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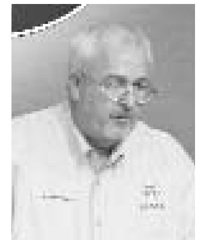

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Perspective

Destroying Value

In Cleveland and other American cities homes are being demolished because five years after the housing bust there is nothing better to do with them. Therein lies a lesson in Austrian business cycle theory.

In a world of uncertainty, waste—the destruction of value—is inevitable. Human action, which aims to replace inferior circumstances with superior circumstances, often involves laboring to transform scarce resources from a less useful form to a more useful form. For example, I transform money earned by my labor into raw beef (by using time and gasoline to drive to the supermarket and engaging in exchange), then I transform the raw beef into a medium-well hamburger through the time-consuming process of cooking. If after I eat the hamburger I wish I had done something else with the money and time (say, bought a chicken), I will regret my course of action and feel I'd wasted both.

We have all devoted time and resources to some project that we later realized was the *wrong* project. That's the price of imperfect knowledge, which plagues all human beings. If we're lucky some of the resources we used might be salvageable and put to other purposes, but the time, effort, and other resources are gone.

The same thing of course occurs in commercial production. An entrepreneur buys inputs and hires labor, thinking the finished product will bring a price that covers costs and yields a competitive return—only to find that people don't want the product, or not badly enough to pay the anticipated price. The loss represents the destruction of value: The value of the inputs *before* the transformation took place turned out to be greater than the value of the finished product.

As I say, this happens because our knowledge is imperfect. It's too bad, but perhaps not a tragedy—just a fact of life we learn to live with and minimize. The tragedy occurs when government intervention distorts price signals and induces people en masse unwittingly to make value-destroying plans. That's part of the story told by the Austrian theory of the business cycle. In the present economic case the Federal Reserve's low-interest-rate policy in the early 2000s and several federal agencies' decade-long easy-housing policies induced builders to produce too many houses relative to what the

demand would have been without those unsustainable policies. The result was the infamous housing boom and inevitable bust. With housing prices apparently on an unstoppable upward trajectory, and government-backed Fannie Mae and Freddie Mac—not to mention too-big-to-be-allowed-to-fail banks—willing to buy lenders' mortgages no matter how shaky, builders and buyers were found in great abundance. Buying more house than one could afford seemed smart when one could get a low teaser rate on an adjustable-rate mortgage for a low-to-no-down-payment home and expect its price to rise significantly in six months. When the higher rate kicked in, one could refinance or sell and walk off with the equity.

But when interest rates rose, the bubble burst, and demand plummeted, this smart scheme turned sour. Houses stood unsold, and many people couldn't pay their mortgages, refinance, or sell at a profit. Foreclosures skyrocketed and the multitude with underwater homes simply disappeared, leaving banks holding a slew of vacant houses that cost money in taxes, code violations, and so on.

As a result, banks now would rather donate the properties to government-created nonprofit land banks and pay for the demolition than hold them and hope for future sales. This is happening in Cleveland, and the *Washington Post* reported that similar programs were being discussed elsewhere.

How does this relate to the waste identified by the Austrian business-cycle theory? To the extent the homes were vacated and allowed to deteriorate because of the process described above, the demolitions represent destruction of value attributable to government. In the absence of the unsustainable bubble-inflating policies, some of those houses wouldn't have been built. In the case of older homes, fewer newly built houses would have competed with them in the real estate market. They would still be occupied and therefore would have been maintained. (There would have been no Great Recession and high unemployment.) Demolition would *not* have been an attractive alternative.

The tragedy is that because of government policy, demolition *is the most attractive* alternative. Think of the resources and labor—now seen to have been squandered—that went into making each house. Imagine what products might have been created instead. It's worse than that: Products always summon complementary products. A housing boom stimulates the production of related shopping centers, office parks, and myriad smaller facilities and products. The resources required to make those things also would have gone elsewhere. Now all those resources, along with much labor and time, are gone because people in government thought they knew how to plan the housing market.

★ ★ ★

Georgia and Alabama have joined Arizona in enacting a tough law directed at undocumented immigrants. As Scott Beaulier, Darrick Luke, and Daniel Smith demonstrate, this is already damaging their economies.

Andrew Morriss has been to Graceland, where he found that the lap of luxury in which its fabulously wealthy late resident lived doesn't look so luxurious today.

Conventional wisdom holds that without the welfare state, the poor would be in dire straits. But what if, as Gary Chartier suggests, government is responsible for the poor's condition in the first place?

If public policy created the housing bubble, the bursting of which has caused so much misery, can it really be a good idea to reinflate the bubble? Richard Fulmer says that according to political logic, the answer is yes.

The more government controls the curriculum, the more inimical schooling becomes to education. Peter McAllister explains.

The eurozone is in trouble, leading Robert Murphy to explore the possibility that it was a colossal mistake in the first place.

Regulation at the national level gets the lion's share of attention from market advocates. But let's not overlook the planning mentality more locally. Sam Staley surveys the taxicab industry.

Here's what our columnists have whipped up: Donald Boudreaux audits the economics textbook writers. Robert Higgs explains why there's so little investment. John Stossel brands government a job destroyer. Charles Baird looks at the latest outrage against free speech. And Tyler Watts, bombarded with claims that we couldn't live without FEMA, responds, "It Just Ain't So!"

Books on libertarianism, the economy, socialism, and the threat to freedom occupy our reviewers.

—*Sheldon Richman*
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Disaster Response Restores Confidence in Government? It Just Ain't So!

BY TYLER WATTS

In a memorable episode of the cult-classic cartoon series "The Tick," the title character is seen in the local café regaling fellow superheroes with his latest adventure, in which he single-handedly stopped an alien plot that would have sucked the earth into a black hole. Skeptical, one of the other heroes responds, "Can you prove any of this?" Hesitating, The Tick simply exclaims, "We're all still here, aren't we?"

In like manner several commentators are singing the praises of the federal government lately, claiming that in the wake of recent natural disasters, federal agencies like the Federal Emergency Management Administration (FEMA) have done a fantastic job.

The *Washington Post*'s Dana Milbank is typical of the pro-government cheerleaders. "Big Government finally got one right," writes Milbank of FEMA's response to Hurricane Irene (tinyurl.com/4yl2f26). Arguing that "the federal government can still do great things," Milbank reckons that FEMA's response to Irene should help restore the public's sagging confidence in government. Yet despite this stellar government performance, wouldn't you know, FEMA faces budget cuts at the behest of those scornful Tea Partiers in Congress. Thus instead of improving the federal government's image in the eyes of citizens, FEMA's newfound brilliance is liable to go unnoticed.

FEMA chief Craig Fugate doing what FEMA does best: giving a press conference.
FEMA

I'll concede that Hurricane Irene was FEMA's best showing ever. (We're all still here, aren't we?) This sudden outbreak of governmental competence notwithstanding, Milbank's appraisal of FEMA as a model of salubrious big government is flawed on economic grounds. Resting his newly buttressed faith in big government on a sample size of n=1, Milbank precludes some highly relevant comparisons. Perhaps FEMA functioned well for once, but should we take this as the new normal for FEMA, or the exception to the rule? And even if we can count on a better FEMA, is federal government-centered emergency response the best we could possibly have?

It's easy to say FEMA was better this time than in its dismal past. The agency's infamous blundering response to Hurricane Katrina (a truly epic category 5 storm) would be comic if it weren't so tragic. Bureaucratic ineptitude led to a hesitant response, as federal officials actually halted emergency supplies and workers coming into New Orleans in the days after the storm. FEMA arguably contributed directly to Katrina's death toll of over 1,800 by blocking or overriding local evacuation efforts. FEMA's top-heavy D.C. bureaucracy was roundly criticized as, well, a disaster.

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In stark contrast, a slew of nonfederal response initiatives, from local government authorities to mega-corporations, brought in all manner of people and supplies quickly and effectively, where they were needed most. As *Freeman* contributor Steven Horwitz has amply documented (tinyurl.com/d4hhxm), companies like Walmart were far more efficient and proactive than the centralized FEMA bureaucracy in getting relief goods to the people in need.

Horwitz and others have noted that incentive structures facing different organizations explain the difference between successful and bungled relief efforts. Those in decentralized competitive situations, such as retailers like Walmart, have the localized knowledge of what goods are needed and where, as well as profit-and-loss incentives motivating them to act on this knowledge. Folks in centralized bureaucracies, on the other hand, naturally lack intricate knowledge of the local details and tend to be motivated by political concerns in distributing the resources they do have.

The divergent results after Katrina are not surprising. While FEMA bureaucrats were halting relief convoys, misdirecting their own supplies, and hosting phony press conferences to placate the media, Walmart, Home Depot, and others were tracking the storm and massing supplies days in advance. They delegated authority to local store managers, some of whom took drastic steps to get their stores open and supplies flowing immediately.

Politicians' knee-jerk response to government failure is, naturally, to increase their own budgets. But with bureaucracies facing such systematically bad incentives, increasing their budgets is not guaranteed to improve results. Nonetheless, Milbank frets about as-yet-unspecified potential cuts to FEMA's budget. To put his worries into perspective let's look at FEMA's spending record over the last few years. In 2005—a year of at least three major hurricane strikes in the United States—FEMA spent around $4.8 billion. By 2010, a year with many hurricanes (but none making landfall in the United States), FEMA's budget had been pumped up to a whopping $10.4 billion, and it was on pace to meet or exceed that number last year.

So FEMA's budget has doubled since Katrina, and only now do we see basic competence, in relatively quiet disaster years? If FEMA faces another really harsh hurricane season—a repeat of 2005—and drops the ball again, does this mean its budget will again need to be doubled, to $20 billion? I can see the dollar signs in the bureaucrats' eyes already. Indeed, as Public Choice economics predicts, and former Obama White House chief of staff Rahm Emmanuel conveniently admitted, big-spending bureaucrats like those in FEMA have strong incentives to "never let a crisis go to waste." They thrive on crises as a primary rationale for larger budgets, even if they played a big hand in making such crises worse to begin with.

So FEMA's budget has doubled since Katrina, and only now do we see basic competence, in relatively quiet disaster years?

In light of this it's not at all surprising that the number of "major disaster" declarations has been rising over time, even in years when nature is relatively calm. FEMA had already declared 78 disasters by the fall of 2011, 30 more than the mega-storm year of 2005. Because disaster declarations are a prerequisite for unlocking federal disaster funds, it's not surprising that FEMA finds ways to define disaster down, or that the number of declarations goes up for election years and in politically sensitive swing states (tinyurl.com/5usys7s).

In reality FEMA's seemingly fantastic response to Irene is likely a product of media hype. The storm had basically fizzled out by the time it hit densely populated areas. Recall that Irene had weakened to a mere tropical storm by the time it reached the Jersey shore, and the main effect on the mid-Atlantic and New England states was torrential rain—not nearly as severe as the massive storm surge and catastrophic flooding from Katrina. Yes, there were power outages and locally severe flooding with Irene, but such are common in the United States. Private businesses and local authorities responded well, as they always do. Milbank offers no compelling reason to believe that a bloated FEMA bureaucracy is essential, or even beneficial, in helping these responses along. FEE

Tough on Immigration Is Tough on Economic Growth

BY SCOTT A. BEAULIER, DARRICK C. LUKE, AND DANIEL J. SMITH

Not to be outdone by Arizona's tough immigration law of 2010, Alabama and Georgia legislators passed their own immigration bills in 2011. The bills received a great deal of media attention because they were widely touted as good for growth and job creation, and were harsher on illegal immigrants than Arizona's law. In a *New York Times* article, for example, Alabama State Rep. Micky Hammon, a coauthor of his state's law, called it "a jobs-creation bill for Americans." Georgia State Rep. Matt Ramsey said after his state's bill passed: "It's a great day for Georgia. We think we have done our job that our constituents asked us to do to address the costs and the social consequences that have been visited upon our state by the federal government's failure to secure our nation's borders."

Georgia's law requires private and government employers to use E-Verify, a federal program, to ensure that workers are eligible to work in the United States. The law also increased the penalties for using fake documents to obtain jobs; offenders now face up to 15 years in prison and $250,000 in fines. Moreover, the law makes it a criminal offense to intentionally transport or harbor illegal immigrants, authorizes local and state law enforcement officials to arrest illegal immigrants and house them in state and federal jails, and requires documentation verifying legal status before people can apply for food stamps or government housing.

Alabama's law goes even further than Georgia's. It not only clamps down on illegal immigration, it also prevents illegal immigrants already in the state from establishing themselves. The law requires public schools to verify students' residency status with birth certificates, bans illegal immigrants from state colleges, and outlaws transporting, harboring, employing, or renting property to undocumented immigrants. The bill also requires law enforcement officers to detain and investigate anyone they reasonably suspect is an illegal.

Opposition to the new laws emerged immediately in both states. In Alabama, churches and charities thought the wording so stringent that they worried about being implicated simply for ministering to illegal immigrants. Episcopal, Methodist, and Catholic church officials in Alabama sued Governor Robert Bentley and Attorney General Luther Strange. The American Civil Liberties Union (ACLU) of Alabama and Georgia, as well as other civil liberties advocacy groups, like the Southern Poverty Law Center, also brought forward lawsuits because the new law will likely result in racial profiling.

> New business paperwork, law enforcement, and incarceration will impose steep costs.

While the specific methods of implementation for Alabama's and Georgia's immigration laws could be altered in the hope of minimizing their social consequences by, for example, randomly checking people for citizenship instead of profiling people who look different or out of place, the negative economic results can-

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not be avoided or minimized unless the laws are ignored. New business paperwork, law enforcement, and incarceration will impose steep costs. All industries will suffer some negative effects, and the fortunes of a number of industries, such as agriculture, restaurants, landscaping, catfish and poultry processing, and construction, will be seriously compromised. Jeffrey Passel estimated in a 2006 study that across the nation, illegal immigrants make up 24 percent of the agricultural workforce, 17 percent of the cleaning industry workforce, 14 percent of the construction workforce, 12 percent of the food preparation workforce, and 9 percent of the production workforce (tinyurl.com/2c37ku).

The effects of the new laws are already being felt throughout the agricultural industry in both states. Illegal immigrants are now so afraid of imprisonment and deportation that they have stopped supplying their labor during harvest seasons. And it's not just illegals who are fleeing the state. Green-card carrying immigrants also quit their jobs in protest and are leaving Alabama.

Wasted Crops

Alabama Live reports that central Alabama farmers requested an emergency suspension of the law because millions of dollars of crops were at risk of not being harvested due to labor shortages (tinyurl.com/7rrf35c). In the *Wall Street Journal*, Alabama Deputy Commissioner for Agriculture and Industry Brett Hall was quoted saying: "We have a big problem on our hands. . . . [F]armers and business people could go under." Economists say the law will hurt Alabama's economy, but politicians such as State Sen. Scott Beason (a Republican) called their arguments "absolutely, positively wrong" (tinyurl.com/7dse64o). He also called the Alabama law "the biggest jobs program for Alabamians that has ever been passed."

Meanwhile Jay Bookman of the *Atlanta Journal-Constitution* reports that Georgia's law has already caused a severe enough labor shortage that farmers are at risk of leaving up to $300 million of crops rotting in their fields (tinyurl.com/3pgzctn).

The construction industry, which has relied on immigrants in recent years, is also being hit hard. Despite the remaining slack from the housing crisis, delays in Alabama and Georgia are common. Nowhere is the story more tragic than in Tuscaloosa, Alabama, where residents and businesses downtown were hit by a tornado last April. Cheap, efficient labor was desperately needed. Yet reconstruction in Tuscaloosa has been slow and has lagged behind Joplin, Missouri, which was hit with a much more severe tornado a month later. While some of the delays in Tuscaloosa can be blamed on red tape, the harsh immigration law certainly has not helped matters.

