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# THE FREEMAN

IDEAS ON LIBERTY

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## Features

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- 8 **Of Fallible Umpires and Rogue Judges** by *David N. Laband*
- 10 **An American Stasi?** by *Wendy McElroy*
- 15 **Can Government Save Us from Manmade Disasters?** by *James L. Payne*
- 17 **The Distorting Effects of Transportation Subsidies** by *Kevin Carson*
- 21 **Doctors Are Government Employees** by *Theodore Levy*
- 25 **Government's Diminishing Benefits from Inflation** by *Jeffrey Rogers Hummel*
- 30 **Malts in the Cafeteria** by *Tracy Stone Lawson*
- 33 **Bank Deregulation: Friend or Foe?** by *Warren C. Gibson*
- 37 **The Most Elusive Proposition** by *Manuel F. Ayau*



Page 17

## Columns

---

- 4 **Ideas and Consequences ~ Wilfrid Laurier: A Canadian Statesman** by *Lawrence W. Reed*
- 13 **Thoughts on Freedom ~ The Power of Freedom** by *Donald J. Boudreaux*
- 23 **Peripatetics ~ Deficit Hawks or War Hawks?** by *Sheldon Richman*
- 31 **Our Economic Past ~ America's Depression within a Depression, 1937-39** by *Robert Higgs*
- 40 **Give Me a Break! ~ Memo to Alan Greenspan: Keep Quiet** by *John Stossel*
- 47 **The Pursuit of Happiness ~ Taking On Unions** by *Charles W. Baird*



Page 23

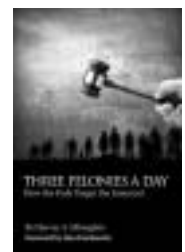
## Departments

---

- 2 **Perspective ~ The Most Dangerous Derivative** by *Sheldon Richman*
- 6 **There's Too Little Trust in Government? It Just Ain't So!** by *Charles Johnson*

### Book Reviews

- 42 **Classical Liberalism in the 21st Century: Essays in Honour of Norman P. Barry**  
edited by *Michael James* *Reviewed by George Leef*
- 43 **The Industrial Revolutionaries: The Making of the Modern World, 1776-1914**  
by *Gavin Weightman* *Reviewed by David K. Levine*
- 44 **Three Felonies a Day: How the Feds Target the Innocent**  
by *Harvey A. Silverglate* *Reviewed by William L. Anderson*
- 45 **Making Poor Nations Rich: Entrepreneurship and the Process of Economic Development**  
edited by *Benjamin Powell* *Reviewed by Robert Batemarco*



Page 44

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# THE FREEMAN

IDEAS ON LIBERTY

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## Perspective

# The Most Dangerous Derivative

In the October 1962 issue of *The Freeman* an obscure 28-year-old lawyer wrote, in one of his first published works, “Giant government has outgrown the capacity of the institutions designed to restrain its encroachments and abuses. . . . [F]reedom, to be meaningful, must find direct expression in practice as well as in principle” ([www.tinyurl.com/32m5z7d](http://www.tinyurl.com/32m5z7d)).

The occasion was the young man’s chronicling of how the small town of Winsted, Connecticut, had defeated a public-housing project by public referendum—three times—after the federally financed housing authority tried to impose it.

Within three years this man had gained considerable fame as well as infamy. You might have heard of him:

Ralph Nader.

So, he’s come a long way ideologically since 1962. Or has he?

Nader’s *Freeman* article came to mind last August when I read his op-ed in—the curiosities continue—the *Wall Street Journal*: “Where Left and Right Converge: Anticorporatist Views Are Becoming More and More Common.”

Leaving aside the dubious left/right reference, Nader’s point is that an unlikely alliance could be forming among people who would not ordinarily be found in the same room. “A convergence of liberal-progressives with conservative-libertarians centering on the autocratic, corporate-dominated nature of our government may be growing,” Nader writes. “I have received earfuls on these matters during my three nationwide presidential campaigns from both workers and taxpayers who call themselves conservatives or progressives. The Main Street versus Wall Street figures of speech bespeak a deep sense of loss of control over just about everything that matters to people’s lives. In their daily discourse they know that big government beats to the drums of big business or, to use the elegant words of conservative philosopher Russell Kirk, ‘a host of squalid oligarchs.’”

Nader aptly points out that corporatists portray themselves as free-enterprisers, which disarms some who truly value free markets and prevents the emergence of effective coalitions in opposition to the policy

elite. “The issues that don’t get nearly the attention they deserve include opposition to the arbitrary erosion of privacy by the Patriot Act and to the daily collection and storage of personal consumer information in corporate databases; resistance to tax-funded sports stadiums, the Federal Reserve’s out-of-control powers, unconstitutional wars and monopolistic practices against small business, and to the swarm of corporate welfare subsidies, tax havens, handouts, giveaways and bailouts,” he writes.

Nader misses the mark on lots of things. For example, he shows little understanding of how the competitive market would work in the absence of corporatist intervention. He may get the diagnosis more or less right, but he usually sees government as the solution rather than the problem. And he overlooks something fundamental. When he refers to “abuses of corporate power, especially when supplemented by state power,” he shows a failure to understand that corporate power *is derived entirely from State power*. Big business can’t impose its own eminent domain, trade rules, IP laws, and banking cartel. Unsupported by the State, business would have nothing but the power of persuasion at its disposal. But since the age of mercantilism, that has never been enough. Hence the abundance of competition-inhibiting measures. You know who gets the short end of the stick.

Corporate power is what I call The Most Dangerous Derivative. It’s the one Congress refused to address in its financial regulation bill.

Ralph Nader a potential ally against corporatism? I can imagine stranger things.

★ ★ ★

Property owners are regularly abused by governments exercising their power of eminent domain. Sometimes the courts intervene to protect victims, but what’s an abused property owner to do when a judge refuses to abide by a higher court’s ruling? David Laband looks at the case of one rogue judge.

Law enforcement authorities at the local, state, and national levels are coordinating their efforts to an unprecedented degree. This is happening in the name of homeland security, but Wendy McElroy sees danger in the monitoring of people on the flimsiest of pretexts.

With the Gulf of Mexico still marred by oil, people expect government to protect them against manmade

disasters. James Payne finds that ironic, considering that bureaucrats have been responsible for some pretty serious disasters in the United States.

The distance between the American economy and a true free market can be measured by how much government has subsidized transportation throughout history. Kevin Carson discusses how subsidies shaped the economy.

Those who are perplexed by the inefficiencies and irrationalities of the American medical system might contemplate what Theodore Levy has learned: Doctors essentially are government employees.

The U.S. government profits from inflation, correct? Actually, it hasn’t in some time and isn’t likely to in the future. Jeffrey Rogers Hummel explains.

The key to understanding the self-destructiveness of democratic politics is the overwhelming temptation to gain power by bribing voters with booty paid for by others. Tracy Stone Lawson found this out at an early age.

Throughout the latest financial debacle banking deregulation was the bogeyman so many loved to hate. Warren Gibson contends, however, that the genuine deregulation which occurred over the last several decades has delivered the goods.

One of the most important—and least intuitive—ideas in economics is the law of comparative advantage. And one of the best explanations of this law was written by Manuel Ayau, Guatemala’s great champion of liberty and a former FEE trustee, who died this past summer. We reprint Ayau’s article in memory of one of freedom’s heroes.

Here’s what our columnists have whipped up this time: Lawrence Reed discovers Canada’s most libertarian prime minister. Donald Boudreaux realizes how powerful freedom is. Roberts Higgs traces the causes of the 1937 depression. John Stossel tires of Alan Greenspan. Charles Baird keeps the pressure on government-employee unions. And Charles Johnson, reading E. J. Dionne’s claim that we must trust government more, protests, “It Just Ain’t So!”

Books on the late Norman Barry, technological progress, abusive federal law enforcement, and entrepreneurship occupy our reviewers.

*Sheldon Richman, Editor  
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## Wilfrid Laurier: A Canadian Statesman

BY LAWRENCE W. REED



Opening to where most Americans trace their ancestry from, we tend to know more European history than the history of our immediate neighbors to the north and south, Canada and Mexico. We can name famous entrepreneurs and political leaders from across the sea but rarely one from right next door.

Last May in a casual dinner conversation with Canadian libertarians in Vancouver, I named the better presidents and prime ministers, respectively, of the United States and Great Britain. It suddenly occurred to me that I couldn't name a single Canadian counterpart.

So I asked my dinner friends, "Among Canada's political leaders, did you ever have a Grover Cleveland or a William Ewert Gladstone, a prime minister who believed in liberty and defended it?"

One name emerged, almost in unison: Sir Wilfrid Laurier. Embarrassed by my ignorance, I had to admit I had never heard of him. Never mind that he's the guy with the bushy hair on the Canadian five-dollar bill; I just never noticed. Now that I've done a little research, I'm a fan.

Laurier's political resume is impressive: fourth-longest-serving prime minister in Canada's history (1896–1911, the longest unbroken term of office of all 22 PMs). Forty-five years in the House of Commons, an all-time record. Longest-serving leader of any Canadian political party (almost 32 years). Across Canada to this day, he is widely regarded as one of the country's greatest statesmen.



Wilfrid Laurier, Canada's most libertarian prime minister.

It's not his tenure in government that makes Laurier an admirable figure. It's what he stood for while he was there. He really meant it when he declared, "Canada is free and freedom is its nationality" and "Nothing will prevent me from continuing my task of preserving at all cost our civil liberty."

A new think tank in Ottawa honors Laurier and another Canadian PM, John MacDonald, in its name: the MacDonald-Laurier Institute. Founders Brian Crowley, Jason Clemens, and Niels Veldhuis have authored a new book, *The Canadian Century: Moving Out of America's Shadow*, in which they explain the political principles and institutions the great Laurier stood for: limited government, light taxes, fiscal discipline, free trade, private property, and the rule of law.

At a time when others in the British Commonwealth had begun to emulate the welfare-state policies of Bismarckian Germany, Laurier had a better idea. Crowley, Clemens, and Veldhuis write:

Laurier's objection to such schemes, like that of his Liberal colleagues, was one of principle: when people were expected to take responsibility for themselves and their famil[ies], they made better provision for their needs and directed their productive efforts where they would do the country and themselves the greatest good. When this natural necessity to strive was diluted by an easy access to the public purse, the ever-present danger was of the enervation

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of the individual and the stagnation of the progress of society. “If you remove the incentives of ambition and emulation from public enterprises”—by which he meant the economic undertakings of individuals and businesses, not state enterprises—Laurier said on the subject in 1907, “you suppress progress, you condemn the community to stagnation and immobility.”

Born in Quebec in 1841, Laurier rose in popularity in spite of his expressed belief in the separation of church and state. The province’s Roman Catholic bishops urged voters to steer clear of him but he built a firm base of local support. The people appreciated his solid character and his desire for goodwill and conciliation among the disparate cultures of Canada. As prime minister he worked to keep the country together by keeping the central government small. Toleration and decentralized federalism became hallmarks of his long legacy in politics.

### Relying on Markets

To help Canadians compete with the colossus to the south, Laurier hoped the country would rely on private enterprise and open markets. A key ingredient, he believed, would have to be a lower cost of government and a lower tax burden in Canada than in the United States. He made it clear, in the words of Crowley, Clemens, and Veldhuis, “that people who came to Canada from south of the border or beyond the seas would find in the Dominion a society of free men and

women where everyone was expected to work hard, and where, if they did so, they would keep more of the fruits of their labours than anywhere else, including the United States of America.”

Laurier never achieved the degree of free trade his conscience supported, but against powerful opposition he pushed Canada away from high protectionist tariffs. He wanted lower duties aimed more to raise revenue

than to favor certain industries or regions at the expense of others. He made progress on some other fronts as well. He proposed balanced budgets as a way to keep Canada’s debt low and manageable. His policies opened the door for an explosion of immigration. Half a million hard-working immigrants rushed to Canada during his tenure, building a strong economy and a melting pot of countless cultures in the process.

Laurier’s record was not perfect from a libertarian perspective. For example, he supported subsidies to transcontinental railroads, a major

departure from his otherwise pro-enterprise, limited-government philosophy. But as twentieth-century Canadian prime ministers go, he clearly stands apart and above. My friends in Vancouver don’t believe any PM since Laurier did as much for liberty as he did.

I now keep a Canadian five-dollar bill in my wallet just for those occasions when I meet a Canadian and the conversation turns to politics. We will lament the caliber of more recent politicians on both sides of the border but at least I can now point to Laurier’s picture and say, “We can do better, and indeed, you have.” DBB

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Laurier lowered tariffs, pursued the limited government he preached, and encouraged conciliation among Canada’s countless cultures.

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# There's Too Little Trust in Government? It Just Ain't So!

BY CHARLES JOHNSON

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There is one point on which I can unequivocally agree with E.J. Dionne, Jr.'s column "Can We Reverse the Tide on Government Distrust?" (*Washington Post*, May 6, 2010, [www.tinyurl.com/28sbgkr](http://www.tinyurl.com/28sbgkr)): "So far, the Obama administration has missed the opportunity to demonstrate . . . how it is changing the way government works. How is its approach to . . . regulations different from what was done before? . . . How are its priorities different?"

How indeed?

Two years in, if there's any noticeable difference between Bush's policies of corporate privilege, endless warfare, bailouts, executive power, and bureaucratic expansion, and Obama's policies of corporate privilege, endless warfare, bailouts, executive power, and bureaucratic expansion, I'd like to know where to find it. The difference between me and Dionne is that Dionne is apparently surprised by this outcome—why hasn't Obama done better? At issue is what used to be called "Good Government"—the problem of ensuring that a centralized managerial State, with expansive powers to intervene in all matters economic, social, or hygienic, will be run cleanly, and competently, by qualified experts. Dionne insists that financial market meltdowns, oil spills, and coal-mine disasters reveal the catastrophic results of a few years of Bush-era government neglect. Those of us who remember the Bush administration may have a hard time accepting the claim that it was an era in which government was not doing enough; and we see these

headline-grabbing catastrophes as only the tail end of a decades-long crisis—a bipartisan, politically created crisis of institutional incentives and industry "best practice-ism," generated, nurtured, and protected by government itself.

So when Dionne reviews a few headlines—the financial-market meltdown, the Gulf oil spill, the coal-mine explosion at Upper Big Branch—he suggests that "It's hard to argue that the difficulties we confront were caused by an excessively powerful 'big' government."

Really? Let's try.

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Recent headline-grabbing catastrophes are only the tail end of a decades-long crisis—a bipartisan, politically created crisis.

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"Deregulated" Wall Street collapsed in 2007 after years of unsustainable bubbles and malinvestment by a handful of immensely powerful big players. The real crisis was not just the "crunch," but the shell game and misallocation that preceded it. The shell game flourished through a private-public partnership between government central banking, cartelized financial industry incumbents, and the industry-connected regulatory enforcers of the government money

monopoly. The crash certainly revealed powerful corporations acting recklessly. But how did they get so powerful, and why were they willing to take those risks? Because government has, for decades, as a matter of policy, encouraged their dominance, invited their investments, subsidized their loan markets, put them

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near the inflation spigot, and subsidized their risk-taking with the promise of tax-funded bailouts. In a freed market, “deregulated” Wall Street’s concentrated wealth and reckless business model would not exist.

British Petroleum (BP), as a corporation, exists because governments created it—the Shah of Iran granted a company owned by the government of the United Kingdom a monopoly concession. The UK government kept its ownership stake until the 1980s. Like all other Big Oil companies, BP extracts the oil it sells mainly from government-controlled land and sea, through monopoly concessions, bureaucratic bidding processes, and politically granted leases. Oil companies use government protection, liability caps, and escrow funds to insulate their businesses from paying the economic and social costs of their actions. In a freed market BP’s concentrated wealth and reckless business model would not exist.

Massey and other Big Coal companies also depend on government leases and use government permits to absolve them of the environmental costs they inflict on their neighbors—including the damage that mountaintop removal mining causes to downstream property owners. They also rely on a regulatory structure that has taken control over workplace safety disputes out of the hands of workers and given it to a politically appointed, industry-dominated bureaucracy, the Mining Safety and Health Administration (MSHA). Where miners’ unions reacted to unsafe conditions by walking out and crippling production until issues were resolved, the MSHA issues an ineffectual fine and tells workers to keep on working in hope and faith. In a freed market Massey’s concentrated wealth and reckless business model would not exist.

