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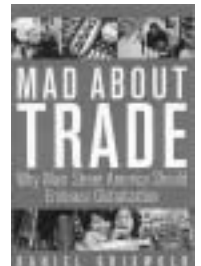
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What Does the Oil Spill Prove?

You've got to hand it to the people who dislike free markets. They see them everywhere, especially wherever any serious problem arises. That no free market exists within a thousand miles makes no difference whatsoever.

Take the oil spill in the Gulf. Market opponents are having a field day. They say this finally demonstrates the need for government to run things. Private firms can't be trusted.

But it looks more like government can't be trusted. The central government is, in law and in fact, the owner of the part in the Gulf where BP drilled for oil. (I did not say it is the legitimate owner.) The owner leased its property to a private company, BP, with a bad safety record, issued permits for the drilling operation, and required the company to use the government's own flawed models in preparing for spills. It then failed to keep a sharp eye on what BP and subcontractors Transocean and Halliburton were doing to its property. That might have something to do with the fact that government regulators don't have the sort of relationship to "their" property that normal private owners do, and they can always be counted on to get friendly with those they regulate. The Minerals Management Service in the Interior Department has a special conflict of interest: It makes money off the drilling it permits and regulates. Thus it could benefit from decisions that are bad for the public.

So what failed here, the market or the State? The call isn't even close. The free market was nowhere near the scene. It has an airtight alibi: It didn't exist.

Now you might get a die-hard anti-market person to concede this. So we move to the next step. What should replace the current hybrid (government-corporate) system? I see only two choices: full government management or full market management. Full government management wouldn't appear terribly promising, considering that the current problems are traceable back to government management. How would things change substantially if, instead of contracting out the drilling to a nominally private company, the government instead

hired the personnel itself and paid them directly from the U.S. Treasury? Who cares if the rig says “BP,” “Transocean,” or “U.S. Government” on it? The same fallible people would be in the same position to make the same fateful mistakes. Not much would change.

That’s because what matters is incentives, not whether a worker is on the government payroll. Why assume that civil service employees know or care more than people paid by corporations?

But, it will be said, government workers will have a mandate to protect the environment and the public. Okay, let’s go with that. Let’s say the decision-makers are environmental hawks who really don’t like oil drilling anywhere. They’ll be tough: no drilling unless it’s 100 percent safe. Leaving aside the obvious problem with this standard, that policy would have costs. The risk of oil spills may drop to zero, but we might have to forgo certain important benefits in the process. Poor people, say, might have their prospects dimmed by more expensive energy.

Is the tradeoff worth it? How do we go about answering that question? Government is no help here. It can certainly impose a plan, but constructing a plan beneficial to the public would be like playing darts in the dark. Mises and Hayek covered this in their writings on State socialism and economic calculation.

Things are sure looking bleak. Government assurances are worthless whether it contracts out for drilling or does it itself. That leaves only the free market. Can it be trusted?

First off, let’s remember that we live in the real world. There are no iron-clad guarantees. The best we can hope for is *relative* security. When people conclude that government management is the best alternative, knowingly or not they have rigged the game. They are comparing the messy real world in which free markets would operate to an impossible government-managed utopia, where regulators have complete knowledge and total dedication to the public interest. This is the Nirvana Fallacy.

Only two options are on the table: an arrangement where incentives align economic activity with the public interest and one where they don’t. Now which setup seems more promising? One where personnel risk no capital, face no prospects of bankruptcy, and procure their revenue by force (taxation) after flattering members of special-interest-serving congressmen? Or one

where capital has to be raised from wary investors in a competitive environment, insurance is priced according to risk, products have to be sold to buyers who are free to say no, and full and strict liability haunts every decision, with bankruptcy always looming and no government bailout even implied?

When you come down to it, the choice is really rather easy.

The fiscal fiasco we’re mired in is driving “responsible” heads to search for new sources of revenue, among them the value-added tax. It’s an idea whose time should never come, Roy Cordato writes.

The Fourth Amendment appears to enshrine the right to privacy against government intrusion. But it hasn’t quite worked out that way, according to research by Joseph Stromberg.

How can a nation of immigrants be so down on immigration? Aeon Skoble has some explanations.

We often assume the Founding Fathers would be spinning in their graves if they knew what’s going on in the United States. But probably not Alexander Hamilton, Nicholas Curott and Tyler Watts suggest.

A new era of financial regulation is upon us. Chidem Kurdas has the details of what’s been cooked up by some of the chefs who prepared the last collapsed soufflé.

Predicting the future is big business, but why do most prognosticators get it so wrong? Steven Horwitz applies some good economics and comes up with an answer.

The record of government regulation is consistently bad. Robert L. Bradley, Jr., and Richard W. Fulmer give us 15 reasons why this has to be the case.

From our columnists: Donald Boudreaux examines the language for bias. Stephen Davies detects a return of the economic way of thinking. David Henderson assesses the state of civil liberties. John Stossel laments the destruction of property rights. And Charles Johnson, confronting the assertion that opposing civil rights legislation means opposing civil rights, responds, “It Just Ain’t So!”

Books on animal spirits, a black entrepreneur, free trade, and *Marbury v. Madison* are evaluated by our reviewers.

—Sheldon Richman, Editor
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Opposing the Civil Rights Act Means Opposing Civil Rights? It Just Ain't So!

BY CHARLES JOHNSON

Just after winning his Republican primary in May, Rand Paul got himself into a political pickle over his views on property rights and the 1964 Civil Rights Act. Having reluctantly discussed concerns about antidiscrimination laws with the *Louisville Courier-Journal* and NPR, Paul made his now-notorious appearance on the *Rachel Maddow Show*, where Maddow grilled him for 15 minutes on whether he opposed government intervention to stop racial discrimination. After saying he favored overturning *government-mandated* discrimination, Paul finally admitted that he opposes Title II, which forbids *private owners* from discriminating in their own businesses.

As he told the *Courier-Journal*: “I don’t like the idea of telling private business owners—I abhor racism; I think it’s a bad business decision to ever exclude anybody from your restaurant; but at the same time, I do believe in private ownership. . . .”

Maddow responded: “I think wanting to allow private businesses to discriminate on the basis of race, because of property rights, is an *extreme view*.” Within a day Progressives were touting the interview as proof of a deep conflict between libertarian defenses of private property and struggles for racial equality. Meanwhile, compromising libertarians like Brink Lindsey reacted by discovering exceptions to libertarian principles—to make room, again, for federal antidiscrimination laws. The entire debate has played out as an argument over libertarianism and “extremism,” with Progressives and many nominal libertarians

both condemning Rand Paul’s simplistic “extremism” about private property and libertarian rights.

I have little interest in defending Paul but it’s strange to treat him like some case study in the dangers of libertarian extremism. *Rand Paul is a conservative, not a libertarian*—let alone an “extreme” one. He’s said as much, in so many words, in repeated interviews. Now, you could simply say, “*He* may be no libertarian, but never mind Rand Paul—what about the issue?” Libertarianism opposes government control of private business decisions; taken to extremes, doesn’t that include laws against racist business practices—the civil rights movement’s crowning achievement?

Well, I do have something to say on behalf of “extremism.” Not on behalf of *sacrificing* the civil rights movement’s achievements to “extreme” stands on antistatist principle. Rather, “extreme” stands on antistatist principle show what the civil rights movement did *right*, and what it really achieved, without the aid of federal laws.

To be sure, uncompromising libertarianism *does* mean uncompromised property rights. That includes, if we’re to be “extremists,” a conscientious defense of businesspeople’s right to be awful, to discriminate against anyone for any reason, so long as they do it on their own property without violence. That ain’t Jim Crow as practiced in the South: State laws and Klan terrorism there enforced segrega-



Organized protests like these sit-ins used economic and social pressure to end racist company policies.

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tion on unwilling businesses. But Maddow's correct—Jim Crow was also a social and economic system, and white businessmen colluded even without legal mandates. Woolworth's lunch counters were segregated by company policy not by law. Rand Paul "abhors" that personally and wouldn't eat there but thinks government shouldn't intervene.

Maddow was baffled: "But isn't being in favor of civil rights, but against the Civil Rights Act like saying you're against high cholesterol but in favor of fried cheese?" She's begging the question; you may as well ask how someone could be for patriotism but against the PATRIOT Act. But while mistaken, the question isn't cheap rhetoric. It's revealing of Maddow's premises about law and social progress.

As she insisted later, "Let's say there's a town *right now*. . . . [T]he owner of the bowling alley says, 'we're not going to allow black patrons.' . . . You may think that's abhorrent and you may think that's bad business. But *unless it's illegal, there's nothing to stop that*—nothing under your worldview to stop the country from resegregating."

Unless it's illegal anything could happen; nobody can stop it; a just social order can only form through social control. Private segregation should stop and only government can stop it; hence, Title II. Paul helpfully suggests you can loudly announce your personal abhorrence of racism, even without laws. Maddow rightly dismisses *that* as a response: Entrenched white supremacy was indifferent to personal outrage; it demanded concerted, political resistance.

But if libertarianism has anything to teach about politics, it's that politics goes beyond politicians; social problems demand social solutions. Discriminatory businesses should be free from *legal retaliation*—not insulated from the *social* and *economic* consequences of their bigotry. What consequences? *Whatever consequences you want*, so long as they're peaceful—agitation, confrontation, boycotts, strikes, nonviolent protests.

So when Maddow asks, "Should Woolworth's lunch counters have been allowed to stay segregated?" neither she nor Paul seemed to realize that her attempted *coup de grace*—invoking the sit-in movement's student mar-

tyrs, facing down beatings to desegregate lunch counters—actually offers a perfect libertarian response to her own question.

Because, actually, *Woolworth's lunch counters weren't desegregated by Title II*. The sit-in movement did that. From the Montgomery Bus Boycott onward, the Freedom Movement had won victories, town by town, building movements, holding racist institutions socially and economically accountable. The sit-ins proved the real-world power of the strategy: In Greensboro, N.C., nonviolent sit-in protests drove Woolworth's to abandon its whites-only policy by July 1960. The Nashville Student Movement, through three months of sit-ins and boycotts, convinced merchants to open all downtown lunch counters in May the same year. Creative protests and grassroots pressure campaigns across the

Politics goes beyond politicians; social problems demand social solutions.

South changed local cultures and dismantled private segregation without legal backing.

Should lunch counters have been allowed to stay segregated? No—but the question is *how* to disallow it. Bigoted businesses shouldn't face *threats of*

legal force for their racism. They should face a force much fiercer and more meaningful—the full force of voluntary social organization and a culture of equality. What's to stop resegregation in a libertarian society? *We are*. Using the same social power that was dismantling Jim Crow years before legal desegregation.

I oppose civil rights acts *because* I support civil rights *movements*—because the forms of social protest they pioneered proved far more courageous, positive, and *effective* than the litigious quagmires and pale bureaucratic substitutes governments offer.

Libertarians must change the terms of this rigged debate. The problem isn't that libertarian views get "extreme," but that some don't take free markets *far enough*, forgetting they mean freedom not just for businesses and stereotypical forms of commerce but for every sort of consensual social experimentation, nonviolent social struggle, and people-powered solidarity free people can practice. The question is not whether to make our views less "extreme," but how to make our "extremism" more thoughtful. Perhaps libertarianism, the nation, and the world are in dire need of creative extremists. FEE

The VAT: Not Just Another Tax

BY ROY CORDATO

Recently there has been a great deal of speculation about how the U.S. government will deal with its massive budget deficits and increasing levels of debt. For readers of *The Freeman* the answer is rather simple: Since most of what the federal government does goes beyond its “legitimate” role, cut spending. Drastically. Discussions about balancing spending cuts with tax increases are misplaced given the current size and scope of government activity.

But, alas, *Freeman* readers are not the relevant decision-makers. Tax increases are driving much of the discussion, and no option is discussed more than a value-added tax, or VAT. Indeed there is much speculation that President Obama’s Bipartisan Commission on Fiscal Responsibility and Reform will include a VAT as the major source of new revenues in any set of recommendations.

The VAT is a pernicious and insidious tax that promises to fuel dramatic growth in government. But this cannot be understood without first examining the mechanics of the tax. The devil is indeed in the details.

Theory

Theoretically a VAT is levied on the “value added” at every stage of production to goods and services ultimately purchased by consumers. The consumer, however, pays the final tab.

The table on the next page shows four stages of production leading to the final sale. (This example is from Michael Schuyler’s *Consumption Taxes: Promises and*

Problems, Fiscal Issue 4, Institute for Research on the Economics of Taxation, 1984.) As each stage is completed, a partially finished product has value added before it is sold to the next stage. In this example, value added is taxed at 10 percent. To simplify, a starting point is picked with “prior producers” having added the first \$10 of value. At the point of sale a 10 percent tax, \$1, is collected. Thus the cost to the manufacturer is \$11.

After adding further refinements the manufacturer sells his partially finished product for \$30 to the wholesaler and charges a 10 percent VAT, receiving \$33. To figure the tax, the manufacturer subtracts the tax from the previous stage to avoid double taxation. Before sending the tax to the government, he deducts the \$1 paid to the original producer. With value added at \$20, he sends \$2 to the government.

The wholesaler adds \$50 in value to the product and sells it to the retailer for \$80 plus the 10 percent, for a total of \$88. But before he sends the \$8 to the government, he deducts the \$3 in VAT paid to the manufacturer. The net tax collected is \$5. Ultimately the retailer sells the finished product to the consumer for \$100 plus the 10 percent VAT, or \$110. Again, the retailer deducts the \$8 that he had previously paid and sends \$2 to the government, or 10 percent of the \$20 in value added at this final stage. (If at any stage a producer sells his goods for less than the cost of his mate-

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government.