The economics of the issue remain unambiguous: Immigration, whether legal or illegal, is a net general benefit for the people of a state or country.

Unambiguous Benefits

Despite politicians' ill-informed rhetoric and pro-law rallies by Tea Party groups, the economics of the issue remain unambiguous: Immigration, whether legal or illegal, is a net general benefit for the people of a state or country. The argument is an easy extension of David Ricardo's argument for free trade; blocking immigration hampers the free operation of an economy in much the same way that blocking trade does. It prevents resources, including labor, from being reallocated to those industries and locations where consumers most urgently want them.

The evidence shows that immigration does not take away jobs or even decrease wages for native workers. Julian Simon in a 1995 study found that immigration does not increase unemployment for U.S. citizens, even among minority and low-skilled workers (tinyurl.com/7bpdqkq). George Borjas and Lawrence Katz, in a study published in 2007, found that the only group adversely affected by immigration in the United States was high school dropouts, who saw a long-run 4.8 percent reduction in wages.

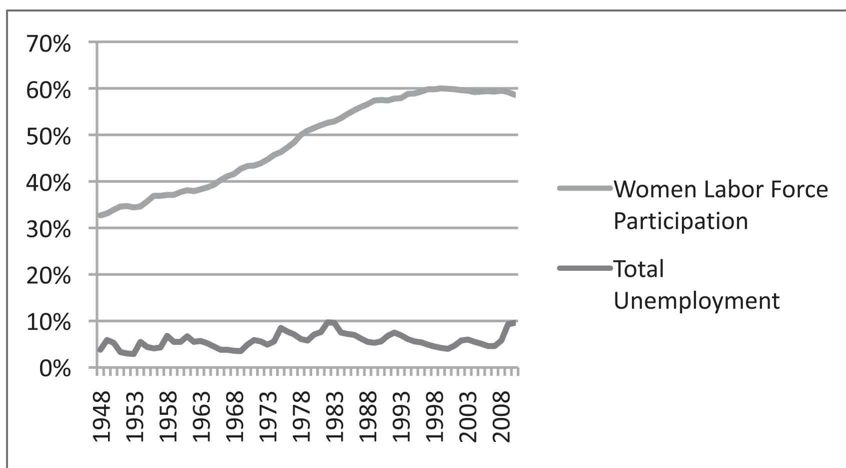
Borjas and Katz assumed that immigrant and native workforces do the same work, an assumption that does not bear out empirically. Even with that assumption,

however, Borjas in 2008 estimated the net economic gain to native workers from immigration to be around $22 billion annually (tinyurl.com/337qkon). When Gianmarco I. P. Ottavanio and Giovanni Peri corrected for this assumption in a 2006 study, they found immigration actually increased natives' wages in the short and long runs because immigrants complement the native workforce (tinyurl.com/ctc37lc).

More Workers, More Prosperity

As coauthor Luke points out from his farm experience, Americans usually don't want the jobs that immigrants are willing to take.

The number of jobs in an economy is unlimited because our wants are unlimited. The more people working, the further down our list of wants we can get. Moreover, the more people working, the more potential customers—and hence business opportunities—we have. Immigrants buy or rent houses, purchase food and goods, and dine at restaurants. This is why the United States did not suffer mass unemployment as our population drastically increased over the last few decades, and why there wasn't a jump in unemployment when women joined the labor force. (See graph.)



Another common argument for the Alabama and Georgia laws is that immigrants will flood U.S. cities beyond capacity in search of higher living standards. If people migrated en masse to those areas with the highest wage rates, one may wonder why all U.S. citizens don't flood Malibu, California. The reason is that real estate values adjust upward to act as a natural brake on migration. In addition, while there is much need for immigrant labor in the United States, workers will come here only as long as the expected wage exceeds their domestic wages plus the costs of relocating. As more immigrants resettle, the relevant wage will drop, decreasing their main incentive for coming in the first place.

The Welfare Argument

A third justification for legal restrictions is to prevent immigrants from living off government programs. Anyone concerned about this should ask why the Alabama, Arizona, and Georgia laws focus almost all enforcement efforts on preventing immigrants from working. Although immigration laws have provided strong incentives for immigrants not to work, Simon's 1995 study calculated that on net they paid more into government programs than they took out.

The justifications for Alabama's and Georgia's laws fail to pass the test of basic economics. Not only do these laws not bode well for the economy, they also tar the civil rights images of two states that historically have suffered poor reputations in that department. In a country founded on open immigration and the basic freedom of human association and commerce, laws of this nature are a travesty. FEE

Going to Graceland

BY ANDREW P. MORRISS

A recent trip to Memphis took me to Elvis Presley's famed home, Graceland. Touring Presley's mansion and its grounds is fascinating for fans of his music, and the Presley estate has done a marvelous job in capturing his music and life. But visiting Graceland mostly interested me as an economist. Walking through the home of a very rich American man from the early 1970s, I was struck by how much the quality of life for average people now exceeds what was available only to wealthy Americans 40 years ago. Let's compare Elvis's Graceland with how ordinary Americans live today.

Graceland began life in 1861 as a 500-acre cattle farm on the outskirts of Memphis, originally owned by S. E. Toof, a printer, who named the farm for his daughter Grace. Toof's niece, Ruth Moore, and her husband eventually acquired the portion of the property where the house now sits, as well as surrounding acreage, completing the mansion in 1939.

It was planned as a showcase for their daughter's musical talents, so acoustics were as important as aesthetics. (Their daughter went on to play with the Memphis Symphony Orchestra.) A 1940 article in the *Memphis Commercial Appeal* raved about the house's "subtle beauty" and the architectural details, including the white marble in the fireplace. Even before Elvis acquired the property, the house had been recognized as being at the upper end of Memphis society homes.

Being a significant home in Memphis meant something beyond Tennessee. Memphis in the mid-twentieth century was no backwater. It was home to important military facilities, including the Memphis Army Depot, the Millington Naval Air Station, and a World War II prisoner of war camp. The first national motel chain, Holiday Inn, was founded there in 1952. The city was a cultural center as well, home to Stax Records, Sam Phillips's Memphis Recording Service, and the nation's first African-American-format radio station, WDIA. The city had a serious side too: The *Commercial*

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Appeal won a Pulitzer Prize for its 1920s coverage of the Ku Klux Klan.

When the Moores divorced they put the property (now reduced to 13.5 acres) on the market. Memphis realtor Virginia Grant had met Elvis's mother, Gladys, by simply marching up to her pink Cadillac and rapping on the window when Grant spotted it outside a department store. Elvis's fame was beginning to cause problems for the neighbors of the Presley house on Audubon Drive. Near-riots at his concerts and other appearances were worrisome. At the famous Gator Bowl "riot" in Jacksonville, Florida, in 1955, hundreds of screaming girls chased Elvis into his dressing room and tore his clothes. They also scratched messages on his car and wrote on it in lipstick. In 1957 the Presleys were looking for a more private and secure location. (Besides the deluge of fan mail to Elvis, his parents were getting over 500 letters a week accusing them of fostering juvenile delinquency.) Although Grant initially thought the Presleys wanted a farm, she recommended Graceland when she learned they just wanted a house on a large lot.

By the end of a day of shopping the Presleys had made an offer on Graceland, closing on the deal for $102,500—about $800,000 in today's dollars. (Gladys died a year later.) At the time of purchase the house was 10,266 square feet; by Elvis's death it had expanded to more than 17,000 square feet. Elvis redecorated and remodeled it extensively, adding features for himself (a swimming pool and a custom eight-foot square bed) and his parents (a chicken coop for his mother).

Presley lived at Graceland until his death there in 1977. Until 1981 the family continued to live in the house, although the neighborhood deteriorated as scores of souvenir shops opened to sell memorabilia, including vials allegedly of Elvis's sweat, to the tourists who came to see the home from the road. In 1981 Elvis's ex-wife, Priscilla (who became one of the executors of Elvis's estate after his father, Vernon, passed away in 1979), hired a consultant to explore opening the house to the public as a way of generating the income necessary to maintain it. (Upkeep and taxes cost more than half a million dollars per year in the late 1970s.) After studying other famous houses open to the public, Priscilla and her advisers crafted a business plan that included purchasing the strip mall across the street to control the environment and, like San Simeon in California, from which visitors would be bused to the property. Hundreds of thousands of people now visit annually.

Comparing Our Lives to Elvis's

In many respects Elvis Presley's life looks to have been that of a wealthy individual with access to resources most of us lack. His two jets are parked across from Graceland; of course the vast majority of Americans lack any sort of plane. Elvis owned dozens of expensive cars and motorcycles, far more than most Americans are likely to own during their lives. But owning planes and cars is not the only measure of quality of life. If we think about the services Elvis was buying when he purchased his airplanes and cars, many Americans today come closer to living like Elvis than we might think.

> Many Americans today come closer to living like Elvis than we might think.

Today firms such as NetJets make it possible for many more people to have access to travel by private plane. (NetJets offers shares as small as 1/16th, or about 50 hours of flying, according to the company's website). For the rest of us air travel has become more convenient and cheaper since airline deregulation in 1978. One study in 1997 found that even after adjusting for changes in amenities, passengers were saving more than $19 billion per year. Average roundtrip fares have fallen by more than a third in real terms.

Of course even flying business class on a major airline is hardly the same thing as flying on Presley's *Lisa Marie*, a Convair 880 that Elvis bought for $250,000 and spent $600,000 refurbishing, using the same design team that decorated Air Force One. Elvis's plane had a bar, conference room, and bed (with seat belts); our commercial airliners do not. And undoubtedly if Elvis were alive today, he would have upgraded his plane to an even more luxurious model. But in terms of the ability to get from one place to another quickly and

conveniently, today's commercial passenger comes closer to Elvis's lifestyle than most thought possible in 1977. Elvis might still need a private jet today to avoid the fans, but he wouldn't need it to get where he wanted to go or ship off a new recording master to RCA from Memphis, whose airport is a hub for both Delta Airlines and Federal Express.

Cars

Similarly, Elvis's many cars continue to set him apart from noncelebrities. But none of Elvis's cars have a stereo equal to the one in my 2011 Subaru Outback, which synchs automatically with my Bluetooth-enabled iPhone, giving me access to more music in my car than Elvis had even back in the Jungle Room at Graceland. Moreover, my Subaru has tires, an engine, and safety features far better than were available even on Elvis's 1973 Stutz Blackhawk, 1971 Mercedes, or 1975 Dino Ferrari. And Bluetooth isn't the only technology Elvis could not have bought in the 1970s for any amount of money. My car has multiple airbags, a continuous variable transmission, and all-wheel drive.

In terms of the ability to get from one place to another quickly and conveniently, today's commercial passenger comes closer to Elvis's lifestyle than most thought possible in 1977.

Of course, Elvis wouldn't likely be driving something as mundane as an Outback (unless his manager, Col. Tom Parker, had negotiated a contract for him to do so at a hefty fee), but even if Elvis were driving a top-of-the-line Mercedes today, the gap between his car and mine would be much smaller than the gap between his Ferrari and my parents' 1970s Toyota Corolla. In part that is because items like cars have improved in quality, but it is also because improvements in finance have made it possible for ordinary people to have access to them. Elvis would still be able to turn up at a dealer and buy a car without a credit check; the difference is that this past summer I was able to buy my Subaru via the Internet without ever meeting the dealer and without the hours of paperwork and haggling that were a routine part of the car-buying experience as recently as the 1990s.

Everything from the selection of options to the financing was arranged by email, the web, or phone. The dealer had access to financing from investors via asset securitization of its loans; it was able to check my credit in seconds using online services; and I paid the deposit with a credit card over the phone (racking up frequent flier miles since I don't have my own plane). Aside from a test drive, the only time a member of my family set foot on a dealer's lot was when my daughter picked up the car.

Elvis could buy a car with a similar lack of personal effort in the 1970s because he had a staff to do things like wait in line at the bank to get a cashier's check or cash, fill out forms, and negotiate details of the purchase. He was able to get excellent service because he was a celebrity. Today all of us have access to similar levels of service, thanks to entrepreneurs like Sam Walton, whose Sam's Club brokered my Subaru purchase.

Televisions

One of the best-known features of Graceland is Elvis's arrangement of three televisions (there were only three networks) in several rooms. Inspired by Lyndon Johnson's use of three TVs to monitor the three network news broadcasts simultaneously, Elvis had a more sensible reason—so he could watch multiple football games. Here our lives really shine compared to his. In the mid-1960s, console TVs cost over $5,000 in today's dollars. When Elvis was watching football on his three color TVs, my parents had a single black-and-white television, whose screen could not have been larger than 20 inches. My grandmother, who lived with us, splurged and bought herself a 24–inch-screen console color analog television (with a remote control!), around which we gathered on Sunday evening to watch *All in the Family* on CBS.

Today my living room has a 60-inch digital flat-screen TV, capable of much higher resolution than anything Elvis (or my grandmother) owned but which cost considerably less than just one of Elvis's sets. Moreover,

it features technology like a "picture in picture" display that makes it unnecessary to have three side-by-side televisions if I want to monitor more than one program. Elvis had to remodel his bedroom to have two TVs positioned so he could see them from his bed. I streamed video to my iPad while lying in bed the first night after I moved into my current home without having to summon a contractor.

Stereos

Another feature of Graceland is the top-of-the-line stereo presented to Elvis by RCA Records in gratitude for the benefits it reaped from his efforts. My music system sounds better than Elvis's expensive stereo (and can play from the TV as well). Some audiophiles might disagree, since the gold standard for many is still a tube-based amplifier like Elvis had. But not only did I have a choice of sound systems, even an audiophile system would be cheaper, better, and smaller than anything in Graceland. Of course the rich still have better systems, yet the rest of us live better than they did in the 1970s. I tried unsuccessfully to find cost figures for Elvis's system but I have no doubt that the combination of my iPhone, a networked hard drive, and a wireless music system provides me with many times the quantity of music available to even an avid collector like Elvis—with far greater convenience and at a fraction of the cost.

The dramatic improvements in our lives over the last 30 years are the results of individuals—not the government—striving to create their own success.

If we look at the more mundane parts of Graceland, the improvement in our lives is even more striking. Elvis was proud of the chandelier that hung in the foyer; lighting fixtures (aside from government-mandated CFL bulbs) are vastly superior in illumination, efficiency, and variety to what was available to him when he decorated Graceland. In the kitchen sits a massive early microwave oven; these are now compact and virtually disposable. (In 1981 a Sears microwave cost almost $500—over $1,100 in today's dollars—but today it is just $119.) A feature worthy of comment in the original news accounts of Graceland was its marble fireplace. Granite countertops and similar features are now present even in apartments marketed to college students. If we dig into the support systems, the differences are even more dramatic. Home Depot sells furnaces more efficient and quieter than what Elvis had in the 1970s; windows today are dramatically superior in their construction and energy efficiency; and appliances such as washing machines and dryers have options unimaginable to even the wealthiest in the 1970s.

In his classic 1945 *American Economic Review* article, "The Use of Knowledge in Society," F. A. Hayek termed the price system "a marvel" for its ability to improve the quality of life without any central direction. That's just the right word. My family (along with yours) lives a quality of life most of us could hardly imagine in 1957 or 1977. It is a marvel that we have come so far so fast. Contrary to Harvard professor (and Massachusetts senate candidate) Elizabeth Warren's recent claim that we owe a good deal of our success to government, the improvements are the results of innovations by engineers, business people, and others striving to create their own success and to find the resources to achieve their own dreams.