Dionne may present his article as a commentary on recent news, but the headlines are only carelessly chosen illustrations for a message that seems copied out of a children’s civics textbook circa 1948. Elected government’s task is to “stand up for the many against the few,” to “make sure that corporations are properly supervised,” and to “protect those with weaker bargaining positions . . . against the harm that those in stronger bargaining positions might inflict.” Our problem is simply that we do not trust the political means *enough*. According to Dionne, if we are ever to solve these

politically created crises, we need to know “that government in a free society is not a distant force but, rather, something that all of us influence and shape.”

To be sure, government is not very distant from the downtown offices of the *Washington Post*. For the rest of us, though, access is somewhat more limited, and not “all of us” have the same influence in shaping government policy. That is done by political insiders and economic incumbents: As scholars like Gabriel Kolko and Butler Shafer have repeatedly shown, government regulatory bodies from the FTC to the MSHA to the SEC have consistently been *captured* by the incumbents in the industries they are supposed to regulate, systematically rigging government regulations in such a way as to build up cartels, exclude competition, and protect businessmen from liability for harmful practices.

Even with the record of regulatory capture and industry-driven policy, Dionne, like many Progressives, simply insists that politicians need even more trust and fewer restraints on action to give them the independence to do the right thing. You might call this kind of Progressivism a theory of *trickle-down politics*: When government devotes the overwhelming majority of its power and resources to foolish or destructive programs directed by concentrated interests—subsidies, bailouts, anticompetitive regulations, or an ever-growing military-industrial “National Security” complex—the proposed solution is to *give that same government even more strength and greater resources* to dispose of, hoping that some of the surplus will eventually make it through the net of insider control to reach programs that offer a pittance to the little guy.

Individualists know that when you reward the institutions that created crisis, you are going to get more crises. Greater regulatory powers will only make government *more* attractive to industry incumbents; the more politics is involved in industry, the more that political pull pays off for the industrialists. The root causes of the crises we’ve faced in recent years are not problems of *competence* or *corruption*. They are problems of *cartelization* and *capture*. The solution is not more trust in government; it’s to realize there are things that just cannot be accomplished politically, which should instead be addressed through decentralized, peaceful social cooperation. FEE

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# Of Fallible Umpires and Rogue Judges

BY DAVID N. LABAND

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There is a striking similarity between blown calls by umpires in baseball and blown calls by judges in our legal system. We now know, unambiguously, that umpires make mistakes—sometimes excruciatingly costly ones. According to baseball purists, those mistakes “are part of the game.” Yet there is a rising chorus of calls for Major League Baseball to adopt some sort of instant replay, which has been embraced by both the NFL and NBA, because egregious errors that affect results more than the skill of the contestants themselves ruin the integrity of the game.

Judges also make bad calls sometimes. We know this because there is a judicial form of instant replay: the appeals process, including review by the U.S. Supreme

Court. Occasionally, even the politically diverse Court clearly indicates to a lower court, through a unanimous decision, that the judge(s) blew a legal call.

Umpire Jim Joyce’s blown call cost Detroit Tigers pitcher Armando Galarraga the 21st perfect game in major league baseball history. After watching the televised replay, Joyce immediately (and tearfully) admitted his mistake. This notwithstanding, baseball commis-

sioner Bud Selig declined to change the call. But would he have acted differently if Joyce had maintained, in the face of overwhelming evidence to the contrary, that his call was correct—or even worse, that he deliberately called the runner safe?

Turning back to the law, what happens if lower-court judges thumb their collective noses at the Supreme Court? This is a timely question, because it is

about to be placed squarely in front of the Supreme Court.

In early 1999 John and Theresa Sophocleus were forced out of their home by Alabama’s Department of Transportation (ALDoT) as part of a highway-widening project. In court ALDoT representatives testified that they needed to raze the home immediately to ensure timely progress

on the road project. In fact, the Sophocleus home was not razed for nine months, during which it was used as a residence for contractors employed by ALDoT. In other words, the specific public purpose given by



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ALDoT to justify the seizure, made under threat of \$10,000-per-day fines, proved to be invalid.

Mr. and Mrs. Sophocleus sued ALDoT, arguing that the taking was unconstitutional since the state did not live up to the expressed public purpose used to justify the seizure and that therefore ownership should revert to them. The first federal judge to consider motions in the case, Susan Walker of the U.S. District Court for the Middle District of Alabama, issued three summary judgments in their favor. Their case then was taken over by Judge Myron Thompson of the same court, who ruled that they should have taken their claim to the state courts rather than the federal courts. But as Alabama State Code 18-1A-et seq. makes clear, as affirmed by Judge Walker, the correct venue for plaintiffs in a civil rights case is the federal judiciary. By an 8-0 ruling (Justice John Roberts had not yet joined the Court) the Supreme Court in 2005 remanded the case back to the district court for remedy.

After stalling four full years, Judge Thompson and the judges on the 11th Circuit Court of Appeals refused to admit the earlier call had been blown and reiterated the previously overturned position. Once again, Mr. and Mrs. Sophocleus will appeal to the Supreme Court.

The original writ they filed with the Supreme Court was only 12 pages long. Their point, simple and powerful, was supported fully by the Supreme Court. Make no mistake—a unanimous Supreme Court decision overturning their ruling means the lower court was told, loudly, that it blew the call. So why did it take Judge Thompson over four years to respond? One interpretation is that he knowingly intended to frustrate the stated direction of the Supreme Court by delaying remedial action until either Mr. and Mrs. Sophocleus or their critical witnesses died or became mentally incapacitated. More important: Why, in the face of overwhelming evi-

dence to the contrary, has the lower court refused to admit it blew the call? This is the critical question for all Americans who believe that they live under the rule of law.

Presumably, the Supreme Court has a deep interest in whether lower-court judges follow their instructions—that is, actually follow the law. The law of the land is enshrined in the Constitution as interpreted by the Supreme Court. If lower-court judges do not pay attention to the Supreme Court, they are not upholding the law. By implication, we do not live under the rule of law; rather, we live under the arbitrary and

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If lower court judges do not pay attention to the Supreme Court, then by implication, we do not live under the rule of law but rather the arbitrary and capricious rule of rogue judges.

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capricious rule of rogue judges, with justice denied when it suits their purpose. The judge is attempting to deny the rule of law to Mr. and Mrs. Sophocleus.

Rogue judges impose their own capricious rulings because they know there is little consequence for their actions. By virtue of lifetime appointments to the federal bench, and with scant likelihood of impeachment by Congress, they can use the legal process and their position to effectively deny justice to victims of civil rights violations. We all have a critical stake in curtailing this type of judicial behavior.

There is one, and only one, remaining protection for Mr. and

Mrs. Sophocleus against the denial of justice orchestrated by rogue Judge Thompson and the complicit appellate judges: Instead of remanding the case back to the lower court for remedy again, presumably with the same expected result, the Supreme Court should impose a remedy. Under the best of circumstances, the chance that the Supreme Court will take a particular case is remarkably slim. Nonetheless, the Sophocleuses hit a home run their first time at bat, but have been denied justice due to interference by rogue umpires. We can only hope that on appeal this time, the Supreme Court ensures that their previous home run is ruled a grand slam on behalf of all Americans. **FEE**

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# An American Stasi?

BY WENDY MCELROY

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The *Fort Wayne Journal Gazette* reported on July 25 that “there are 72 fusion centers around the nation, analyzing and disseminating data and information of all kinds. That is one for every state and others for large urban cities.”

What is a fusion center?

The answer depends on your perspective. If you work for the Department of Homeland Security, it is a federal, state, local, or regional data-coordination unit, designed to improve the sharing of anti-terrorism and anti-crime data in order to make America safer. If you are a privacy or civil-rights advocate, it is part of a powerful new domestic surveillance infrastructure that combines data from both the public and private sectors to track innocent people and so makes Americans less safe from their own government. In that respect, the fusion center is reminiscent of the East German Stasi, which used tens of thousands of state police and hundreds of thousands of informers to monitor an estimated one-third of the population.

The history of fusion centers provides insight into which answer is correct.

Fusion centers began in 2003 under the administration of George W. Bush as a joint project between the departments of Justice and Homeland Security. The

purpose is to coordinate federal and local law enforcement by using the “800,000-plus law enforcement officers across the country” whose intimate awareness of their own communities makes them “best placed to function as the ‘eyes and ears’ of an extended national security community.” The fusion centers are hubs for the coordination. By April 2008 there were 58.

The growth has continued under the Obama administration. Indeed, President Obama has also continued Bush’s concealment of domestic intelligence activity by threatening to veto legislation that authorizes broader congressional oversight or review of intelligence agencies by the

Government Accountability Office (GAO). As a result



**Fusion centers encourage everyone to report on anyone doing any of this suspicious stuff.**

(Clockwise from top left: Bill Lynch, Quinn Dombrowski, Sor Cyress, The Q)

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of that threat, the GAO provision was removed from the Intelligence Authorization Act.

Due to secrecy, it is difficult to describe a typical fusion center. But if the Indiana Intelligence Fusion Center is typical, this is what one looks like:

Indiana's center has essentially become an arm of Indiana law enforcement. . . . It has 31 full-time staffers and two part-time employees. Some . . . are state employees. Others are assigned to the center from other agencies, such as the FBI, Transportation Security Administration, and Marion County Sheriff's Department. They are joined by workers from the Department of Correction, the Indiana National Guard, the Indiana State Police, the Department of Natural Resources and local campus police. . . . There are also private sector analysts on contract. Previously those analysts were from EG&G Technical Services of California. The most recent contract with EG&G called for payment of \$1.1 million. . . .

Fusion centers invite reports from public employees such as firemen, ambulance drivers, and sanitation workers as well as from private-sector sources such as hospitals and neighborhood watch groups. They often operate tip hotlines; this means a "suspect's" name could be submitted by a disgruntled employee, a hostile neighbor, or an ex-spouse who seeks child custody.

What or who is targeted by this sweeping coordination of data?

To get an idea, let's look at the Los Angeles Police Department (LAPD) program, which the U.S. Office of the Director of National Intelligence said "should be a national model." In June 2008 the departments of Justice and Homeland Security recommended expansion of the LAPD program to other cities.

In April 2008 the *Wall Street Journal* reported on a new LAPD policy that compelled officers to report

"suspicious behaviors" to the local fusion center. LAPD Special Order #11, dated March 5, 2008, defined a list of 65 suspicious behaviors, including using binoculars, taking pictures or video footage "with no apparent esthetic value," abandoning a vehicle, taking notes, and espousing extremist views. Local police were converted into domestic surveillance agents.

Voices of caution were present from the inception of fusion centers. Former U.S. Rep. Bob Barr stated: "Using the resources of federal and state law enforcement to encourage the citizenry to submit to the government information on the political, social and even

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Fusion centers encourage the violation of privacy rights, deny due process for the accused, encourage racial/religious profiling, help create a "snitch" nation, abuse dissidents, and more.

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religious views of other people, is in itself outrageous. For the government to then database that information, disseminate it widely, and clearly imply that views with which it may disagree provides an appropriate basis on which to surveil citizens and collect information on them, is beyond the pale. It is also a poor and inefficient use of police resources."

Violation of privacy rights, excessive secrecy, lack of congressional oversight, the inevitability of inaccurate and noncorrectable information, the lack of due process for the accused, the encouragement of racial/religious profiling, the creation of a "snitch" nation, the political abuse of dissidents—the objections

scroll on, followed by specific abuses that bear them out. Here's a brief sample:

### Specific Abuses

*Maryland:* Fifty-three nonviolent political activists, including antiwar and anti-death penalty activists, were labeled as terrorists and actively surveilled for 14 months.

*Minnesota:* Eight anarchist protesters who planned to protest the Republican National Convention in Minneapolis were preemptively arrested and charged with terrorism. In Minnesota, a crime can become terrorism if it disrupts the conduct of government.

*Texas:* A leaked intelligence bulletin from the North Central Texas Fusion System asked police officers to report on Islamic and antiwar lobbying groups.

*Missouri:* Supporters of third-party presidential candidates, pro-life activists, and conspiracy theorists were targeted as potential militia members.

*Virginia:* A terrorism threat assessment included certain universities as breeding grounds for terrorism, including historically black colleges.

A more comprehensive list of fusion abuse is available in the ACLU's Survey of Reported Incidents ([www.tinyurl.com/28nqkch](http://www.tinyurl.com/28nqkch) [PDF]). See also the ACLU's interactive map for what's happening in your state ([www.tinyurl.com/36t8zoe](http://www.tinyurl.com/36t8zoe) [PDF]).

### Spying on the Peaceful

Clearly, the elaborate infrastructure of fusion centers has spied on peaceful citizens. Those who believe the abuses are aberrations, rather than an inherent or intended function, may argue that increased transparency will bring accountability and solve the problem. But that belief is naive. At least four reasons indicate that a lack of transparency and accountability are built into the system—the absence of real congressional oversight being number one.

Second, the ACLU and others have filed numerous Freedom of Information Act requests. They have had to fight tooth and nail for any scrap of information.

Third, as the ACLU notes, “[T]here appears to be an effort by the federal government to coerce states into exempting their fusion centers from state open-govern-

ment laws. For those living in Virginia, it's already too late; the Virginia General Assembly passed a law in April 2008 exempting the state's fusion center from the Freedom of Information Act. According to comments by the commander of the Virginia State Police Criminal Intelligence Division and the administrative head of the center, the federal government pressured Virginia into passing the law. . . . [T]here is a real danger fusion centers will become a 'one-way mirror' in which citizens are subject to ever-greater scrutiny by the authorities, even while the authorities are increasingly protected from scrutiny by the public.”

Fourth, much of the information used by fusion centers comes from private databases such as Accurate, Choice Point, Lexis-Nexis, Locate Plus, insurance claims, and credit reports. Moreover, the centers access millions of government files like the Federal Trade Commission ID theft reports and DMV records. Why is this important? The federal government has adopted various laws to prevent

the maintenance of databases on average Americans, but if fusion centers access the other existing files, they would bypass those laws.

A massive database on peaceful citizens, a tip hotline that encourages turning in neighbors, the casting of suspicion on daily activities, enlisting private workers as national surveillance agents—this is a police state in the making. And if its creation is invisible to most people, well, that is another characteristic of a police state. You are not a believer until it knocks on your door . . . in the middle of the night. **FEE**

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Clearly, the elaborate infrastructure of fusion centers has spied on peaceful citizens. These are the makings of a police state.

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## The Power of Freedom

BY DONALD J. BOUDREAUX

**W**ARNING: After reading this column, many of you will want to send me emails condemning me for my apostasy or telling me why I am mistaken.

I welcome your feedback as I beg your indulgence. So, here goes: I don't believe that the welfare state, or the regulatory state, inevitably leads to widespread poverty or to oppressive collectivism.

There was a time when I worried that the dependency and inefficiency caused by government interventions would create a vicious, self-reinforcing cycle that fueled more calls for even greater intervention—a process that would continue until the State suffocated all individualism and initiative. But I no longer believe that such a progression—or, better, retrogression—is inevitable.

Two reasons explain my change of mind. The first is observed reality, and the second is what I (perhaps too vainly) believe to be a better understanding of society, politics, and economics.

Let's first look at reality. From at least the 1930s—or as scholars such as Arthur Ekirch argued, from a much earlier time—government's role in the American economy has expanded dramatically. And yet we continue to grow more prosperous. Beyond any doubt, Americans of 2010 are better fed, clothed, housed, informed, educated, medically cared-for, traveled, rested, and entertained than were Americans of 1930—or even of 1980. Despite some tax relief and deregulation since the late 1970s, these improvements in our living standards occurred with government taxing and regulating and redistributing as never before in the United States.

Look also at other countries. Although ordinary people in nations such as France and Sweden aren't as

wealthy as ordinary Americans, they are nevertheless extraordinarily wealthy by historical standards. And they're getting wealthier despite their governments' heavy interventions in their economies.

It's a fact that real and growing prosperity is not necessarily quashed by government intrusion.

This does not mean, of course, that these intrusions do not *reduce* the level of prosperity and the rate of economic growth. I've no doubt that they are harmful—that ordinary men and women would be wealthier and more secure (and freer) were the State to remove its tentacles and tax collectors from the economy.

But these tentacles and tax collectors are not necessarily fatal.

Nor are such interventions the leading edge of totalitarianism. As obnoxious and as intrusive as, say, the IRS and the FDA are, modern America is not remotely comparable to the Soviet Union under Stalin (or even under Gorbachev). Americans are incomparably more free than were the subjects of the Soviet regime.