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Calculating Value Added and the Value-Added Tax by the Subtraction Method					
Producer	Selling Price without Tax	Purchases from Other Producers	Value Added	10% of Value Added	Selling Price (Including 10% VAT)
Prior Producers	\$10	\$0	\$10	\$1	\$11
Manufacturers	30	10	20	2	33
Wholesaler	80	30	50	5	88
Retailer	100	80	20	2	110

rials, he would pay tax only on the actual selling price.)

In principle there is no difference, in terms of the total tax collected, between a VAT and a retail sales tax. But the compliance costs of a VAT would be much higher because the tax is collected at every stage of production.

Practice: The Invoice-Credit Method

Most governments have adopted the “invoice-credit method” for collecting a VAT. The United States would likely do the same. This method makes tax collection automatic. In the example, which doesn’t use that method, companies deduct the amount of tax already paid at each stage of production before sending in the tax on value they added. But with the invoice-credit method, the taxpayer at each stage is responsible for the entire amount of the tax on his sale and can only obtain a credit for taxes paid previously if he provides an invoice from his suppliers. For example, the retailer that purchases the product from the wholesaler for \$88, VAT included, must pay the full \$10 tax on his sale to the final customer and then submit an invoice provided to him by the wholesaler showing that he paid \$8 in tax. Only then can he get credit for it.

Michael Schuyler, economist at the Institute for Research on the Economics of Taxation, points out that the invoice-credit method ensures that the tax is “self-policing.” Focusing on the transaction between the manufacturer and wholesaler in the example, Schuyler

writes, “Suppose . . . that the manufacturer wants to understate the sale price of its output . . . so that it can reduce its tax. . . . Would the wholesaler allow the phony amount to be listed on its purchase invoice? The wholesaler would object because the [amount gained by] the manufacturer would be lost to the wholesaler.”

Thus there is a strong incentive for businesses to police the reporting of their suppliers.

A Central Planner’s Dream Tax

From the perspective of the State, this is a near-perfect tax. It touches every stage in every production process, from new homes to hair cuts, and allows the government, because of the required invoices at every point, to keep track of every business’s buying and selling. For a State bent on managing the details of business, possibly to implement CO₂ controls or to make sure that politically favored firms (say, unionized ones) are patronized, the information can establish a useful database.

But beyond this, the VAT would be a revenue-generating machine, unmatched by any other form of taxation. First, it guarantees that a percentage of the total value of all goods and services sold in the economy goes to the State. Nothing escapes the tax. Also, because it is levied on such a broad base, very small increases in the rate would bring in large amounts of revenue. While this is also theoretically true of a retail sales tax, the multilayered enforcement mechanism of a VAT makes it almost impossible to avoid. Note that the tax on the full value added up through any stage

of production is the responsibility of the company operating at that stage, until the company provides the needed invoices from his suppliers that allow him to receive the credit. As a product passes through different stages of production, the incentive is always to collect the tax from those you are selling to and to collect the invoices from those you are buying from. Every business becomes a revenue agent. With very little enforcement effort, the government watches the money roll in.

Adding insult to injury for the taxpayer and icing on the cake for the State, the tax is usually hidden from the final consumer. Unlike a retail sales tax, the VAT is usually included in the sticker price of the product. Con-

sumers are not directly confronted with the fact that they are paying it. This both makes the tax easy to increase and masks the true cost of government. If we are ultimately going to reduce the size of the State, individuals need to feel the pain it inflicts. This starts with making people keenly aware of the taxes they pay. There is no tax more hidden from the people who pay it than a VAT.

The VAT is not just another tax. It poses a fundamental threat to liberty and a free society. And since a tax with such massive revenue-generating capabilities would be nearly impossible to repeal, it is likely that there would be no turning back the advancement of Leviathan. **FEE**

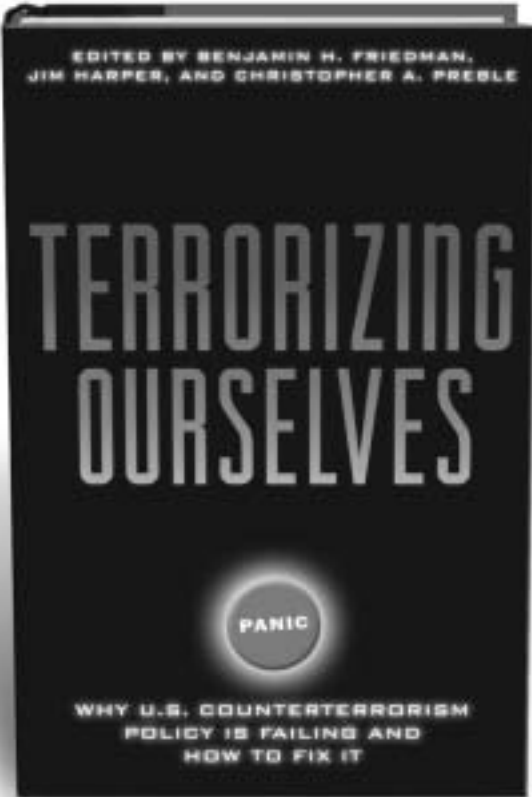
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— JAMES FALLOWS, National Correspondent, *The Atlantic Monthly*

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The Fourth Amendment and Faulty Originalism

BY JOSEPH R. STROMBERG

“All arrests are at the peril of the party making them.”

—Alexander H. Stephens, August 27, 1863

These days the Fourth Amendment to the Constitution means next to nothing. Consider, for example, the choice offered a few years ago: surveillance under routine, easy “warrants” from the drive-through FISA Court or warrantless surveillance at the whim of George W. Bush and his allegedly boundless reserve of unitary-executive authority. A January 2006 Justice Department memo (“Legal Authorities Supporting the Activities of the National Security Agency . . .”) explained the executive’s claims in mind-numbing and unconvincing detail. But the memo at least suggested how far below any practical service to Americans’ liberty the Fourth Amendment has fallen, and did so by heaping up available (and rather bad) search-and-seizure precedents, many of which arose from the terminally futile war on drugs (pages 37–38). The result is something like “your Constitution on drugs”—with the searchers and seizers on steroids.

Turning to the Fourth Amendment itself, we read: “The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.”

This sounds pretty good, doesn’t it? And solid, like it might actually mean something. Alas, no such utopian

state of affairs actually obtains. It is possible of course that my elementary school teachers just plain lied to us when they spun golden tales about American freedoms.

Yet surely there is more to it. But if so, what doom befell the Fourth Amendment? We might try looking at various eventful periods when governments—state and federal—felt unusually strong needs to arrest, search, and seize, such as the Civil War, Reconstruction, World War I, Prohibition (see Lacey, in works consulted below), World War II, the Cold War, and (naturally) the war on drugs. It seems, however, that long-running

negligence, evasion, and misinterpretation have done more harm to the Fourth Amendment than have various short-run authoritarian panics. Central to this slow but continuous process was the rise of modern policing in the nineteenth century, creating a new institution not foreseen in American constitutions (state or federal) and therefore largely incompatible with them and unaddressed by them (see *Roots*).

Gradualism and crisis, always headed the same way, have yielded a constitutional trail of tears catalogued in American state and federal case law. The U.S. Supreme Court hardly noticed the Fourth Amendment until the twentieth century. In the Prohibition-era case *Carroll v. U.S.* (1925), the Court sanctioned searches of private automobiles on the rather forced analogy of ships at sea. (The next time cops pull you over and search your

Gradualism and crisis,
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yielded a
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of tears.

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car, you may blame Chief Justice William Howard Taft.) But the amendment's core meaning survived awhile longer in areas where it was thought to have always applied.

Meanwhile, emboldened by the Fourteenth Amendment, the Supreme Court undertook to supervise state police practices from the late 1940s on; it would decide if the states were following the Fourth and other amendments. This new project annoyed the states but did little enough for the public. Examining federal search practices in *U.S. v. Rabinowitz* (1950), the Court declared the word "unreasonable" the key to the Fourth Amendment. Henceforth the Court would philosophize on the "reasonableness" of searches ("in the circumstances") and periodically announce our ever-waxing-and-waning rights on the accordion model of civil liberties. Warrants pretty much disappeared.

We have been saddled with this unsatisfactory outcome ever since. The subjectivity of judicial balancing acts, along with fluctuating judicial moods, has made the Court's understanding of "reasonable" rather less stable than that of the Oxford English Dictionary. The war on drugs has rendered the Court (particularly "conservative" justices) unsympathetic to complaints about searches. The upshot is that the Fourth Amendment is now mostly just another empty marker at which American politicians, bureaucrats, and ideologues can wave when praising the precious freedoms that supposedly cause Americans to be hated.

Legal History vs. Politicized Originalism

In constructing the above account, I have relied heavily on the work of Thomas Y. Davies, professor of law at the University of Tennessee. (The rhetoric is mine.) In essays running from 1999 to 2007 Davies painstakingly reconstructed the late eighteenth-century context of the Fourth Amendment, accounted for its later reinterpretation, and thus described its effective demise. At the same time, he assessed conservative constitutional "originalism," which he finds harmful.

For Davies the key to Fourth Amendment mysteries is the displacement of eighteenth-century common-law rules by later legal tinkering. As "judge-discovered" law, common law constituted a whole system (albeit uncodified) able to address almost any issue that could get into court, naturally or under a legal fiction. It centered on private prosecutions between parties, who were often large landholders, and its rules aimed at protecting their rights and "quiet enjoyment" of their property. (The radical historian Barrington Moore, Jr., has noted the aristocratic origins of our civil liberties.)

Of course common law adopted, or was forced to adopt, a number of royalist and Parliamentary premises perhaps not essential to its workings, in such matters of State concern as sovereignty, treason, customs, and revenue. Given its environment, common law also incor-

porated social prejudices regarding women, employees ("servants"), and other disfavored classes, and remained mired in semi-feudal verbiage. Common lawyers worked new content into their "feudal" categories in a way that eased the transition from "feudalism" (for lack of a better term) to English agrarian capitalism and from one form of State to another. In the hands of Whig justices like Sir

Edward Coke (1552–1634), locked in battle against Stuart royal prerogative, the common law became a potential weapon for individual and popular rights against State abuses. Coke's views were very influential in revolutionary America.

In the nineteenth century, though, the common law came to be seen as a barrier both to industrial capitalism and to further expansion of the modern state; for these and other reasons it was interpreted into nothingness or quietly abandoned.

Common-Law Arrest, Search, and Seizure

With common-law rules in view, Davies sees the whole point of the Fourth Amendment as control of warrants to be achieved by defining them strictly. In the common-law environment of the late eighteenth century, *warrantless* searches—or arrests—were rare and subject to strict conditions. Thus con-

The Supreme Court's understanding of "reasonable" has been rather less stable than that of the OED.

fined, these few warrantless actions hardly threatened public liberty. Let us see why.

First of all, no one—constable or freeman—could arrest or search someone merely for looking “suspicious.” Accusers (public or private) *had to have a case* before applying for any kind of warrant. To have a case, an actual crime had to have been committed already. An accusation also had to include sworn testimony of *one or more* witnesses asserting direct, personal knowledge supporting the belief that a named defendant had done the deed. Strung-out informants selling hearsay “evidence” about crimes that might occur in the future were not consulted, although hearsay could be admitted to establish background facts. Judicial action—indictment, issue of warrants—rested on the kinds of evidence described above. Arrest warrants did not normally issue for misdemeanors. The defendant remained at large but would be wise to attend his trial. A search warrant gave permission to look only for the specific things named.

Further, a defendant never appeared *as a witness*, but could, with or without counsel, impeach the evidence against him and cross-examine witnesses. Accordingly, the rule against self-accusation (self-incrimination) did not protect a defendant’s *trial rights*, but meant instead that his diary, calendar, papers, and effects—as extensions of himself—were not subject to general ransacking and fishing expeditions. The other side had to make its case without such modern conveniences. Only Parliament claimed to be able to license fishing expeditions (such as the “general warrants” that so nettled colonial Americans) and mainly in the narrow areas of “treason,” customs, and revenue. (The last two items came under admiralty law with its civil [Roman] law rules.) The Fourth Amendment sought to limit the ability of Congress to play such games.

There was a short list of *warrantless* arrests and searches allowed under common law. An officer or freeman who saw a misdemeanor underway in his presence (affray or breach of the peace) could make an arrest.

Someone traveling at night could be detained overnight to account for himself. In “hot pursuit” of a fleeing felon who had committed an actual crime, an officer or freeman could “break” (into) a house. Here again is the combination of actual crime and *personal* knowledge. There were a few other complications, but they and the above-mentioned practices were rooted in common sense and had definite boundaries.

Under common-law rules arrests were few and far between. In a system based on enforcement by private parties (freemen), or by constables with few additional powers, defendants could sue for “personal trespass” anyone who brought a bad prosecution. Logically enough, a right to resist false arrest also existed. (Nowadays the concept of false arrest is nearly dead

Under common-law rules arrests were few and far between, defendants could sue anyone who brought a bad prosecution, and there was a right to resist false arrest.

and resistance is not generally recommended.) Damages for bad prosecutions were a useful incentive for keeping peace officers and private prosecutors reasonably careful. Tightly drawn warrants, where required, actually protected officers from resistance or suit.

Since arrests were few and generally followed indictment—and that on real evidence—defendants not formally accused were seldom detained. Hence modern dilemmas involving interrogation seldom arose. Asking questions was a judicial function

carried out at trial. Constables, who were considered judicial (not executive) officers, had little discretionary authority and few occasions for third-degree Q&A sessions in the back room. And of course common law had no plea bargaining, that ubiquitous, contemporary solution of “overworked” courts that Paul Craig Roberts and Lawrence M. Stratton refer to as a form of torture.