Today most Americans live lives that approach and in some cases exceed the material well-being available only to rich celebrities just 40 years ago. Given how much Elvis Presley loved his fans, I think that's something he would be happy to know. FEE

Some Sins of Textbook Economics

BY DONALD J. BOUDREAUX

People who are ignorant of economics are susceptible to all sorts of misunderstandings. Fortunately knowledge of even just the basics of sound economics is a powerful inoculant against many dangerous falsehoods and half-truths.

This fact, however, does not imply that exposure to more economics is necessarily good. The sad reality is that economists too often present their analyses of markets in ways that confuse not only unsuspecting non-economists but also—and too often—economists themselves.

A frequently encountered instance of this confusion is economists' discussion of competition. What introductory economics textbooks describe as "perfect" (or "pure") competition resembles nothing that occurs in the real world. In the world of the textbooks, firms don't differentiate their products from those of their rivals. Firms never try to win more customers by improving the quality of their products. Also, firms don't advertise. Indeed they don't even cut prices because each "perfectly competitive" firm is a "price taker": It's too small to affect the market price and so can sell as much as it wishes at whatever price prevails in the market.

> What introductory economics textbooks describe as "perfect" competition resembles nothing that occurs in the real world.

These and other problems with the model of "perfect competition" have been pointed out repeatedly, especially by economists steeped in the Austrian tradition—see, for example, Hayek's essay "The Meaning of Competition." Yet the typical economist still clings to the notion that "perfect competition" is perfect competition. This typical economist, it must be admitted, does understand that the conditions necessary for "perfect competition" to prevail in actual markets can never exist. But the model remains the ideal against which real-world markets are judged. The closer real-world markets appear to be to textbook "perfectly competitive" markets, the more competitive real-world markets are assumed to be.

And competition being a good thing, this typical economist presumes that policies advertised as moving real-world markets closer to the "perfectly competitive" ideal are desirable.

Assumed Conclusions

But such a presumption is unwarranted, in part because many of the conclusions of the analysis are snuck into the model's initial assumptions.

Most important among this model's foundational assumptions is that competitive forces play out only in the form of price cuts. Therefore anything that prevents prices from being cut (down to levels that the model specifies as appropriate) is regarded as an obstacle to competition—indeed, as an element of monopoly that prevents the economy from operating more efficiently.

To this day, many mainstream economists describe any firm that can raise, even modestly, the price it charges for its product without driving away all of its customers as possessing some monopoly power.

Note the confusion: A pest-control producer that aims to increase its sales by making a better mousetrap is regarded by this model as behaving monopolistically! Competing for customers by doing something other than simply cutting prices is, according to the model, not competitive.

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You can't make this stuff up.

Another example of how economists commonly confuse themselves (and others) involves the issue of "market failure." That same introductory economics textbook that teaches the model of "perfect competition" explains a few chapters later that markets perform suboptimally whenever some groups of people act in ways that affect other groups of people without the consent of these third parties. The textbook then explains that, happily, economists know how to design taxes or regulations to fix the problem.

Externalities and Assumptions

Such situations—economists call them "externalities"—are indeed bad. If Smith pays Jones to hit me in the head with a hammer without my consent, I—the third party—am unquestionably made worse off. (A simple, and best, solution in *this* case is to give me an enforceable property right in my person: No one can hit me and get away with it without my consent.)

But the stories that economists typically tell of externalities—and of how to "solve" them—too loosely sneak in illegitimate assumptions.

Here's an example: Smith pays Jones for pork chops whose production at Jones's pig farm next door to where I live fills my house with obnoxious odors. The economist leaps to the conclusion that I am wronged. Perhaps I am. But suppose that I bought my house knowing that it was next door to a pig farm. Am I still wronged? No: The price I paid for my house was discounted because of its location within smelling distance of the farm. Not only have I consented to endure swinish odors in my home, I've been compensated for doing so (in the form of a lower price than that of a similar home located in a sweeter-smelling neighborhood).

Or suppose, alternatively, that the pig farm moves into my neighborhood by surprise, after I buy my house. Now am I harmed? The answer is unclear. If the location of my house is such that homebuyers should reasonably expect the possibility that farms might set up shop nearby, then when I bought my house there was an open question about whether or not homeowners have the right to odor-free air in the neighborhood. And because this question cannot be answered by economics alone, it's illegitimate for an economist to conclude that the farm necessarily should be taxed or regulated for the purpose of cleansing the neighborhood air of stinky odors.

> Collective decision-making itself—from citizens voting to politicians spending taxpayers' money—is infected with perhaps the largest and most intractable externalities.

The Largest Externalities

Economists are correct to point out that externalities exist. But economists are far too frivolous in going about labeling this or that effect an "externality"—and, what is even worse, are far too glib in supposing that government can be trusted to "internalize" externalities in ways that improve the allocation of resources rather than making it worse.

Don't forget what too many economists seem never to grasp: Collective decision-making itself—from citizens voting to politicians spending taxpayers' money—is infected with what are perhaps the largest and most intractable externalities. Costs are imposed on third parties constantly.

Economics done properly would highlight the dangers of trying to cure externalities with a process that itself is deeply infected with externalities. Unfortunately economics is too often done improperly. FEE

Government Is No Friend of the Poor

BY GARY CHARTIER

You've heard it all too many times to count, I suspect. Apologists for big government—the *New York Times*'s Paul Krugman and *Washington Post*'s Eugene Robinson being good recent examples—are convinced there's just no good alternative to government social services. Without the government, people will go hungry. They'll die in the streets. We'll lapse back into an era of mass poverty. So anyone who questions the need for the State's antipoverty efforts is heartless, clueless, or both.

I'm not convinced.

To be sure, it's easy to see why an uncritical observer might think people like Krugman and Robinson are right. We can certainly look back on centuries—millennia, even—during which poor people have gotten the short end of the stick, in which poverty has coexisted, heart-breakingly, with great wealth. And perhaps those memories make it tempting for some people to buy the civics-class story that the only thing standing between us and a world full of Dickensian nightmares is activist government.

The U.S. government's holdings and seizures of land are among the systemic causes of poverty.
Sam Felder [flickr]

But that would be a mistake. The poverty and exclusion evident throughout history, and still very much a part of today's world, can frequently be traced precisely to the unjust acts of government officials and their cronies. When people are denied ownership of land they've homesteaded with their labor so feudal overlords can turn them into serfs, the culprit isn't freedom, or the market—it's government support for the wealthy and well-connected. Ditto for cases in which people are denied the right to work by laws, like England's old Acts of Settlement, that limit their ability to travel in search of new opportunities.

More generally: There's no reason to trust activist government because the people in charge can be expected, time and again, to back those with power and influence over those without. Being poor doesn't make you a favored object of government attention—instead, it means you're likely to be used and abused. Politicians will claim to be defending your interests when they're really promoting their own. They'll continue to enact rules that limit your ability to support yourself and make it costly for you to provide decent shelter and clothing for yourself and your family. And law enforcement agencies will subject you to violence—whether they're enforcing drug laws or immigration restrictions, or ensuring that you conform to zoning regulations and local codes designed to be easy for middle-class people to follow while making your life costly and difficult.

Government action in contemporary society makes and keeps people poor. Licensing laws, zoning regula-

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tions, and similar restrictions make it hard for poor people to enter particular job markets and to operate businesses out of their homes. Without these kinds of government regulations in place, people would be less likely to be poor.

Poverty is a *systemic* problem. It's a product of lots of different, overlapping, mutually reinforcing factors. Getting rid of just one abuse or inequity here or there might well leave many people poor. But systemic change, change that addresses all the different factors that make poverty a persistent, ugly feature of our lives, can make a profound difference. And the kind of systemic change we need is change that eliminates State-secured privileges and State-imposed liabilities, not another State-created bureaucracy designed to ameliorate problems the State itself has created.

If we focus on actual government practice we find that poor people are not served particularly well by the State, which routinely intrudes into the lives of recipients of assistance.

State Poverty

Government's role in making and keeping people poor is just one of the factors that make poverty endemic and make it hard to survive while poor.

For instance: Governments don't treat recipients of the antipoverty aid they disburse especially well. It's important to avoid comparing idealized State practice with imaginary worst-case practice in the government's absence. If we focus on actual government practice we find that poor people are not served particularly well by the State, which routinely intrudes into the lives of recipients of assistance, violating their privacy and seeking to regulate their behavior. People pay a high price for aid from the State. Government aid programs come with hidden price tags.

And governments increase the number of poor people in part precisely through some antipoverty programs, which can create perverse incentives both for people to remain poor enough to qualify for government funds and for bureaucrats to keep people poor in order to retain their own jobs.

Governments raise the cost of being poor. Building codes and zoning regulations raise the cost of housing and so make it harder for people to find inexpensive homes. Some people are forced to live without permanent housing at all, while others must spend much larger fractions of their incomes on housing than they otherwise would. As for food, that's also more expensive thanks to agricultural tariffs and import quotas. In the absence of government policies that make meeting their basic needs unnecessarily expensive, poor people would have more disposable income and would be more economically secure.

More than that, though, governments actively take money from poor people. Many poor people pay more in taxes than they get back in services under the State's rule. These people would have more resources on net in the absence of the State's demand for tax money. In addition many people are poor, or poorer, today because the State has actively stolen land and other resources from them or their ancestors or has sanctioned such thefts committed by the wealthy and well-connected. (Think eminent domain among other methods.) Historically the existence of a peasant class and of a class of displaced urban workers willing to accept employment on dismal terms is inexplicable without reference to State violence or State tolerance for or endorsement of violence by the wealthy and well-connected.

The government raises the cost of obtaining key goods and services. The State does a range of things (notably requiring professional licenses, hospital accreditation, and prescriptions and enforcing drug and medical device patents, and other restraints on trade) to make particular services such as health care especially expensive.

All these different factors fit together, each one making people's conditions worse than they'd otherwise be and making the effects of the other factors more severe. People often start out with less money because of large-scale past injustices. They have less money now because of government limitations on the kind of work they can do and where they can do it. Their ability to pro-

vide decent lives for themselves and their families is further limited because the government raises the cost of living, and government regulation of the economy drives down the overall level of productivity even further in ways that obviously hurt the poor the most.

In sum the government plays a crucial role in creating and perpetuating poverty—and that's really the most important thing to recognize. But of course that doesn't mean that, absent the government's abuses, people wouldn't have accidents, confront disasters, and make unwise choices. With costs of living reduced, as they would be if the government completely left the economy alone, people would find it easier to deal with these challenges. They'd still need one another's help, but those who think there'd be no way to get this kind of help except through tax-funded government agencies are mistaken.

The existence of State antipoverty programs crowds out alternatives and reduces the effectiveness of those that remain. It's easy to view these alternatives as essentially ineffectual and anemic. But a crucial reason they're not more vibrant is that State action commandeers money and attention that might otherwise be directed to these alternatives, creating the illusion that in the government's absence, they couldn't be much more effective.

> The existence of State antipoverty programs crowds out alternatives and reduces the effectiveness of those that remain.

Support for poverty relief doesn't just come from tax funds now. People give money to charitable causes over and above their tax bills today, despite the huge sums the State claims. There's no reason to think they would not do so if the government absented itself from economic life. It is naive to suppose that the wealthy and powerful are opposed to State funding for services to the poor at present; the poor have far less clout than the wealthy and powerful, and yet the State provides minimal services for poor people. Why suppose that wealthy and well-connected people willing to see the State spend their tax money to support services for the poor would be dramatically less willing to contribute to the support of such services if the government weren't involved? (Why do people give money to good causes, including voluntary programs that help the poor? Why do wealthy and well-connected people endorse State spending on programs that provide services to poor people? Presumably for a combination of reasons, including, in no particular order, compassion, social norms, the desire for good reputations, the desire to avoid bad reputations, and the desire to avoid social disorder. All of these reasons would be operative in a free society.)

Mutual Aid

In addition, mutual-aid networks could provide many of the services well-intentioned statists want the government to offer. Societies in which people pooled risk and provided pensions, health care, and other services functioned effectively before the rise of State social services, and there's no reason they couldn't do so again in the government's absence—and, indeed, wouldn't function much better given that people would have access to more resources and the State would not be regulating them out of existence.

Both charity and mutual aid are more viable than government-run antipoverty programs, more able to help poor people, precisely because those programs have high administrative costs. (Thanks to Tom Woods for this point.) Programs supported freely by people in the government's absence would not feature such high costs. Because donors could choose among multiple programs, there would be persistent pressure for administrative costs to be reduced.

In addition, social norms could ensure predictable, consistent support of community-wide aid programs without taxation. General acceptance of a social norm entailing regular contributions to a community income support fund, or leaving the edges of fields available (as in Leviticus) for gleaning, could ensure that poor people who needed it could rely on community assistance.

State-managed antipoverty programs draw on tax resources taken unwillingly from people. People work less energetically and enthusiastically when they know that some of what they produce will in effect be taken from them at gunpoint. Thus taking resources from

people through taxation to fund antipoverty programs can function as a drag on the economy. By contrast, when people give willingly to support antipoverty efforts, their own objectives are not being thwarted; if they wish to support these efforts, they will be willing to work hard to do so. With the government out of the economy, people can work enthusiastically to earn wealth and foster overall economic productivity even as they support significant antipoverty efforts.

Advocates of government antipoverty programs sometimes worry that the absence of the State would mean a return to the misery and squalor typical of many people's lives in the eighteenth and nineteenth centuries; they too often attribute these conditions to the absence of State regulation and antipoverty programs. But it's important to emphasize that these conditions reflected the much lower overall levels of societal wealth. People weren't poor because of the absence of State regulations and antipoverty programs; they were poor in part because there was very little wealth overall and thus less for those who wanted to help the poor. (Thanks to Tom Woods again on this score.) And of course the misery and squalor weren't entirely natural or inevitable: Some resulted from persistent—and remediable—injustice on the part of elites and their political cronies.

Libertarianism isn't a philosophy of atomism. Libertarians have every reason to value interdependence and shared responsibility.

Rectification

It's also important to emphasize that getting the State out of the economy doesn't—can't—mean simply stopping State intervention. It also has to mean providing rectification for State-committed and State-sanctioned wrongdoing. Politically privileged elites have stolen land and resources from poor, working-class, and middle-class people—directly and by securing tax-funded subsidies and government contracts. There's no way to understand the distribution of wealth and power in contemporary society without acknowledging this history of theft and violence. To the extent that it's possible, past injustice ought to be remedied. For instance, people ought to be able to homestead land engrossed by the State, especially land allocated arbitrarily to the State's cronies. If land and other resources were made available for homesteading or returned to those from whom they were taken, the poverty of the State's victims could be significantly reduced.

Structural changes would also make poverty less likely in the absence of government intervention. Rules that made it harder for absentee landlords to sit on undeveloped, uncultivated land could open up this land for homesteading by people with limited resources and thus provide them an avenue to greater economic security. Eliminating subsidies and legal privileges for hierarchical corporations would increase the likelihood that people could enjoy the job security associated with working for themselves (with less risk than accompanies being an independent contractor in a less healthy economy) or in partnerships or cooperatives and that, when they did work for others, they could bargain successfully for better compensation.

Libertarianism isn't a philosophy of atomism. Libertarians have every reason to value interdependence and shared responsibility. Obviously, that's true of the interdependence fostered by the market order. But it's also true of the interdependence of friends and family members and strangers who work together to help one another meet life's challenges. People working together don't need the government's help to deal with poverty. The government often makes the problem worse, and it's definitely not needed to remedy deprivation and economic insecurity.