Some readers of this magazine will dispute my observations of the real world. I report them not to be con-

troversial but merely to be honest.

Assuming that my empirical observations are sound, what explains these facts? Why haven't 80 years of a national government unmoored from constitutional restraints—and with an unending itch to poke, prod, and tax nearly every aspect of Americans' lives—resulted in economic stagnation and Big Brother of the kind that haunts the characters in George Orwell's great novel *1984*?

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Why haven't 80 years of a national government unmoored from constitutional restraints resulted in economic stagnation and Big Brother?

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I believe that the answer is the power of freedom.

Freedom is a beautiful flower with more robustness than crabgrass. Freedom is *not* delicate or easily uprooted. Like crabgrass, freedom is not indestructible; it can be killed. But freedom is not a frail institution that collapses and dies the moment it is attacked by some element foreign to its nature. If it were, we all would long ago have been well and truly enslaved.

The human spirit seizes opportunities to flourish even with less-than-maximum scope; it naturally resists being confined to the arbitrary will of others. We do not all fall in line behind the commissar or Congress's commands simply because we're ordered to do so. (How many Americans *really* care if the busboy at a restaurant is an "illegal" alien?) And even when we abide by the letter of legislation, we are wonderfully crafty at violating its spirit if that legislation is felt to be inappropriate.

So, too, with the free market. It is perhaps the most remarkably vigorous of all human institutions. Heavily taxed and loaded with arbitrary regulations, the market keeps on keeping on. Entrepreneurs creatively find ways around government intrusions or they discover techniques for reducing the intrusions' ill effects.

Everyone who understands the logic of markets knows that, say, the unexpected destruction of a factory by an earthquake will barely slow the market's relentless push to improve living standards. We understand that markets are remarkably resilient at dealing with—and reducing the bad effects of—natural obstacles such as mountains that separate suppliers from customers, or weather disasters that destroy existing inventories and supply lines.

Although we'd be even wealthier if these obstacles and weather disasters never materialized, their existence does not condemn us to everlasting poverty. Entrepreneurs—given sufficient freedom—are guided by prices and profits to overcome these obstacles. Likewise, entrepreneurs—given sufficient freedom—are guided by prices and profits to overcome government-erected obstacles.

The vital question here is, how much freedom is sufficient? I have no answer, except to say, "Freedom is sufficient for economic growth even when it is far less than we should have and are capable of having."

Many libertarians will read this column and wince, thinking I'm discounting the importance of freedom. But they would be mistaken.

In fact, the theme of this column is to celebrate the great and creative power of freedom. To point out that freedom can be hobbled and hamstrung by a predatory State and nevertheless continue to shower blessings on ordinary men and women is to praise freedom—to applaud it loudly and lovingly.

Additionally, those persons who recognize the resilience and vigor of freedom and free markets gain even greater credibility when insisting that the role of the State should be reduced. If it were true that the slightest burden government placed on freedom led inexorably to tyranny and poverty, then anyone who champions freedom might be thought to do so for purely pragmatic reasons. But the champion of freedom who recognizes that the economy might still be reasonably dynamic in the

face of government regulations, and who doubts that such regulations will lead to his or her being tyrannized, is an even more believable spokesperson for freedom, for that person can speak more from principle than from narrow pragmatism.

He or she can say, "Look, even though eliminating this tax or repealing that regulation will not mean the difference between poverty and plenty, I still believe that the tax should be eliminated or the regulation repealed. The reason is that they are *immoral*. There's a practical case for reducing government's role, but even when practical considerations do not loom large, ethical considerations *do*. Even though this tax or that regulation won't condemn us to a material hell, they nevertheless violate human rights that ought never be violated." FEE

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## Recognizing the resilience of freedom and the free market despite the intrusions of a predatory State makes defenders of liberty more credible.

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# Can Government Save Us from Manmade Disasters?

BY JAMES L. PAYNE

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Please, folks, can't we have a little more sophistication about what it takes to prevent environmental disasters? The politicians seem to be stuck on the idea that more government is the solution, and many journalists echo the theme. In discussing the BP spill and several other manmade environmental disasters last summer, *Washington Post* reporters David A. Fahrenthold and Ylan Q. Mui summarized their explanation of what goes wrong in these situations: "Private interests that took risks in search of a payoff; a government that wasn't trying hard enough to stop them." According to this theory, environmental mishaps mean we didn't have enough government regulation.

The problem with this view is that "government" is an abstraction. In practice everything done in the name of government is done by government employees, ordinary human beings who can be, well, as fallible as anyone. To support this point we need only look at one of the cases Fahrenthold and Mui cited in buttressing their idea that government needs to protect us: the careless spraying of insecticides like DDT.

In the 1950s airplanes flew over swamps and suburbs, fields and forests, drenching everyone and everything with a rain of DDT and other insecticides. It was a triple fiasco: 1) it failed to control the target insect pests (such as the spruce budworm, the imported fire ant, and the gypsy moth, among others); 2) it cost a lot

of money; and 3) the spraying slaughtered living things on a vast scale. It killed some farm and domestic animals; it killed hundreds of species of beneficial insects and nematodes; and it killed wildlife, including foxes, raccoons, rabbits, fish, and birds, turning affected areas into—in the eyes of a sensitive environmentalist—an eerie wasteland.

Who carried out this irresponsible madness? Rachel Carson fingered the culprits in her celebrated 1962 book, *Silent Spring*. The point is often overlooked today, but *Silent Spring* was not so much a critique of pesticides but a condemnation of their irresponsible use. In case after case, the organizations that drenched land and wildlife with poisonous insecticides were . . . wait for it . . . government agencies! For example, in 1958 the U.S. Department of Agriculture launched a campaign to spray 20 million acres in nine southern states in

an attempt to eradicate fire ants. The department won congressional approval for the program by making the unsupported assertion that fire ants were dangerous to livestock and crops, when in actuality, as Carson documented, they were no significant threat to either. The



**The government has caused disasters in the past by spraying indiscriminately for pests.**  
U.S. Forest Service

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spraying did not control the fire ant, but it did cause massive kills of wildlife, especially fish and birds. The program was, said Carson, “an outstanding example of an ill-conceived, badly executed, and thoroughly detrimental experiment in the mass control of insects.”

In New York State the U.S. Department of Agriculture joined forces with the New York Department of Agriculture and Markets in a futile attempt to eradicate the gypsy moth. In 1957, Carson continued, they “showered down the prescribed DDT-in-fuel-oil with impartiality. They sprayed truck gardens and dairy farms, fish ponds and salt marshes. They sprayed the quarter-acre lots of suburbia, drenching a housewife making a desperate effort to cover her garden before the roaring plane reached her. . . . Birds, fish, crabs, and useful insects were killed.”

In Michigan, in an attempt to control the Japanese beetle, government agencies joined forces to dust the suburbs of Detroit with aldrin, a pesticide 100 times more toxic to birds than DDT. The first offender in this debacle was the Michigan state legislature, which gave state agencies the power to spray indiscriminately, without notifying landowners or gaining their permission. The spraying was carried out by the Michigan Department of Agriculture, backed by the pesticide-tropic U.S. Department of Agriculture. When worried citizens reported dead birds and sickened humans and animals, Carson reports, government agencies stonewalled. The Federal Aviation Agency, the Detroit Department of Parks, and the Detroit police all vouched for the safety of the operation even though they had no evidence on the point.

*Silent Spring*—the gospel of the environmental movement—abundantly demonstrates that government can be an irresponsible, insensitive polluter. This raises an interesting question: Why has this point been forgotten?

My explanation of this blindness is that these reporters—and environmental activists in general—are victims of the “watchful eye illusion.” Human beings have a disposition to believe in authority and to ascribe godlike wisdom and maturity to it. This orientation

probably begins in childhood when parents are viewed as wise and capable. As children grow up, many transfer this faith in authority to government, producing the watchful eye illusion: the belief that government is wise and responsible. This illusion will lead people to forget about—or repress—all the evidence demonstrating that government officials are often unwise and irresponsible.

The 1950s spraying scandal hasn’t been government’s only environmental miscue. For another, look at the Hanford Nuclear Reservation in the state of Washington, where the federal government’s radioactive spills are now expected to cost taxpayers \$50 billion to clean up. In just one type of pollution at that site, the feds deliberately vented 725,000 curies of radioactive iodine-131. This was over 36,000 times as much radioactivity as was released in the 1979 Three Mile

Island accident in which naughty private interests were supposedly “taking risks in search of a payoff.”

Just as government can be an irresponsible polluter, it can also be an ineffective regulator. Many people don’t grasp this reality because, again, they are blinded by their faith in authority. With naive confidence, they propose, for example, that “government should regulate oil drilling,” thinking that this will prevent oil spills. If they could overcome the

watchful eye illusion they would realize that they need to put their proposal more carefully: “Assuming that the government employees doing the regulating are alert, thoughtful, energetic, and responsible, and never lazy, complacent, uninformed, irrational, careless, corrupt, or paralyzed by red tape, government should regulate oil drilling.” Thus stripped of illusion, the idea that government can protect the environment loses much of its luster.

In the final analysis, overcoming environmental abuse is not likely to be achieved by governmental dictation. Instead, it is a process of social learning that includes everyone: friends and neighbors, reporters, pamphleteers, teachers, researchers—and companies too, as they discover how pollution hurts their image and their bottom line.

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# The Distorting Effects of Transportation Subsidies

BY KEVIN CARSON

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Although critics on the left are very astute in describing the evils of present-day society, they usually fail to understand either the root of those problems (government intervention) or their solution (the operation of a freed market). In Progressive commentary on energy, pollution, and so on—otherwise often quite insightful—calls for government intervention are quite common. George Monbiot, for instance, has written that “[t]he only rational response to both the impending end of the Oil Age and the menace of global warming is to redesign our cities, our farming and our lives. But this cannot happen without massive political pressure” (*The Guardian*, Dec. 2, 2003, [www.tinyurl.com/2c2emmz](http://www.tinyurl.com/2c2emmz)).

But this is precisely backward. Existing problems of excess energy consumption, pollution, big-box stores, the car culture, and suburban sprawl result from the “massive political pressure” that has already been applied, over the past several decades, to “redesign our cities, our farming, and our lives.” The root of all the problems Monbiot finds so objectionable is State intervention in the marketplace.

In particular, subsidies to transportation have probably done more than any other factor (with the possible exception of intellectual property law) to determine the present shape of the American corporate economy.

Currently predominating firm sizes and market areas are the result of government subsidies to transportation.

Adam Smith argued over 200 years ago that the fairest way of funding transportation infrastructure was user fees rather than general revenues: “When the carriages which pass over a highway or a bridge, and the lighters which sail upon a navigable canal, pay toll in proportion to their weight or their tonnage, they pay for the maintenance of those public works exactly in

proportion to the wear and tear which they occasion of them.”

This is not, however, how things were actually done. Powerful business interests have used their political influence since the beginning of American history to secure government funding for “internal improvements.” The real turning point was the govern-

ment’s role in creating the railroad system from the mid-nineteenth century on. The national railroad system as we know it was almost entirely a creature of the State.

The federal railroad land grants included not only the rights-of-way for the actual railroads, but extended



**The open road might symbolize freedom, but it embodies a long history of State subsidies for corporations.**

UpstateNYer [commons.wikimedia.org]

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15-mile tracts on both sides. As the lines were completed, this adjoining land became prime real estate and skyrocketed in value. As new communities sprang up along the routes, every house and business in town was built on land acquired from the railroads. The tracts also frequently included valuable timberland. The railroads, according to Matthew Josephson (*The Robber Barons*), were “land companies” whose directors “did a rushing land business in farm lands and town sites at rising prices.” For example, under the terms of the Pacific Railroad bill, the Union Pacific (which built from the Mississippi westward) was granted 12 million acres of land and \$27 million worth of 30-year government bonds. The Central Pacific (built from the West Coast eastward) received nine million acres and \$24 million worth of bonds. The total land grants to the railroads amounted to about six times the area of France.

Theodore Judah, chief engineer for what became the Central Pacific, assured potential investors “that it could be done—if government aid were obtained. For the cost would be terrible.” Collis Huntington, the leading promoter for the project, engaged in a sordid combination of strategically placed bribes and appeals to communities’ fears of being bypassed in order to extort grants of “rights of way, terminal and harbor sites, and . . . stock or bond subscriptions ranging from \$150,000 to \$1,000,000” from a long string of local governments that included San Francisco, Stockton, and Sacramento.

Government also revised tort and contract law to ease the carriers’ way—for example, by exempting common carriers from liability for many kinds of physical damage caused by their operation.

Had railroad ventures been forced to bear their own initial capital outlays—securing rights of way, preparing roadbeds, and laying track, without land grants and government purchases of their bonds—the railroads would likely have developed instead along the initial lines on which Lewis Mumford speculated in *The City in History*: many local rail networks linking communities into local industrial economies. The regional and national interlinkages of local networks, when they did occur,

would have been far fewer and far smaller in capacity. The comparative costs of local and national distribution, accordingly, would have been quite different. In a nation of hundreds of local industrial economies, with long-distance rail transport much more costly than at present, the natural pattern of industrialization would have been to integrate small-scale power machinery into flexible manufacturing for local markets.

Alfred Chandler, in *The Visible Hand*, argued that the creation of the national railroad system made possible, first, national wholesale and retail markets, and then large manufacturing firms serving the national market. The existence of unified national markets served by large-scale manufacturers depended on a reliable, high-volume distribution system operating on a national level. The railroad and telegraph, “so essential to high-volume production and distribution,” were in Chan-

andler’s view what made possible this steady flow of goods through the distribution pipeline: “The revolution in the processes of distribution and production rested in large part on the new transportation and communications infrastructure. Modern mass production and mass distribution depend on the speed, volume, and regularity in the movement of goods

and messages made possible by the coming of the railroad, telegraph and steamship.”

### The Tipping Point

The creation of a single national market, unified by a high-volume distribution system, was probably the tipping point between two possible industrial systems. As Mumford argued in *Technics and Civilization*, the main economic reason for large-scale production in the factory system was the need to economize on power from prime movers. Factories were filled with long rows of machines, all connected by belts to drive shafts from a single steam engine. The invention of the electric motor changed all this: A prime mover, appropriately scaled, could be built into each individual machine. As a result, it was possible to scale machinery to the flow of production and situate it close to the point of consumption.

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With the introduction of electrical power, as described by Charles Sabel and Michael Piore in *The Second Industrial Divide*, there were two alternative possibilities for organizing production around the new electrical machinery: decentralized production for local markets, integrating general-purpose machinery into craft production and governed on a demand-pull basis with short production runs and frequent shifts between product lines; or centralized production using expensive, product-specific machinery in large batches on a supply-push basis. The first alternative was the one most naturally suited to the new possibilities offered by electrical power. But in fact what was chosen was the second alternative. The role of the State in creating a single national market, with artificially low distribution costs, was almost certainly what tipped the balance between them.

The railroads, themselves largely creatures of the State, in turn actively promoted the concentration of industry through their rate policies. Sabel and Piore argue that “the railroads’ policy of favoring their largest customers, through rebates” was a central factor in the rise of the large corporation. Once in place, the railroads—being a high fixed-cost industry—had “a tremendous incentive to use their capacity in a continuous, stable way. This incentive meant, in turn, that they had an interest in stabilizing the output of their principal customers—an interest that extended to protecting their customers from competitors who were served by other railroads. It is therefore not surprising that the railroads promoted merger schemes that had this effect, nor that they favored the resulting corporations or trusts with rebates.”

### Reprising the Role

As new forms of transportation emerged, the government reprised its role, subsidizing both the national highway and civil aviation systems.

From its beginning the American automotive industry formed a “complex” with the petroleum industry

and government highway projects. The “most powerful pressure group in Washington” (as a PBS documentary called it) began in June 1932, when GM president Alfred P. Sloan created the National Highway Users Conference, inviting oil and rubber firms to help GM bankroll a propaganda and lobbying effort that continues to this day.

Whatever the political motivation behind it, the economic effect of the interstate system should hardly be controversial. Virtually 100 percent of roadbed damage to highways is caused by heavy trucks. After repeated liberalization of maximum weight restrictions, far beyond the heaviest conceivable weight the inter-

state roadbeds were originally designed to support, fuel taxes fail miserably at capturing from big-rig operators the cost of pavement damage caused by higher axle loads. And truckers have been successful at scrapping weight-distance user charges in all but a few western states, where the push for repeal continues. So only about half the revenue of the highway trust fund comes from fees or fuel taxes on the trucking industry, and the rest is externalized on private automobiles.