In the United States, federalism set further limits. Only a few matters fell under federal jurisdiction, fewer still under exclusive federal jurisdiction. At the state level special language in revolutionary-era state constitutions about the “law of the land” or “due process of law”—“terms of art”—protected and perhaps “constitutionalized” common-law rules of arrest, search, and

seizure. (“Due course of law” referred to trial procedures.) At the federal level specific constitutional language in the Fourth and Fifth Amendments and elsewhere served a similar purpose. And in practice America avoided what Jeffersonians most feared: a federal claim to enforce the whole common law, which potentially reached everything under the sun. The objects of federal action were limited in number, and the claim of extreme federalists to general common-law jurisdiction failed. But the common-law *rules* (“due process,” “law of the land”) seemed well entrenched at both levels of government. *Could* courts and legislatures legally (“constitutionally”) throw away these protections? It is hard to say what informed legal opinion would have said on this point in 1790. Later, of course, courts and legislatures contrived to do exactly that.

Rise and Fall of the Fourth Amendment

The framers’ quest to establish certain common-law rights largely failed. The disjunction between the clauses of the Fourth Amendment encouraged the leap to a “reasonableness” standard. In fact, as Davies shows, the words “unreasonable searches and seizures” were Revolutionary-era rhetoric condemning British general warrants of the 1760s and 1770s as *without reason* (outside of reason) and therefore illegal and unconstitutional; they were not meant to license future judicial speculation. The core ideas of the Fourth Amendment were better expressed in the Massachusetts Constitution of 1780 and the Ohio Constitution of 1802. Davies speculates that James Madison’s innovative phrase, “probable cause,” was meant to allow a little leeway for customs and revenue enforcement, which already enjoyed partial exemption from common-law rules. (A warehouse, for example, did not enjoy the same immunities from search and seizure as a private dwelling.) Still, even Madison’s slightly weakened version meant something, although “probable cause” (taken by itself) had a big future as a means of reducing restrictions on power to a nullity.

In Davies’s view the Fourth Amendment unraveled for several reasons. Judicial and legislative amnesia

undercut the common-law rules. With growing industrialization, capitalists feared workers, Protestants feared Irish immigrants, and most people feared property crime *more than they feared the State*. To allay these fears and address some genuine problems caused by overcrowding, urban elites created police forces in major American cities by the 1830s. In eighteenth-century terms these new bodies were “standing armies.” Their practices brought about pressure for revised rules of arrest, search, and seizure, and new rules encouraged the new police practices. Davies speculates that the rise of “relativistic and probabilistic notions of truth and proof,” diminished reliance on oaths, and fear of too few convictions also eroded the old common-law regime.

Finally, state and federal courts rather forcibly dragged “due process” into property law—rather notoriously in *Dred Scott* (1857), with its substantive

due process for slaveholders—with a little left over for trial procedures. “Due process” of arrest, search, and seizure receded into the shadows. In search of improved ideas, American state courts looked to Britain, where since 1780 judges had been adjusting the rules in favor of industrialism and modern State practices. (Right-wing commentators who gripe about “foreign law” influences ought to investigate *this* connection.)

For once the federal government was fairly innocent. Precedents that undermined the old common-law regime largely trickled up from the states, especially in the second half of the nineteenth century. The upward trickle was slow at first: Down to 1935 federal marshals still had to have proper warrants to make an arrest.

Here then is today’s Fourth Amendment as seen by a life-form afflicted with supreme-judicial eye syndrome:

“The right of the people to be secure in their persons, houses, papers, and effects, against *unreasonable* searches and seizures, shall not be violated, and no Warrants shall issue, but upon *probable cause*, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.”

The framers’ quest to establish certain common-law rights largely failed.

(As this ocular condition worsens, all but a few objects dwindle into dim grayness.)

On Davies's argument the view that the Fourth Amendment came into its own from the mid-twentieth century forward, when reasonableness took center stage, puts the cart well before the horse. And yet the Fourth Amendment cannot really be recovered. This is where good legal history—*concrete originalism*—leaves us. Potentially beneficial constitutional provisions are of little use today, even when their meanings can be reconstructed in legal-historical context. We can't go back, since "activist" judges and legislators have worked for almost 200 years to institutionalize a legal regime with only slight resemblance to any original plan.

Can Anything Be Done?

Oddly enough, nineteenth-century Anglo-American legal bragging about freedom crested at roughly the time when many common-law rules worth saving were on the way out.

Common law had reactionary social biases, to be sure, but an accelerated "trickle-down"—to everyone—of important rights that common law protected might have been preferable to their elimination. Purging common law of its English royalist and absolutist accretions was precisely the goal of St. George Tucker's annotated edition of Blackstone (1803). And there was no reason to stop with Tucker's "republicanized" Blackstone. More right than wrong on this, Murray Rothbard wrote that the common law minus some "statist accretions" fairly approximated a libertarian law code. Thinkers outside the mainstream periodically rediscover the radical potential of English law: people like Gerrard Winstanley, John Lilburne, John Adams, Thomas Jefferson, Lysander Spooner, and others closer to our own time. They may not agree with one another, but their example is interesting.

This is the path not taken. Most arrests and searches today are without warrant, and getting a formal warrant

Most arrests and searches today are without warrant.

is fairly easy. Concrete, sworn personal knowledge has yielded to vague ("reasonable") suspicion or whimsy as a "standard." Once we enjoyed rules that provided for concrete privacy. By the 1960s privacy seemed so imperiled that the Supreme Court with its usual jobbery was driven to invent an artificial "right of privacy" just to restore some balance. Later, "originalist" conservative justices wrathfully informed us that *passage of a law* by Congress is nine-tenths of "due process" (you *voted*, didn't you?) and the rest is enforcement—stern law-and-order formalism indeed. Translated, conservative "due process" seems to leave us subject to arrest, search, or seizure at the whim of any functionary capable of forming a whim.

Americans have let themselves be systematically excluded from land, from effective political participation, and from effective legal participation. When collapse of the new-model system comes, as one day it must, we may perhaps give ourselves a new constitution. Where might we begin? Chapter XXIX of Magna Carta looks rather promising. **PBB**

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Secure in Freedom

BY DONALD J. BOUDREAUX

Language is indispensable to civilization. But because we rely on language so heavily—because it is our chief means of communicating with each other as well as a tool for forming and storing our thoughts—if used carelessly it can misshape our thoughts.

Careless language (or, even worse, verbal legerdemain) often turns words or phrases with positive connotations into Trojan horses that sneak mistaken, vague, or confusing notions into our thought processes.

A familiar example is the word “fair.” By definition, “fair” denotes something desirable. So by attaching the word to any noun or verb, a speaker anoints the thing as something good. The speaker is subtly instructing the listener simply to accept without question that the thing described by the word is good. A careless listener, then, is at high risk of accepting a conclusion that, with careful thought or without having heard the word “fair,” he might not accept.

Consider the frequently heard phrase “fair wage.” If Sen. Jones explains his support for raising the legislated minimum wage, he’s sure to insist that his goal is for low-skilled workers to receive a “fair wage.” Scholars seeking to explain the consequences of minimum-wage legislation objectively then have to overcome the emotional bias that the word “fair” smuggles into the conversation.

Another example is the phrase “secure our borders.” Opponents of open immigration frequently allege that illegal immigrants are proof that America’s borders aren’t “secure” and that those of us who wish to abolish numerical limits on immigration are insensitive to the need for government to “secure our borders.”

Such allegations, however, sneak in so many implicit presumptions that rational discussion becomes quite difficult.

The very phrase “insecure borders” conjures an image of government failing at its most fundamental responsibility—namely, protecting citizens from invading marauders. People see in their minds’ eyes an America increasingly at risk of being conquered by foreigners, leaving Americans at the mercy of invading rapists, plunderers, and murderers.

Immigrants, however, aren’t invaders, much less warriors in a conquering army.

Reasonable people can disagree over what kinds of national-security protections should exist on America’s borders and what sorts of screening of would-be immigrants should be done to reduce the risks of terrorist attacks on American soil. But it is not reasonable to

Immigrants aren’t invaders, much less warriors in a conquering army.

imply that immigration is chiefly, or even mostly, an issue of national security. Unfortunately, such an unreasonable implication is precisely what people who frame immigration as a matter of border security sneak into the discussion.

For perspective, ask if America’s borders were insecure until 1921 when, with the Emergency Quota Act, Uncle Sam first began seriously to restrict the *number* of immigrants allowed into the United States. Were Americans, until just 90 years ago, living in peril of their lives and livelihoods because U.S. borders were “insecure”?

Or ask this question: Does the fact that Uncle Sam imposes no numerical limits on foreign *visitors* to the United States mean that American borders are insecure? Short of the U.S. government’s imposing draconian restrictions (to be enforced with draconian measures) on visitors—say, admitting only 1,000 visitors annually, each of whom must first get a high-security

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clearance from the State Department—it's almost impossible to see how numerical restrictions on foreign visitors would make America's borders more secure. Therefore, anyone who would now seriously suggest that the lack of numerical restrictions on foreign visitors to America is evidence that U.S. borders are "insecure" or "broken" would justifiably be ridiculed.

Keep these points in mind when you encounter debates over immigration policy.

My proposal is to return to the policies under which anyone who wanted to immigrate to America could do so as long as he or she had no serious communicable disease and was not a terrorist.

That policy was much like the one we have today for foreign visitors to the United States: Anyone may visit America as long as he or she likely poses no serious threat to Americans. So, too, before 1882 anyone could immigrate to America as long as he or she posed no serious threat to Americans. (This policy actually continued largely unchanged until 1921, with the horrid exception of would-be immigrants from China. Starting in 1882 Uncle Sam imposed severe restrictions on Chinese people's ability to immigrate into America.)

In fact, the security of American borders—if by this phrase we mean genuinely decreased risks to Americans' persons and property—would almost certainly rise with open borders.

My proposal is to return to the policies under which anyone who wanted to immigrate to America could do so as long as he or she had no serious communicable disease.

Points of immigrants' entry, such as Ellis Island, would be reestablished. All peaceful persons immigrating to America would flow in through these points, be checked for communicable diseases and for ties to terrorist organizations, and, if cleared on both fronts, enter the United States. Uncle Sam would no longer spend hundreds of millions of dollars policing the borders, catching "illegal" immigrants,

deporting them back to Mexico, and monitoring employers who might have hired "illegal" immigrants. Those resources could be used instead to seek out and to apprehend terrorists.

Because all legitimate steps to secure the borders would aim only at reducing Americans' risk of being violated in their persons and property, government's policing efforts would—with the open-borders regime I recommend—focus on this goal. Such worthy efforts would not get mixed in with, or be confused with, efforts to prevent peaceful people from coming to America and

finding gainful employment here.

With government enforcement efforts concentrated on securing us from criminal violence and theft, we would be more secure than we are now with so many resources and so much manpower instead concentrated on "protecting" us from people whose only crime is to seek out better economic opportunities. **FEE**

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In Defense of the Huddled Masses

BY AEON J. SKOBLE

In April Arizona attracted national attention when it enacted a strict anti-immigration law, SB1070, which authorizes police having “lawful contact” with a person who arouses “reasonable suspicion” that he is an illegal alien to make a “reasonable attempt . . . to determine the immigration status of the person.” The law is intended to make life more difficult for illegal immigrants. It has been widely criticized for unnecessarily expanding police powers and inviting harassment of legal immigrants, especially Hispanics, and U.S. citizens of Hispanic descent.

The controversy surrounding immigration is not limited to Arizona, of course; many states have wrestled with the issue. But something about this is confusing: Almost all Americans are the descendents of immigrants, and the inscription on the base of the Statue of Liberty seems to give an explicit welcome message to immigrants. So why should anyone be concerned about the “problem” of immigration in the first place? What underlies the anxiety? I am not a psychiatrist, of course, but from reading both print and web discussions I think there are several reasons, each of which I believe is unfounded, though I will make a concession for one. In many cases, the anxiety and self-contradiction are due to conceptual confusion about rights and economics.

One of the concerns I see expressed frequently is that immigrants will come here and go on welfare. This argument has traction even among people who would otherwise be sympathetic to a libertarian open-borders position: It’s bad enough we have to subsidize people

who don’t work, so why increase the number of people we subsidize?

This argument grants the idea that open borders would be fine as long as everyone were working. People who make this argument recognize that immigrants in the past came to the “land of opportunity” to make a better life for themselves. Proponents of immigration like to point to the Ellis Island experience, in which people came to America from the old world, found jobs, and by the third generation were solidly upper middle class. Here opponents of immigration will note that there was no welfare state to speak of, so the immigrants had to work to succeed. The fear now is that immigrants can skip that step. They will come to make a better life, sure, but that just means they will soak up our generous welfare benefits.

Is this argument to be taken seriously? On the one hand, there’s the counterargument that no one has the right to stop anyone from moving any-

where or prevent anyone from employing anyone. On this view, borders must be open regardless of whether some people come here for welfare. Proponents of this position are sometimes accused of taking libertarian purity too far. I am not sure what it means to be “too pure”—either one has principles or one doesn’t. In any case, if it turned out that immigration did put more pressure on the welfare system, that might help in the effort to roll it back.



Our great-grandparents weren't exactly welcomed, either.

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On the other hand, though, there is no evidence that illegal immigrants are a net drain on the welfare rolls. First, illegal immigrants can't just move here and file for welfare checks. Second, while they may get some benefits of the welfare state, they are a net gain for the economy. The majority of them do come here to get better jobs than they would have been able to get at home—in some cases they take jobs that native-born Americans won't take. Keep this in mind as we examine the next bogeyman.

Taking Whose Jobs?