Poverty has multiple causes—but many of those causes interact with and reinforce one another. Many are created by government action. If we get the government out of the economy and see to it that past injustices committed or sanctioned by the government are remedied, we can effectively meet the challenge of poverty together. FEE

Blowing Bubbles: Getting Ready for the Next Bust

BY RICHARD W. FULMER

Imagine you are a private in the army. Your sergeant orders you to dig a hole. When you finish, the sergeant is horrified to find that you have dug a hole. He dresses you down and then orders you to dig another hole. Insane? Welcome to today's world of American banking.

Over the course of several decades politicians—both Democrat and Republican—encouraged banks and mortgage companies to ease lending standards in hopes of making housing more affordable for the poor. They also urged the government-sponsored enterprises (GSEs) Freddie Mac and Fannie Mae (the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association) to purchase the resulting low-quality loans from lending institutions. This freed up money, enabling banks to make more loans than would have otherwise been possible. These actions, along with low short-term interest rates set by the Federal Reserve and tax advantages for home buyers, sparked a housing boom. Home prices soared and investors flocked to purchase mortgage-backed derivatives. Speculation became rampant, and houses were bought simply to resell, or "flip," when prices rose.

A Federal Reserve official presents the newest policy response to the present economic malaise.
scienceatlife [flickr]

Eventually, the bubble burst. Housing prices collapsed and thousands of home buyers defaulted on their mortgages, sending derivative prices into a death spiral and sparking a Wall Street sell-off. The rest is history: a history that the government is apparently anxious to repeat. The Fed is still pushing its easy-money policies with a vengeance, down-payment subsidies for low-income home buyers are still available for the taking, and lenders are still being pressured to ease standards for minorities and for low-income home buyers. The thinking appears to be that if housing prices can be driven back up to their pre-bust levels, everything will be fine. Homeowners who are currently "underwater" (meaning they owe more on their homes than the homes are now worth) and all those banking and investment houses that saw the value of their mortgage-based securities plummet will supposedly be back in the black.

There is only one problem with this scenario: The pre-bust price levels are not sustainable. We have the bust to prove it.

In the midst of the attempt to reinflate the bubble, politicians, needing to deflect blame for the collapse, have settled on Wall Street and the mortgage lenders as the most plausible villains. (Which is not to say they are blameless; the State-banking partnership is as old as the republic.) Last September the Federal Housing Finance Agency, which oversees Fannie and Freddie, announced it was suing the nation's 17 largest

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banks—some of which the government had recently bailed out—for selling risky mortgages to the two GSEs. Yet just two months before, the Department of Justice "requested" that a number of banks lower lending standards for minorities with poor credit ratings, threatening them with discrimination charges if they failed to comply.

How did banks get into this damned-if-you-do-damned-if-you-don't nightmare? It started in 1977 with the Community Reinvestment Act (CRA). The act requires "each appropriate Federal financial supervisory agency to use its authority when examining financial institutions, to encourage such institutions to help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions." As Thomas Sowell wrote in his book *The Housing Boom and Bust*, the act, though seemingly innocuous, was based on the "implicit assumption that government officials are qualified to tell lenders to whom they should lend money entrusted to them by depositors or investors." Sowell notes that lawmakers never seriously questioned this assumption.

The CRA Gets Teeth

At first the CRA had little impact but it was given teeth by subsequent legislation. The main impetus for additional regulation came from Federal Reserve studies run in the early 1990s showing differing home loan approval rates for black and white applicants. Largely ignored were the findings by these same studies of no racial differences in default rates among approved borrowers. As Sowell explained in *Economic Facts and Fallacies*, had minorities been unfairly denied loans, their default rates should have been significantly lower than the rate for whites. Instead, the equal default rates indicate the various groups were being held to the same standards.

Imagine a thoroughly racist loan officer looking for the slightest excuse to deny a loan to a minority home buyer. Minor flaws that he would ignore if the applicant were white are eagerly used as justifications for rejecting a mortgage to a minority applicant. Only black and Hispanic borrowers with stellar credit ratings would have their loans approved. The few loans the officer did make to minority borrowers would have a far lower default rate than those he made to whites. The data, however, showed no such differences.

Regardless, lending institutions were subjected to a firestorm of media abuse. Under pressure from both Congress and the White House, federal regulatory agencies loosened lending rules and imposed penalties on lenders failing to meet politically dictated racial quotas.

> Under pressure from both Congress and the White House, federal regulatory agencies loosened lending rules and imposed penalties on lenders failing to meet politically dictated racial quotas.

In 1993 the Department of Housing and Urban Development (HUD) began legal actions against mortgage bankers who declined "too many" minority loan applications. HUD also pushed Freddie and Fannie to increase their purchases of low- and moderate-income (LMI) mortgages. In 1995 regulators required banks to prove they were making a mandated number of loans to LMI borrowers, directing them to use "innovative or flexible" lending practices to achieve their quotas. Still other ways were found to pressure banks into making risky loans. For example, when Congress repealed legislation prohibiting banks from affiliating with securities and insurance companies, it denied the restored freedom to banks with CRA ratings below "satisfactory." Similarly, regulatory permission for mergers and for opening branch offices was tied to banks' CRA community service activities, such as hiring minorities, making donations to approved nonprofit organizations, and earmarking loans for minority-owned businesses.

In 1999 the *New York Times* reported that Fannie Mae, under increasing pressure from the Clinton administration to buy more LMI loans, encouraged banks "to extend home mortgages to individuals whose credit is generally not good enough to qualify for conventional loans." Clinton's successor, George W. Bush, contributed to the expanding bubble as well, signing

the American Dream Downpayment Act in 2003, which provided, and still provides, down-payment subsidies to low-income home buyers.

The drive to make homes more affordable actually made them less so. Prices soared as hundreds of thousands of first-time home buyers flooded into the market. Still, few people buy a home outright; most take out a mortgage. As long as the monthly payments were affordable, home sales could continue apace. To drive monthly payments down, politicians and lenders only needed to get a bit more creative. With plenty of reserves thanks to the Fed's easy-money policies, banks were more than eager to step up. No-down-payment loans became commonplace, as did adjustable rate mortgages (ARMs) and even so-called "liar loans" for which borrowers were not even required to show they could pay the money back. It did not matter because, of course, housing prices would continue rising forever. If anyone defaulted on his mortgage, the lender would just foreclose on the house and resell it for a tidy profit.

According to Peter J. Wallison and Edward J. Pinto in *Forbes* (Feb. 16, 2009), in late 2004:

> [The chairmen of Freddie and Fannie] were telling meetings of mortgage originators that the GSEs were eager to purchase subprime and other nonprime loans.
>
> This set off a frenzy of subprime and Alt-A [rated between subprime and prime] mortgage origination, in which—as incredible as it seems—Fannie and Freddie were competing with Wall Street and one another for low-quality loans. Even when they were not the purchasers, the GSEs were Wall Street's biggest customers, often buying the AAA tranches of subprime and Alt-A pools that Wall Street put together. By 2007 they held $227 billion (one in six loans) in these nonprime pools, and approximately $1.6 trillion in low-quality loans altogether.
>
> From 2005 through 2007, the GSEs purchased over $1 trillion in subprime and Alt-A loans, driving up the housing bubble and driving down mortgage quality.

Critics argue that only 6 percent of the subprime loans made to low-income home buyers were provided by CRA-covered banks. However, CRA loans contributed disproportionately to the defaults. According to Bank of America's October 2008 quarterly report, CRA loans represented only 7 percent of its total mortgage lending, yet these loans made up 29 percent of its mortgage losses.

HUD pressured mortgage lenders not subject to the CRA—like Countrywide Financial—to sign "Memoranda of Agreement" stating they would make more loans to minority and low-income borrowers.

CRA Infection

The CRA's largest impact, however, was that it led to an overall drop in lending standards. As Thomas E. Woods, Jr., reported in *Meltdown*, "The push for relaxed lending standards for low- and middle-income borrowers was so pervasive and systematic, persisting for a full decade, that it is no surprise that it should have spilled over into the standards for higher-income borrowers as well." Low standards did more than just "spill over," however. HUD pressured mortgage lenders not subject to the CRA to sign "Memoranda of Agreement" stating they would make more loans to minority and low-income borrowers. Countrywide Financial was the first lender to sign and, perhaps not coincidentally, the first lender to go bankrupt when the housing bubble burst. Once hailed as a leader, Countrywide is now reviled as a "predatory lender."

Speculators, availing themselves of zero-down-payment loans and ARMs, purchased house after house with no intention of actually living in any of them. Instead they resold them as prices continued climbing. In the end, a number of homes were built strictly as investment vehicles. "Flipping" homes in this manner could be very lucrative—right up until the housing market crashed. Many speculators, caught between

sales, defaulted on their mortgages. Because they had put little or nothing down, the losses were borne by whichever institutions held the mortgages when the music stopped—or the taxpayers.

Many homeowners, seeing the value of their houses soar during the boom years, cashed in by refinancing their homes at the higher market values and pocketing the difference. When prices tumbled back down, they were left owing more money on their homes than they were now worth. Some, like the speculators, simply walked away.

Still, critics point out that the dollar value of CRA loans paled in comparison to the leveraged debt that Wall Street investors amassed. Imagine an upside-down pyramid of debt with the pyramid's apex serving as its base. This apex was made up of home mortgages. Piled on this relatively small base were trillions of dollars in leveraged derivatives such as credit-default swaps (essentially insurance against bond or, in this case, loan failure) and other mortgage-based securities.

As top-heavy as this inverted pyramid was, the fact remains that it could have survived had its base been solid. Instead, its foundation was riddled with bad home loans because the government had coerced banks and other lending institutions into handing out money to people who could not afford to repay it. Further, Congress demanded that Freddie and Fannie buy hundreds of billions of dollars' worth of these subprime loans, enabling lending institutions eagerly to make even more such loans with no incentive to vet borrowers. Investors were blinded to the risks by triple-A ratings handed out by a government-sanctioned cartel of credit rating agencies evaluating the mortgage-based securities.

Three years after the housing bust, the Federal Reserve is still following easy-credit policies.

Three years after the housing bust, the Federal Reserve is still following easy-credit policies. Last September it doubled down with an announced purchase of $400 billion in longer-term Treasury securities hoping to lower long-term interest rates and thereby boost spending and investment. At the same time the government is continuing to pressure banks to make risky loans and sell them to Freddie and Fannie, which were taken over by the government after they went bankrupt. (Last fall Freddie said it needed to borrow $6 billion more from the Treasury after it lost $4.4 billion in the third quarter of the year.) The new twist is that federal regulators are now suing banks for doing what the government demanded, and is still demanding, that they do. This is not too surprising given Washington's need to pin the blame on someone, anyone, other than Washington. The politicians and regulators also need to be looking ahead, though, for the villains on whom they can blame the new and bigger bust that they currently have in the works. It is nothing short of breathtaking. But then, blowing bubbles always is. FEE

Regime Uncertainty, Then and Now

BY ROBERT HIGGS

In a 1997 article, "Regime Uncertainty: Why the Great Depression Lasted So Long and Why Prosperity Resumed After the War" (tinyurl.com/98l4e), I advanced the idea of *regime uncertainty* in an attempt to improve our understanding of the Great Depression's extraordinary duration and of the highly successful postwar transition to a genuinely prosperous market-oriented economy. The idea is more definite than the hoary but vague idea of "business confidence," though they're related.

In my conception regime uncertainty pertains above all to a pervasive uncertainty about the property-rights regime—about what private owners can reliably expect the government to do in its actions that affect private owners' ability to control the use of their property, to reap the income it yields, and to transfer it to others on mutually acceptable terms. Will the government simply take over private property? Will it leave titles in private hands but strip the owners of real control and profitable use of their properties? In any event the security of private property rights rests not only on the letter of the law but also on the character of the government officials who enforce—or threaten—presumptive rights.

Between 1935 and 1940 this matter attained prime importance. So many businessmen and investors lost confidence in their ability to forecast the future property-rights regime that few were willing to venture their money in long-term investments. They constantly sought clarification of the government's designs, as President Franklin D. Roosevelt raged against "economic royalists" and blamed a "strike of capital" for the economy's ongoing troubles, including the depression of 1937–38, which undermined the general public's confidence in the New Deal.

Treasury Secretary Henry Morgenthau tried repeatedly to persuade Roosevelt to make a public statement to reassure investors, but the President steadfastly rejected this entreaty. Morgenthau ultimately became so frustrated that in a 1937 cabinet meeting, he blurted out to his boss: "What business wants to know is: Are we headed toward Socialism or are we going to continue on a capitalist basis?" Strange to say, Jim Farley and even Henry Wallace backed Morgenthau's insistence that the President spell out what kind of economic system the administration sought to foster.

The government's frantic actions in the past few years have surely shaken investors' confidence about future property rights in the United States.

In his plea Morgenthau encapsulated the wide-ranging uncertainty that Lammont du Pont expressed in the same year, when he said: "Uncertainty rules the tax situation, the labor situation, the monetary situation, and practically every legal condition under which industry must operate. Are taxes to go higher, lower or stay where they are? We don't know. Is labor to be union or non-union? . . . Are we to have inflation or deflation, more government spending or less? . . . Are new restrictions to be placed on capital, new limits on profits? . . . It is impossible to even guess at the answers."

I doubt the regime uncertainty that a growing number of commentators and analysts have perceived since 2008 is as great as that of the latter 1930s. However, the government's frantic actions in the past few years have surely shaken investors' confidence about future property rights in the United States. The takeovers of Fannie Mae, Freddie Mac, AIG, GM, and Chrysler; the massive interventions in financial markets; the huge

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bailouts of banks and other financial institutions, mixed with letting Lehman Brothers go down while salvaging Bear Stearns—all these actions and many others suggest that a rational investor might well attach a huge risk premium to any money he ventures even for the intermediate term, not to mention the long term.

Moreover, the upsurge of the federal government's size, scope, and power since the middle of 2008 has scarcely calmed investors' minds. New taxes and higher rates of old taxes; potentially large burdens of compliance with new financial and energy regulations; unpredictable new mandatory health care expenses; new, intrinsically arbitrary government oversight of so-called systemic risks associated with *any type* of business—all these unsettling prospects and others of substantial significance must give pause to anyone considering a long-term investment, because any one of them has the potential to turn a seemingly profitable investment into a big loss.

> The frenzy of government action in 2008 and 2009 has left behind a steeper yield curve, just as the Second New Deal did.

The Current Picture

In testing my hypothesis about regime uncertainty, I have marshaled three distinct types of evidence: historical documentation of government actions and public reactions; findings of public-opinion surveys, especially surveys of businessmen; and financial-market data.

My most striking financial evidence for the New Deal episode pertains to the yield curve for corporate bonds—that is, to the spreads between the effective yields on high-grade corporate bonds of various maturities. I found that this yield curve suddenly became much steeper between the first quarter of 1934 and the first quarter of 1935 (when the New Deal lurched from its first, or business-tolerant, phase to its second, or business-hostile, phase) and remained very steep until it flattened between the first quarter of 1941 and the first quarter of 1942 (when the New Deal handed the reins to the military and the big businessmen who, along with the President, ran the war-command economy). I interpreted these extreme spreads from 1935 to 1941 as risk premiums on longer-term investments caused by regime uncertainty.

Does the corporate-bond yield curve show the same kind of shift during the past few years that it displayed in the face of the regime uncertainty that prevailed from 1935 to 1941? To find out I examined a number of series of corporate-bond yields by term to maturity.

I found that in 2008, before the onset of the financial panic in September, the corporate-bond yield curve was quite flat—that is, the yields increased only slightly with term to maturity. When the panic hit, yields became extremely volatile, especially for the bonds with two years to maturity (the shortest term in the data), and remained volatile for almost a year. After mid-2009 the volatility diminished. Once the dust had settled, the yield curve for corporate bonds had become substantially steeper.