This doesn’t even count the 20 percent of highway funding that’s still subsidized by general revenues, or the role of eminent domain in

lowering the transaction costs involved in building new highways or expanding existing ones.

As for the civil aviation system, from the beginning it was a creature of the State. Its original physical infrastructure was built entirely with federal grants and tax-free municipal bonds. Professor Stephen Paul Dempsey of the University of Denver in 1992 estimated the replacement value of this infrastructure at \$1 trillion. The federal government didn’t even start collecting user fees from airline passengers and freight shippers until 1971. Even with such user fees paid into the Airport and Airways Trust Fund, the system still required taxpayer subsidies of \$3 billion to maintain the Federal Aviation Administration’s network of control towers, air



The civil aviation system has, from the start, been a creature of the State.

traffic control centers, and tens of thousands of air traffic controllers.

Eminent domain also remains central to the building of new airports and expansion of existing airports, as it does with highways.

Subsidies to airport and air traffic control infrastructure are only part of the picture. Equally important was the direct role of the State in creating the heavy aircraft industry, whose jumbo jets revolutionized civil aviation after World War II. In *Harry Truman and the War Scare of 1948*, Frank Kofsky described the aircraft industry as spiraling into red ink after the end of the war and on the verge of bankruptcy when it was rescued by the Cold War (and more specifically Truman's heavy bomber program). David Noble, in *America by Design*, made a convincing case that civilian jumbo jets were only profitable thanks to the government's heavy bomber contracts; the production runs for the civilian market alone were too small to pay for the complex and expensive machinery. The 747 is essentially a spinoff of military production. The civil aviation system is, many times over, a creature of the State.

### The State and the Corporation

It's hard to avoid the conclusion that the dominant business model in the American economy, and the size of the prevailing corporate business unit, are direct results of such policies. A subsidy to any factor of production amounts to a subsidy of those firms whose business models rely most heavily on that factor, at the expense of those who depend on it the least. Subsidies to transportation, by keeping the cost of distribution artificially low, tend to lengthen supply and distribution chains. They make large corporations operating over wide market areas artificially competitive against smaller firms producing for local markets—not to mention big-box retailers with their warehouses-on-wheels distribution model.

Some consequentialists treat this as a justification for transportation subsidies: Subsidies are good because they make possible mass-production industry and large-

scale distribution, which are (it is claimed) inherently more efficient (because of those magically unlimited “economies of scale,” of course).

Tibor Machan argued just the opposite in the February 1999 *Freeman*:

Some people will say that stringent protection of rights [against eminent domain] would lead to small airports, at best, and many constraints on construction. Of course—but what's so wrong with that?

Perhaps the worst thing about modern industrial life has been the power of political authorities to grant special privileges to some enterprises to violate the rights of third parties whose permission would be too expensive to obtain. The need to obtain that permission would indeed seriously impede what most environmentalists see as rampant—indeed reckless—industrialization.

The system of private property rights . . . is the greatest moderator of human aspirations. . . . In short, people may reach goals they aren't able to reach with their own resources only by convincing others, through arguments and fair exchanges, to cooperate. [[www.tinyurl.com/n8jxxp](http://www.tinyurl.com/n8jxxp)]

In any case, the “efficiencies” resulting from subsidized centralization are entirely spurious. If the efficiencies of large-scale production were sufficient to compensate for increased distribution costs, it would not be necessary to shift a major portion of the latter to taxpayers to make the former profitable. If an economic activity is only profitable when a portion of the cost side of the ledger is concealed, and will not be undertaken when all costs are fully internalized by an economic actor, then it's not really efficient. And when total distribution costs (including those currently shifted to the taxpayer) exceed mass-production industry's ostensible savings in unit cost of production, the “efficiencies” of large-scale production are illusory. FEE

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# Doctors Are Government Employees

BY THEODORE LEVY

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Doctors speak frequently among themselves about problems in medicine: decreased collections; inability to spend more time with patients; difficulty getting consults from specialists, especially for Medicare/Medicaid patients; enormous time wasted with patients who aren't really sick (sometimes they're old and lonely; sometimes they're unemployed with nothing else to do—visits to the doctor for the poor are often a family affair, with three generations crowding the waiting area); the incredible wasted resources in the emergency department. (Due to federal EMTALA laws, no one needing emergency care can be turned away from an ER.)

But there's one thing doctors *never* talk about, even though it easily explains the problems patients have in getting good treatment and doctors have in providing it:

*Doctors are government employees.*

I'm not talking about only the doctors that work in the Department of Veterans Affairs or the hospitals run by the Bureau of Indian Affairs. I'm not talking about the training centers known as county hospitals, where students learning the practice get to make mistakes on poor people prior to actually going out in the real world.

I'm talking about *all* doctors—because the government contributes about 50 percent of all health care dollars to physician pay. And 40 percent more is contributed by third-party payers that are themselves highly regulated by government and routinely follow the government's lead in pricing.

People in the United States don't need to have it explained to them why FedEx and UPS do a better job than the U.S. Postal Service (USPS). They know why they stand in long lines when they use the USPS and face surly unpleasant employees behind the counter. It's a government monopoly. For years, the post office I frequent had a number dispenser, like at a deli. You'd wait for your number to be called. I would typically walk in,

pull the number—say, for example, 57—and find they were currently calling 13. Recently, this technique was discontinued. I asked the postal employee why, and he explained studies showed the system made people feel they were waiting too long, so the Postal Service got rid of the number dispensers—not to speed things up . . . just to make it harder to know how long you had to wait.

People in the United States don't need to be told why their garbage pickup is not always as dependable as their dry cleaning pickup. They know

one is paid for out of taxes while the other is paid for out of pocket, that one is a monopoly you have no choice but to use while the other is a service you can take or leave, or change. They know the dry cleaning company will *never* berate them if they don't pre-sort their clothes properly before pickup.

But the fact is, many post office employees are not happy either. Like doctors, they feel hampered by regu-

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50 percent of health care dollars come from government. 40 percent come from highly regulated third parties that follow the government's lead in pricing.

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*Theodore Levy (ted\_levy@me.com) is a physician in the Southwest. This article first appeared at TheFreemanOnline.org.*

lation; like doctors, they often find themselves drowning in paperwork. Every one of them sees inefficiencies they have to live with because the system doesn't provide easy ways to correct or eliminate them.

Why should medicine be different? Because doctors are smart? Not smart enough, it seems, to avoid a field thoroughly transmogrified by government regulations. Because health is important? So are sanitation and communication. Epidemiology tells us improvements in the former account for a significant increase in longevity in the last century, and communication is so important we have essentially eliminated much of the post office's work by a technological fix the government doesn't control: email.

If doctors and patients want better health care, there's an easy way to achieve it. Doctors have to start working only for patients, and patients have to start paying doctors for their services.

Granted, it's not quite as simple as it sounds. Here are two quick difficulties:

- Doctors are trapped in a system that likely overtrains them. This lowers supply and maintains a high physician income. That could change over time as people refuse the high fees, but only to the detriment of doctors already out of training.
- Doctors have to operate on patients in hospitals or surgicenters, and both are highly regulated by state and federal governments, making efficient and cost-effective service more challenging.

But the first step is clear: Don't expect good quality service from a government employee. And don't expect, if you are a government employee, to be able to provide good quality service. FEE

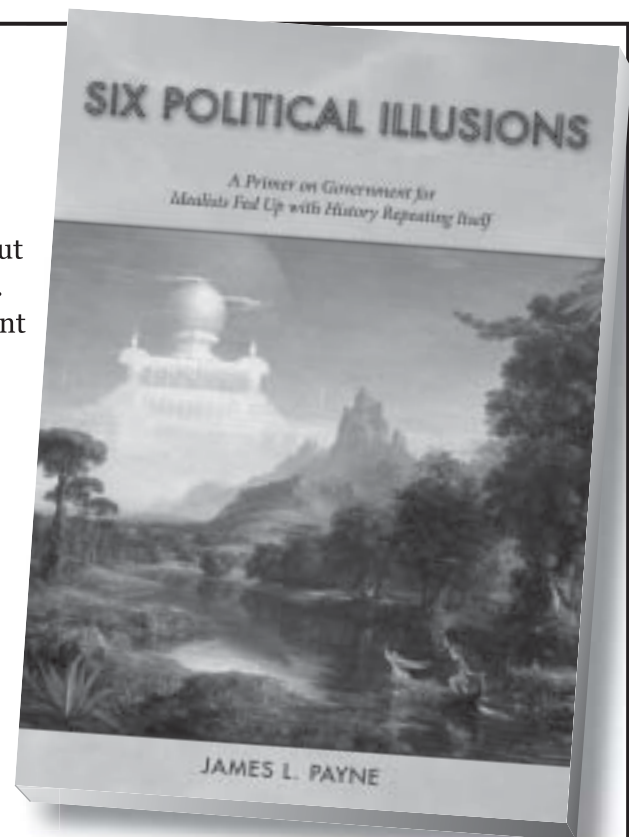
## What Accounts for Government's Growth?

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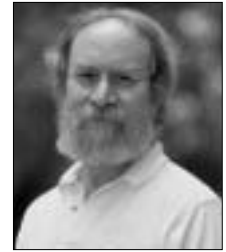
*"I wish someone had put such a book into my hands at age 20. It would have advanced my political sophistication by decades,"* says Payne, age 71, author of 15 books on government and politics.



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# Deficit Hawks or War Hawks?

BY SHELDON RICHMAN



Last month I asked if the American people can afford a world-girdling foreign policy more befitting an empire than a republic. Look at it this way: War hawks make poor deficit hawks. Facing a \$13 trillion national debt and trillion-dollar-plus annual budget deficits, we can't afford to be complacent about foreign interventions costing \$12 billion a month.

It's not just that the budget numbers are daunting: The very institutions of small-government republicanism are suffocated by the quest for global hegemony. As James Madison said, "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."

The soul of the American founding, Thomas Paine, noted in *The Rights of Man* that in British history "taxes were not raised to carry on wars, but . . . wars were raised to carry on taxes."

This philosophy was heard throughout the nineteenth century.

Since the 1960s criticism of foreign intervention has come mostly from the political camp opposed to free markets and strict limits on government power. But a slightly longer historical perspective reveals that indi-

vidualist, limited-government, free-market advocates who had fought the New Deal also opposed America's budding empire. They were loosely associated in what has come to be called the Old Right. Among this group were FEE founder Leonard Read; early staffer F. A. Harper (who later founded the Institute for Humane Studies); Frank Chodorov, first editor of *The Freeman* after Read purchased it in 1954; Felix Morley, a founding editor of *Human Events*; Garet Garrett, the novelist and journalist; and John T. Flynn, the Progressive-journalist-turned-FDR-critic and author of *We Go Marching*, the definitive critique of fascism, militarism, and corporatism.

These men, writing mostly in the late 1940s and '50s, when the Soviet Union loomed, understood that liberty was imperiled by the centralized power of the garrison state. We see this view expressed throughout the writings of the old individ-

ualists. For example, Morley wrote in the spring 1957 issue of the conservative journal *Modern Age*: "We are trying to make a federal republic do an imperial job without honestly confronting the fact that our traditional institutions are specifically designed to prevent centralization of power. . . . To make our policies conform to our institutions is to revert to isolationism [noninterventionism]. It would mean the termination



United States Marine Corps

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of our alliances; withdrawal of all troops to our own shores; reduction of military expenditure to a truly defensive level. . . .”

Even earlier, in 1947, Chodorov sounded the alarm against centralized power through interventionist foreign policy: “If we will, we can still save ourselves from the cost of empire building. . . . How a people choose to order their lives is their own concern, and meddling by an outsider, even ‘for their own good,’ arouses resentment. Since the internal affairs of any nation are never beyond reproach, invasion of the privacy of another is as presumptuous as it is mischievous. Political isolationism—minding one’s own business—is an essential of peace.”

Flynn, a muckraking reporter who had exposed special-interest corporatism in the Hoover and Roosevelt administrations, had an unrivaled understanding of how domestic and foreign policies interact. In analyzing how federal policy makers are able to expand their power over the economy without inciting conservative opposition, he observed in 1944: “[M]ilitarism is the one great glamorous public-works project upon which a variety of elements in the community can be brought into agreement. This economic phase of the institution, however, is not always stressed, being smothered under the patriotic gases pumped out in its defense. Nevertheless, this economic aspect is never absent from the consciousness of most people who champion militarism.”

Summing up, Flynn wrote: “We have managed to accumulate a pretty sizable empire of our own already—far-spreading territories detached from our continental borders. . . . We have now managed to acquire bases all over the world. . . . There is no part of the world where trouble can break out where we do not have bases of some sort in which, if we wish to use the pretension, we cannot claim our interests are menaced. . . . Because always the most powerful argument for a huge army maintained for economic reasons is that we have enemies. We must have enemies. They will become an economic necessity for us.”

Harper added his voice to the critics of the garrison

state in his 1951 essay “In Search of Peace,” when the most vocal militarists were big-government Democrats: “Charges of pacifism are likely to be hurled at anyone who in these troubled times raises any question about the race into war. If pacifism means embracing the objective of peace, I am willing to accept the charge. If it means opposing all aggression against others, I am willing to accept that charge also. It is now urgent in the interest of liberty that many persons become ‘peace-mongers.’”


He (like Ben Franklin) scoffed at the idea that we must give up liberty to gain security: “Relinquish liberty for the purposes of defense in an emergency? Why? It would seem that in an emergency, of all times, one needs his greatest strength. So if liberty is strength

and slavery is weakness, liberty is a necessity rather than a luxury, and we can ill afford to be without it—least of all during an emergency.”

Finally, Read pressed his signature theme of personal responsibility when addressing issues of war and peace. He argued in “Conscience on the Battlefield” that the individual in battle cannot escape judgment for his own actions by seeking shelter in a

collective, such as a nation: “[P]lease understand that I don’t care to discuss what you call your foreign policy. It is too late for that. The judgment which now concerns you must be rendered on you as an individual—not on parties or mobs or armies or policies or processes or governments.”

His admonition against foreign intervention was a matter of common sense: “In many instances, you recognize your incompetence to assign causation even to your own acts. It is, therefore, next to impossible for you to determine the just from the unjust in cases that are remote to your experience, between peoples whose habits and thoughts and ways of life are foreign to you. Thinking only of yourself you recognize your own scope and proper limits of your own actions. But interference in strange areas may make you the initiator of violence rather than the protector of rectitude.”

We can learn from these individualist prophets of peace. 

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The Old Right resisted American imperialism as much as it did the New Deal, and for the same reasons.

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# Government's Diminishing Benefits from Inflation

BY JEFFREY ROGERS HUMMEL

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For millennia governments have resorted to expanding the money stock, either through coinage debasement or fiat money, to finance their expenditures. This expedient, with its resulting price inflation, has occurred most noticeably during wars. And the Zimbabwe hyperinflation of 2007–08, the second worst in world history, peaking at a rate of 79.6 billion percent *per month*, reminds us that monetary expansion remains an option for desperate governments in poor countries—even during peacetime.

For wealthy developed countries, however, inflation over the last few decades has in fact become a trivial source of government revenue. This outcome stems not merely from the worldwide decline in inflation rates that began in the 1980s. That disinflation was as much an *effect* of the way sophisticated financial systems now prevent governments from gaining much revenue from even severe inflation as it was a *cause* of falling inflation revenue. Yet most libertarians have overlooked this crucial development in the dynamics of government finance. They anachronistically harp on how the U.S. or European governments might cover significant fiscal shortfalls with the printing press, completely oblivious to how insignificant for such governments this hidden tax has become.

Governments can potentially gain revenue from inflation in three ways. The first is the most obvious and the one most emphasized by libertarians: By issuing fiat money the government benefits in the same

way as an undetected counterfeiter. Simple fiat money, such as the Continentals issued during the American Revolution or the Greenbacks and Confederate currency issued during the Civil War, is easiest to understand. It is directly spent to cover government purchases, and the resulting increase in prices over what they otherwise would have been reduces the purchasing power of money held by the

general public. The government gains by exactly the same amount the public loses in this implicit tax on real cash balances. Economists have dignified this implicit tax with the term *seigniorage*.

Currently nearly all fiat money is instead issued by central banks, such as the Federal Reserve. This arrangement makes seigniorage a bit more complicated, sometimes requiring a well-taught course in economics to comprehend it, but the final result is identical. One arm of the govern-

ment, the central bank, creates fiat money and lends it to another arm of the government, the Treasury, which then spends it, in a process known as monetizing the debt. Legally the Fed cannot purchase securities from the U.S. Treasury directly, and must buy them on the open market from private holders, but that makes absolutely no difference since, in either case, more of the government's deficit has been financed by new issues of fiat money.

