive government spending are senior citizens. When the economic calamity arrives, they and the politicians who created all of the spending programs will be dead. Any politician who endeavors to eliminate the massive spending programs, in an effort to forestall the calamity, will be run out of office by the program's beneficiaries. That means the status quo rules.

People might ask: What can be done to preserve American exceptionalism and greatness? My answer to such a question is a question: How do Americans systematically differ from citizens of past great nations who supported political actions that ultimately drove their nations into the ground? FEE