Thus just as the steeper yield curve of the latter 1930s corresponds precisely with the so-called Second New Deal, when Roosevelt and his leading advisers went on the warpath against investors as a class, the steeper yield curve since mid-2009 corresponds with the bigger government left in the wake of the financial-market volatility and frenetic government action between September 2008 and the middle of 2009 and with the subsequent rash of extraordinary government measures.

Given the current regime uncertainty, investors will probably continue to remain for the most part on the sideline, protecting their wealth in cash hoards and low-risk, low-return, short-term investments and consuming wealth that might otherwise have been invested. Slow economic recovery, at best, will be the result. FEE

State-Mandated Thinking

BY PETER MCALLISTER

Is this statement true? "If SpongeBob SquarePants is the mayor of Minneapolis, then Napoleon lost the Battle of Waterloo."

It is. On the other hand, this is not: "If Napoleon lost the Battle of Waterloo, then Spongebob Squarepants is the Mayor of Minneapolis."

Confused? Welcome to our government-school curricula.

In the July/August 2011 issue of *The Freeman*, Neal McClusky warned of the efforts of the U.S. Department of Education to establish a national curriculum in our schools ("Coming Soon: The Federal Department of Standardized Minds," tinyurl.com/3b3y6ub). As a teacher, I agree this would be a serious mistake. A monolithic school system would eliminate what little opportunity for innovation educators still possess and would force students into cookie-cutter courses, regardless of the students' needs and abilities. It would lower our disgraceful levels of academic performance even further and, most ominously, it could facilitate the establishment of a national system of propaganda masquerading as education.

Bureaucrats working for a government monopoly should not be deciding what goes in here.
Digital Shotgun [Flickr]

To understand why a national curriculum would lead to these consequences, we need only to look at the consequences of curricula already established by state and local governments.

The SpongeBob example is indicative. It illustrates a topic from the logic section of the high school mathematics curricula of several states, including New York and California. It is based on Bertrand Russell's formal-logic convention known as material implication, the explanation of which could easily run to the length of a book and confuse most highly educated adults. If you examine any series of high school mathematics textbooks published in the United States within the last 30 years, you are certain to find material implication along with abstruse aspects of number theory, non-Euclidian geometries, and a host of other unrelated, obscure topics. This constitutes the knowledge of mathematics that state bureaucrats require our children to learn.

Before becoming a teacher I spent 26 years as an executive managing departments that specialized in the use of applied mathematics for a major bank. In 1998 I established a unit responsible for guiding the development of quantitative tools for a franchise that boasted 125 million customers spread out over 102 countries. Given the scope of the assignment, I had carte blanche to employ the best analytical talent available. I hired half a dozen scientists and mathematicians from the National Laboratory System, the National Institutes of Health, and an Ivy League faculty. One of my analysts was described by a Nobel laureate as the "best research scientist under 40 in the world," another as "the best thing to come out of Los Alamos since the bomb." As much as I like bragging about my unit, there is a reason I'm bringing this up: Not a single one of these exceptionally talented indi-

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viduals was an American citizen. With one exception, though, they all held doctorates from leading American universities. This absence of qualified American analysts was not a coincidence: Americans were systematically underrepresented in the bank's several other analytical units, as well as in the analytical units of our competitors.

Incoherent Curriculum

I began teaching mathematics and social studies at the high school level in February 2003. By June of that year I understood clearly why there were relatively few qualified Americans in quantitative analytical positions in banking. Our state curricula have rendered the subject of mathematics both incomprehensible and largely irrelevant. The blueprint for the last half-century of U.S. instruction in quantitative skills was developed primarily by two groups: professors of abstract mathematics and progressive professors of education. A striking characteristic of the mathematicians was their limited knowledge of the practical applications of their discipline. A striking characteristic of the educators was their willingness to accept any content from the mathematicians, regardless of how arcane it was. The result was "the new math," a disintegrated hodgepodge that has caused mathematics to become unfathomable to young minds.

What is the effect of these state curricula? Students come to view mathematics as a senseless game unrelated to reality.

The nature of the government school curriculum development process militates against the creation of an integrated, hierarchical presentation of any subject matter. State curricula are developed by large committees of experts who often have their own pet themes and topics they wish to insert into our schools. The result invariably becomes a laundry list of unconnected information. Once assessment criteria are established, the "knowledge by fiat" process is complete and these curricula become impervious to revision, regardless of whether they are relevant to students' future adult lives.

This process has generated curricula that make it extremely difficult for students to develop a coherent knowledge of mathematics. Teachers are required to introduce topics seemingly at random, and in many instances it is impossible for teachers to tie these topics to other information the student has encountered. The quadratic formula, which is indispensable in the design of objects from flashlights to the Golden Gate Bridge, typically is introduced well before most students are capable of understanding its derivation or even its purpose. Since students are required to know this formula, they often "learn" it by singing it to the tune of "Pop Goes the Weasel." In geometry we require adolescents to learn excruciatingly complex definitions and terms in order to prove the simplest theorems. Euclid's *Elements* was devised about 300 BC and until the nineteenth century was regarded as the standard of geometric proof. Only after the widespread acceptance of non-Euclidian geometries did mathematicians realize Euclid's system relied on more fundamental axioms than he stated. As mathematics professor Morris Klein has pointed out, for 22 centuries mathematicians failed to detect Euclid's lack of rigor, yet today we expect adolescents not only to see this but also to grasp the need for proof that involves axioms that are more difficult to understand than the theorems they support. No justification or motivation is provided for this approach to geometry.

What is the effect of these state curricula? Students come to view mathematics as a senseless game unrelated to reality. They have to memorize procedures and then spit them back so they can test well enough to move on to memorize higher level, mind-numbing procedures that they will spit back at some later date. Mathematics has enabled man to grasp everything from the nature of subatomic particles to the shape of the universe. It is now almost universally regarded by American students simply as a series of "floating abstractions," with no ties to anything relevant or real, on the same metaphysical level as Santa Claus.

One of the most disconcerting phenomena I have encountered since I have become a teacher is that by the time they reach high school, large numbers of students do not want to understand the basis of mathematics.

They are actually resistant to any attempts to show how the material we are covering comes from the real world. I have lost track of the number of times students have said, in effect, "Don't explain this topic to me. Just give me the formula and let me memorize it." This should frighten anyone involved in education. Our schools are producing students who have reached the stage where they have given up any attempt to grasp the conceptual foundation of mathematics. To them, learning mathematics is simply a matter of learning how to manipulate a series of strange little symbols whose meanings defy comprehension. Thanks to our state mathematics curricula, young men and women are declaring nakedly that they have the learning processes of parrots.

There are several improvements to our mathematics curricula that could be made immediately if state involvement were ended. The most obvious would involve a complete overhaul of content and a careful ordering of topics so that students can obtain a hierarchical understanding of this subject. Additionally, to provide students with an appreciation of the practical necessity of mathematics, its instruction should be coordinated carefully with instruction in science. Basic mathematics is about measurement. Students need something to measure to make this subject relevant and to motivate an awareness of its enormous power. Coordinating it with science would achieve both of these ends. Unfortunately the lockstep approach to knowledge transmission dictated by state departments of education makes any of these improvements impossible.

The most disturbing consequences of government control of curricula, however, occur within the social sciences. These courses typically are developed by individuals who either have no experience with free markets or who are openly hostile to them. As a result the distinction between education and indoctrination is often ignored. These beliefs are rarely questioned.

A review of the various states' performance standards in the social sciences discloses little evidence of anti-market bias. Instead the aversion comes primarily from two sources: a tendency of people who are attracted to employment in the government sector to embrace statist politics, combined with the acceptance by many teachers of fallacies regarding the nature of a free society.

Anti-Market Proselytizing

There are strong incentives for government school employees to favor the expansion of government, and teachers' unions don't even pretend to be even-handed ideologically. The political orientation of most teachers has been demonstrated recently by their reaction to our current economic malaise. Any attempts to rein in government spending, especially on education, are met with harsh condemnations within the government school community. National Education Association president Dennis Van Roekel has described the attempts of various state governments to confront ballooning pension liabilities as "blistering attacks on working families" and has characterized the actions of lawmakers as "fitting for comic book arch-villains." American Federation of Teachers president Randi Weingarten likewise has greeted any efforts to improve school efficiency with denunciations that border on allegations of child abuse. Every discussion of the causes of the cutbacks in education, within any government school forum, has been overwhelmingly one-sided, with teachers blaming everyone who favors limited government.

> The distinction between education and indoctrination is often ignored in social science curricula.

Anti-market proselytizing is the most dangerous consequence of entrusting the education of our children to a government-run monopoly. If schools presented the ethical and political justifications of a free society fairly, there would be no reason to fear the introduction of any other viewpoints, regardless of how cogently they were argued. The problem is our system is rigged against this. As Isabel Paterson pointed out in *The God of the Machine*, "[E]very politically controlled educational system will inculcate the doctrine of state supremacy sooner or later. . . . Once that doctrine has been accepted, it becomes an almost superhuman task to break the stranglehold of the political power over the life of the citizen." We have not yet reached this point,

but it is clearly where we are headed. Avoiding it will require profound changes in the structure of our schools. Contrary to the aspirations of the U.S. Department of Education, ending the State's role in curriculum determination is an excellent place to start making these changes.

Ridiculous Fads

Educators have been remarkably unscathed by the consequences of their teaching methodologies. This has led to the adoption of ridiculous fads, primarily at the local level, that have generated significant cognitive damage. In *The War Against Grammar*, classics professor David Mulroy describes how many school districts effectively no longer require instruction in formal grammar. The "invented spelling" movement likewise has resulted in the relaxation of the requirement that beginning readers learn to spell correctly. Instruction in handwriting may be on the chopping block presently. In reading, the abandonment of phonics in favor of "whole-word recognition" has led to a generation of nearly illiterate Americans. This occurred despite overwhelming evidence of the inadequacy of the whole-word approach. None of these developments could have transpired if there had been a genuine marketplace for ideas in instructional methods.

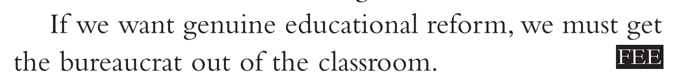
> Sadly, in the absence of the State releasing its grip on course contents, all we can look forward to is more federal interference.

The latest fad, surely to be incorporated into any set of national standards, is the call for a "21st-Century Curriculum." Although inchoate, it portends to be the next step in the abdication of the responsibility to train students' conceptual faculties. It focuses on the development of skills in the use of multimedia, technology, and "collaborative problem solving," but there is no mention of students' glaring deficiencies in mastering the rudiments of learning. It incorporates Howard Gardner's theory of multiple intelligences that, although not Professor Gardner's fault, has given rise to the romantic notion that every student can excel at something. This will likely lead to a distorted emphasis placed on music, art, dance, and athletics despite the limited career opportunities associated with these skills. This curriculum will replace the vestiges of a rational, structured approach to education with less content, an emphasis on "life skills," and the practice of plunging the intellectually nascent into "real-world contexts" wherein they engage in "problem-based learning." Our 12-year-olds may no longer be able to read, but maybe they will finally resolve the Arab-Israeli conflict.

The only students who currently receive any benefits from improved curricula are high-achieving high school students. The competition among Advanced Placement, International Baccalaureate, and college-extension courses provides the academically elite with several options to meet their requirements that are far better than their government school alternatives. The institutions that provide these courses devote a great deal of time and resources to assuring they are appropriately structured, accurately graded, and competently taught. Unlike their state counterparts, these purveyors do not have a captive market. They must strive constantly to improve their quality while minimizing expenses. This is what students of every caliber in every grade desperately need: expanded, high-quality curriculum choices. Sadly, in the absence of the State releasing its grip on course contents, all we can look forward to is the possibility of another level of federal interference.

Most of the attention of educational reformers has focused on teacher quality and parental choice. Although these concerns certainly are legitimate, they pale in comparison to the problems caused by government control of curricula. Incomprehensible courses taught by skilled teachers in charter schools are still incomprehensible. Moreover, it is dangerous to invest any entity—government or private—with the sole authority to determine the information to be taught to our children. We have unelected officials determining what constitutes appropriate knowledge. This is too close to the State determining the Truth.

If we want genuine educational reform, we must get the bureaucrat out of the classroom. FEE



Occupying Wall Street

BY SHELDON RICHMAN

The Occupy Wall Street agenda is vague, but the protesters at least have the good sense to know that something is awry with the political-economic system we labor under. Protesters carried a variety of signs, one of which stated, "End corporate welfare." The Associated Press reported, "Demonstrators said Saturday they were protesting against bank bailouts and the mortgage crisis." One 21-year-old man told the AP, "The enemy is the big business leaders of Wall Street, the big oil company leaders, the coal company leaders, the big military industrial leaders."

Considering the housing and financial debacle that began in 2008, the continuing hardship it unleashed, the fortunes made in the run-up to the bust, and the tax-financed bailouts that followed, what's wrong with feeling that "the system" has done a number on most Americans? It's perfectly reasonable to think that some radical changes are needed. Our lives and well-being *are* subject to the moves of large organizations over which we have no control. But to know *what* should change, one has to understand what happened.

> Putting new people in charge won't alter that fact that the bureaucracy wields powers that *should not exist.*

Note that in the young man's statement above, one word is glaringly absent: government. (He does use the word "military," but many people across the political spectrum seem to think the Pentagon is not part of the government.) Unfortunately, the protesters most likely fail to appreciate that everything associated with the Great Recession is a product of a longstanding and deep-seated *partnership* between big influential business/financial interests and government—the corporate state. Through most of American history, banks and other financial institutions have operated in league with government, especially since the Federal Reserve opened its doors nearly a century ago, and this money-manipulating cartel has facilitated war, cheap credit to favored interests, and bailouts.

So why aren't the protesters *also* outside the Fed, the Treasury, and the Capitol?

Most if not all of them likely favor a big expansion of government, but in light of our political-economic history, that would be precisely the wrong way to go because it would further empower the same coercive bureaucracy that gave us this crisis. Putting new people in charge won't alter that fact that the bureaucracy wields powers that *should not exist*.

What the protesters miss is that corporate power is derived from *government* power—it's the *most dangerous derivative* (tinyurl.com/bllhqa6). Without State power no bank (or collection of them) could set the economy on a balsawood platform of inflated currency and cheap credit, creating the conditions for recession and long-term unemployment, nor could it stick taxpayers with the cost of bad investments. Such mischief requires a central bank and congressional power to compel the taxpayers. Washington and Wall Street need each other. They don't agree on everything, but their public feuds should not mislead anyone into thinking they are adversaries. They are in cahoots, dependent on a system that constrains regular people's honest economic activities and benefits an exploitative elite.

I will not rehearse here how corporate-state policies created the housing and financial bubble that burst and plunged the country into the Great Recession. Instead, I want to indicate that the corporate state is not new in America. It has been more the rule than the exception.

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There's no better illustration than the New Deal, particularly the National Industrial Recovery Act (NRA), which cartelized business through industry-generated and -enforced codes that suppressed competition, restricted production, and kept prices high during the Great Depression. John T. Flynn, the muckraking reporter who despised government-business collusion, bureaucratic control, and militarism, told the story in "Whose Child Is the NRA?," which appeared in *Harper's Magazine*, September 1934.