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Most libertarians have overlooked the fact that sophisticated financial systems now prevent governments from gaining much revenue from severe inflation.

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Monetary cranks often attach undue importance to the fact that the Treasury pays interest to the central bank for these loans. Admittedly, interest earnings cover the operating expenses of the Fed, which therefore never has to go to Congress for an appropriation, and the precise incentives faced by these two separate arms of the government may differ. But the Fed ultimately rebates most of its interest earnings back to the Treasury (in 2008, for instance, \$35.5 billion out of \$41.0 billion, or 86 percent). If you consolidate the balance sheets of the central bank and the Treasury, the process looks exactly like simple fiat money. Even when much of the money the central bank creates is lent to private banks, as during World War I, or purchases private securities, as has been happening recently, the interest rebate to the Treasury still indirectly generates the same seigniorage as a direct purchase of Treasury securities. The new fiat money flowing into the private sector simply releases money held by others to purchase Treasuries.

### Declining Purchasing Power

The second way that government can gain from inflation relates to transfers between debtors and creditors. If inflation is totally unanticipated or unexpectedly high, interest rates will not have risen enough to compensate for the decline in the purchasing power of any loans. Net debtors gain, and net creditors lose. Government is, of course, the economy's biggest debtor. Unanticipated inflation therefore reduces the real value of government debt. During the Great Inflation of the 1970s private investors holding long-term U.S. Treasury securities actually earned negative real returns despite receiving positive nominal interest. As a consequence, from 1946 to 1982, while the nominal debt that the U.S. government owed to the general public rose from \$242 billion to \$925 billion, that debt in 1946 dollars had actually fallen to \$201 billion.

The third way that government can gain from inflation stems from interaction with explicit taxes. Under a progressive income tax, inflation pushes people into

higher tax brackets even if their real incomes remain constant. The U.S. government thus enjoyed automatic tax hikes requiring not one iota of change in the tax code throughout the 1970s. Under President Ronald Reagan the income tax brackets were indexed, but bracket creep continues with the alternative minimum tax. Moreover, indexing does not eliminate inflation's tax on saving, both through the personal income and capital gains taxes. When interest rates rise to offset expected inflation, the tax rate applies to the higher nominal returns, which represent just inflation's "phantom gains," to borrow a phrase from David Henderson. Real returns quite likely remain constant. These tax interactions, along with seigniorage and real debt reduction, not only bring about transfers from the public to government, they also distort the economy's per-

formance, creating what economists call deadweight loss, additional losses to the general public that exceed any gains. But we are focusing here just on gains to government.

### Fractional Reserve

Each of these three potential sources of inflation revenue has become attenuated in developed countries. The main factor impairing the first, seigniorage, is fractional reserve banking. Banks, as private institutions that increase the money

stock, can magnify inflation but do *not* generate seigniorage. To the extent that bank-created money causes any inflationary fall in real cash balances, the offsetting gains remain within the economy, accruing to the banks themselves or, absent monopoly privileges, flowing back via competition to their customers. The government doesn't just fail to realize any seigniorage, its ability to do so is diminished. We can visualize why by comparing an economy in which banks hold 100 percent reserves—in which every \$10 in circulation is backed by \$10 of government-issued fiat money—to an economy with fractional reserves—in which every \$10 in circulation is backed up by only \$1 dollar of fiat money. Now assume a \$100 billion increase in the total money stock. With 100 percent reserves, government

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Fractional reserve banking diminishes seigniorage because whatever inflationary gains banks generate remain in the economy.

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fiat money (also called the monetary base) increases by the full \$100 billion, all of which constitutes seigniorage. With the 10-to-1 ratio, in contrast, the same increase in the money stock is driven by only a \$10 billion increase in the fiat base, so seigniorage is only one-tenth as much. Nonetheless, in both cases, the \$100 billion increase in the total money stock sets off the same price inflation.

In other words, the lower the reserve ratio in a fractional reserve banking system, the less seigniorage government gets from a given increase in the price level. Or what amounts to the same thing, the greater will be the inflation cost of any given amount of real seigniorage. Fractional reserve banking in effect lowers the demand for government-created base money, reducing the seigniorage tax base (that is, the public's real holdings of non-interest-paying base money).

### Public Choice and Seigniorage

This threat to seigniorage provided a major Public Choice motivation for the myriad government regulations of banking in the past, from the imposition of reserve requirements to the creation of central banks with a monopoly on the issue of bank notes, all of which helped hold up the demand for government base money. The financial innovations and regulatory changes of the last several decades, however, have all but swept away most of these constraints on bank-created money.

Outside of America's two hyperinflations (during the Revolution and under the Confederacy during the Civil War), seigniorage in this country peaked during the Civil War under the Union, when it covered about 15 percent of the war's cost. By World War II seigniorage was financing only a little over 6 percent of government outlays, which amounted to about 3 percent of gross domestic product (GDP). During the Great Inflation of the 1970s seigniorage was below 2 percent of federal expenditures, or less than half a percent of GDP. Consider today how little of your own cash balances is in the form of government-issued Federal

Reserve notes and Treasury coin rather than in the form of privately created bank deposits and money market funds. Prior to the recent financial crisis, M2 (a broad measure of the money stock that includes all checking accounts, savings and small-time deposits, and retail money market funds) was more than eight times the size of the monetary base.

Partly that is because reserve requirements (which should not be confused with government-imposed capital requirements) became virtually a dead letter in the 1990s. Many countries, including Australia, Canada, New Zealand, Sweden, and the United Kingdom, abolished them outright. In the United States the Fed eliminated all reserve requirements on the forms of

money M2 adds to M1 (a narrower measure of the money stock that includes only currency in circulation and certain checking accounts) and permitted banks to freely sweep customers' money between M1 checking accounts and M2 accounts. Congress has furthermore given the Fed authority to abolish the remaining reserve requirements on M1 in 2012.

### Conversion to Debt

The Fed's response to the financial crisis has only accelerated these trends. It is true that in the three months after September 2008, the Fed doubled the monetary base,

from \$850 billion to \$1.7 trillion, so that M1 now has over 100 percent reserves behind it. But the Fed simultaneously eliminated nearly all seigniorage from this unprecedented expansion of fiat money. It did so by starting to pay interest on bank reserves, something other major central banks, including the European Central Bank, were doing already. Essentially this converts any reserves that banks hold as deposit at the central bank into more government debt rather than proper fiat money. The Fed is now borrowing money from the banks and relending it to the Treasury or private parties. This means that the only forms of money that still provide the U.S. government full seigniorage are currency in the hands of the gen-

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Eliminating most  
reserve requirements  
and paying interest  
on the rest have  
mostly eliminated  
the government's  
ability to simply  
print money to  
pay its debts.

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eral public and the actual cash held in bank vaults (which are a small part of a bank's total reserves). And this new restraint on seigniorage will become tighter in the future as people replace currency with bank debit cards and other forms of electronic fund transfers.

What about the other two ways that governments have benefited from inflation? The unexpected inflation of the 1970s, through its reduction of the real value of the national debt, actually generated about twice as much revenue for the U.S. government as did seigniorage during the same period. That still is not a lot, and investors are much savvier these days. Globalization, with the corresponding relaxation of exchange controls in all major countries, allows them easily to flee to foreign currencies, with the result that changes in central-bank policy are almost immediately priced by exchange rates and interest rates. Add to this the ability to purchase from many governments securities that are indexed to inflation, and it becomes highly unlikely that investors will be caught off guard by anything less than sudden, catastrophic hyperinflation (defined as more than 50 percent per month)—and maybe even not then.

### All Pain, Little Gain

As for inflation's interaction with explicit taxes, while it definitely hurts taxpayers and the economy, it seems not to have helped the U.S. government much. Since the Korean War, federal tax revenue has been bumping up against 20 percent of GDP. That is quite an astonishing statistic when you think about all the changes in the tax code over the intervening half-century. Thus the Great Inflation had no obvious impact on explicit government revenues, even before the tax brackets were indexed. It would require a more complex quantitative analysis that adjusted for changes in the tax code and in the economy to determine just how much periods of high inflation boosted the tax bite, but we can safely say that the effect was not dramatic.

Because of all these factors combined, governments in developed countries have little incentive to resort to

monetary expansion, which no doubt contributed to inflation's worldwide decline after 1980. Reid W. Click, in a study of 90 countries between 1971 and 1990, finds that average annual seigniorage exceeded 5 percent of GDP in only eight countries: Egypt, Poland, Malta, Nicaragua, Argentina, Chile, Yugoslavia, and Israel. Almost none of the developed countries could boast seigniorage amounting to more than 1 percent of GDP, despite the fact that the study incorporated the inflationary years of the 1970s. Joseph H. Haslag's smaller sample of 67 countries over a longer period, 1965 to 1994, finds that seigniorage averaged about 2 percent of total output for the entire sample, ranging from as low as 0.25 percent to as high as 9.98 percent (for Ghana). And Stanley Fischer puts the average seigniorage of industrial countries between 1973 and 1978, a period of high inflation, at 1.1 percent of gross national product. I know of no more recent studies, but with disinflation, the widespread paying of interest on bank reserves, and the consolidation of European countries under the European Central Bank, these averages should be lower for the period from 1990 to today.

### How Much Would It Take?

By comparison, let us now run some numbers to estimate how much inflation might be needed to close the looming "fiscal imbalances" (as they are euphemistically styled) that face not merely the United States but most of the world's welfare states. The 2010 report of the Congressional Budget Office (CBO) projects that in 25 years some combination of spending cuts or tax increases equivalent to no less than 12.3 percent of GDP will be needed to close the U.S. government's fiscal gap. Assuming that revenues from explicit taxes remain capped at 20 percent of GDP, whether for structural or political reasons, and that politicians will have little incentive to cut spending, seigniorage will have to come up with the difference. Given that 10 percent inflation during the 1970s generated revenue amounting to 0.5 percent of GDP in the United States, a straight-line extrapolation suggests that

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Inflation's interaction with explicit taxes definitely hurts taxpayers and the economy, but doesn't help the government much.

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covering the growing fiscal shortfall would require more than a tripling of the price level, year after year after year. Within three years the dollar would be worth only about 2.5 percent of its original value.

Such continual triple-digit inflation would be unprecedented, the highest the United States has ever experienced outside of its two hyperinflations. We admittedly have not included any short-term government gains from a reduction in the real value of its debt, which biases our inflation estimate upward, but we also have not adjusted for the loss of seigniorage on interest-earning reserves, pushing the bias downward. Moreover, seigniorage itself faces its own Laffer curve (known as the Bailey curve, after the economist Martin Bailey). To avoid higher taxes on their real cash balances, people spend money faster as inflation rises, thereby exacerbating the price increases. Higher rates of inflation thus generate proportionally ever-smaller revenue increases. Once we also acknowledge that the CBO's projections are probably too optimistic, we can see why our estimate that financing the explosion in Social Security, Medicare, and Medicaid payments will necessitate a 246 percent annual inflation is far too low.

How likely is it that governments in the developed countries will be willing or even able to unleash such appalling currency depreciation? Recall how politically unpalatable the mere double-digit inflation of the

1970s was. Could central banks maybe cease paying interest on reserves and then reimpose or raise reserve requirements to generate more seigniorage at any given inflation rate? Although the answer is technically yes, the likelihood is slim indeed. Now that the genie is out of the bottle, any fiddling with reserve requirements (or other bank regulations) in a way that significantly increases seigniorage will destroy the banking industry as we know it. Think of reserve requirements as a tax on banks, requiring them to hold assets earning zero interest. The higher the requirement, the higher the tax rate. After ending interest on reserves, the Fed would have to multiply the current low reserve tax by a factor in the neighborhood of 15 or more, plus extend reserve requirements to money market funds, to make seigniorage truly lucrative. Given that the U.S. government has just engaged in a gigantic bailout of the banking system, I do not find this prospect probable.

I am not denying that the future may bring higher inflation, if for no other reason than expectations of a fiscal crisis could start a flight from the dollar (or pound or euro) without any immediate change in central-bank actions. But the bottom line is that inflation's implicit tax on real cash balances will no more be able to resolve the escalating budgetary problems of the welfare states than would an excise tax on chewing gum. **FEE**

Financing the exploding government debt via inflation would require a tripling of prices, year after year after year. This is extremely unlikely.

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# Malts in the Cafeteria

BY TRACY STONE LAWSON

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When I was in sixth grade, three of my classmates and I ran for student council president. The entire student body would vote, and the one with the most votes would be president; second-most, vice president; third, secretary; and fourth, treasurer. Looking back, I suppose the other three offices were mostly for show. The presidency was the only job that *really* mattered, and that was the job I wanted.

I hope you'll believe me when I say I was motivated by only the purest intentions—I sincerely wanted to make the school a better place. I put a lot of time and thought into my speech and carefully selected an outfit to wear.

I realize now that my ideas for leading the school through the 1976–77 school year were nothing monumental. I wanted to place a suggestion box in the library so any student could make his or her ideas known; I wanted to start a student newspaper. Maybe there was something in the speech about soliciting student volunteers to pick up litter from the playground, and that the big kids should be deterred from bullying the little kids. At the time it seemed like a solid platform.

Todd, a red-haired, freckled boy on whom I'd had a crush since fourth grade, gave the first speech on election day. It (unlike him) was nothing remarkable. Though my heart was still loyal and he was definitely the cutest boy in our class, he was not, I decided, presidential material. My best friend, Debbie, gave her speech next. She was a worthier opponent, and prettier than I was, but still I felt confident, thinking I had a real shot at the power seat at Sharonville Elementary.

Then it was Chris's turn. I remember just one sentence from his speech, but it was the sentence that tor-

pedoed my dreams of the presidency: "Elect me and we will have malts in the cafeteria . . . every day!"

Now, really—frozen chocolate malts were a coveted treat. They cost a quarter extra, and the cafeteria ladies put them on the lunch menu maybe twice a month. To blithely suggest that it was within the student council president's authority to open the floodgates and provide unlimited chocolate malts was irresponsible.

But it didn't matter as long as the voters believed it.

My carefully thought-out speech was lost to the ages. Nothing I said would have mattered at that point. Chris had the election in the bag.

Chicanery! I was indignant, and even though the word *chicanery* wasn't in my vocabulary at the time, I had just been schooled on the concept.

When the votes were tallied, the results were announced over the school public-address system. Chris had been elected president, I was vice president, Debbie was secretary, and Todd treasurer.

A month after our inauguration it became painfully clear that Chris could not deliver on his campaign promise, and his approval rating plunged. Hobbled by the bureaucracy in the cafeteria, he resigned office before he could be impeached. As vice president I assumed the president's duties, and the suggestion box was installed in the library.

Malts in the cafeteria. Every time a politician makes a promise, that's what I hear. It's all just malts in the cafeteria. FEE

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*Tracy Stone Lawson (tracy.s.lawson@gmail.com), a native of Cincinnati, has learned everything she knows about free-market economics by hanging around with her husband, Bob, for the last quarter century. Bob has learned all he knows about tap dancing, and malts, by hanging around with Tracy. This article first appeared at TheFreemanOnline.org.*

# America's Depression within a Depression, 1937–39

BY ROBERT HIGGS



The Great Depression in the United States is generally dated as beginning in 1929 and ending in 1941, give or take a year. This has led many commentators to disregard or to pass quickly over the serious depression that began in 1937 and ended—if returning to the 1937 level can be considered a depression's end—in 1939 or 1940.

The contraction's dimensions certainly qualify it as a major bust. Real annual GDP fell by more than 5 percent between 1937 and 1938. Real gross business product declined by almost 7 percent; real gross private domestic investment by 21 percent; real private investment in producers' durable equipment by more than 31 percent; and real private investment in new industrial structures by more than 50 percent. The Federal Reserve's index of industrial production dropped from 8.3 in the spring of 1937 to 5.6 in May 1938—a plunge of 33 percent—and it did not regain its 1937 peak until the fourth quarter of 1939.