Another argument is that immigrants will take jobs away from “real Americans.” The first thing we notice about this argument is that it contradicts the previous one. Make up your mind: Are they coming to take your job or to go on welfare? But more substantially, competition is supposed to be good not bad. When one company competes with another, they are obliged to improve service or lower prices. It is the same thing with labor: If there are other people competing for your job, you'll have to get better at it. (This would be true even if we had hermetically sealed borders. If you are that uncompetitive at your job, it will be outsourced.) Individual workers, like companies, have no right to be free from competition. Anticompetitive policies impoverish everybody. Lastly, this argument presupposes a fixed number of jobs, such that if one worker is replaced by another, he will never again be able to work at all. In a free market, where resources are scarce and demand is open-ended, there is always work to be done and thus no shortage of jobs. Protectionism is just as bad for workers as it is for companies.

Some fear that since many immigrants are coming from Mexico and the rest of Latin America, increased immigration will lead to increases in the drug trade. This argument is predicated on several mistakes. First, immigrants cannot move their climate with them. I don't think you can grow coca plants in Wisconsin. If it's not a matter of moving the crops, then the concern must be that there will be more places to send drugs. But that's an argument for allowing immigration and

normalizing immigrants' status as Americans with kids in school and jobs in the community. How many of your neighbors and coworkers are drug dealers? Of course, if there were no prohibition, this would be a non-issue. But again we see a contradictory set of fears. Those who think drugs should be illegal, and are worried that increased immigration will increase the drug trade, are undermining their own position. Assimilated, productive, middle-class immigrants won't be nearly as likely to be drug mules or abettors of illegal activity.

More broadly, some fear that increased immigration will produce more crime. (In one sense this is tautologically true: Increased illegal immigration by definition is increased “crime.”) There's no way to predict whether immigrants from Guatemala are more or less likely than immigrants from Italy or Ireland to commit crimes, but burglary, robbery, and assault are already illegal. So we have a system in place to respond to crimes regardless of the ethnicity of the criminal. Some argue that this creates added burdens on the penal system, but that's not a reason to curtail immigration. Of course, the penal system would be considerably relieved of its burden if it were rid of victimless crimes, and in any event violent immigrant offenders could be deported rather than sentenced to American prisons.

No Irish Need Apply

Iam afraid that one additional fear about increased immigration is a generic dislike of those of darker complexion. (I hasten to add that I understand that not all anti-immigrant sentiment is so motivated, but it's myopic to deny that any of it is.) This concern requires some historical perspective. There was a time in the history of American immigration when the Irish were, for all intents and purposes, nonwhite. They were openly discriminated against. Later, when the Irish had been here for a couple of generations, the Italians, Poles, and Jews became the new aliens. Now we think nothing of seeing a Jewish-American or Italian-American CEO or Supreme Court justice, or an Irish-American president.

Today, seeing waves of immigrants from Latin America, South and East Asia, and the Middle East,

Individual workers,
like companies, have
no right to be free
from competition.

perhaps some people are concerned about America becoming less white. I can't say that I feel the need to take this concern too seriously. It seems hypocritical to think that your ancestral homeland has made a great contribution to the American melting pot, but that no new homelands should be able to add to the mix. Nevertheless, for those who are concerned about their neighbors being culturally different, again the solution is to have a completely open stance on immigration. Earlier generations of "foreigners" who emigrated freely were relatively quick to assimilate to the prevailing cultural norms, even while simultaneously changing those norms. The best way to keep new immigrant subcultures alien, mysterious, and possibly hostile is to marginalize them and drive them underground. They can't assimilate if they can't get jobs and send their kids to school.

Ultimately, "assimilation" is a two-way street: As new groups settle in, elements of the new cultures become part of the ever-changing norm. If you asked a fourth-grader to name four "regular American foods," you will surely hear "pizza," and probably "tacos."

The best way to keep new immigrant subcultures alien, mysterious, and possibly hostile is to marginalize them and drive them underground.

The one point I will concede to the anti-immigration contingent is the worry about voting. Will large numbers of (presumably legal) immigrants vote to make changes antithetical to the American ideal? Well, they might vote for reductions in the welfare state. It turns out that assimilated and upwardly mobile immigrant groups don't support expanded welfare programs any more than indigenous groups do. If they voted to roll welfare programs back, that wouldn't be a bad thing. More worrying, will they vote in such a way as to chill speech by, for instance, pressing for bans on cartoons depicting Mohammed? I would be concerned if trends like that started to emerge. Fundamental constitutional principles are not supposed to be subject to majoritarian whim, but I realize they sometimes are. So rather than think of solutions to the problem, it might be better to think of ways to avoid it in the first place. The best way

to do that is to help the immigrants to become Americans. That means allowing them to seek work and find ways to contribute to the economy; it means allowing them the freedom to assimilate into, even while subtly changing, American culture—the very same freedom your grandparents had. **FEE**

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Alexander Hamilton and the Perils of State Capitalism

BY NICHOLAS CUROTT AND TYLER WATTS

Historians have long praised Alexander Hamilton's activist government promotion of capitalism. Hamilton's "financial revolution" brought secure government debt, fluid securities markets, and a modern banking system to the United States. Most scholars believe these factors were responsible for the amazing growth of the U.S. economy in the subsequent 200 years. Thus while George Washington is commonly

known as father of his country, Hamilton is lauded as the father of American capitalism.

Hamilton may indeed be worthy of this title; but lest we give him and his economic ideas undue credit, we should pause to consider exactly what kind of "capitalism" Hamilton and his Federalist allies bestowed on the U.S. economy. Capitalism can mean different things to different people. Economic prosperity requires a legal system that protects individuals and secures their property from expropriation, whether it be private theft or political predation. Advocates of this system of rules often call it "capitalism." We'll call it "free-market capitalism." And it's a good thing for gov-

ernment to let this kind of capitalism develop by protecting private property, sanctity of contract, and consensual exchange. This ensures individual freedom of choice—and not coincidentally, it is the only known recipe for economic prosperity.

Another line of argument claims that governments should actively create and promote the products, organizations, and institutions of capitalism. Let's call this "state capitalism." Advocates of state capitalism argue that the institutions of capitalism should be forcefully imposed even if they are unwanted. The theory is that this will make the nation wealthier and so it should be done regardless of any objections.

It is by no means certain that the forceful imposition of the mere institutional trappings of an advanced capitalist economy actually promotes economic growth. Under the legal framework of free-market capitalism, individuals save, invest, trade, and set up markets as they see fit. Intricate patterns of interaction emerge, including some of today's complex



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institutional forms of finance, industry, and commerce. Focusing on creating these institutions instead of the framework that lets them grow puts the cart before the horse. It means constructing the byproducts of progress instead of the mainspring that makes such progress possible.

Thus the statist approach to capitalist development is backward and unlikely to create wealth, even if the constructed institutions are industrial or financial. Constructivism—the idea that government can design economies to ensure growth—doesn’t work because central planning cannot substitute for the knowledge generated by the trial and error of the market process. Even the best-intentioned government officials cannot replicate the competition of market participants guided by profit and loss. Moreover, it defies human nature to assume that those who would implement state capitalism would promote solely the general welfare, without any bias toward shaping these institutions to benefit themselves or the special interests they represent.

The Early U.S. Economy

Proponents of state capitalism point to the historical development of American financial institutions as their strongest supporting evidence. In particular, Hamilton and his “financial revolution” embody the ideas of government leadership in building up a nation’s financial infrastructure. Fans of the finance-led growth hypothesis like to trumpet Hamilton’s achievements, which include a well-funded government debt, active securities markets (a stock exchange), a large and vibrant banking sector, and an enlarged money supply.

Thus many historians argue that with this infrastructure in place the financial means were created for corporate development and the growth of large-scale industry. They contend that Hamilton’s policies set the stage for the industrial revolution in America and that this experience should be replicated everywhere today.

But is government design really necessary for free-market capitalism to flourish? A closer investigation of early U.S. economic performance challenges that hypothesis.

At the close of the American Revolution, the United States was economically “underdeveloped.” In 1790 about 90 percent of the nation’s four million peo-

ple were farmers. There were few large cities, and the population was clustered on the coast and near larger rivers. Poor roads impeded communication and commerce with the sparsely populated interior regions.

As for money, the United States was on a specie standard, with foreign silver and gold coinage forming the basis of the money supply. As of early 1791 there were three banks in the country, one each in Boston, New York, and Philadelphia. All issued banknotes representing claims on specie money. Although the bank notes were reportedly safe and reliable, they did not circulate widely, and there were constant complaints of a “scarcity of money.” While actual money—in both coin and note form—was present and fueling transactions in the commercial centers, in the remote farming regions barter was still commonplace.

Like banks, securities markets were rare. In 1792 only five domestic securities were quoted in New York. There were irregular and economically insignificant transactions in domestic and foreign equities. However, a larger, more continuous securities market was arising due to speculation in state and Continental Congress bonds issued during the Revolutionary War.

Grand Financial Scheme

When Hamilton became the first secretary of the Treasury under the Constitution in 1789, he surveyed a U.S. economy that was significantly less financially developed than England’s. Yet he also saw an opportunity to use his new office to spur the development of financial institutions and thereby give mercantile interests a helping hand. In the political climate of the early 1790s he was able to use the outstanding war debts as a tool to overhaul America’s financial system.

Hamilton laid out his grand financial scheme in four reports to Congress from 1790 to 1791. According to historian Frank Bourgin, Hamilton’s reports “constituted a unified and integrated program of planning on such a grand scale that even today it would appear as a magnificent conception of an economy directed and controlled toward socially chosen objectives.”

Hamilton used the public debt to implement an economic program that provided the impetus for the country’s first continuous securities market and also for

its first brush with central banking. The first plank of his program was to secure the government's credit by honoring the pre-constitutional war debt. Congress obliged in 1790, authorizing over \$60 million in new U.S. bond issues to take responsibility, at face value, for all revolution-era debts.

The second plank in Hamilton's program called for the creation of a national bank. Northern merchants largely supported the proposal, pointing to the advantages it would procure for their economic interests and for strengthening the position of the central government. Agrarian southerners were mostly opposed, arguing that such a bank would be unconstitutional and interfere with states' rights. President Washington was eventually convinced by Hamilton's broad interpretation of Congress's constitutional powers and signed the Bank Bill into law on April 25, 1791.

The BUS Bubble

The Bank of the United States (BUS) was not technically a central bank in the modern sense; it was not granted a monopoly of note issue, nor did it regulate the commercial banking system. It was, however, granted important legal privileges: It was the only bank exempt from an otherwise nationwide restriction on branch banking, and its banknotes were accepted in payment of customs duties. This privilege provided the bank with a strong advantage over its competitors. The BUS charter called for an initial capitalization of \$10 million—an enormous sum at the time. Three-quarters of it, however, was to consist of the new government bonds. Thus Hamilton used the bank to boost the market for government debt, making the bank and the government codependent. The size, scope, and privileged position of the BUS ensured that its actions would exert a titanic influence on the money supply and credit conditions in the United States.

Hamilton also introduced other measures to round out the overhaul of the financial system. Thanks to his prodding, a bimetallic currency was introduced to enlarge the money supply. The federal government began to recognize gold as legal tender in addition to

the Spanish-based silver dollar at a 15:1 silver-to-gold ratio. And finally, Hamilton ushered in a policy of activist industrial promotion and protectionism in the form of tariffs, subsidies, and “public-private partnerships” designed to foster large-scale industry. The entire Hamiltonian program—the BUS in particular—was, in the words of David Cowen, designed to “stimulate the economy [and] enhance the shaky credit of the government.”

The Funding Act and Bank Bill brought about massive speculation in government debt and BUS stock. Although only five securities—three U.S. bonds and two bank stocks—were publicly quoted in 1792, public interest in them was intense and widespread, ranging from millionaire financiers to day laborers and widows. When the BUS opened, it began pumping vast amounts of credit into the economy. A substantial portion of BUS

When the Bank of the United States opened, it began pumping vast amounts of credit into the economy.

loans went to stock speculators in the form of “accommodation loans,” or unsecured debt, similar to modern-day margin accounts. A classic asset bubble ensued as the intense demand for these issues led to higher and higher prices. But this stock mania was soon revealed to be unsustainable. An abrupt contraction of credit by the BUS in February 1792 led to a massive selloff in securities markets—the first stock market bust in American history.

Many of the speculators were heavily leveraged, expecting to repay the accommodation loans with the sale proceeds of ever-appreciating stocks and bonds. When the short-term loans came due and the banks refused to extend further credit for fear of being drained of their specie reserves, leveraged investors had no other choice but to settle their debts by liquidating their securities portfolios.

The crash piled up unprecedented losses and left several prominent speculators in debtors' prison. Many economic historians laud Hamilton for successfully managing this crisis by using government funds to support bond prices and steady the nerves of the market. But government involvement in money and banking caused the panic in the first place. Furthermore, the events of 1792 did not signal the resolution of the BUS

credit expansion. Over and above the securities panic, the inflationary practices of the BUS set into motion an unsustainable investment boom and consequent bust that would play out over the entire decade.

The BUS engaged in monetary overexpansion through the early 1790s, causing price inflation and disorder in the intertemporal structure of production along the lines theorized by capital-based macroeconomics. This expansion also pushed down real interest rates by making banks far more eager—and able—to lend. The resulting distortion of marginal returns to investment and saving led entrepreneurs to make malinvestments in transportation improvements, manufacturing, and other capital-intensive projects. Furthermore, the expectation of inflation induced individuals to bet on continued price increases by borrowing money to purchase real estate. Thus the atmosphere of easy money created by the bank also channeled resources into western land speculation and fueled local real estate bubbles.