Flynn notes that the NRA is commonly regarded as the "Charter of Labor" or the product of President Roosevelt's Brain Trust, the collection of Progressive academics who informally advised FDR. In fact the NRA's roots lie elsewhere:

> The actual business of putting together the NRA began in March, 1933, after Roosevelt took office. But one must look far beyond the throb and pother of those feverish days to understand the swift succession of moves and the cast of characters behind them. . . . Regimentation of business means, in the minds of those who use the term, forming businessmen into regiments, bringing business under regulation, controlling production, prices, trade practices, the rules of the game. For seventy years at least business men have been, in varying degrees, in favor of this. . . . Later on the Chamber of Commerce of the United States raised the slogan of "Self-Rule in Industry." This was not a struggle to shift the control of industry from the government to industry itself. Industry wanted not freedom from regulation but the right to enjoy regulation.

Self-rule meant the power to penalize code violators who wished to compete freely. (Without enforcement, cartels fall apart as members "cheat.") As the Chamber and prominent businessmen such as General Electric president Gerard Swope, along with Wall Street lawyers, pushed for government-backed industry cartels, members of the House and Senate were advancing bills, which Roosevelt opposed, to set maximum hours for workers. An alternative bill emerged from discussions that included Hugh S. Johnson, who had worked for Bernard Baruch on Wall Street; John Dickinson, a Wall Street lawyer; and Chicago labor lawyer Donald Richberg.

"When, therefore, the NRA act was brought forward, it was to defeat the [Sen. Hugo] Black and [Rep. William] Connery bills, to turn the subject over to employers and to give them, besides, something they had wanted for years but dared not now insist on—the modification of the antitrust laws and the privilege of self-rule in industry," Flynn wrote. (Note: The freed market was not among the alternatives.) He concluded that big business made out well with the NRA:

> If now we keep all this in mind it will be easy to understand all that has happened since NRA became a law. I am reliably informed that [Chamber President H. I.] Harriman told his directors that it was *a complete victory for the Chamber.* They got more than they hoped—modification of the antitrust laws, self-rule in industry, defeat of the Black and Connery bills, the right to regulate hours and minimum wages transferred to the trade associations under NRA supervision instead of by statute. In short, with the exception of the collective bargaining provision—which as we have seen was subsequently robbed of much of its original strength—the NRA plan represented *almost entirely the influence and ideal of Big Business Men.* The share of the Brain Trust in its paternity was microscopic; the share of the Chamber of Commerce and other business interests was predominant. [Emphasis added.]

This *was no anomaly.* Government power ultimately will be influenced and controlled by those whom the occupiers despise. So, protesters, rail against Wall Street. But rail, too, against its indispensable partner—government, with its unique legal power to wield aggressive force—and realize that the genuine antipode of the system you oppose is the freed market. FEE

The Euro: The Folly of Political Currency

BY ROBERT P. MURPHY

The financial markets continue to surge and collapse based on the latest news from Europe. As of this writing, the big events are Slovakia's unwillingness to contribute to a bailout fund and the failure of Dexia, a French-Belgian bank with assets of almost $700 billion. As the sovereign debt crisis has intensified in the last few months, it is becoming a real possibility that the euro itself will soon collapse.

Even if it managed to squeak through and survive—aided by massive taxpayer infusions along the way—the euro's vulnerability underscores the folly of a political currency. More so than any other currency in history, the euro has been a creation of technocrats working for modern nation-states. That the euro may well be on its deathbed hardly a decade after its birth demonstrates the futility of central planning. A durable monetary system, free from recurring crises, can only emerge spontaneously from voluntary exchanges in the marketplace.

Maybe there's a way for Greece to link its fiscal and monetary policies after all . . .
TaxBrackets.org

The European Union and euro were officially created by the Maastricht Treaty in 1993. In addition to the political and cultural objectives, the EU and the single currency, which went into circulation in 2002, were significant steps in the effort to turn Europe into a unified *economic* zone patterned after the United States.

Before the introduction of the euro, a large business based in France that, say, had a factory paying workers in Italy and which bought machine parts from Germany would be vulnerable to shifts in the exchange rate between the franc, lira, and mark. But with a single currency the firm could focus on its customers and product lines, rather than worrying about the foreign-exchange market. This stability across the continent would (supposedly) give European businesses the same advantages that U.S.-based firms enjoy, since Americans in all 50 states use the dollar.

Because a currency's ability to facilitate transactions only increases as more people use it, at first we might expect that the nations adopting the euro would want as many of their neighbors as possible to join. Yet in reality there were formal rules (called the Maastricht criteria, also the "convergence criteria") that new applicants needed to satisfy before adopting the euro. The rules set standards for countries' inflation rates, budget deficits, government debt, exchange rates, and long-term interest rates.

At first glance it seems odd that the developers of a new currency would want to restrict its usage. To repeat, the whole point of a currency union is to reduce transaction costs among the individuals using it. Thus it would seem that these benefits would only increase as the group grew.

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Yet there are other factors at work, which the designers of the euro understood (if only imperfectly). In particular the euro is a *fiat currency*, meaning that the printing press could be used to achieve political ends. This explains why governments already using the euro are reluctant to admit relatively spendthrift governments into their club: There is a danger that the more profligate members will hijack monetary policy directly, *or* that they will require a monetary bailout (as we are seeing in practice).

Benefits of a Commodity Standard

Notice that these potential problems would be nonexistent under a fully backed commodity standard. For example, suppose that the creators of the euro, rather than reading the work of mainstream monetary theorists such as Robert Mundell, instead had studied the proposals of Ludwig von Mises in *The Theory of Money and Credit*. In this alternate universe the authorities in Brussels would stand prepared to issue new paper euros to any individual or institution (including governments and central banks) that handed them a fixed weight of gold.

Under this Misesian scheme the monetary authorities would maintain 100 percent gold backing of the currency; there would be the required weight of actual gold sitting in the vaults in Brussels backing up every paper euro in existence. In this scenario the authorities in Brussels wouldn't care about the creditworthiness or the spending habits of the institutions applying for new euros. So long as the applicants handed over the correct amount of physical gold, the authorities would be happy to print up the appropriate number of euros.

The reason for this nonchalance is that the various users of the euro—if it were backed 100 percent by gold—couldn't affect the euro's purchasing power because they couldn't affect future "monetary policy" regarding the currency. If the people in Region A used the euro, they wouldn't be affected by (say) a default on bond payments by some government in Region B that also used the euro. The euros in existence, as well as the ones to be issued in the future, would have a constant redemption rate in gold, regardless of the fiscal solvency of a particular user of the euro.

In case the Misesian thought experiment is too fanciful, we have a much more pedestrian (if imperfect) example: U.S. state governments and their use of the dollar. If the California or Illinois state governments default on the billions of dollars in outstanding bonds that they have issued, no one is worried that this will lead to a collapse of the dollar itself, or that the relatively frugal states (such as Idaho) will elect to leave the "dollarzone" and adopt their own currency.

We can imagine a situation analogous to the crisis in Europe right here in the United States. All it would take is a Federal Reserve willing to issue extra dollars because member governments ran irresponsible fiscal deficits.

Thinking through the logic of the situation, it becomes clear that the reason for the difference is that the Federal Reserve (at least in the past) wouldn't bail out insolvent state governments. To be clear, the people in Idaho might be affected by a default on California state bonds, but not because both areas used dollars as their currency.

However, if the Fed *did* start bailing out insolvent state governments, then the various states in the "dollarzone" might sit up and take notice. People in Idaho would realize they were paying higher prices because the Fed was creating billions of new dollars out of thin air to prop up the market for state bonds. In this environment a coalition of frugal state governments might demand that their profligate peers adopt austerity measures or else the frugal states would indeed abandon use of the dollar.

As this thought experiment illustrates, we can imagine a situation analogous to the crisis in Europe right here in the United States. All it would take is a Federal Reserve willing to issue extra dollars because member governments ran irresponsible fiscal deficits. We *don't* currently link state government finances and the fate of the dollar because the Fed thus far hasn't altered its

policies based on state spending. Under a fully backed commodity standard, this independence of monetary and fiscal policies would be more absolute and would have prevented a crisis like the one now unfolding in Europe.

Those who have followed the mainstream economists' handling of these issues know that gold convertibility is hardly touted as a solution to the euro crisis. In fact Paul Krugman recently blamed the crisis on the attempts to foist a "nouveau gold-standard regime" on European countries.

This is quite an extraordinary spin. How in the world could Krugman take a fiat currency, explicitly designed from day one by technocrats and without even a historical connection to a commodity money, and denounce it as a modern-day gold standard?

The answer is that Krugman is relying on the mainstream theory of optimal currency area. This theory tries to outline the optimal jurisdictions for different fiat currencies. In this approach the downside of having too large a region using the same currency is that the "optimal" amount of inflation might differ within the region, leading to unnecessary economic pain and hence political conflict.

In the present crisis Krugman and many others think the "obvious" solution would be for Greece to devalue its currency. This would make it easier to repay its debts and would make Greek exports more competitive, thus boosting economic growth.

Alas the problem (according to people like Krugman) is that Greece is not the master of its own economic destiny. Since it adopted the euro it is now powerless to inflate its way out of trouble. Thus the Greeks are condemned to suffer from fiscal austerity and a painful deflation of wages and prices (also known by the misleading term "internal devaluation").

Now we can understand the (tepid) connection that Krugman and others are drawing between the current situation in Europe and the classical gold standard. Under the latter, if one country printed too much money its domestic prices would rise faster than those of its peers. The country would experience a trade deficit as its own exports became relatively expensive. The outflow of gold from the country would force officials to tighten monetary policy until wages and prices had fallen (if not in absolute terms, at least relative to the levels of other nations) and international competitiveness had been restored. Under the classical gold standard each nation's currency was pegged at a fixed exchange rate to gold, so that no country could gain an advantage by devaluing its own currency. All adjustments to ensure sustainable trading patterns had to occur through changes in relative prices and wages, *not* through fluctuations in exchange rates.

Further Integration

The mainstream theory of optimal currency area sheds light on another (alleged) lesson being drawn from the present crisis: the need for fiscal union among the eurozone states. For example, Mario Draghi, the incoming head of the European Central Bank, recently said Europe needs to "make a quantum step up in economic and political integration." Mainstream theory shows that it is suboptimal to have a single currency covering areas with governments enacting different fiscal policies, and hence the "obvious" conclusion is that the European governments must be brought under the control of a single agency.

As usual one intervention leads to another. After historically co-opting and then suppressing the market-chosen monies (gold and silver), the European governments in recent years upped the ante by creating a new fiat currency. Even though the ostensible safeguards failed miserably—Greece and several other participating governments have come nowhere near obeying the Maastricht criteria—the alleged solution is the creation of even more centralized power, with even less control by the people being so ruled.

The people of Europe are being conned. They do not need to sacrifice even more political sovereignty to a group of international bureaucrats and bankers. The dream of the euro—an integrated economic zone with a stable currency—can be achieved through the classical-liberal tenets of free trade and sound money. Continued experiments with fiat money regimes will lead us through a perpetual series of crises, until we are left with a single global fiat currency, the issuer of which has zero accountability to the hapless citizens forced to use it. According to many cynical observers, this after all may be the ultimate plan. FEE

Taxi Regulation and the Failures of Progressivism

BY SAM STALEY

As the American people head into another election year some will be puzzled by the rise and the staying power of Progressive ideals—according to which government manages the private economy supposedly for the social welfare. But in truth they've been operating at the local level for more than a century.

Overestimating the power of Progressive ideas locally is difficult. Many who eschew the heavy hand of the federal government—railing against corporate bailouts, Medicare, or government ownership of companies—embrace even more extensive government manipulation of private market activity closer to home.

> Many who eschew the heavy hand of the federal government embrace even more extensive government closer to home.

For example, taxicabs are almost all privately owned and operated in the United States, yet municipal taxi commissions and boards regulate virtually every aspect of the business. The codes themselves can include a dizzying array of regulations, from specific details about where cab companies can locate, to how many hours they can operate, what price they can charge, and what equipment they can use to accept calls. My own survey of taxi regulations in 15 cities uncovered 27 separate types of regulations.

Considered separately each regulation may seem reasonable, but the cumulative result has been to protect exiting companies from competition, depress wages for drivers, discourage innovation, and limit services to new customers and markets. Taxi regulations and codes fix prices by law, mandate the way fares are collected (meters), dictate hours of operation (24-hour dispatch service), regulate financial operations (by requiring financial reporting), promote public safety (vehicle inspections), set standards for language fluency and driver competence (tests), and include dozens of other regulations.

Over time many of these ordinances have grown in scope. Where a code might have first been established to ensure a basic minimum level of safety, perhaps requiring vehicle inspections for brakes or lights, modern codes can stretch to dozens and hundreds of pages involving complex and often complicated procedures and standards as the commission legislates every detail of running a taxi business. New York City has just completed a public bidding process for selecting the kind of vehicle taxi drivers will be allowed to use.

This detailed approach to regulation of private business is consistent with the Progressive mindset and political philosophy. Progressives for the most part adopt what political scientists call a "public interest" view of government. Elected officials are said to represent the will of the people, and civil servants thus dutifully carry out their vision of the public will. The problem is that public officials and taxi boards don't always pursue the public interest, lack sufficient infor-

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mation about the taxi market itself, and often rely on cumbersome, outdated decision-making to enforce their codes and rules.

For example, most taxicab codes assume that operators are full-time employees. In fact most drivers are part-time and choose to drive taxis for lifestyle reasons as much as to maximize their income. My study of the taxi market in Port Chester, New York, estimated that two-thirds of the drivers are part-time. In addition, fares and trips were not evenly distributed throughout the day: They peaked at specific times such as the morning and afternoon rush hours and lunch. Full-time drivers tended to earn fares throughout the day. Part-time drivers met excess demand. In addition, most revenue was earned taking patrons outside the city (and the reach of the taxi commission).

Regulation vs. Diversity

Most taxi codes can't accommodate this kind of diversity within the industry. The regulations are one-size-fits-all, and almost all either fail to address or acknowledge the valuable role part-time drivers play in meeting customer demand. Part-time drivers, for example, often handle calls through a cell phone and focus their activity around fixed passenger pickup places such as taxi stands, the airport, or train stations. They often charge fixed prices for specific types of trips, regardless of distance. Many drivers also develop a steady and stable client list through personal service.

Most taxi codes can't accommodate the kind of diversity often seen in taxi markets.

Yet taxi regulations force the same requirements on every car, driver, and company regardless of service provided. Often part-time drivers are still required to have meters that calculate fares based on distance (when flat fares can easily be negotiated), be officially attached to a dispatch company, or meet requirements such as maximum age limits on vehicles regardless of amount of use. Quite simply, the taxi codes can't keep up with the dynamics of the service provided.

Some cities regulate taxis at even greater levels of detail. Many cities require companies to submit financial reports to the local government so officials can evaluate their fiscal solvency when they renew dispatch company licenses. Ordinances require dispatch companies to lease office space regardless of the number of calls or the technology that enables them to handle calls in a home office. Many ordinances also require all companies, regardless of their market or client base, to formally affiliate with a dispatch company.

In a survey of taxicab regulations in Ohio, *Taxicab Regulation in Ohio's Largest Cities* (1999), the Buckeye Institute found that cities regulated prices in a variety of ways. For example, two cities—Akron and Canton—did not regulate taxi fares at all. They let individual companies decide what prices to charge. The state's largest cities—Cincinnati, Cleveland, and Columbus—set maximum rates. Only Toledo and Youngstown set rates by ordinance.

In my survey no single regulation was found in a majority of cities. In fact, fewer than half the cities surveyed required fares to be set by distance-based meters. Only 40 percent regulated logos and taxi colors, or mandated radio dispatching. One-third capped the number of vehicles, required public hearings for licenses, or mandated service hours or physician certificates. In terms of overall burden the most restrictive cities required 13 separate regulations while others required just a handful.