The rate of unemployment, which had been declining since 1933, now ascended rapidly. In May 1937 the Bureau of Labor Statistics unemployment rate (which counts persons employed in emergency programs, such as the Works Progress Administration and the Civilian Conservation Corps, as *unemployed*) had fallen to almost 12 percent. It then rose slowly until winter, when it began to climb rapidly, reaching a peak at 20.7 percent in April 1939 before falling. The decline accelerated in the latter part of the year. (Estimates of unemployment that count workers in emergency employment programs as *employed* place the rate of unemployment at 9.2 percent in 1937, 12.5 percent in 1938, 11.3 percent in 1939, and 9.5 percent in 1940.) Private nonfarm hours worked fell by about 9

percent between 1937 and 1938 and did not exceed their 1937 amount until 1940.

Investors took a beating. Standard and Poor's index of common stock prices fell between 1937 and 1938 by 25 percent. The market value of stocks traded on the New York Stock Exchange went down by more than 40 percent. All stocks and bonds traded on registered security exchanges lost 41 percent of their market value.

These dire events came as a shock to most people, including President Franklin D. Roosevelt, most of his leading subordinates, and most supporters of the New Deal.

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Roosevelt clung to the belief that his policies would soon end the depression, despite the persistence of negative indications.

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In 1935 and 1936, when the economic recovery was proceeding faster than it had in the previous two years, Roosevelt administration leaders had begun to believe their policies were working successfully and that before long those measures would lift the economy out of the depression completely. "The President," according to historian Alan Brinkley, "clung fervently to that conviction despite the persistence of high unemployment, the absence of significant new

private investment, and the continuing sluggishness of several major industries." The President therefore resolved to propose a balanced budget for the fiscal year beginning July 1, 1937.

When the bust had become undeniable, Roosevelt described it as a recession rather than a depression, to distinguish it from the terrifying slide between 1929 and 1933, but his heart did not coincide with his language. "The collapse," writes Brinkley, "created an anxiety within the government that at times verged on

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panic,” and the President’s subsequent speeches and actions revealed that he had no real understanding of why the contraction had occurred or how he might contribute to its reversal. Representative Maury Maverick of Texas told his colleagues in the House, “Now we Democrats have to admit that we are floundering. We have pulled all the rabbits out of the hat, and there are no more rabbits. . . . We are a confused, bewildered group of people, and we are not delivering the goods.”

Ever the politician, the President blamed the depression on “economic royalists” intent on destroying him—“I welcome their hatred,” he declared—and he set in motion a large-scale investigation by the newly created Temporary National Economic Committee, as well as dramatically beefed-up antitrust prosecutions to bring these “princes of property” to heel and to punish them for mounting a “strike of capital” intended to “sabotage” recovery. As New Deal insider Raymond Moley wrote in 1939, the President’s “calling of names in political speeches and the vague, veiled threats of punitive action all tore the fragile texture of credit and confidence upon which the very existence of business depends.”

For the past half-century, however, dispassionate analysts have generally dismissed the President’s capitalist-devil theory and have explained the bust in two main ways: A Keynesian interpretation blames primarily a fiscal shock caused by the federal government’s reduction of its budget deficit from \$3.6 billion in calendar year 1936 to \$0.4 billion in calendar year 1937; alternatively, a monetarist interpretation blames primarily a monetary shock caused by the Fed’s doubling of its member commercial banks’ required-reserve ratios between August 1936 and May 1937. This monetary policy triggered a decline in the money stock, which had been growing rapidly since 1933: The money stock (M2 definition) fell by 2.4 percent between the second quarter of 1937 and the second quarter of 1938.

Notwithstanding these macroeconomic interpretations’ status as leading competitors in mainstream

macroeconomics, they have been vigorously challenged over the years. The Keynesian view has serious empirical and logical defects too numerous to recount here; until recently, leading mainstream economists had largely abandoned the rudimentary Keynesian framework of analysis. The monetarist interpretation also presents serious problems. In a study published by the European Commission’s Directorate General for Economic and Financial Affairs in February 2010, Paul van den Noord concludes that “while the 1937/38 recession is generally attributed to a tight stance of macroeconomic policy” that produced negative fiscal and monetary shocks, the likely effects of these shocks cannot account for the actual magnitude and contour of this contraction, and “this view is thus questionable.”

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### Roosevelt created an uncertain, hostile climate for businesses that helped cause the 1937 depression.

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To strengthen his explanation of the depression within the Depression, van den Noord appeals, as have other economists (notably Richard Vedder, Lowell Gallaway, Harold Cole, and Lee Ohanian), to factors that also impressed many analysts at the time: rapidly rising real wage rates caused in large part by the Wagner Act’s stimulus of labor unionization, govern-

ments’ tolerance of sit-down strikes, and the Roosevelt administration’s vocal hostility—expressed in word and deed—to businesspeople and investors, which caused entrepreneurs and capitalists to fear an impending dictatorship that would greatly weaken or destroy the free-enterprise system. The President’s shrill denunciations of businessmen in 1936 and 1937, his attempt to pack the Supreme Court and reorganize the government, his administration’s stream of tax proposals aimed at fleeing investors, and the New Deal’s many economic regulatory ventures—particularly the Securities and Exchange Commission and the National Labor Relations Board, among many other menacing developments—generated what I call “regime uncertainty,” which helps to explain the extraordinary collapse of investment, especially long-term investment, in 1937 and 1938. FEE



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# Bank Deregulation: Friend or Foe?

BY WARREN C. GIBSON

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**B**anking has changed a lot during my lifetime—for the better. The changes are partly due to technology (ATMs, online access), but also to deregulation that subjected banks to a lot more competition. What were the major deregulatory moves and how might they have contributed to the recent crisis? Before addressing those questions, a little personal history.

I got interested in money and banking at a very young age. My mother often took me along on shopping trips, explaining what money was, why we needed it in stores, and how my father got it for us. Trips to the bank were a special treat. The Cleveland Trust branch near us was an imposing affair, with a limestone façade, high ceilings, and tellers ensconced behind ornate barred windows. The architecture was intended to instill confidence, but to me it was just a magic place.

Later, my sixth-grade class operated a student branch of another bank, the Society for Savings. Twice a month our classroom was rearranged like a bank branch. Tellers (all boys, as I recall) would accept student deposits of a dime, a quarter, or sometimes a whole dollar. Assistant tellers (girls) would write the amount of the deposit in the student's passbook, while the boys handled the cash. After closing we tallied the deposits and packed the loot—perhaps \$50—into a canvas bag, and a privileged student would trundle it off to the principal's office under the watchful eyes of two “guards.” What great lessons we learned: thrift, honesty, attention to detail!

By the time I was 14 I was earning good money shoveling snow, raking leaves, and mowing lawns. I had

become something of a saving fanatic. I soon found out that the local savings and loan (S&L) offered higher interest than commercial banks, so I opened an account there. Savings passbooks seem quaint in hindsight, but mine was a treasured possession, a tangible reminder of my growing nest egg.

Not just the passbooks, but the entire banking experience of the 1950s looks quaint from today's perspective. The banks were open from 10 to 3 five days a week, and there were no automatic teller machines, no debit cards, and only a crude form of credit card (mom's charge-a-plate was accepted only by the downtown department stores). Those were the days of the 3-6-3 rule of banking: pay 3 percent on deposits, lend it out at 6 percent, and head for the golf course at 3 p.m. No need to worry about competition. For one thing, potential competing banks from other counties

or other states were not allowed to open branches inside Cuyahoga County. And the interest paid on savings accounts was set by government regulators. Banks and especially their S&L brethren did try to compete by offering bonuses like toasters to new account holders.

The stagflation of the 1970s blew the cozy world of banking wide open. When price inflation approached and then exceeded 10 percent, savers began to realize their passbook accounts were guaranteed losers of purchasing power. Some turned to Treasury bills, but at

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The entire banking experience of the 1950s looks quaint today.

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one point the public servants at Treasury, beset by small savers wanting to buy \$1,000 T-bills, shooed them away like so many flies by simply raising the minimum purchase to \$10,000. Money market mutual funds were devised and helped fill the gap. These funds were a clever innovation that let small savers participate in a pool of short-term, high-quality, market-rate instruments. Prudent management made it possible to maintain a dollar-per-share price, and check-writing privileges were soon added. Eventually this form of asset was included in the broader monetary aggregates. Savings poured out of banks into the new funds.

### Regulation Q

The banks badly needed relief from the infamous Regulation Q, which capped the interest rates they could pay. Relief appeared in the form of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA).

Interest-rate ceilings were phased out, and for the first time in many years interest could be paid on demand deposits (checking accounts). Repeal of Regulation Q was framed as a consumer protection measure, and rightly so. Interest limits—and price controls in general—are now thoroughly discredited.

The repeal of usury laws decriminalized high-interest personal loans, which was beneficial to marginal borrowers generally. It did, however, contribute in a minor way to the expansion of unsustainable subprime mortgages.

DIDMCA included minor increases in regulation. All banks—not just those that were members of the Fed—became subject to regulation by the Federal Reserve System. The Fed could now set reserve requirements for all banks, offer them discount loans, and provide check-clearing services. Also, deposit insurance, which is a subsidy to the banks, was raised from \$40,000 to \$100,000 per depositor. It is a subsidy because although banks pay premiums for deposit insurance, those premiums are almost certainly lower than what private insurance companies would charge.

The Garn-St. Germain Act of 1982 soon followed. Banks were allowed to offer money market deposit accounts in competition with the money market mutual funds that had lured so many savers away. There were numerous other minor changes, but the act's most important provision was deregulation of S&Ls. Savings and loans were bank-like institutions that had been allowed to pay slightly more on deposits but were allowed to offer only one kind of loan: home mortgages. It was this tradeoff, prompted by politicians who saw it as their job to promote homeownership, that primarily distinguished S&Ls from commercial banks. Garn-St. Germain eliminated the S&L interest-rate advantage and raised the limits on the amount of consumer lending and nonresidential real estate lending they were allowed to undertake.

S&Ls held mortgages that yielded modest returns and had many years to run, but by 1980 they were hav-

ing to pay ever-higher rates to retain deposits, mostly passbook savings accounts payable almost on demand. They were caught in a classic borrow-short/lend-long squeeze. To make matters worse, most S&L managers lacked the specialized knowledge and personal connections necessary for successful commercial real estate lending. These and other factors led to

the S&L crisis of the late 1980s. Had they anticipated these developments, Senators Garn and St. Germain might have phased in the changes more gradually. Overall, though, Garn-St. Germain and DIDMCA ultimately strengthened competition and fostered innovation, thereby serving consumers well.

The Financial Institutions Reform, Recovery and Enforcement Act of 1989 was passed as a cleanup measure. Little remains of this act other than the establishment of the Office of Thrift Supervision, currently targeted for abolition.

The Riegle-Neal Interstate Banking and Branching Efficiency Act took effect in 1994. By opening up *interstate* branch banking, this act finally caught us up with Canada, which has had large nationwide banks almost since the founding of the Dominion. There were no Canadian bank failures at all during the 1930s, when

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## The stagflation of the 1970s blew apart the cozy world of banking.

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some 9,000 U.S. banks failed. With branch banking outlawed, small towns in the United States could only be served by small and often fragile local banks. This restriction was a major contributor to the two waves of U.S. bank failures during the Depression.

Nowadays we can travel across the country and see familiar bank names like Chase, Citibank, Wells Fargo, or Bank of America. Young people in particular find this no more surprising or disturbing than the ubiquity of McDonald's or Chevron. Riegle-Neal has been an unqualified success in this regard.

### Gramm-Leach-Bliley

The Gramm-Leach-Bliley Financial Services Modernization Act of 1999 takes the stage next. It repealed (for the most part) the separation of investment banking from commercial banking and insurance, as discussed in my and Jeffrey Rogers Hummel's October *Freeman* article on the Glass-Steagall Act. Two minor restrictions remain: Investment banks and commercial banks must be held in separate subsidiaries, and commercial banks still cannot hold shares of corporate stock on their books.

Gramm-Leach-Bliley is widely blamed for the banking crisis of 2008–2009. But before the crisis, several of the largest investment banks had remained stand-alone institutions, and it was only after the crisis that they all acquired commercial banks, as allowed by the law. It is not clear that those which had taken advantage of Gramm-Leach-Bliley were any more to blame than those that hadn't.

The Commodity Futures Modernization Act of 2000 was a classic example of regulatory catch-up. Sophisticated derivative securities called credit default swaps (CDS) had arisen in the markets. A CDS insures the holder of a debt security against default. Risk is thereby transferred from a risk-averse party to a risk-tolerant party at a price agreeable to both. CDS purchasers need not actually hold the reference instrument, in which case they are speculating. Though not entirely new, these derivative securities had

exploded in volume as part of a trend toward more sophisticated instruments.

Regulators were at odds as to whether a CDS is a security subject to regulation by the Securities and Exchange Commission or a futures contract subject to regulation by the Commodity Futures Trading Commission. A turf war broke out. Neither side won, and credit default swaps went largely unregulated. But the presumption that regulation would have prevented problems with CDSs is dubious if one thinks, for example, of the failure of the SEC to catch Bernie Madoff even though a whistle-blower tried for years to get it to pay attention.

### Reserve Obligations

The Financial Services Regulatory Relief Act of 2006 was concerned with bank reserves. These are the funds banks keep to back up their deposit obligations; they consist of so-called "vault cash" plus their reserve account at the Fed. At present banks must hold reserves amounting to approximately 10 percent of their demand deposit obligations. Although analogous to the stash you and I might keep for personal emergencies, banks cannot draw their reserves down below 10 percent, come hell or high water.

However, elimination of the 10 percent requirement would be a nonevent in today's environment, given that most banks now choose to hold reserves substantially in excess of 10 percent. At any rate, the requirement can't be dropped before 2012, and (in case anyone was wondering) there is no way that anticipation of its elimination had anything to do with the financial crisis. Under the act, payment of interest on reserves was originally scheduled to begin in 2011 but was moved up to 2008, as part of the TARP bailout. The original intent of this provision was to provide Fed money managers with an additional tool to shepherd short-term interest rates, but something quite different has happened instead: Payment of interest gave banks a new incentive to hold excess reserves. This incentive is at least partly

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Restrictions on interstate banking were a major contributor to the 9,000 bank failures of the Depression.

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responsible for an explosion of excess reserves, from about \$2 billion to over \$1,000 billion in the last two years.

This brief summary of recent regulatory changes has given only a hint of the bewildering array of laws, regulations, and agencies that deal with banking. Commercial banks are regulated by the Federal Reserve System, the Federal Deposit Insurance Corporation, the Comptroller of the Currency, and the Office of Thrift Supervision (OTS). The National Credit Union Administration is a parallel agency for credit unions, and there are also state banking regulators. Competition and rivalry among these agencies may be a good thing if you like the prospect that their squabbling makes them less effective. But the competition got a little crazy, culminating in the great chainsaw incident of 2003.

OTS had gotten oversight of S&Ls. Director James Gilleran marketed his agency as a champion of innovations such as option adjustable-rate mortgages, later to be the downfall of so many unqualified borrowers. “Our goal is to allow thrifts to operate with a wide breadth of freedom from regulatory intrusion,” he said in a 2004 speech.

### The Chainsaw Incident

In the summer of 2003 leaders of the four federal agencies that oversaw the banking industry gathered to highlight the Bush administration’s commitment to reducing regulation. They posed for photographers behind a stack of papers wrapped in red tape. One held garden shears and another a bolt cutter, but Gilleran topped them all with a chainsaw! One of Gilleran’s biggest catches was the infamous Countrywide Mortgage, which chose to place itself under OTS regulation in 2007 and proceeded to generate huge volumes of unsustainable mortgages.

Is this an indictment of deregulation? It might better be called “regulatory deregulation,” which is different from genuine deregulation. When banks or any other

businesses are highly regulated, their customers stop worrying about their business practices, assuming the regulators have things in hand. If regulators then begin to promote risky behavior while the public continues to believe they are enforcing prudence, problems invariably arise. Such problems would be much less likely if market discipline displaced regulation entirely—that is, scrutiny by stockholders, bondholders, customers, auditors, independent rating agencies, and of course laws punishing fraud and theft.

### Overwhelmingly Beneficial

The record outlined above shows that the deregulatory actions of the last 39 years have been overwhelmingly successful. We must look elsewhere for the causes of the 2008–2009 crisis: government encouragement of risky mortgage lending, low interest rates engineered by the Fed, and to some degree one of the bank regulations that was never lifted. This was the Community Reinvestment Act (CRA) of 1977. This law forced banks to stop “discriminating” against borrowers who lived in low-income areas. In practice this meant diverting some funds away from creditworthy borrowers toward high-risk borrowers. The CRA

clearly contributed to the deterioration of credit quality in mortgage lending, but no constituency was strong enough to buck the egalitarian tide and get CRA repealed.