Eventually a correction to the credit overexpansion occurred, but it took time and required a painful monetary contraction. Initially, as the newly injected bank credit worked its way through the economy, it created a disparity in international prices. Steep inflation within the United States made American exports relatively more costly abroad and foreign imports into the country relatively cheaper for Americans, leading to a reduction in net exports. By 1795 specie was flowing out of the country to pay for the increased imports, and the growth rate of bank-issued money tapered off. As a result, the money supply and price level began to fall, causing the real interest rate to rise sharply. In the ensuing credit crunch businesses that counted on rolling over short-term debt for their financing were rendered unsustainable. At this point many investments that had appeared reasonable when they were undertaken were revealed to be errors, and a wave of business failures ensued.

The long-run consequences of the Hamiltonian financial revolution were a crushingly large central government and a burdensome government debt. According to advocates of state capitalism, this last aspect was actually a good thing—they portray government debt as a blessing because it allowed for a strong central government. But contrary to their mercantilist interpretation, a bloated central government is not a blessing. As Thomas DiLorenzo's book *Hamilton's Curse* demonstrates, the strong central government, built on Hamiltonian policies, enabled unnecessary military spending, unjustified wealth transfers, and a slew of ever-expanding governmental programs and activities down to the present day.

The long-run consequences of the Hamiltonian financial revolution were a crushingly large central government and a burdensome government debt.

Despite Hamilton

Hamilton's schemes impregnated the U.S. economy with the institutions of a financially advanced, capitalist economy. But the accelerated development of securities markets and the banking industry was premature. The truly beneficial aspects of these markets would have developed in due time through the natural course of economic growth. Hamilton's reforms merely induced a precursory period of unproductive trading in government debt instru-

ments and credit-fueled speculation. More important, the centralized banking system created by Hamilton's nationalist party destabilized the American economy. The new banking system immediately created a sequence of financial panic, deep-seated malinvestment, and a delayed recession.

Hamilton's expansionary program did no better over the long run. Primarily, it left the United States with an economy prone to central bank-induced business cycles and a squandering of economic resources on redistributive policies and wars, financed by the accumulation of a burdensome debt. On net the Hamiltonian revolution was not a blessing for the U.S. economy. The United States became the world's leading economy despite the legacy of Alexander Hamilton, not because of it. **FEE**

The Economic Way of Thinking Makes a Comeback

BY STEPHEN DAVIES



As readers of this magazine know, its main goal, and that of FEE as a whole, is economic education—that is, to explain and spread essential economic insights so more people become familiar with the “economic way of thinking,” as Israel Kirzner called it. This brings insight to politics, society, and history. Above all, it gives a better understanding of the basis of a free society and of the malign consequences for liberty, prosperity, and social peace of denying the realities of economic life—or trying to, rather.

Even a brief look at the contemporary media or political debates—or conversations with acquaintances—quickly reveals how much this understanding is needed. Put simply, the level of ignorance of basic economic insights is staggering. Elementary fallacies such as the “broken window” argument pop up regularly and are apparently widely shared.

All of this has obvious and damaging effects on public debate and ultimately on public policy. To the extent that policy and debate actually reflect widespread misunderstanding of economic principles, among both the general public and the opinion-forming elite, they will be misguided—at best futile, at worst damaging and counterproductive. When results are disappointing, the reasons will not be understood and the frequent response will be to push even further down the wrong route and to reinforce failure.

One view is that ’twas always thus. According to this school of thought, the evidence we have from social surveys and mass observation is that the economic way of thinking is counterintuitive and difficult for the majority to grasp. Some argue that this reflects how we are hardwired as a species to think about the world in certain ways that in turn predispose us to look at economic matters in a particular

fashion. So we see only intended results and ignore unintended ones, underestimate the benefits of trade and are wary of strangers, see the costs of change more readily than the benefits, and so forth. If these perspectives are widely held, then a democratic system that reflects popular predilections will always tend in an economically harmful direction.

It Wasn't Always Thus

However, the evidence of history suggests that this condition is not predetermined or inevitable. Even if there is some kind of biological predisposition, it is not so strong that it cannot be overcome by education and propaganda (in the original, good sense of the word). The record also suggests that this is true for intellectual and political elites as well as the general public. The evidence for this is the history of the early nineteenth century in both Britain and France, as well as the United States, when economic ideas were widely understood and were a major part of popular culture and public discussion.

The works of Smith, Malthus, Ricardo, and Nassau Senior were all widely read and discussed. In France, Say's 1803 *Treatise of Political Economy* was one of the best-selling books of its time. The works of their popularizers made their ideas accessible to the mass of the public.

An early example of this in England was Jane Marcet (1769–1858), who published a successful introduction to economics (particularly Say and Ricardo) in her 1824 *Conversations on Political Economy*. Even more prominently, the great classical-liberal feminist and pio-

Put simply, the level of ignorance of basic economic insights is staggering.

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neer sociologist Harriet Martineau (1802–1876) published a series of short stories that illustrated and explained economic principles, collected as *Illustrations of Political Economy* (1831). Sold in a low-cost format, these were the best sellers of the time. Martineau followed up with further series on such topics as reform of the Poor Law, which was equally successful. Later in life she wrote regular editorials for the *Daily News*, a popular paper, many of which were concerned with economic exposition and argument. John Stuart Mill also combined the roles of economic thinker and popular expositor. His *Political Economy* was a popular as well as intellectual success.

Educated Public, Educated Policy

All this had a significant effect on public opinion as reflected in popular culture and entertainment, letters to the press, and voting patterns. On issues such as free trade, government regulation, the Poor Law, and government finance, there was a clear movement toward support for economically sensible policy, limited government, and sound money. Thus demands for the repeal of the income tax, for stringent reductions in government spending, and for complete free exchange (which meant general *laissez faire* and not just free trade) became a staple of British radical working-class politics and liberal politics generally, as reflected in the policy of Gladstone as both chancellor and prime minister. Moreover, these attitudes and the underlying understanding persisted. When a campaign began to restore protection in the early 1900s, the response was a popular countermovement that culminated in the landslide victory of the Liberals on a free-trade platform in 1906.

Of course there were also plenty of rejoinders and hostile responses to this successful spreading of economic ideas. The two most prominent exponents of this reaction were Thomas Carlyle and John Ruskin. It was Carlyle who coined the phrase “the dismal science” to describe economics—on grounds that economic thinking led to support for the abolition of West Indian

slavery, an institution he supported. He and Ruskin did not put forward a form of economics of their own. Rather, they attacked economic reasoning as such. In this they were more clear-sighted and intellectually honest than many contemporary authors.

How It Was Lost

So if we compare the situation for much of the Twentieth century and today with what went before, we have to ask, “What happened?” There are many explanations of why economic reasoning fell out of favor, such as the rise of mass media. Three seem particularly pertinent, however. First, from about the 1890s onward economics became increasingly mathematical and, as such, abstruse and inaccessible for many people. At the same time it was affected by the general movement of intellectual life into the academy, with its associated specialization.

A second factor was the movement to make economics into a value-free social science. It lost its earlier connection to political and social philosophy and its moral element, which had been one of its main features. Arguments about efficiency are simply less moving than ones that combine this with a moral perspective (as Martineau’s work did, for example). Finally, functioning as both cause and effect was a general shift of public discourse to a position that denied constraints, one based on the passionate conviction that everyone could have his cake and eat it too—as a right. Since a central insight of economics is the necessity of tradeoffs, economic argument found itself at odds with this sentiment and found fewer receptive listeners.

Recently, though, there are the first faint signs that economics is once again becoming a part of wider culture. There is the success of a new generation of popularizers, including Russ Roberts, who has followed the example of Martineau in using the fictional mode. This can only be a good thing, and we must try to ensure that politics and public discourse, from all points on the ideological compass, once again become economically aware.

FEE

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Financial Regulation Snake Oil

BY CHIDEM KURDAS

Recent turmoil set off by the threat of Greek insolvency shows how fast markets change. Fear about the inability of European governments to pay their debts caused the 2010 turbulence. By contrast, the 2008–2009 havoc was rooted in the collapse of property values. The next crisis will be about something else, possibly another government’s debt.

Meanwhile, Congress put the finishing touches on a mammoth regulatory bill called the Restoring American Financial Stability Act of 2010. (Editor’s note: It was passed and signed in mid-July.) As I write there is no way to know what final shape it will take. But considering how it was shaping up, what are the probable effects?

The rationale for this vast expansion of government oversight is to prevent, or at least reduce, financial instability, as the bill’s title declares. Therefore it is useful to remind ourselves of why and how markets became so unstable in the first place.

There are two fundamental reasons why markets gyrate. One is human emotion, in particular a penchant for over-optimism about financial prospects, which turns into panic once things go downhill—a pattern known colloquially as greed and fear. Business cycles are unavoidable to the extent they’re rooted in human behavior. On top of this, governments have caused normal cycles to become extreme and destructive with a multiplicity of interventions and their own financial woes—as with Greek sovereign debt.

Thus the boom in the American housing market

was set off by optimism that property prices would keep rising and the bust initiated by the panic that ensued when prices faltered. But the cycle became monstrous because the Federal Reserve kept money creation too loose in 2001–2004. To make matters worse, Congress pushed the two government-created entities, mortgage buyers Fannie Mae and Freddie Mac, to go easy on less creditworthy loans.

As a result of these policies, taking out a mortgage became child’s play. People who might have otherwise been more prudent mortgaged up to the hilt, and enormous piles of mortgages became available to be bunched together and turned into securities—a lucrative activity that drew the attention of Wall Street, but was done largely by Fannie Mae and Freddie Mac.

When real estate turned, it took down banks that lent heavily to developers, homeowners who borrowed beyond their means, and financial companies that held or insured mortgage-backed securities. As for Fannie and Freddie, they continue to suck down billions of dollars of taxpayer money every month, with no end in sight.

Human nature has not changed, and the government is becoming more interventionist, not less so. So the conditions that produced the dramatic bubble-and-bust remain in place. How, then, will the Financial Stability Act prevent crises?

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Since it is not practical to analyze all the disparate elements that constitute a 2,300-page grab bag of a bill, I will focus on the centerpieces that were most likely to become law. These are from the version of the bill introduced April 15, sponsored by Sen. Christopher Dodd.

The first is the creation of a supra-bureaucracy called the Financial Stability Oversight Council, with nine voting members who are to make decisions by majority vote. Among them are the Treasury secretary, the Federal Reserve chairman, the Securities and Exchange Commission chairman, the director of the Federal Housing Finance Agency, and an independent member appointed by the president.

Almost all council members are heads of departments and agencies that have been around for decades and shown not the slightest ability to prevent risky behavior by financial firms, the population at large, or for that matter themselves and fellow government entities. Somehow, they are supposed to do together what they don't do on their own.

The act also adds a new bureaucracy, the Office of Financial Research, with responsibility to collect and process data and conduct studies for the council. This newly created apparatus of the council and research office is to work as "an early warning system to detect and address emerging threats to financial stability and the economy," according to a congressional committee report.

The research office would get the power to subpoena information from any financial company. It is "to develop and maintain metrics and reporting systems for risks to the financial stability of the United States" and "monitor, investigate, and report on changes in system-wide risk levels and patterns."

If you ask what the systemwide risks are, you won't find an answer in the act. The director of the office, appointed by the president for a six-year term, "shall have sole discretion in the manner in which" he or she exercises the authority provided by the bill. Indeed, the wide discretion the bill provides to future bureaucrats is remarkable. What they're going to do to promote stabil-

ity is about as clear as how snake oil was supposed to cure cancer, bunions, and lovesickness.

The act says certain bank companies may be required to have a "risk committee" with "at least one risk management expert having experience in identifying, assessing, and managing risk exposures of large, complex firms." That is like requiring water to flow downhill. Almost every financial business already has risk control people. Even hedge funds have risk managers.

Risk management is a well-established discipline with an ever-increasing number of practitioners who spend their time trying to measure and reduce future hazards. In finance the number of risk management experts has grown tremendously in past years—without any legal mandate. These specialists have been notably unsuccessful in preventing occasional crises, as the past

several years demonstrated.

Risk experts constructed the mathematical models that gave misleadingly benign views of the dangers in mortgage-related complex instruments. The models will improve over time, but will occasionally be mistaken regardless of legal requirements. It is not the case that financial companies want to lose money.

The basic reason they sometimes do lose money is that making money requires some risk. This is no different from many other activities, such as drilling for oil. Yes, you can end up with a nasty spill, but no risk, no oil. Similarly, no financial risk, no financial gain.

The object is not to avoid risk but rather to keep it under control, and that has always been a most delicate task. The early twentieth-century economist Frank Knight made a distinction between risky situations, where the possible outcomes and their odds can be estimated, and uncertainty, where there is no meaningful way to know the probabilities. There are known unknowns and then there are unknown unknowns.

Throwing dice exemplifies risk with known odds. By contrast, Fannie Mae (which, along with Freddie Mac, is unaddressed in the new law) is a source of uncertainty; the consequences of its creation were unexpected, and its future is an unknown unknown at this time. It stands

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as a shadowy but colossal monument to man's ability to create monsters in the name of doing good.

Dealing with risk is hard enough; we're lost dealing with uncertainty. This shows up especially with rare but big events—known as the tail risk of a bell-shaped probability distribution. More vividly, Nassim Nicholas Taleb, a trenchant critic of financial industry practices, has dubbed them black swans.

As long as an event like the real estate slump has not yet happened, people make money by ignoring it. Therefore risk managers “play politics, cover themselves by issuing vaguely phrased internal memoranda that warn against risk-taking activities yet stop short of completely condemning [them],” to quote from an earlier book by Taleb, *Foiled by Randomness*, published a decade ago—when risk managers were already recognized players.