Optimal Numbers

Perhaps the most illustrative example of the "government knows best" mindset is found in regulations limiting the number of cabs, drivers, and companies. The theory is that there is an "optimal" number of vehicles for a given market size and the commission's staff can figure out what that is. It is also presumed that the regulatory board will make decisions about what rules to enforce based on objective criteria. A cottage industry has even emerged of consulting firms that have developed sophisticated statistical models to estimate the number of taxicabs that should be allowed to operate in a city.

In the real world, however, the demand for taxis is dynamic and markets are often separated by the types and needs of diverse customer bases. In Dayton, Ohio, one company focused on airport services,

another on spontaneous calls from the street (street "hails"), and a third on specialized services to the local transit agency.

Moreover, the boards and commissions themselves are mostly run by citizens with little knowledge of the taxi market and staff that have little background in the specific workings of the industry.

Not surprisingly, inefficiencies reign. One indicator of inefficiency is the black market for taxi medallions (government-granted licenses that allow someone to operate a taxicab). Caps on the number of taxis as well as other regulations increase the costs of entry into the business, restricting supply well below demand. Common sense (as well as basic economics) suggests that if enough taxis are plying the streets of cities to meet demand, illegal medallion markets would not exist.

In fact medallions in the black market can command staggering sums. In New York City a cap on taxicabs created an illegal market of "gypsy cabs" that may have reached 30,000 in the 1990s. While the city government is slowly increasing the number of medallions, the official price runs upwards of $600,000. In fact, two medallions recently sold for $1 million each in a private sale in October 2011. In Boston the going rate for a black-market license is $400,000. In less restrictive cities licenses still can cost $25,000 or $30,000.

Existing cab companies, which often have representatives on the boards and commissions that regulate their industries, typically use their influence to prevent competition.

Pricing Out the Competition

While this price might not seem high for many middle-income families, the typical annual wage for a taxicab driver hovers around $30,000. In effect the high prices for a medallion make it virtually impossible for drivers to save up enough money to buy their own cab or start their own company. Increasingly severe restrictions are a boon to existing medallion holders because the value of their licenses increase. Thus one of the more pernicious effects of tightly regulating the taxi market and preventing supply from fluctuating to meet demand is dramatically fewer entrepreneurial opportunities. Low-income and minority communities are hit the hardest when markets that should have easy access are closed.

Meanwhile existing cab companies, which often have representatives on the boards and commissions that regulate their industries, typically use their influence to prevent competition. Local taxicab ordinances often have "need and necessity" provisions for new applicants that end up protecting a cartel of existing taxicab companies. Under such provisions the presumption is that the commission or board has already set the optimal number of cabs and level of service for the city. A prospective cab company must present evidence that it will serve a part of the market that is not currently being served by existing companies. Often applications are denied simply because existing companies showed they have the capacity to serve the market if it existed. New applicants are caught in a regulatory Catch-22. They have to prove that a market exists for their service. But if that market existed, established companies argue, they would be serving it. Therefore the underserved market doesn't exist. Application denied.

Unfortunately taxicab regulation demonstrates yet another hard, cold reality of politics: Once the regulatory authority is established in local ordinances, local politics make it difficult to deregulate. The benefits of regulation are concentrated in the hands of a few key players, usually existing taxicab owners and medallion holders, who have strong financial incentives to lock out new competition. They have access to the regulatory apparatus and relationships with regulators that put upstart companies and innovators at a distinct disadvantage. Entrepreneurs are not free to compete in the marketplace. To enter the market they need the permission of regulators influenced by those with a stake in maintaining the status quo.

Laudable Beginnings

Progressives led municipal reform movements across the nation during the 1880s and 1890s in a laudable attempt to purge cronyism and patronage from corrupt political systems. They led efforts to create electoral transparency and fiscal accountability, and recast politics in a more "professional" framework. Many of these municipal reforms led to the professionalization of city management. Even the institution of civil service was a step forward for most cities. Civil-service standards and exams for police and firefighters helped professionalize services. Although the downstream effects of public-sector unionization led to bloated budgets and inefficiency, fiscal transparency and accountability were laudable reforms.

Few areas of urban policy reflect the overly optimistic worldview of Progressive thinking, and the negative consequences for consumers and suppliers, as much as taxicab regulation.

Progressivism, however, has a dark side few fully appreciated at the time. Caught up in the emotional appeal of "scientific management," many thought government could and should be run like a business. One of the highest profile Progressives was President Woodrow Wilson, a father of modern-day public administration, who wrote pioneering articles in the late nineteenth century advocating the separation of administration from politics in government. The theory put the trained expert—the bureaucrat—at the center of political administration.

Few areas of urban policy reflect the overly optimistic worldview of Progressive thinking, and the negative consequences for consumers and suppliers, as much as taxicab regulation. The fatal flaw in the Progressive view is the belief that administration could in fact be separated from political pressure. Unlike the private market, where greed, egos, and inefficiency would be punished by losses, legislative election cycles are poor mechanisms for providing accountability. FEE

In this classic work, Skousen examines gold's unique ability to retain it's purchasing power and limit the havoc governments can wreak on the global economy. By examining the history and mechanics of gold-based monetary systems, Skousen lays out the case for a workable--and urgently needed-return to the stability of gold.

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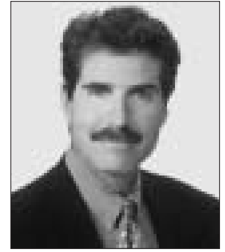
Government the Job Killer

BY JOHN STOSSEL



President Obama says government will have to build the nation out of the economic trough.

"We're the country that built the intercontinental railroad," Obama says. "So how can we now sit back and let China build the best railroads?"

I guess Obama doesn't know that the transcontinental railroad was a Solyndra-like Big Government scandal. The railroad didn't make economic sense at the time, so the government subsidized construction and gave the companies huge quantities of the best land on the continent. As we should expect, without market discipline—profit and loss—contractors ripped off the taxpayers. After all, if you get paid by the amount of track you lay, you'll lay more track than necessary.

Crédit Mobilier, the first rail construction company, made enormous profits by overcharging for its work. To keep the subsidies flowing it made big contributions to congressmen.

Where have we heard that recently?

The transcontinental railroad lost tons of money. The government never covered its costs, and most rail lines that used the tracks went bankrupt or continued to be subsidized by taxpayers. The Union Pacific and Northern Pacific—all those rail lines we learned about in history class—milked the taxpayer and then went broke.

One line worked. The Great Northern never went bankrupt. It was the railroad that got no subsidies.

We need infrastructure, but the beauty of leaving most of these things to the private sector—without subsidies, bailouts, and other privileges—is that they would have to be justified by the profit-and-loss test. In a truly free market, when private companies make bad choices, investors lose their own money. This tends to make them careful.

By contrast when government loses money, it just spends more and raises your taxes, or borrows more, or inflates. Building giant government projects is no way to create jobs. When government spends on infrastructure, it takes money away from projects that consumers might think are more important. When government isn't killing jobs by sucking money out of the private sector, it kills jobs by smothering the private sector with regulation. I talked to Peter Schiff about all this. Schiff is a good authority because he was one of the few people to warn of the housing bust. Now he's had a run-in with the federal government over job creation.

Schiff, who operates a brokerage firm with 150 employees, recently complained to Congress that "regulations are running up the cost of doing business, and a lot of companies never even get started because they can't overcome that regulatory hurdle."

Schiff claims he would have hired a thousand more people but for regulations.

"I had a huge plan to expand. I wanted to open up a lot of offices. I had some capital to do it. I had investors lined up. My business was doing really well. But unfortunately, because of the regulations in the securities industry, I was not able to hire."

People don't appreciate the number of regulations entrepreneurs face. Schiff pays ten people just to try to figure out if his company is obeying the rules.

"Even my brokers . . . find out that maybe 20 percent, 30 percent of their day is involved in compliance-related activity, activity that is inhibiting their productivity. . . . All around the country, people are complying with regulations instead of producing, instead of investing and growing the economy. They're trying to survive the regulations," he said.

This is no way to create jobs or wealth. Keynesian pundits and politicians can't understand why businesses sit on cash rather than invest and hire unemployed workers. It's really no mystery. Government is in the way. FEE

John Stossel hosts Stossel *on Fox Business and is the author of* Myths, Lies, and Downright Stupidity: Get Out the Shovel—Why Everything You Know is Wrong. *Copyright 2011 by JFS Productions, Inc. Distributed by Creators Syndicate, Inc.*

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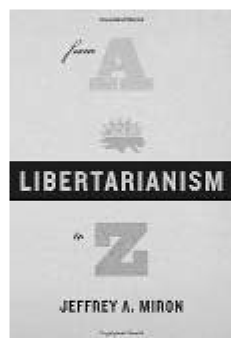
Book Reviews

Libertarianism, from A to Z

by Jeffrey A. Miron
Basic Books • 2010/2011 • 198 pages • $24.95 hardcover; $15.99 paperback

Reviewed by Aeon J. Skoble



Harvard University economist Jeffrey Miron's primer on libertarian thought proceeds just as the title indicates: a collection of alphabetically arranged short essays on 105 topics. This is a more effective technique than one might imagine: Since many people unfamiliar with libertarianism approach it by way of specific questions and challenges, Miron provides answers.

Readers of *The Freeman* will be familiar with this experience: How would libertarianism handle drunk driving? (That's under "D.") What do libertarians think about organ sales? (Under "O.") What do you mean by "unintended consequences"? (Look under "U.") The entries are not at all superficial, though; they are well thought out and carefully reasoned discussions of the topics. Just as important, they are well written: Since Miron's intention here is to communicate the good sense of these ideas, it really makes a difference that he can write clear and effective prose. And he goes beyond surface-level questions (such as minimum wage) to tackle more complicated issues like Pareto efficiency, fiat money, and abortion. Miron also includes entries on how libertarianism differs from conservatism and (modern American) liberalism, and how consequentialist approaches differ from rights-based approaches.

Another asset of this book is the way Miron uses some of the basic concepts of economics in ways that are not only accessible to the non-economist but also show how the "economic way of thinking" applies to a variety of problems that the average reader might not think of as economic. For example, in the entry on protection of endangered species, Miron appeals to the concept of incentives. Although this solution is counterintuitive, assigning private property rights in endangered species or their habitats will create better incentives for good stewardship. There are many examples in Africa of the success of this approach, so Miron is able to supplement the theoretical explanation of why this works with empirical evidence. He contrasts this effectively with statist approaches by showing how these end up being counterproductive. Worse than being ineffective, these policies can create incentives for behavior that is the opposite of what is intended. It's important that Miron can show this. Since a book like this has its chief value in outreach, it needs to provide answers to these sorts of questions from people who might not be predisposed to classical liberalism or the economic way of thinking. When he does appeal to precise notions like externalities or moral hazard, the reader is directed to entries on those.

Another feature I found compelling is the way Miron acknowledges the reality of moral disagreement where relevant, while nevertheless directing the reader to think in terms of policies that might make a positive change. For example, consider capital punishment. This isn't strictly speaking a definitional issue for libertarianism: It's possible to be a libertarian and think either that murderers deserve death or that no one has the right to take a life. But Miron encourages the reader to think about the issue differently. He frames the usual death penalty debate as "a distraction" and suggests that the reader approach the problem from the other side: "Society wastes substantial energy arguing about the death penalty rather than focusing on policies that would actually reduce crime, such as ending drug prohibition, legalizing prostitution, and improving educational outcomes." We could argue about what is the best way to punish murderers, but perhaps it would be more productive to create conditions in which there would be fewer murders. The quoted sentence refers the reader to the relevant entries in which Miron shows what the causal links are.

Oddly, there are no entries for "rights" or "liberty." This seeming lacuna is explained when one reads the entry "consequential versus philosophical libertarianism," in which Miron contrasts the approach he favors,

which he refers to as "consequentialist," with the "philosophical," or rights-based, approach. He argues that the latter approach is poorly supported and in any case less useful when trying to get others to see the benefits that libertarianism offers to a society. There is something to be said for the latter point, but the former point is belied by dozens of books by philosophers who explore the possible meanings of rights and liberty. Miron then says that the rights-based approach *is* consequentialist in that rights theorists claim that respecting rights has the best consequences. While a correct way to characterize John Stuart Mill, this doesn't really encompass the point of rights for John Locke or for neo-Lockeans and neo-Aristotelians.

But to dwell on this intra-libertarian dispute would be to diminish the overall quality of the book. *Libertarianism from A to Z* is accessible and readable, and makes its points clearly and concisely. Libertarians will want to have it partly as a reference work. You may already have come to accept libertarian principles but not remember how fiat money works. But it is also an excellent choice to recommend (or give) to friends or relatives who do not agree with this approach but are open-minded enough to want to inquire. Miron has thus done us a great service. FEE

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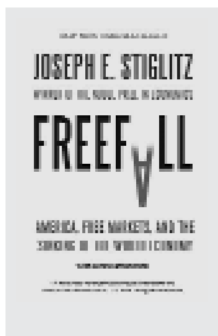
Freefall: America, Free Markets, and the Sinking of the World Economy

by Joseph E. Stiglitz
W. W. Norton • 2010 • 361 pages • $27.95 hardcover; $16.95 paperback



Reviewed by Lawrence H. White

In 2001 Joseph Stiglitz was co-recipient of the Nobel Prize in economics, a fact prominently noted on the dust jacket of *Freefall*, his book on the financial crisis. In 2002 Stiglitz and two coauthors produced a report, commissioned and published by the government-sponsored housing agency Fannie Mae, stating that the risk of a failure by Fannie Mae was "extremely small"; indeed, "under the assumptions they adopted, the risk to the government from a potential default on GSE [Fannie and Freddie] debt is effectively zero." That report is mentioned nowhere in *Freefall*.

In 2008 Fannie Mae (and its sibling, Freddie Mac) both failed. Their debts were assumed by the federal government. The loss imposed on taxpayers was recently estimated by the Congressional Budget Office at $325 billion through 2011, with additional losses to come.

In the above-mentioned report Stiglitz and his coauthors noted the view that there was an implicit government guarantee that enabled Fannie and Freddie to borrow at below-market interest rates. Their estimates of taxpayer risk were based on the assumption that "the implicit government guarantee on GSE debt is equivalent to an explicit guarantee." In *Freefall*, by contrast, Stiglitz declares, "Fannie Mae began as a government-sponsored enterprise but was privatized in 1968. There was never a government guarantee for its bonds; had there been, its bonds would have earned a lower return, commensurate with U. S. Treasuries."

That statement is seriously misleading. Fannie (and Freddie) had an all-but-explicit guarantee and received other favored treatment from the government. Reflecting the implicit guarantee, their bonds paid lower yields than those of other private financial institutions. Their borrowing-cost advantage was worth billions per year.

The misleading treatment of Fannie Mae and Freddie Mac is just one example of a pervasive feature of *Freefall*: It often traffics in ideological spin. Stiglitz notices the mote of ideological bias in the eye of "those who have done well by market fundamentalism," but ignores the beam in his own.

Free of false modesty Stiglitz describes himself as a member of "a small group of economists" who in the years before 2008 "tried to explain why the day of reckoning that we saw so clearly coming had not yet arrived." He views himself as a courageous outsider, but it is difficult to share Stiglitz's outsider picture of himself in light of the well-placed insider roles he has occupied during his career: chairman of the President's

Council of Economic Advisers (1995–97) and chief economist at the World Bank (1997–2000).