The Dodd-Frank financial “reform” bill is now law. It requires bureaucracies to generate about 67 studies and 243 new regulations, so it’s difficult to say at this point how the new act will play out. Dodd-Frank restricts banks’ “proprietary trading” activities—a concept to be delineated by regulators and, no doubt, artfully skirted by clever bankers. The most important deregulatory reform—allowing nationwide branching—is left intact. Perhaps the act’s full effects will become apparent only when the next financial crisis hits.

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Deregulation cannot be blamed for the 2008–2009 crisis. As for the Dodd-Frank “reform” law, its full effects might not become clear until the next crisis.

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# The Most Elusive Proposition

BY MANUEL F. AYAU

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Most explanations of the division of labor are actually explanations of increased productivity due to specialization. The most common example is Adam Smith's pin factory in *The Wealth of Nations*, where each worker becomes better at his job because that's all he has to concentrate on.

But the increase in wealth from the division of labor *per se* has to be explained on its own merits—that is, assuming no increase in individual productivity. What has to be explained is how the division of labor itself increases collective, not individual, productivity—be it of hunter-gatherers or an industrial society. Also needing explanation is how the division of labor came about spontaneously and flourished without a prior coherent explanation, and what mechanisms inform and induce people toward optimizing their well-being through the division of labor in the family, the group, the city, and the world. (Spontaneous generation and belated understanding are common to many other economic phenomena that, like money, have not until lately been explained by economists even though they have gone on for millennia.)

A frequently repeated explanation of the division of labor is Smith's statement of the "natural propensity to truck, barter, and exchange." Arguably, the human propensity is just the opposite: that people would prefer to be independent and self-sufficient, and that they trade because they perceive that they will be better off. They subjectively value what they receive more than what they give up. Thus people accept the disadvantage

of becoming more dependent on others as a tradeoff for being better off. If people thought they would be worse off by trucking, bartering, and exchanging, we would not detect any such propensity. In other words, it is correctly perceived self-interest that drives exchange.

The explanation of the division of labor that refers to *comparative cost* has been used in mainstream economic texts almost exclusively to explain international trade. But international trade is only a special case of

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What has to be explained is how the division of labor itself increases collective, not individual, productivity.

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this principle, which explains many things, including the emergence of society itself. Because of its many neglected implications, the law of comparative cost is a principle that deserves more attention, especially in the economics texts—for, after all, the essence of the rest of the textbooks is no more than an elaboration of how this division of labor is spontaneously coordinated by market prices, money, and so on. It is unfortunate that in the

overwhelming majority of textbooks, the division of labor is largely taken for granted. So, unsurprisingly, it is a rare student who can explain how people gain by exchange, without recourse to the increased productivity of specialization.

Some explanations of trade rely on the fact that people differ in their subjective valuations and so when they trade, they relinquish something they value less than what they get in return. True enough. But in this

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*Manuel Ayau, who died in August at age 84, was Guatemala's leading classical liberal scholar and intellectual entrepreneur, founder of Francisco Marroquín University, a former FEE trustee, and a Freeman contributor. This is reprinted from the October 2004 Freeman.*

explanation, the amount of physical output does not increase; it only changes hands. We are not told how the division of labor itself increases real, valued output without an increase in individual productivity. So let's give it a try with simple numbers.

Assume two parties in the worst case: one participant is less productive than the other in everything. This assumption is necessary to explain why the more productive party cooperates with the less productive party. (As will become clear, the sole exception would be the case in which the former is equally better endowed in every task.)

Peter and Paul require only bread (B) and garments (G). Peter makes bread twice as fast and garments three times as fast as Paul. Note that Peter's superiority over Paul is greater in making garments than it is in making bread. That is what is meant by comparative (as opposed to absolute) advantage.

Let's now see what their respective cost differences for the two products lead them to do. In looking at the results, we assume that their productivity does not increase as a result of the division of labor, or specialization. We will indicate the productivity of each according to how many loaves of bread and how many garments they can make in 24 hours. (As Mises wrote: "The theorem of comparative cost . . . does not deal with value or with prices. . . . [W]e can content ourselves with comparing only physical input and physical output.")

**Production Without Division of Labor**

Peter		Paul	
12 hrs	12 hrs	12hrs	12 hrs
12 bread	6 garments	6 bread	2 garments

**TOTAL PRODUCTION: 18B + 8G**

Note that their rates of substitution (or opportunity cost) are different: for Peter, one garment equals two loaves of bread; that is, in the time it takes him to make one garment he can make two loaves, or the opportunity cost of one garment is two loaves. By the same standard, Paul forgoes three loaves for every garment he makes. That difference in opportunity costs represents a potential for gains from trade for each party.

Now let's look at the results of Peter and Paul's cooperation.

**PRODUCTION WITH DIVISION OF LABOR**

Peter		Paul	
8 hrs	12 hrs	24 hrs	0 hrs
8 bread	8 garments	12 bread	0 garments

**TOTAL PRODUCTION: 20B + 8G**

Not bad: Production under a division of labor increased by two loaves of bread, without changing individual productivity or total time. The only change was in the way they allocated their time according to comparative advantage. Peter now has more garments than before and Paul has more bread, leaving them opportunities for exchange. Paul can now trade five of his loaves for two of Peter's garments, leaving them each with the same number of garments as *before* they divided the labor, but with an *additional loaf of bread*—for the same amount of effort. Thus each is better off than before.

We can also look at this picture in terms of time gained. To Peter, the extra loaf of bread represents one hour—the time it would have taken him to bake it. To Paul, the loaf represents two hours. They can now put that time toward purposes they had to forgo previously. And if we express the time gained in terms of garments, Peter will have gained one-half G and Paul one-third G. Notice that the respective gains change according to how we measure them: if we measure them with bread, the gain is equal. If we measure them in hours, Paul gains more, and if we measure them in garments, Peter gains more. Is there an "objective" measure of gain?

Obviously, trade does not come about because people go through this exercise. But they intuitively do what goes by the name of cost/benefit analysis, for they are quite conscious of what they must forgo to acquire whatever they get in exchange. In our example, with the same expenditure of time and without increasing individual productivity, the productivity of the combined effort increases the wealth of the group, creating the opportunity for exchange with mutual gain.

The coordinating mechanism is, of course, the relative prices of things with which demand and supply are expressed, the study of which is called *price theory*. With prices, it is easy for someone to do a cost/benefit analysis, to figure whether it is worthwhile for him or her to make or to save a buck. No woman would buy a skirt if she could make it with less effort than it takes to earn the necessary money. And no woman would make a skirt if she could obtain it with less work making something else and trading for the skirt (unless she values skirt-making for its own sake—say, as a hobby).

The law of comparative cost may be best illustrated by the secretary who intercepts her boss on his way to the copy machine and suggests that she make the copies. When he informs her that he knows how to make copies better than she does, she replies, “Yes, but you earn more than I do, so your opportunity cost is higher.”

Among the important implications of the law of comparative cost is that the “wealth gap” in a market economy, the concern of so many people and such international organizations as the World Bank, does not mean that the rich are responsible for poverty. In the market one can make a fortune only by trading with and by enriching others. This realization torpedoes the claim to the moral high ground of the wealth redistributionists.

Finally, comparative cost also helps us understand other “mysteries,” such as how all social and even professional activities and resources, including land—however slowly—tend to be allocated by the market process (the invisible hand) in a socially optimum manner. These and other insights have important implications for tax, social, and economic policies that, given due consideration, would avoid many undesirable and unintended consequences. **FEE**

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## Memo to Alan Greenspan: Keep Quiet

BY JOHN STOSSEL



I'm getting tired of Alan Greenspan. First, the former Federal Reserve chairman blamed an allegedly unregulated free market for the housing and financial debacle. Now he favors repealing the Bush-era tax cuts.

This has a certain sad irony. Recall that Greenspan once was an associate of Ayn Rand, the philosophical novelist who provided a moral defense of the free market, or as she put it, the separation of state and economy. Greenspan even contributed three essays to Rand's book *Capitalism: The Unknown Ideal*—one for the gold standard, one against antitrust laws, and one against government consumer protection.

It was slightly bizarre when Greenspan accepted President Reagan's appointment to run the Fed—maybe he thought that as long as the Fed exists, better someone like him run it rather than one who really believes government should centrally plan money and banking. Be that as it may, Greenspan went on to pursue an easy-money policy in the early 2000s that is widely credited, along with the government's easy-mortgage policy, for the boom and bust that followed.

During a congressional hearing two years ago, Greenspan shocked me by blaming the free market—not Fed and housing policies—for the financial collapse. As the *New York Times* gleefully reported, “[A] humbled Mr. Greenspan admitted that he had put too much faith in the self-correcting power of free markets.”

He said he favored regulation of big banks, as if the banking industry weren't already a heavily regulated cartel run for the benefit of bankers. Bush-era deregulation is a myth perpetrated by those who would have government control the economy.

But now Greenspan, going beyond what even President Obama favors, calls on Congress to let the 2001 and 2003 Bush tax cuts expire—not just for upper-

income people but for everyone. “I'm in favor of tax cuts, but not with borrowed money. Our choices right now are not between good and better; they're between bad and worse. The problem we now face is the most extraordinary financial crisis that I have ever seen or read about,” he told the *Times*.

He says he supported the 2001 cuts because of pending budget surpluses, but now that huge deficits loom, new revenues are needed.

Why? Brian Riedl of the Heritage Foundation says that since the cuts, “The rich are now shouldering even more of the income tax burden.” The deficit has grown not because we are undertaxed but because govern-

ment overspends. “Tax revenues are above the historical average, even after the tax cuts,” Riedl writes.

Given the stagnant economy, this is the worst possible time for tax increases. (Is there ever a good time?) Taking money out of the economy will stifle investment and recovery,

and it's unlikely to raise substantial revenue, even if that were a good thing.

Finally, the stupidest thing said about tax cuts is the often-repeated claim that “they ought to be paid for.” How absurd! Tax cuts merely let people keep money they rightfully own. It's government programs, not tax cuts, that must be paid for. The tax-hungry politicians' demand that cuts be “paid for” implies the federal budget isn't \$3 trillion, but \$15 trillion—the whole GDP—with anything mercifully left in our pockets being some form of government spending. How monstrous!

If cutting taxes leaves less money for government programs, the answer is simple: Ax the programs! **FEE**

*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.*

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Tax cuts merely let people keep money they rightfully own.

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# Book Reviews

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## **Classical Liberalism in the 21st Century: Essays in Honour of Norman P. Barry**

*edited by Michael James*

University of Buckingham Press • 2009 • 250 pages • \$35.95

Reviewed by George Leef



Longtime readers of *The Freeman* may have noticed the absence of articles by Norman Barry. A contributing editor, Barry died in October 2008, at the age of 64. (His last *Freeman* article, “The Americanization of Japan,” was published in May 2007; [www.tinyurl.com/kpg2h3](http://www.tinyurl.com/kpg2h3)).

This splendid volume, which had been in the works before Barry’s death, contains one essay by him and 11 others by scholars who knew him and appreciated his work. Their writings all deal with topics that were of great interest to Barry.

Taken as a whole, the book amounts to a wonderful coda to Barry’s intellectual symphony: his demonstration that a free society with a minimal, “night watchman” State is vastly preferable to all of the megastate alternatives. In contrast with many modern academics who settle into a narrow subfield and exhaust its every nook and cranny, Barry worked on a large number of issues regarding classical liberalism. The essays in the book similarly address an array of related topics, each making important contributions. Alas, in a short review there isn’t enough space to discuss them all.

One of Barry’s foremost concerns was the inevitable tendency for the State, whenever empowered to “solve” perceived social problems, to expand and crowd out voluntary action. Professor Martin Ricketts drives that point home, writing, “In the place of charities, churches, trade unions, clubs, mutual cooperatives, families, friendly societies, public companies, private companies, partnerships and a host of variants structured by individuals to meet local circumstances, state action

imposes regulatory conformity. This is capable of making financial systems less stable, the environment less protected and social capital more vulnerable to erosion as life ebbs away from the very spontaneous institutions that nurtured it.” That is to say, there is an opportunity cost to State action.

Barry tried to combat the childish notion that our choices are between government control and doing nothing. In recent years that false dilemma has most clearly been illustrated by the debate over environmental policy. The book contains two essays presenting classical-liberal stances on environmental protection.

First, Colin Robinson argues that it’s a mistake to adopt an “atheistic” position in the face of the questionable science cited by climate-change alarmists (flatly denying there is any climate problem); rather we should instead be “agnostics” who argue that even if there is such a problem, relying on State coercion to deal with it will turn out badly. Robinson observes, “Such actions, by governments or international organizations, concentrate on consensus views (which have frequently been wrong in the past) creating informational monopolies and suppressing dissenting opinions. It suffers from the same problems as does the now discredited central planning.” He presents a strong case that we’ll do far better by relying on market institutions rather than government mandates and prohibitions.

Julian Morris follows with an essay exploring common-law remedies for environmental degradation. He suggests that organizations dedicated to environmental problems should rethink their overwhelming reliance on lobbying and legislation, pointing to the success of groups like the Anglers’ Conservation Association.

Another essay I find particularly appealing is Elaine Sternberg’s on the topic of business ethics and corporate social responsibility. She argues that those notions are subversive because they “undermine the negative freedom that is intrinsic to classical liberalism and to ethical conduct.” For years we have been hearing the claim that businesses have “social obligations” and must consider the well-being of all “stakeholders,” but Sternberg sees such demands as a way of browbeating business executives into substituting other people’s goals for what ought to be their focus, namely efficiency and profit maximization.

I also strongly recommend Terence Kealey's essay, "Science Is Not a Public Good." Kealey offers a bracing, iconoclastic argument against the prevalent notion that basic science is a "public good" that would be underproduced without government funding. Contrary to popular belief, it does pay for companies to invest in basic science because doing so helps them learn from others who are doing research and capitalize on it through "second-mover" advantages. When government steps in, scientific research is not increased or enhanced. On the contrary, political funding diverts resources into research that pleases politicians and their supporters.

Another *Freeman* contributor, Stephen Davies, has an essay on Barry's contributions to modern classical-liberal thought. Davies covers the four main areas Barry concentrated on (constitutionalism, business ethics, welfarism and communitarianism, and spontaneous order) and finishes with the observation that, despite the appearance that classical liberalism gained ground during the 1980s and 1990s, Barry was pessimistic. Communism and central planning may have been discredited, but statist welfare thinking continued to dominate political discussions.

This excellent book is a fitting tribute.

**FEE**

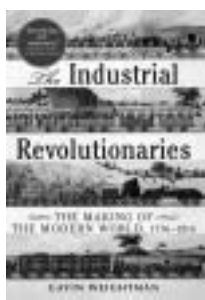
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### **The Industrial Revolutionaries: The Making of the Modern World, 1776–1914**

by Gavin Weightman

Grove/Atlantic Books • 2009/10 • 432 pages • \$27.50  
hardcover; \$16.95 paperback

Reviewed by David K. Levine



For anyone interested in technology, the Industrial Revolution, or technical progress more broadly, this is a wonderful book. When I compare how people lived, say, in 1809 to how we live today, I am continually stunned by all that has happened. From horse-drawn carriages to iPhones in two centuries. It is hard to be an economist, or perhaps even a human being, without an intense curiosity about how all this came about.

*The Industrial Revolutionaries* doesn't answer that fundamental puzzle, but it puts a lot of interesting pieces on the table. It is marvelous reading as well. This is not a dry account of innovation and technological progress, but a living, breathing history of the people who made that progress happen. Some of them (for example, Samuel Morse) you will have heard of before—although perhaps not quite in the light portrayed in this book. Others are scarcely household names.

For me much of the mystery isn't so much in how innovation takes place, but in how it is adopted, spread, improved, and made to work. That discovery process is the soul of this book.

Many of the protagonists of this story believed that their ideas might be stolen, sometimes taking elaborate measures to preserve their secrets and obtaining patents. It is hard to read this book and conclude that this is anything but a mistake. Technology is difficult to transfer. Those who succeeded the best are those who helped the world learn of their ideas and took advantage of others to improve their ideas and make them practical. Little progress has ever been made by putting ideas under lock and key, whether in the form of patents or trade secrecy.

Let me quote Weightman, discussing the Arkwright water frames. "If you glance at a diagram of the first of Arkwright's water frames, it is immediately apparent that copying it would be no easy task. . . . [T]here was no substitute for finding someone who had spent time in the Mill." Hard practical knowledge—that's what innovation is all about—is not so easily stolen.