Same Goes for Government

This criticism applies no less to government agents. Nobody has a reliable way to predict rare events, and human nature is all for ignoring them. Regulators don't do any better—from the chairman of the Federal Reserve on down, officials issue vague warnings but don't stop risk-taking. After all, they are subject to the same behavioral biases and face similar incentives. Just as shareholders are displeased when a bank does not make money, voters are displeased when a government imposes economic hardship.

Therefore, like banks, governments keep dancing as long as the music lasts. It is hard to imagine that changing. So preventing future crises is the least likely outcome of the Stability Act. But might it have some other benefit?

Emergency measures used by the U.S. Treasury and the Federal Reserve to prop up companies in 2008–2009 left in their wake the absurd problem of too-big-to-fail—taxpayers appear to be on the hook for any large financial concern whose failure might have far-reaching impact. Given that taxpayers also ended up with the vast pension liabilities of General Motors, the problem of bailouts is not really confined to financial companies, though it is widely described as such.

Nobody has a reliable way to predict rare events, and human nature is all for ignoring them.

Nobody wants a repeat of the widespread panic and losses caused by the bankruptcy of Lehman Brothers in September 2008. That failure resulted in market chaos in large part because the assets of Lehman clients got tied up in bankruptcy courts, not just in the United States but in the United Kingdom. With their capital frozen in years-long litigation, the clients sold securities to raise money, with the predictable catastrophic effect on prices.

So instituting a process by which large financial companies can be shut down without a lengthy bankruptcy case would both reduce the impact of failures and get rid of the notion that investment banks need to be bailed out. Expedient, orderly, and internationally coordinated winding down of failed companies is an obvious solution for the too-big-to-fail problem.

The act gives the Treasury, in conjunction with judges from the U.S. Bankruptcy Court for the District of Delaware and other agencies, broad powers to take control of a financial business perceived as a threat to the system and turn it over to the Federal Deposit Insurance Corporation (FDIC) for liquidation. The FDIC, which unwinds failed commercial

banks, is to do the same for other financial businesses.

“Once a failing financial company is placed under this authority, liquidation is the only option; the failing financial company may not be kept open or rehabilitated,” says a Senate committee report.

That may sound like a way to prevent bailouts, but the government is given such open-ended discretion that perverse outcomes are possible. To go this liquidation route a company does not need to be actually in default as long as the Treasury determines that it is a sufficiently serious threat. On first read, my primary concern was that companies that were not going to fail might be liquidated.

On second thought, it is just as possible that those which are failing will be bailed out instead of being liquidated. This could happen if there are politically powerful interests behind a company. Think of the unions that came out on top in the government's handling of GM. In effect, we're asked to trust politicians and

bureaucrats. No doubt they will make politically advantageous decisions, with goodies for the politically favored and sticks for the politically vulnerable.

A better alternative to the creation of this extensive authority would be to streamline bankruptcy to make it simpler and faster. The act calls for studies of bankruptcy and international coordination, the latter of which is necessary because large investment banks are global entities—but the possibility of bankruptcy reform is remote. That could reduce legal fees, not something that a Democratic Congress will allow. Lawyers are a major constituency for the Democrats. They will be among the big winners of the regulatory onslaught, which is bound to increase the demand for legal services.

More Of The Same

It is ironic that the act expands the government's domain in the name of stability, since public policies have increased instability, public functionaries have been clueless in foreseeing threats, and politicians have created uncertainty—with Fannie Mae, for instance.

One of the members of the Stability Council, the Federal Housing Finance Agency, was set up by a 2008 law to be the successor to the Office of Federal Housing Enterprise Oversight. The latter, the overseer of Fannie and Freddie, presided over debacle after debacle, year after year, from accounting shenanigans to endless taxpayer bailouts. Congress obviously wanted an agency with a different name.

But the new bureaucracy is simply the old one merged with another entity. So the same bureaucrats that did so well ensuring the safety and soundness of Fannie and Freddie are supposed to ensure financial soundness on a wider stage in the new setup! If that does not inspire confidence, neither do other members of the council.

The Securities and Exchange Commission let Bernard Madoff continue his Ponzi scheme year after year despite repeated complaints from a whistleblower and even news stories about the fraud. More recently another astounding SEC failure came to light.

In 2009 Texas resident Robert Allen Stanford was nabbed for an \$8 billion fraud—Stanford International Bank had for years sold certificates of deposit promising unachievable returns. An investigation found that the

SEC Fort Worth office had known since 1997 that Stanford was likely operating a scheme. Despite examinations indicating this, the enforcement division chose not to take action.

The preferred excuse for numerous government debacles is that the bureaucracies lacked authority, personnel, or information. Yet the SEC in fact repeatedly examined Stanford and had the power to stop his activities.

Here is the punch line to the Stanford affair. In a dramatic instance of the revolving door for former regulators, the SEC lawyer who made enforcement decisions at Fort Worth left and represented Stanford—before he was told that this was improper. That's how regulation works in reality.

Expanded Crony System

The vast new powers given to regulators will no doubt enhance the fees and salaries that former bureaucrats like this SEC lawyer command. They will have greater opportunities to sell their protection and expertise to the regulated and will also, of course, benefit from enlarged budgets while in public employment. Politicians and political staffers, too, will be able to extract more money from the regulated and get lucrative jobs in the financial industry.

This is already an established trend, with President Obama's former White House counsel moving to Goldman Sachs and a former aide to Rep. Barney Frank on the House Financial Services Committee taking a job with a derivatives exchange. Such crossovers will no doubt become even more common as firms look to protect themselves while government agents get a broad mandate to intervene and decide which companies to liquidate and which to bail out—who's a systemic risk and who's not.

Even as they go “tsk-tsk” chiding business lobbies, the President and Congress are laying the groundwork for an infinite growth in the crony system intermingling government with private interests. The rest of us will pay for the resources that will be redistributed in favor of bureaucrats, politicians, lawyers, and the politically favored. The impact of the act on financial stability is uncertain at best, but its corrupting influence on the Republic is a sure thing.

FEE

Why Do Futurists Get So Much Wrong?

BY STEVEN HORWITZ

The Austrian economist Ludwig Lachmann once walked into the colloquium room at New York University, where the blackboard displayed this quotation: “When it comes to the future, one word says it all: You never know. – Y. Berra.”

Having built much of his economics on the unknowability of the future, Lachmann noticed the quote. However, having lived in South Africa for decades and being unfamiliar with the wit and wisdom of the former New York Yankees catcher, he pondered the chalk inscription for a bit, turned to those assembled, and in his heavy accent said, “I’m afraid I’m not familiar with the works of Professor Berra.”

It is indeed difficult to predict the future, but many folks make a good living trying. From self-proclaimed “futurists” who hope to sell books and DVDs with their predictions about the decades to come, to cartoon visions of the flying-car, meal-in-a-pill, three-hour-workday 21st century so common in the 1950s, to the authors of some of the finest science fiction of the last hundred years—trying to imagine and describe what the future holds keeps a lot of people occupied and makes some wealthy. But how good are the predictions? What is it that makes predicting the future so difficult?

Obviously if we are trying to predict the specific actions of specific individuals, or the price of Apple stock in 2015, the difficulties are clear. I am more interested in bigger and broader predictions. Is there a pattern to the ways people tend to err in predicting how

technology will evolve and be used? If such a pattern exists, what might explain it and how could “futurists” learn from that explanation? I think the answer to the first question is yes, and below I attempt to answer the second set of questions.

To do so, we must recognize one important insight about technology, social evolution, and economic growth. It is common for people to attribute the western world’s stunning economic growth over the last 200 years to technology. True, technology does contribute to growth in important ways, although it’s also



This kind of futurism ignores economic considerations.
James Vaughan (flickr.com/x-ray_delta_one)

true that economic growth helps create new technologies by generating capital to fund research. Technology, however, does not create wealth by itself, as decades of technology transfers to the third world demonstrate. For technology to lead to wealth, the right institutions are required. I like to call this the Three I’s approach: Innovation = Invention + (good) Institutions.

More specifically, the market must be free enough that technology can be turned from simply an invention into an innovation. Rising wealth requires innovation, and innovation happens when inventions meet the market.

In their excellent book, *How the West Grew Rich*, Nathan Rosenberg and L. E. Birdzell provide many historical examples to illustrate this point. Consider how

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many ancient civilizations developed better technology than the West did during the same period. For centuries the Chinese were on the cutting edge of invention and Western Europe lagged behind. But why couldn't the Chinese translate that invention into increases in wealth and the sort of industrial revolution we later saw in the West? One answer is that the Chinese lacked the West's decentralized political institutions, which were crucial for nations engaging in wealth-generating trade, which in turn required protection of property rights and enforcement of contracts. The West grew rich because it had the institutions to translate inventions into innovations.

This is the piece of the puzzle so often overlooked when people speculate about the future, particularly the future of technology. By ignoring how technology must interact with markets to generate increasing living standards, futurists tend to get too caught up in the big important technologies and imagine they will be used primarily for the most noble of purposes. It turns out that what seem to really enhance the standard of living and the quality of life for many human beings are things that are far more mundane and commercial than those imagined by many who make a living predicting the future.

Revolutionarily Mundane

Take two examples that were common in mid-twentieth-century visions of the 21st century: flying cars and the meal-in-a-pill. The flying car, of course, was the height of the romantic vision of the technological future. The assumption was that our mastery of flight would link up with the obvious centrality of the car to the emerging suburb-oriented mass culture to give us the ultimate in personal conveyance. What the futurists overlooked was that technology alone won't do the trick. Inventions have to be profitable to be real innovations. As it turns out, the flying car was, and still is, simply too expensive to produce to be worthwhile for the vast majority of Americans. In addition, the cost of coming up with the equivalent of highways would likely be prohibitive as well.

Instead, the way technology has interacted with the car has been much more mundane. Without question, cars today, despite their inability to fly, are far better than even the best one driven by futurists in mid-century. Blinded by "big technology" and deaf to the importance of economic considerations and marginal adjustments, the futurists failed to imagine terrestrial vehicles with CD/mp3/DVD players, GPS, built-in cell phones, computer-monitored performance, sturdier tires, and enhanced safety devices, not to mention overall quality. Getting 100,000 miles, which used to be one measure of a high-quality car, is now expected. Our lives today have been notably enriched by the incremental improvements in the automobile. Would we be even better off with a flying car? Perhaps, but if one is to predict the future, one has to take both costs and human preferences seriously. Neither has seemed to justify the flying car.

Futurists tend to get too caught up in the big important technologies.

The meal-in-a-pill works in somewhat of the opposite direction. That vision of the future was concerned with abstract notions of technological efficiency and scientific notions of health: Why waste time worrying about food and risking eating the wrong things when you can get all the nutrients you need by swallowing a

few pills every day? Of course this overlooked two key factors: Humans enjoy eating in itself—efficiency be damned—and markets would make it possible for more and more people to consume a larger variety of high-quality foods than even the most optimistic of futurists could have imagined.

One need only think of the common food staples of today that were unknown even a generation ago. Having grown up in the middle-class suburbs in the 1970s, I don't believe I ever saw an avocado in my house or ate sushi until I was well into my adult years. My own kids take foods like this for granted, even growing up in a rural town in New York State, over an hour from any major city. No longer is just "ground beef" acceptable even at the most common of restaurants. We must have high-quality Angus beef, washed down with a coffee drink made with high-quality beans and prepared in a manner that was once consumed only by the upper

crust of Americans. (How many Americans knew what a cappuccino was in the 1950s?)

Further consider that, contrary to the spirit of futurism, we can afford to consume food that is produced in *less-efficient, more labor-intensive ways* through organic farming and the “slow food” movement. These are the indulgences of a rich society where we have put our technology to use not to make the mundane act of eating more efficient, but to open up that mundaneness to the variety of human desires. The proliferation of cooking shows, books, and even whole TV networks, not to mention the fancy kitchens more people can afford, is evidence of how technology meeting the market improves our lives—not by large, dramatic changes but by the accretion of marginal ones that enable us to enjoy the mundane more completely.

Information Supertollbooth

The Internet is another example of this problem. A number of writers foresaw the Internet, and many imagined, romantically again, what a boon to human intelligence, science, and the arts it would be to “have the world’s libraries at your fingertips.” And indeed we have precisely that. What the futurists did not see was how the Internet’s greatest impact would be through commerce. Again, Innovation = Invention + Institutions. Putting the world’s libraries at our fingertips required profitability, and as it turns out, what made the Internet profitable was e-commerce.

Yes, the world’s libraries are at our fingertips, but you need a credit card to buy a book from Amazon. That’s not a bug. It’s a feature. Without the market, there wouldn’t be a way to accomplish the romantic vision of the futurists.

But even there it took years for the vast majority of e-commerce to be profitable. For most of the first decade or so of the World Wide Web, the only profitable business was that most mundane of human activities: sex. Adult websites provided perhaps the only consis-

tently profitable business in cyberspace; they also pioneered many of the technology-meets-commerce innovations that are now part of our everyday web experience. For example, adult sites were among the first to master streaming video and to figure how best to use credit cards securely. They launched a number of the consumer-friendly data-tracking processes that are now standard at places like Amazon.com. Futurists saw the technology but overlooked that its biggest impact would come through its combination with commerce, and that this combination would be driven by the demand for sexual content.

Good futurists wouldn’t have overlooked the sexual aspect because almost every other advance in communications technology of the last hundred years has had sexual content at its leading edge. In our own times one need only point to the early success of the VCR, a significant demand for which came from people who wanted to watch adult films in the privacy of their own homes rather than in some dreadful theatre on the wrong side of town. Nude photographs are as old as photography itself, and the same is true of pornographic films. Even as you read this, there is a burgeoning market in 3-D adult films that will surely drive the spread and improvement of that technology. For an invention to enhance wealth and happiness, it must meet up with the market.