A major theme of *Freefall* is that incentive-distorting government regulations had little to do with the financial crisis. The plot line of his narrative is indicated by the title of chapter six: "Avarice Triumphs over Prudence." The crisis happened in a "deregulated market," or a market characterized by "lax regulation," and so "it was something that Wall Street did to itself and to the rest of society." He writes of "the deregulatory frenzy of the 1980s, 1990s, and the early years of [the 2000s]," and "the current rush to deregulation," events not evident in the actual historical record.

Stiglitz makes his case for government intervention by holding free markets to the straw-man standard of frictionless efficiency. He touts his own academic research as showing that when the conditions for perfectly frictionless efficiency are not satisfied, "there [are] always some government interventions that could make everyone better off."

This is argument by existence proof: The brief for government intervention is that we can *imagine* a case in which it improves things. It *could* make everyone better off—*assuming* an ideally omniscient and benevolent intervener. Might not actual government interveners fail to meet the conditions for their own perfection? Might they fail to know just where and how to intervene?

At least Stiglitz recognizes that government policies played a crucial role in creating the housing bubble. He notes that the Federal Reserve's loose monetary policies under Greenspan fueled the housing boom and acknowledges the role of the moral hazard fostered by too-big-to-fail policies. He points out the cronyism involved in bailouts to Wall Street, particularly from the Federal Reserve Bank of New York.

Stiglitz offers a straightforwardly Keynesian analysis of the Great Recession, blaming it on insufficient aggregate demand. Therefore the government should "attack with overwhelming force" in the form of massive stimulus spending, an approach he suggests might be called "the Krugman-Stiglitz doctrine."

Overall the book is a patchwork of nonscholarly accounts of historical events beside attempts to render scholarly economic theories into plain language. In many places the book disappointingly reads as though the author lacked the time to state his case systematically and coherently, to anticipate the strongest objections to his arguments and state them fairly, then address them carefully with evidence. FEE

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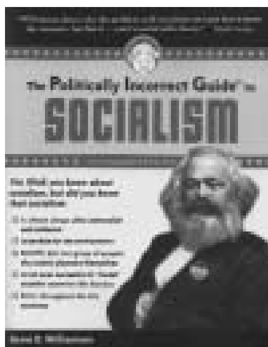
The Politically Incorrect Guide to Socialism

by Kevin D. Williamson
Regnery • 2011 • 272 pages • $19.95

Reviewed by George Leef



What do the following have in common: hungry Venezuelans, starving North Koreans, ecological devastation in the former Soviet Union, and functionally illiterate students in Washington, D.C., high schools? Give up? They are all consequences of socialism.

In his book *The Politically Incorrect Guide to Socialism*, economics professor and *National Review* editor Kevin Williamson gives the reader an easily understood yet highly informative disquisition on the nature of socialism, its inherent flaws, and the reasons it continues to spread. In connection with that last point, two of Williamson's chapters cover the political infatuation with "energy independence," which he argues is socialist in essence, and the push to saddle Americans with the politicized medical care system known as Obamacare.

Williamson's arguments are sharp and his examples illuminating. His book is like a wrecking ball going to work on the already feeble edifice of socialism.

"Hold on a minute," some will say. "You can't compare the bad things that happen in a totalitarian state like North Korea with our well-intended and generally popular public school system in America." Williamson shows, however, that the crucial element of socialism is present in both, namely governmental control over the provision of goods and services that would otherwise

be done by private enterprise. That invariably leads to waste and inefficiency—or even worse.

Williamson does a first-rate job of explaining why those arrangements stifle productivity, depress quality, and hinder innovation. It is because government officials (and the type of government is immaterial) do not know what consumers want. That information only comes from the market's price system, which socialism prevents from working. It is also because government officials have no incentive to satisfy consumer wants since their money is not given by buyers but taken from taxpayers. Starving peasants in Korea and illiterate students in the United States—the roots are the same.

The poverty of India has been compared to the remarkable wealth enjoyed by the people of Hong Kong and Singapore before, most famously by Milton Friedman, but that is no reason not to emphasize it again. Following World War II, Williamson observes, India was seemingly poised for great economic expansion, having suffered little from the war and benefiting from infrastructure built by the British. India's economy, however, remained stagnant due to the naive socialism of Nehru, the first prime minister, who admired Soviet central planning. Grinding poverty gripped most of the country.

Singapore and Hong Kong, in contrast, had suffered considerable war damage. Nevertheless both enjoyed rapidly rising incomes for all income classes. The fact that prosperity was widespread is important in heading off the common objection that capitalism only helps a few. Those two city-states were able to escape from poverty by rejecting socialism and adopting laissez faire: prices were free, investors could seek profitable opportunities without government interference and keep their earnings (or swallow their losses) and taxes and regulations were minimal.

Williamson also points out that in recent years India has begun rapid economic development, but only because new leaders have lightened the heavy yoke of socialism.

Defenders of socialism almost always point to Sweden and say that its experience proves that socialism can work. Williamson's chapter "Why Sweden Stinks" refutes that notion. Sweden seemed to have the best of all possible worlds—a high standard of living combined with an expansive "safety net" and generous government benefits. The trouble is that socialism is unsustainable because it erodes the human qualities that built up the wealth that the socialist state consumes. Williamson writes that Sweden "is rapidly transforming itself into the sort of society that will not be able to support the relatively successful welfare-state arrangements that characterized it throughout most of the twentieth century." As Hayek observed, socialism changes the character of the people gradually, undermining habits of work, thrift, and self-reliance. We are seeing that in Sweden.

Speaking of Hayek, another of his famous insights regarding socialism was that under it, the worst people usually rise to the top. I wish that Williamson had included a chapter on that point. We hear so often from socialism's advocates that their system would work beautifully if it were controlled by good people rather than murderous dictators like Stalin. It would have been worth several pages to attack the idea that there is some magic formula to keep vicious, power-mad people from scheming their way to the top of a system that gives them what they crave.

Finally, although I applaud Williamson's effort, he has bundled together under the label "socialism" several policies better labeled "corporatist" or "collectivist" since they don't entail government ownership or abolition of the market economy—only interventions that hamper it. Ethanol subsidies are bad, but we don't have a federally owned energy sector and "public education" doesn't prevent (though it surely hampers) home and private schooling. Such distinctions are important. FEE

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New Threats to Freedom: From Banning Ice Cream Trucks in Brooklyn to Abandoning Democracy Around the World

edited by Adam Bellow
Templeton Press • 2010/2011 • 304 pages • $20.76 hardcover; $11.96 paperback

Reviewed by Wendy McElroy

New Threats to Freedom, edited and introduced by HarperCollins's executive editor Adam Bellow, is an ambitious anthology. Its premise: The twentieth century faced unique threats to freedom, such as communism and fascism, and the 21st century equally confronts unique challenges to the preservation of freedom.

Thirty renowned authors examine 30 of those "threats," which include the emergence of sharia law within western nations, the paradoxical uniformity that "politically correct" diversity has spawned, the abandonment of democracy promotion abroad, the State regulation of daily life, the imposition of campus speech codes, and the "threat" of cyber-anonymity.

At first glance the "new threats" seem like a grab-bag of issues that will rouse and rile a reader committed to individualism . . . and they do so in rapid secession.

The thought-provoking essay "The Isolation of Today's Classical Liberal," by legal scholar Richard A. Epstein, appears directly before the socially conservative essay, "Single Women as a Threat to Freedom," in which antifeminist Jessica Gavora dismisses a plausible lifestyle choice largely because "single women are pro-statist." "The Rise of Antireligious Orthodoxy," by conservative Mark Helprin, directly precedes an essay by the notoriously antireligious left-radical Christopher Hitchens; the juxtaposition is not meant to provide balance, since Hitchens deals with the issues of multiculturalism and diversity.

Yet clearly this is a carefully constructed anthology. At a third or fourth glance, an integrating theme emerges. At its root *New Threats* is a socially conservative collection on issues that this movement assesses as threats; the anthology's libertarian contributors indicate where these two movements intersect.

Consider the excellent essays by libertarians Max Borders and Katherine Mangu-Ward.

In "The Urge to Regulate," Borders recounts how bureaucratic regulation crushed his dream of starting a small home-based business designed to sell products at a farmer's market. He imagines a parallel world without "regulatory barriers," in which hard work and reputation are allowed to succeed. Then, poignantly, Borders speculates about "the possible worlds that government interference destroys." These are populated by working people who long to provide for their families.

In "The War on Negative Liberty," Mangu-Ward analyzes the bizarre spectacle of Americans asking the government to strip them of lifestyle choices like smoking or consuming trans fats. Or at the very least they wish government to impose punitive taxes on such choices. She compares the Taliban's prohibition of women eating ice cream to the Brooklyn mom who turns in an unlicensed vendor. The common denominator: "[B]oth want the same thing—a targeted ban on ice cream."

Borders and Mangu-Ward address fundamental questions that mirror each other. Borders asks, "What makes people want to control others?" Mangu-Ward asks, "[H]ow could people who cherish freedom clamor for the state to take away their choices?"

In opposing government regulation of business and its imposition of political correctness on food choices, the two essays exemplify issues on which libertarianism and social conservatism converge. Similarly, a few non-conservative authors like Hitchens touch on the rare areas of confluence between the right and other positions. In areas of difference, however, it is the conservative voice that is heard. As such *New Threats* is a fascinating window into the psychology of social conservatism and the issues that will be "burning" for them in the future.

What are some of the differences on issues? Perhaps they are most pronounced in foreign policy. *New Threats* authors equate democracy with liberty and think that Americans should export it. In "The Abandonment of Democracy Promotion," Tara McKelvey—a senior editor at *The American Prospect*—claims such exportation

"belongs high on the U.S. foreign-policy agenda and should be supported by substantial resources." Former *New Republic* contributing editor James Kirchick concludes in "Transnational Progressivism" that "any threat to American global predominance . . . is in and of itself a threat to freedom, not only to our own, but especially to those people living in dark places."

An aggressive foreign policy designed to export a specific political system is a difference of opinion with libertarians, indeed.

New Threats is, in rapid turn, provocative, annoying, and enlightening. It is also puzzling in its omission of certain issues and seemingly obvious points. For example, given the 21st-century focus, little discussion of technology occurs outside of a critique of cyber-anonymity. Abstract "ingratitude" is included as a threat to freedom whereas concrete reproduction and population control in light of new technologies is not. In presenting sharia law as a threatening parallel legal system, it is not clear why sharia courts could not operate as Hasidic ones currently do.

Nevertheless *New Threats* is fascinating and extremely well written. Social conservatives will be delighted; libertarians will embrace fully half of it; Progressives with high blood pressure had best be selective . . . or at least consult a doctor beforehand. FEE

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Employer Speech and Freedom of Association

BY CHARLES W. BAIRD

I have argued that forcing a worker to submit to the will of a majority of his colleagues on the question of whether a union will represent him is a violation of that worker's freedom of association (tinyurl.com/cepz2s). Association with a union is rightly a matter of individual not collective choice. Here I want to consider attempts by unions further to diminish worker freedom of association by trying to silence or at least obstruct employer campaign speech in the run-up to representation elections.

Freedom of association in union representation elections requires that workers be able to cast an informed vote. Workers must have access to both pro- and anti-unionization arguments. We can count on union organizers vigorously to present pro-unionization arguments. They start doing so long before any representation election is scheduled because they must get 30 percent of eligible workers to sign cards requesting unionization before the National Labor Relations Board (NLRB) will order an election.

We usually can count on employers vigorously to present anti-unionization arguments, but they have less time than union organizers have to make their case. They often don't know about union organizing efforts until the union has collected the requisite signatures. The time between the NLRB's order to have an election and the actual election is crucial if workers are to be able to hear the employer's side of the story and thus be able to make an informed choice about how to vote.

Employers who don't follow union marching orders can face public smear campaigns, including the appearance of "Scabby the Rat."
Schlomo Rabinowitz [flickr]

In 1947 Congress amended Section 7 of the National Labor Relations Act (NLRA) to make explicit the right of workers to refrain from unionization. To give effect to that right, Congress added Section 8(c), which affirmed the right of employers to engage in free speech during election campaigns. Congress wanted workers to hear both sides of the debate over whether to unionize so that they could make informed decisions.

In 1948 the NLRB endorsed this intent of Congress by declaring, in *General Shoe Corp.*, that its primary duty under the new law was to support workers' right to "make a free and fair choice" on the question of whether to unionize. Absent force or fraud, election debate is, the Board asserted, the best way to enable workers to do so.

In *Linn v. United Plant Guard Workers* (1966) the Supreme Court noted approvingly that the NLRB does not "police or censor propaganda used in the elections it conducts, but rather leaves to the good sense of the voters the appraisal of such matters, and to opposing parties the task of correcting inaccurate and untruthful statements." The Court went on to affirm that "debate . . . should be uninhibited, robust, and wide-open, and that it may well include vehement, caustic, and sometimes unpleasantly sharp attacks."

Notwithstanding the clear intent of the 1947 Congress, and the eager endorsement of that intent by the 1948 NLRB, and the 1966 Supreme Court, the present NLRB demurs. It takes its orders from unions, and unions seek to silence employer speech.

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The failed card-check bill would have silenced employer speech because it would have forced an employer to recognize a union as the monopoly bargaining agent over his employees if it collected the signatures of at least 50 percent of them on cards requesting such recognition. There would be no election campaign during which employers could give their side of the debate.

Card Check by Fiat

Union cronies in Congress failed to deliver on card check, but on August 26, 2011, the pro-union NLRB troika—Mark G. Pearce, Craig Becker, and Wilma B. Liebman—created a limited form of card check by regulatory fiat. In its *Lamons Gasket* decision the troika overturned the Board's 2007 decision in *Dana Corp*.

The NLRA permits an employer voluntarily to recognize a union as the monopoly bargaining agent over his employees if the union collects the signatures of at least 30 percent of them on cards that request such recognition. In *Dana Corp.* the NLRB ruled that when an employer chooses to grant recognition to a union without first letting the employees vote on whether to be subjected to union rule, the affected employees could immediately demand an election to challenge the employer's voluntary recognition.

Union rule over workers, lasting at least six months, can be achieved by a 30-percent card check rule.

In *Lamons Gasket* the troika declared that the affected employees would have to wait for at least six months, and in some cases up to one year, before they could hold a challenge election. This means that union rule over workers, lasting at least six months, can be achieved by a 30-percent card check rule.

Why would an employer choose to turn his workers over to union rule without a secret ballot election? Because he fears a "corporate campaign." Following Saul Alinsky's *Rules for Radicals*, a union picks a target enterprise to unionize and demands that the target not resist. If the target chooses to defend itself and its workers against unionization, the union forms coalitions with leftist community-activist groups to try to destroy the target's standing in the community and its relationships with lenders, suppliers and customers. The union and its allies smear the target and its officials as monsters who want to take away their employees' freedom of association. The union and its allies, often including benighted clergy, claim the moral high ground. But employers who choose to resist really occupy the moral high ground. They promote their employees' freedom of association.

Shortened Election Process

In another attack on employer campaign speech, in June 2011 the NLRB troika decided to cut the representation election process from its present median of 38 days to ten days. With less time to speak, employers will speak less.

There are several reasons for workers to choose to be union-free. For example, union-free enterprises offer more job security than their union-impaired counterparts because the latter are too sclerotic to frequently changing global market conditions. Union-free firms can reward workers on the basis of productivity. In union-impaired firms pay is based on job classifications and seniority. Union-free workers are free to excel, while union-impaired workers are chained to a contract. Unions promote an adversarial relationship between workers and employers, while union-free employers are free to enlist workers as partners in building durable and growing value.

The NLRA illegitimately forces workers into representation elections. To make matters worse, the current NLRB seeks to obstruct the access of workers to arguments in favor of remaining union-free. Employers are the most reliable conveyors of those arguments. Employers must be free to speak. FEE