Most of the book discusses the less well-known inventions that were every bit as integral a part of the Industrial Revolution as the steam engine. Weightman is careful to explain just how essential these "lesser" (but in fact merely less well-known) inventions were. The entire Industrial Revolution centered not on an idea or invention or two, but on interlocking sets of inventions and ideas. Take the improved iron produced first by Wilkinson. Did you know that railroad tracks in the United States were originally made of wood? You can imagine the success of railroads that ran on rotted and broken wooden tracks. Yet until the demand for transportation increased and the Wilkinson methods were

successfully recreated in the United States, we lagged behind England in railroads.

How did England get such an edge on France in the Industrial Revolution? I can't say that Weightman has entirely solved that puzzle, but he convinces me that the French Revolution played an enormous role. Just as the United States leapfrogged past Germany when Hitler drove out his scientists, so England and the rest of the world advanced past France when France executed or drove into exile its innovators. The tale of French innovators during the revolution is fascinating, and it's good for the rest of us that many managed to escape.

Speaking of unsung heroes, how about the English "navvies," the all-around workmen who built everything from railroads to tunnels? You wouldn't think that "unskilled" labor was so important, but having workmen with basic technical skills and a decent diet made all the difference—so much so that to build railroads in France, the English used their own workmen.

The book is full of speculators, revolutionaries, and heroes. How did Japan catch up to Western Europe, going from medieval technology to the modern era in mere decades? Read the story of the Choshu samurai who remade their country. Or in the other direction, read the pathetic story of Samuel Morse, a man far more interested in taking credit for other people's work than in advancing the cutting edge of technology. Do you know of Justis Liebig, the pioneer of organic chemistry, and the role organic chemistry played in the late stages of the Industrial Revolution? I did not. The book is full of romance as well. I wouldn't have imagined that the invention of the torpedo was directly responsible for *The Sound of Music*. Not the movie—the real life story the movie was based on.

Innovation, for whatever else it may be, is *fun*. Weightman manages to convey this while laying out a wealth of information about how it really takes place. [EE]

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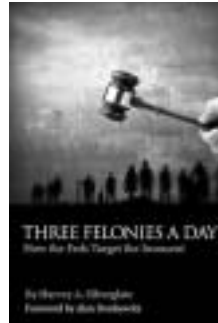
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### Three Felonies a Day: How the Feds Target the Innocent

by Harvey A. Silverglate

Encounter Books • 2009 • 323 pages • \$25.95

Reviewed by William L. Anderson



In the fall of 1989 the communist regimes of Eastern Europe collapsed, and two years later the Soviet Union itself was no more, replaced by Russia and a number of newly independent nations. Communism and its accompanying show trials, gulags, and politically oriented prosecutions, along with the faux legal system that undergirded it, supposedly disappeared.

Perhaps the most chilling quote of the Soviet era came from Lavrentiy Beria, Stalin's head of the secret police, who bragged, "Show me the man, and I will find you the crime." Surely, that never could be the case in America; we're committed to the rule of law and have the fairest justice system in the world.

Civil libertarian attorney Harvey Silverglate begs to differ, and his newest book, *Three Felonies a Day: How the Feds Target the Innocent*, is a frightening reminder that the federal "justice" system in this country seems to have picked up where the Soviets left off. We suffer from a combination of vague, expansive laws, the drug war, and prosecutors who are ruthless, relentless, and who face no consequences for their own lawbreaking. That has turned federal criminal law into a conviction machine, sweeping up the innocent along with the guilty.

The very expansiveness of federal law turns nearly everyone into lawbreakers. Like the poor Soviet citizen who, on average, broke about three laws a day, a typical American will unwittingly break federal law several times daily. Many go to prison for things that historically never have been seen as criminal.

Writing about the Kafkaesque nature of the federal system, Silverglate notes:

Prosecutors are able to structure plea bargains in ways that make it nearly impossible for normal,

rational, self-interest calculating people to risk going to trial. The pressure on innocent defendants to plead guilty and “cooperate” by testifying against others in exchange for a reduced sentence is enormous—so enormous that such cooperating witnesses often fail to tell the truth, saying, instead, what prosecutors want to hear.

This should make everyone fearful. Silverglate declares that federal prosecutors don’t care about guilt or innocence. Instead, many subscribe to a “win at all costs” mentality, and there is little to stop them.

Silverglate is hardly alone in making that accusation. In 1998 Bill Moushey wrote a devastating ten-part series for the *Pittsburgh Post-Gazette*, “Win at all Costs.” Moushey described the caldron of lies that FBI investigators, prosecutors, and other federal officials regularly tell. Even when it was clear they had no case, prosecutors often soldiered on just to inflict financial punishment on people they targeted.

Paul Craig Roberts and Lawrence W. Stratton recently published a second edition of their book, *The Tyranny of Good Intentions*, which documented just how bad the federal “justice” system has become. Other writers, including well-known Houston attorney Tom Kirkendall, and a number of people associated with the Cato Institute have joined the growing chorus of critics.

Silverglate’s book first explains how law *should* work, and then demonstrates how federal law *really* works as he weaves through dozens of cases showing clear prosecutorial abuse. An ugly, recurrent feature is that prosecutors often manipulate the media. People are prone to believe what officials say about defendants in high-profile cases. Many believed at first that the Duke lacrosse players were guilty of rape, only to find out the entire episode was a hoax concocted by a lying prostitute and a local prosecutor desperate to win an election.

The book recounts a disturbing number of cases documenting how investigators and prosecutors decide on a target, then find a crime to pin on him. For example, Silverglate points out that Michael Milken pleaded guilty to “crimes” that the Supreme Court a few years later would rule were not crimes at all. One of the federal prosecutors in Milken’s case bragged to a group of

Rutgers University law students that the prosecutors, led by Rudolph Giuliani, “were guilty of criminalizing technical offenses. . . . Many of the prosecution theories we used were novel. Many of the statutes that we charged under . . . hadn’t been charged as crimes before. . . . We’re looking to find the next areas of conduct that meets any sort of statutory definition of what criminal conduct is.”

It is not stretching the imagination to say that Beria himself would have been proud of the tactics these prosecutors used to get Milken.

*Three Felonies a Day* is a book worth reading. It challenges the honest “law and order” types who reflexively defend our system of “law enforcement.” It also provides intellectual ammunition to those who argue that the federal government is badly out of control. Indeed, for a country that supposedly prides itself on the rule of law, the idea of channeling the former Soviet Union is both outrageous and tragic. FEE

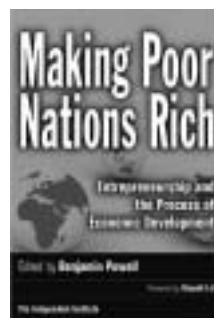
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### **Making Poor Nations Rich: Entrepreneurship and the Process of Economic Development**

*edited by Benjamin Powell*

Stanford University Press • 2008 • 480 pages • \$29.95

Reviewed by Robert Batemarco



During the 2008 presidential campaign, a critic of then-candidate Barack Obama stated in a letter to the *Wall Street Journal*, “If he becomes president, I hope he hires some economists who understand why Great Britain, China, Hong Kong and South Korea all prospered when they let private industry rather than government allocate their country’s resources.” Benjamin Powell of the Independent Institute has edited a volume that will amply provide Obama’s economists with that understanding. *Making Poor Nations Rich* tightly weaves theory and history together into a compelling case that if a country is to generate and sustain strong economic growth, it must

have institutions that channel entrepreneurship into productive activities.

Powell opens with four theoretical essays whose common theme is that “the engine of economic growth is not better inputs, but rather an environment in which entrepreneurial activities can be capitalized upon.” That environment is shown to determine whether entrepreneurship gets channeled into uses that make capital more productive, generating prosperity for all, or into such activities as conquest and obtaining sinecures in the bureaucracy, permitting a few to live high at the expense of the many.

A seemingly counterintuitive observation from the last essay in this section is that “those countries with the highest economic freedom . . . have a rate of business failure that is almost twice as high as countries with the lowest economic freedom. . . .” This reminder that capitalism is a profit and *loss* system, in which the losses play an indispensable role, cannot be emphasized enough to those who have elevated the bailout to the chief economic policy tool.

The next four chapters are devoted to countries that failed to grow because they failed to establish institutions that foster productive entrepreneurship. The wide variety of cultures and circumstances covered in this section adds to the robustness of the findings.

George Ayittey’s discussion of how country after country in Africa opted to throw out the capitalist baby with the colonialist bathwater on independence is a sobering example of libertarian class theory in action. He minces no words, characterizing most African countries as ruled by “unrepentant gangsters.” His essay is replete with details of specific poverty-inducing policies, supporting his contention that most African states direct entrepreneurship into destructive paths. As he pithily summarizes, “Because politics constitutes the gateway to fabulous wealth in Africa, the competition for political power has always been ferocious.” No wonder negative growth is the rule in those countries.

Essays on Latin America and Romania show some of the difficulties of overcoming colonial and communist legacies, respectively. The Latin American essay recounts numerous false starts on the road from parasitic to constructive entrepreneurship. Whether it

was land reform programs or the neoliberal privatizations of the 1980s and 1990s, the result was the continued fleecing of the weak by the strong, with free markets wrongly getting the blame. The Romanian case shows the harm to entrepreneurship of a radically uncertain regulatory environment based on executive decrees.

This section ends with Sweden, long lionized by American “liberals” for its advanced welfare state. Here we learn how the high taxes, heavy labor-market regulation, and opulent safety net that comprise that welfare state have smothered entrepreneurship. While Sweden could live off its previously accumulated capital for a while, it eventually was beset by a host of predictable problems. The silver lining in Sweden’s case is that when these problems reached crisis level, some of the most counterproductive policies were jettisoned.

The success stories covered in the last part of the book also avoided adopting market-driven reforms until their hands were forced by necessity. Certainly ideology played little role in Ireland, where the same politician whose policies caused the problems (downgraded debt that could not be monetized and abysmal economic growth) conceded to reality and reversed course. Elsewhere, it took some changes in personnel. Once that occurred, crises begat reform in New Zealand (lagging growth induced by protectionism and a sclerotic labor market, plus a 1984 currency crisis), India (a 1991 foreign-exchange crisis), Botswana (the third-poorest nation in the world in 1965), and China (over 36 million dead from disastrous economic policies from 1949–1976). These cases contrast with Robert Higgs’s finding that crises in the United States led to permanent movements away from free markets. One possible explanation is that those countries had run out of margin for error. (As I write these words, the United States may soon find itself in that situation.) The essayists who discuss each of these disparate success stories also document some degree of backsliding once the situation was stabilized.

This book is extremely valuable for anyone who wants to know what works and what doesn’t in national economic development. FEE

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## Taking On Unions

BY CHARLES W. BAIRD



In my last column (July/August) I noted that unions seem to be losing respect among the public. It now appears that that loss of respect is translating into an increased willingness by voters, and even some politicians, to challenge unions, especially those that represent government employees. Rahm Emanuel famously opined that “You never let a serious crisis go to waste. And what I mean by that is it’s an opportunity to do things you think you could not do before.” Perhaps now we can take on unions as we could not do before. The current Great Recession and ongoing profligacy at all levels of government have created a crisis out of which may emerge a more rational attitude toward labor unions.

Too many Americans have thought unions are necessary to assure that working people get fair compensation and reasonable working conditions on the job. Now more and more people are becoming aware of the harm unions do. For example, Fox News, CNN, and the broadcast networks have widely publicized a significant and growing compensation gap between the government and private sectors. One who enters “public sector pay vs. private” in the Google search box discovers 35,600,000 references. For example, on March 8 *USA Today* ran a major article titled, “Federal Pay Ahead of Private Industry.” There are similar gaps at the state and local levels.

Government-employee unions (GEUs) are largely responsible for such gaps. While only 7.2 percent of private-sector workers are union members, among state government employees the figure is 32.2 percent, and at the local level it is 43.3 percent. Private-sector unions have to temper their compensation demands because the employers they deal with face vigorous competition

from union-free employers. In contrast, GEUs and the employing agencies with which they deal sit on the same side of the bargaining table. They have a common interest: to pick the pockets of taxpayers, and the taxpayers have no alternative suppliers to whom to turn.

In the Winter 2010 issue of the *Cato Journal*, Chris Edwards ([www.tinyurl.com/25uhvwd](http://www.tinyurl.com/25uhvwd)) showed that in June 2009 total state and local government compensation exceeded private-sector compensation by 45 percent in three broad occupational groups. The gap in wages and salaries was 34 percent, while the gap

in benefits, including pensions, was 70 percent. Adding the 50 states together, total state and local compensation in 2008 was \$1.1 trillion annually. If that is 45 percent higher than it needs to be, bringing state and local compensation in line with the private sector would save more than \$450 billion. By comparison, the sum of all state and local operating deficits in 2010 was \$181 billion.

Similarly, a Heritage Foundation study ([www.tinyurl.com/2en3qcc](http://www.tinyurl.com/2en3qcc)) found that for the same jobs the federal versus private compensation gap was 30–40 percent. Reducing federal compensation to comparable private compensation would save \$47 billion in 2011.

This problem has long been understood by labor economists. The difference now is that these issues are receiving wide attention from the general public—even in left-leaning constituencies. On March 21 Rasmussen reported that 52 percent of California voters thought that the state’s GEUs “place a significant strain on the state’s struggling budget.” Although GEUs get to

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Labor economists have long understood the problems with public-employee compensation. Now the issue is receiving attention from the general public.

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“bargain” in private over taxpayer money, the results of that charade are in plain view. In a time when their own budgets are under severe strain, taxpayers are increasingly outraged over government extravagance and the GEUs that cause it. When Jerry Brown was governor of California in the 1970s he signed legislation that gave California GEUs monopoly bargaining privileges. The 52 percent of California voters who think that those unions are straining the California budget will have a chance to vote against Brown in the November gubernatorial race.

Some other politicians who have long been in thrall to GEUs are having second thoughts. Willie Brown, the former speaker of the California Assembly and former mayor of San Francisco, said in an interview with the *Wall Street Journal* on July 9, “The deal used to be that civil servants were paid less than private sector workers in exchange for an understanding that they had job security for life. But we politicians—pushed by our friends in labor—gradually expanded pay and benefits . . . while keeping the job protections and layering on incredibly generous retirement packages.” He added, “When I was Speaker I was in charge of passing spending. When I became mayor I was in charge of paying for that spending. It was a wake-up call.”

On June 29 the Washington, D.C., city council took on the powerful American Federation of Teachers when it ratified a revolutionary union contract supported by Schools Chancellor Michelle Rhee. The contract includes a voluntary performance-based salary system; weakens tenure rules, thus making it easier to get rid of bad teachers; and specifies that teacher performance will be based on student achievement and evaluations by non-union professionals appointed by Rhee who are permitted to make surprise classroom visits. Such a contract would have been unthinkable anywhere before this year, much less in Washington, hitherto a model of subservience to unions.

Some politicians and voters are also taking on private-sector unions. In early July the Chicago city

council unanimously approved the construction of a giant Walmart store in the Pullman Park area of the city. That park is the hallowed union site of the beginning of the famous Pullman strike of 1894. Moreover, the Council authorized the development of 24 new Walmart stores in the near future. Walmart is union-free and has long been the *bête noir* of the SEIU and the UFCW. Union opposition has excluded and/or restricted Walmart development in many union-friendly jurisdictions such as Chicago. Nevertheless, even Mayor Richard Daley supported the council’s decision against the unions and in favor of the new Walmart jobs and the thousands of shoppers whose access to Walmart will increase.

Meanwhile, back in California, the voters in two San Diego County cities—Chula Vista and Ocean side—banned project labor agreements (PLAs) in any construction project paid for with city money. Moreover, the Coalition for Fair Employment in Construction collected enough signatures to put a PLA ban on the November ballot in the city of San Diego. When a government imposes a PLA every contractor, even those who are

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union-free, must operate according to union work rules and compensation levels. Employees of union-free firms must pay union dues and pay into union retirement funds for as long as they work on a PLA project. A PLA nullifies any competitive advantage that a union-free contractor may have over a union-impaired counterpart. PLAs increase the cost of government projects on which they are imposed by an average of 12–18 percent. In times of government budget crises they are an obeisance to unions that voters cannot afford and against which they are increasingly willing to vote.

These and other examples of taking on unions, such as Blanche Lincoln’s June primary victory over union-supported Bill Halter in Arkansas, give me hope that unions, as we know them in America, will become increasingly irrelevant. **FEE**