If anything, futurists aren’t imaginative enough! The future is always a lot weirder than we think it will be precisely because the spontaneous order of the marketplace will create outcomes that no one can design and that are very hard to predict. Rather than focusing on the big, dramatic technologies and what seem to be their efficiency-enhancing elements, predictors of the future should be thinking more about the everyday things that matter to human beings and trying to imagine how technological change might interact with commerce and culture to produce the weird but still recognizable future.

FEE

For an invention
to enhance wealth
and happiness, it
must meet up with
the market.



The Evil of Government Debt

BY SHELDON RICHMAN

As we've seen in the last two issues, Destutt de Tracy, writing in early nineteenth-century France, had solid insights about the market process and government spending as a form of consumption not investment. In light of that, no one will be surprised that Tracy opposed government borrowing. In this day of trillion-dollar-plus federal deficits, his critique is especially relevant.

Tracy begins by noting that government debt is "a subject on which the general good sense has greatly preceded the science of the pretended adepts. Simple men have always known, that they impoverished themselves by spending more than their income, and that in no case is it good to be in debt. . . ."

On the other hand, "men of genius believed and even wrote, not long since that the loans of government are a cause of prosperity, and that a public debt is *new wealth* created in the bosom of society." (All emphasis has been added.)

In his sarcasm about "men of genius," Tracy was clearly rejecting the idea that government borrowing creates wealth. He had already disposed of the claim that government spending could stimulate productive economic activity. Rather than adding to "the general mass of circulation," he said, government expenditures "only change its course and in a manner most often disadvantageous." Here is Bastiat's "broken window" a few decades early.

Still, he takes up this question: "When expenses are very considerable, ought we to felicitate ourselves on being able to meet them by loans, rather than taxes?"

Politicians and pundits say yes, believing that borrowing brings good economic times, provides money in emergencies, and "thus . . . is the true palladium of society."

"Yet," Tracy responds, "I think I have good reasons for combating their opinion."

Here Tracy pauses, cagily, to state he "will say nothing of the grievous effects of loans on the social organization, of the enormous power they give to the governors[,] of the facility they afford them of doing whatsoever they please, of drawing everything to themselves, of enriching their creatures, of dispensing with the assembling and consulting the citizens; which operates rapidly the overthrow of every constitution."

Economic Effects

"The first thing said in favour of loans," he wrote, "is, that the funds procured by these means are not taken involuntarily, from any one." Tracy didn't buy the argument: "I think this an illusion. In effect it is very true, that when government borrows it forces no one to lend; . . . When, therefore, the lenders carry their money to the public treasury it is freely and voluntarily; but the operation does not end there. These capital-

ists have lent, not given: and they certainly intend to lose neither principal nor interest. Consequently, they force the government to raise, one day or other, a sum equal to that which they furnish and to the interest which they demand for it. *Thus, by their obligingness, they burthen without their consent not only the citizens actually existing, but also future generations. . . .*"

Borrowing doesn't dispense with taxes; it merely shifts them to the future, except that they must be raised high enough to pay the interest as well as the principal. "Thus, sooner or later, it [borrowing] affects industry as much and in the same manner as if it had been levied at first."

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

**Borrowing doesn't
dispense with taxes;
it merely shifts them
to the future.**

But this raises a question “which I am astonished to have seen no where discussed”: Does government have “a right thus to burden men not yet in existence, and to compel them to pay in future times [its] present expenses?”

No, Tracy answered. “One generation does not receive from another, as an inheritance, the right of living in society; and of living therein under such laws as it pleases. The first has no right to say to the second, if you wish to succeed me, it is thus you must live and thus you must conduct yourself. For from such a right it would follow that a law once made could never be changed.”

Here he offered a proposal:

“[W]hatsoever is decreed by any legislature whatsoever, their successors can always modify, change, annul; and that it should be solemnly declared, that in future this salutary principle shall be applied, as it ought to be, to the engagements which a government may make with money lenders. By this the evil would be destroyed in its root: for capitalists, having no longer any guarantee, would no longer lend; many misfortunes would be prevented, and this would be a new proof that the evils of humanity proceed always from some error, and that truth cures them.”

Repudiation

He was calling for future generations to repudiate the government debt of past generations and predicting, sensibly, that no one would lend money to the government if that principle is in effect! Laissez-faire advocates were true radicals in those days.

Tracy also debunked the claim that money lent to the government has no opportunity cost:

“The second advantage which is found in loans, is that the sums which they furnish are not taken from productive consumption: since it is not undertakers of

industry who place their funds in the hands of the state; but idle capitalists only living on their revenue, who choose this kind of annuity rather than another. . . . [E]ven admitting that all were equally idle if the state had not borrowed, it is certain that if they had not lent it their money they would have lent it to industrious men. From that time these industrious men would have had greater capitals to work on, and, by the effect of the concurrence of lenders, they would have procured them at a lower interest.”

Well, then, how about this justification for borrowing: Loans “furnish in a moment enormous sums, which could only have been very slowly procured by means of taxes, even the most overwhelming.”

Tracy rejects this too. “Now I do not hesitate to declare that I regard this pretended advantage as the greatest of all evils.”

Use Is Abuse

Some might contend this is an *abuse* rather than a *use* of credit, but not Tracy. “I answer, first, that the abuse is inseparable from the use, and experience proves it.

“But I go farther. I maintain that the evil is not in the abuse; but in the use itself of loans, that is to say that the abuse and the use are one and the same thing; and that every time a government borrows it takes a step towards its ruin. The reason of this is simple: A loan may be a good operation for an industrious man, whose consumption reproduces with profit. By means of the sums which he borrows, he augments this productive consumption; and with it his profits. But a government which is a consumer of the class of those whose consumption is sterile and destructive, dissipates what it borrows, it is so much lost for ever [*sic*]; and it remains burdened with a debt, which is so much taken from its future means. This cannot be otherwise.”

I think you’ll agree that they’re not making many economists like that anymore. **FEE**

Does government have “a right to burden men yet not in existence, and to compel them to pay [its] present expenses?”

Regulatory Failure by the Numbers

BY ROBERT L. BRADLEY, JR., AND RICHARD W. FULMER

Between the current financial mess and the debate over carbon dioxide emissions controls, there is a lot of talk about regulation these days. We are told, for example, that the recession would have been prevented if proper regulations had been in place. While it is true that (by definition) the “right” regulations would have prevented bad and ensured good, it is also true that had an omniscient, omnipotent, omnibenevolent dictator been in charge, the recession would have been avoided as well. The problem, of course, is that God didn’t run for president during the last election.

Enacting the right regulations is somewhat simpler than electing an omni-everything being to run the world—but not by much. As evidence, consider all the bad regulations that got us into this mess in the first place. Also consider the oft-heard argument that financial regulators needed to “get out ahead of the innovators.” Clearly, a job for the omniscient. There is, after all, a reason why the Wright Brothers’ flight at Kitty Hawk preceded the establishment of the Federal Aviation Administration.

Any time government regulators try to do much more than lay out the basic rules of the game, unintended consequences and moral hazards rear their ugly heads. The following list of pitfalls, adapted from our book *Energy: The Master Resource*, is offered as a caution to regulatory enthusiasts.

1. *Laws and regulations may institutionalize the tragedy of the commons.* The rule of capture (which stated that oil

belonged to whoever pumped it out of the ground) and related regulations led petroleum companies to drill as many wells as possible in order to get the oil before their competitors could. By encouraging companies to drill otherwise unnecessary wells, the rule led to wasted resources and sometimes to reservoir damage.

Groundwater in the United States is still a common-property resource. Because no one owns it, no one has an incentive to conserve it. Farmers in California, enjoying subsidized water prices, have been growing water-intensive crops such as rice and cotton in desert areas despite endemic water shortages.

2. *Special interests lobby the government to get their products or services mandated by regulation.* The mandated use of ethanol in automotive fuel is an example. In the United States most ethanol is made from corn. Farmers who grow corn and companies that make ethanol from it have heavily pressured Congress to require its use. As a further subsidy the government has banned imported ethanol even though it can be purchased from other countries for less than it costs to make it here. One unintended consequence has been an increase in food prices. As the price of corn has risen, so has corn-based animal feed and with it the price of beef, milk, chicken, and eggs.

3. *Regulations can create (or destroy) entire industries overnight.* The use of such power adds uncertainty and

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risk to the market. If risk reaches unacceptable levels, investors put their money elsewhere. The concentration of political power in Washington forces companies to lobby Congress and the White House for protection against its arbitrary use. Corporate lobbying, in turn, increases people's distrust of the system.

4. *Regulations are often the result of compromise.* After concessions have been made to this powerful representative or that influential senator, the resulting law or regulation may be very different from the original proposal and have far different consequences. Politics may be "the art of the possible," but what is politically possible may be neither practical nor environmentally friendly.

Compromise can also result in laws so vaguely worded that they can be interpreted in any number of ways. In the end it is left up to regulatory agencies and the courts to decide what a bill actually means. Their interpretations may be very different from the original intentions of the bill's proponents.

The Clean Air Act Amendments of 1977, for example, stated that only new factories and power plants would have to meet the tighter emissions standards imposed by the act. Existing plants would continue to be regulated under the preexisting standards unless the old plants were "substantially modified." Unfortunately, Congress did not precisely specify what "substantially modified" meant.

In 1998 the Environmental Protection Agency (EPA) sued the owners of a number of old plants, charging that the upgrades done over the years to these plants had cumulatively added up to "substantial modifications." The owners responded, with some justification, that the EPA had originally approved their changes and that altering the rules after the fact amounted to passage of a retroactive law, something explicitly forbidden by the U.S. Constitution (Section 9, Article 3).

5. *Lobbyists may support regulations as a way of hurting their competition.* Utility companies with "old source" power plants, for example, welcomed the Clean Air Act's

1977 amendments because they put potential competitors at a disadvantage by raising the cost of market entry.

Other amendments to the Clean Air Act required power companies to reduce sulfur dioxide emissions by installing scrubbers. A less expensive way to lower emissions would have been to switch to low-sulfur coal, but eastern labor unions and coal mining companies (which produce high-sulfur coal) successfully lobbied to get the requirement for scrubbers enacted into law. This resulted in a waste of resources since (otherwise unnecessary) scrubbers had to be built, installed, and powered.

In the United States during the twentieth century, government intervention in the energy market was commonly industry-driven. Firms often organized lobbying groups to obtain favorable regulation or special

subsidies. Free-market economist Milton Friedman complained, "Time and again, I have castigated the oil companies for . . . seeking and getting governmental privilege."

6. *Regulations can eliminate or alter feedback.* Feedback is an essential component of any activity. Imagine how dangerous the world would be for a person who had lost the ability to feel pain (as happens with certain forms of leprosy). Such a person could do serious damage to himself

by continuing to walk on a badly sprained ankle or putting his hand on a hot stove without knowing it.

Government action can create a sort of institutional leprosy by weakening or even destroying the feedback loops that make it possible for companies to know whether their activities are of any value. For instance, by taxing productive companies in order to subsidize unproductive ones, governments perpetuate the waste of resources.

7. *"Hard cases make bad law."* All too often, regulations are hastily written in response to the public's demands that the government "do something" in the face of a crisis. Petroleum price controls during the 1970s are a case in point. Under the provisions of the rules, refiners could charge more for higher-octane fuels, so they were encouraged to increase the lead content to artificially boost octane ratings.

Politics may be "the art of the possible," but what is politically possible may be neither practical nor environmentally friendly.

At the same time that crises lead to demands for action, they tend to increase the cost of any action. For instance, in response to the power shortage of 2000–2001, the state of California negotiated long-term contracts for the purchase of electricity. Within a few months market electricity prices dropped well below what, in the midst of the crisis, had appeared to be justified. California taxpayers bore the costs of this multibillion dollar mistake.

8. *Regulations often have unintended side effects.* New laws or regulations may change the incentives people face and encourage them to act in ways that the lawmakers had not foreseen.

Recall the 1977 Clean Air Act amendments that placed strict emissions regulations on new power plants, while grandfathering existing facilities. Those rules increased the costs of new plants relative to existing ones, encouraging power companies to keep older plants in service longer than they otherwise would have. Old plants are less efficient than new ones, and the result was more fuel used and more pollution created.

Fears of oil spills have led lawmakers to prohibit offshore drilling in many of America's coastal areas. As a result, the nation must import more oil than would otherwise be the case. However, imported oil is delivered via tanker. Notwithstanding the recent tragedy in the Gulf of Mexico, tankers pose a greater oil spill danger than does offshore oil production. Similarly, forbidding drilling in onshore and near-shore locations forces oil companies to drill in more hostile areas, making accidents more likely. American coastlines are, therefore, actually less safe thanks to such legislative "protection."

The Community Reinvestment Act and the American Dream Downpayment Act were supposed to merely increase home ownership. As should have surprised no one, however, they also set off a housing price bubble.

9. *Regulators do not bear the costs of their regulations and have little incentive to ensure that the benefits outweigh those costs.* The U.S. Forest Service does not pay the cost of building timber roads in the nation's forests; the money

is paid out of the Treasury. However, the Forest Service is allowed to keep some of the proceeds from timber sales. This practice provides an incentive to build logging roads into remote areas of the nation's parks to allow timber companies access to trees that would otherwise be uneconomical to harvest.

The result, according to Tom Bethell (*The Noblest Triumph: Property and Prosperity Through the Ages*) is that "[b]y 1991, the service had constructed 360,000 miles of roads—eight times the length of the U.S. Interstate Highway System." Because the cost of many of these roads exceeded the value of the timber harvested, resources were wasted. Because the link between costs and rewards was eliminated, damage is being done to thousands of acres of parkland through deforestation, loss of habitat, and soil erosion for no net gain.

10. *Public officials are self-interested, and their self-interest may not always be in the public interest,* as James Buchanan and Gordon Tullock, the main developers of Public Choice theory, pointed out.

For instance, managers with the federal government are often paid in proportion to the number of people who report to them. Their incentive, therefore, is to expand their departments. All too often they act in accordance

with this incentive regardless of the cost to taxpayers.

More familiar are the politicians who purchase votes by using tax dollars to pay for projects of questionable value, or city officials who get kickbacks in return for construction contracts.

11. *Once in place, regulations are difficult to eliminate—Friedman's "tyranny of the status quo."* For example, even though the problems with ethanol have been known for years, the regulations requiring its use have yet to be repealed.

No matter how detrimental a regulation is, or how outdated it has become, there is usually someone who benefits by it. The beneficiaries of the regulation generally have a stronger interest in keeping it in place than anyone else has in getting rid of it. As a result, they are willing to spend time and money lobbying the government to support their position. While the benefits of a

Public officials are self-interested, and their self-interest may not always be in the public interest.

regulation may be enjoyed by a relative few, the costs are often spread out among many. If the per-person cost of a regulation is only a dollar or two a year, no one has a financial incentive to travel to Washington to lobby against it. Economists call this the *problem of concentrated benefits and diffused costs*.

Moreover, the benefits of any particular government action are usually quite visible, but the costs are often hidden. For example, if the recycling industry receives a subsidy, the new facilities and jobs are open to public view. Those gains may be more than offset by the loss of facilities and jobs in other industries because taxes raised to subsidize the recycling industry leave consumers fewer dollars with which to purchase other goods and services.

Perhaps most important, people just do not like to admit when they have made a mistake, and politicians are no exception. If the “Smith Act” causes problems, Senator Smith is unlikely to apologize and propose that his act be repealed. Instead, the senator will probably argue that his legislation was not properly funded or enforced. In the end the law is more likely to be expanded than repealed.

For example, the laws and regulations encouraging lenders to give home mortgages to people who cannot afford to pay them back are still in effect. Rather than admit their mistake, legislators create straw men (such as Wall Street “greed”), then pass regulations to battle them.

12. *Industries exert enormous influence over the government agencies created to regulate them.* Reformers, believing this problem is due to an imbalance of power, often seek to remedy the situation by increasing the authority of the regulatory agency. Such measures will likely serve only to solidify the positions of those companies that already dominate the regulated business.

Industry sway over government agencies is a natural result of the incentives inherent in the regulatory process. As already noted, no one has more incentive to lobby regulatory agencies than do the companies they regulate. And regulators’ self-interest gives them a powerful incentive to listen.

There is also the “revolving door” phenomenon whereby personnel leave industry for jobs with government agencies and vice versa. Some see this as proof of corruption, but there is a simpler, less sinister, explanation. When an agency is created to oversee a business, one of its first needs is employees with knowledge of that business. Where can it go for such people but to the industry itself? Similarly, when government employees retire and wish to begin second careers, where can they go other than to the business about which they have spent their professional lives learning?

13. *Laws and regulations stifle innovation.* Once a particular solution is written into law, there is little incentive for companies to develop a better one. Laws are notoriously difficult to change, particularly when lobbyists’ businesses depend on the mandated solution. Even if the mandated solution was cutting-edge technology when the law was signed, technology quickly becomes outdated in a free market.

14. *National regulations can create nationwide problems.* In 1978 the Carter administration, mistakenly convinced that the country was running out of oil and natural gas, passed the Powerplant and Industrial Fuel Use Act. Under the act existing plants were prohibited from increasing their use of natural gas, and new plants were prohibited from using either natural gas or fuel oil. This restriction left coal as the only alternative despite the fact that coal emits more pollution and CO₂ than does natural gas. (While nuclear power was also an alternative, the Three Mile Island incident, which occurred the following year, made the option politically impossible.) President Reagan lifted the restrictions on existing plants in 1981 and on new plants in 1987.

15. *The existence of regulations and regulatory bodies gives people a false sense of security.* Bernie Madoff’s victims, for example, were reportedly as angry with the SEC for leading them to relax their guard as they were at Madoff for taking advantage of them. Consumers who believe that government watchdog and licensing agencies weed out incompetent and fraudulent service providers may be less vigilant than they would otherwise be.

No one has more
incentive to lobby
regulatory agencies
than do the companies
they regulate.



Confiscating Your Property

BY JOHN STOSSEL

In America, we're supposed to be innocent until proven guilty. Life, liberty, and property can't be taken from you unless you're convicted of a crime.

Your life and liberty may still be safe, but have you ever gone to a government surplus auction? Consumer reporters like me tell people, correctly, that they are great places to find bargains. People can buy bikes for \$10, cars for \$500.

But where did the government get that stuff? Some is abandoned property. But some I would just call loot. The cops grabbed it.

Zaher El-Ali has repaired and sold cars in Houston for 30 years. One day, he sold a truck to a man on credit. Ali was holding the title to the car until he was paid, but before he got his money the buyer was arrested for drunk driving. The cops then seized Ali's truck and kept it, planning to sell it.

Ali can't believe it

"I own that truck. That truck done nothing."

The police say they can keep it under forfeiture law because the person driving the car that day broke the law. It doesn't matter that the driver wasn't the owner. It's as if the truck committed the crime.

Something has gone wrong when the police can seize the property of innocent people.

"Under this bizarre legal fiction called civil forfeiture, the government can take your property, including your home, your car, your cash, regardless of whether or not you are convicted of a crime. It's led to horrible abuses," says Scott Bullock of the Institute for Justice, the libertarian law firm.

Bullock suggests the authorities are not just disinterested enforcers of the law.

"One of the main reasons they do this and why they love civil forfeiture is because in Texas and over 40 states and at the federal level, police and prosecutors get to keep all or most of the property that they seize for their own use," he said. "So they can use it to

improve their offices, buy better equipment."

Obviously, that creates a big temptation to take stuff.

This is serious, folks. The police can seize your property if they *think* it was used in a crime. If you want it back, you must prove it was *not* used criminally. The burden of proof is on you. This reverses a centuries-old safeguard in Anglo-American law against arbitrary government power.

The feds do this, too. In 1986, the Justice Department made \$94 million on forfeitures. Today, its forfeiture fund has more than a billion in it.

Radley Balko of *Reason* magazine keeps an eye on government property grabs: "There are lots of crazy stories about what they do with this money. There's a district attorney's office in Texas that used forfeiture money to buy an office margarita machine. Another district attorney in Texas used forfeiture money to take a junket to Hawaii for a conference."

When the DA was confronted about that, his response was, "A judge signed off on it, so it's OK." But it turned out the judge had gone with him.

Balko has reported on a case in which police confiscated cash from a man when they found it in his car. "The state's argument was that maybe he didn't get it from selling drugs, but he might use that money to buy drugs at some point in the future. Therefore, we're still allowed to take it from him," Balko said.

"When you give people the wrong incentives, people respond accordingly. And so it shouldn't be surprising that they're stretching the definition of law enforcement," Balko said. "But the fundamental point is that you should not have people out there enforcing the laws benefiting directly from them."

Balko is exactly right.

FEE

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

Capital Letters

Can We Really Do Without FDIC?

Warren Gibson's otherwise interesting article, "Federal Deposit Insurance: A Banking System Built on Sand" (*The Freeman*, June 2010, <http://tinyurl.com/2v5u9cf>), contains at least three errors. One is that "the Fed, out of confusion, failed to inject new money" during the time of the Hoover administration. Not so. Federal Reserve notes increased by 25 percent, from \$4 billion to \$5 billion between 1930 and 1933; see Irving Fisher's 1935 book, *100% Money*, pp. 5–6. It was the \$8 billion contraction in demand deposits that made the big difference.

Second, Gibson faults modern fractional reserve banking because "We think of banks as custodians of our money, keeping it safe for us and making it available whenever we need it. But present-day banks are not deposit banks." Wrong. We deposit our savings—non-consumed income. Money (cash) is only one of the media through which we make deposits. As Adam Smith well puts it in the *Wealth of Nations*, "money is the mere instrument of transfer." The other instruments include electronic transfers and checks. Thus, so long as banks pay us back our deposits when we want them, they commit no fraud.

Third, he says that "Any benefit this system [FDIC insurance] provides is incidental to its real objective: to serve the cartel." The claim is seriously misleading. A run on one bank may jeopardize the survival of all banks, including those with financially sound investments (assets), since no bank has enough cash to redeem its liabilities—pay all depositors. Thus, all depositors will lose some of their savings if a run on banks were to occur in the absence of deposit insurance. An economy's growth also depends upon increasing savings to provide the capital (funds) businesses need for their investment. In the absence of the security of deposits created by the FDIC, the rate of savings with banks would be lower, hence the rate of investment. Therefore, besides saving banks from the hazards of bank runs and contagion, the public—depositors

and businesses—directly benefit from the deposit insurance.

—JAMES C.W. AHIKPOR

Professor of economics, California State University,
East Bay

Warren Gibson replies:

I thank Prof. Ahikpor for his response to my article on federal deposit insurance and would like to respond briefly to his three objections.

On Fed monetary policy during the Great Depression, I rely on Milton Friedman and Anna Schwarz's definitive *A Monetary History of the U.S.* in which chart 31 shows a decline in the money stock from about \$45 billion in 1929 to \$30 billion in 1933. Friedman summarized this as the Fed's "disastrous mistake between 1929 and 1933, when it permitted the quantity of money to decline by a third and thereby turned a severe recession into a disastrous depression" (*Money Mischief* p. 208).

When I wrote, "We think of banks as custodians of our money, keeping it safe for us and making it available whenever we need it," I was attempting to describe what I believe (perhaps mistakenly) to be the average person's perception of what banks do. A dictionary definition of "deposit" is "that which is placed somewhere for safekeeping," like depositing your jewels in a hotel safe, so perhaps bank "deposits" should be given some other name. I agree with Lawrence White's and George Selgin's view that fractional reserve banking need not be fraudulent; Murray Rothbard and others are wrong about this. I am not charging fraud but merely suggesting that fractional reserve banking is misunderstood by the general public and perhaps should be spelled out more explicitly to depositors. I also suggest that reserve ratios are too low compared to what would come out of a free-banking system, where market forces severely discipline both managers and depositors.

My statement that the benefits of FDIC insurance are "incidental to its real objective: to serve the cartel"

was admittedly a bit hyperbolic. But in assessing the FDIC or anything else we have to ask: compared to what? Prof. Ahikpor compares FDIC insurance to no insurance whereas my article suggested that private insurers would enter the picture. Private insurers would have incentives that would make a bank panic (a contagion of bank runs) extremely unlikely. They might, for example, adopt option clauses which were successfully used by free banks in Scotland in the 1800s. The FDIC, by contrast, does not eliminate risk but instead socializes it, and in so doing it politicizes, subsidizes, and de-incentivizes the banking system. Lastly, regarding his comment on saving and investing: Of course prosperity depends on saving and investment. But there can be too much saving. The right amount for each of us is the

amount at which the marginal benefit of an additional dollar saved matches the marginal cost. Where there is a free market for investments, the overall saving rate is determined by the interplay of savers acting on their marginal cost/benefit estimates. Government interference such as subsidized deposit insurance can result in too much saving.

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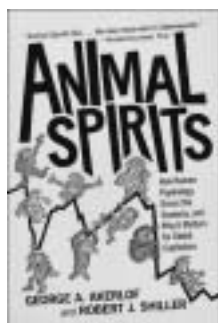
Book Reviews

Animal Spirits: How Human Psychology Drives the Economy, and Why it Matters for Global Capitalism

by George A. Akerlof and Robert J. Shiller

Princeton University Press • 2010 • 256 pages • \$16.95
paperback

Reviewed by Dwight R. Lee



Neoclassical economic theory (in which I include Austrian economics, ignoring the methodological differences) doesn't explain everything in the world, not even everything that occurs in what is considered the economic realm. In recent years this has been the theme of the growing subdiscipline "behavioral economics," which has, often usefully, focused attention on economic anomalies—outcomes inconsistent with the predictions based on fully informed and perfectly rational actors.

This isn't surprising, given the usefulness of making simplifying assumptions in theoretical endeavors. Obviously no one is fully informed or perfectly rational, but the assumption that they are generates remarkably accurate predictions on issues that interest economists.

One of the most powerful implications of neoclassical economics is that the case for free markets doesn't depend on people being fully informed and rational, as is mindlessly repeated in many principles textbooks. Quite the contrary, the case for markets is that they increase the rationality of economic decisions by providing information and motivation through prices, profits, and losses that cannot exist without markets.

With that as background, I review *Animal Spirits* by George Akerlof and Robert Shiller. Both Akerlof and Shiller have done creative and interesting work, much of it based on the anomalies highlighted in behavioral economics. They begin by considering how "animal spirits" affect economic decision making. That term originated with Keynes, who used it to describe emo-

tional factors that enter into, and often distort, investment decisions that are necessarily made with incomplete information.

Akerlof and Shiller take a more expansive view of animal spirits, which they break into five categories: confidence, fairness, corruption and antisocial behavior, money illusion, and stories. The five chapters in Part 1 discuss those separately, showing how they can lead to irrational economic outcomes and how understanding them can help us design appropriate policies for correcting them. The remaining chapters look at how animal spirits may be responsible for the current economic downturn.

Not having the space to deal with each of these chapters individually, I'll keep my discussion general. Although Akerlof and Shiller suggest that they appreciate the importance of markets, their emphasis is clearly on "market failure." A few examples illustrate their tendency to qualify any positive statement about capitalism (emphasis in original): "Capitalist societies . . . can be tremendously creative. . . . On the other hand, *left to their own devices*, capitalist economies will pursue excess, as current times bear witness." "But the bounty of capitalism has at least one downside. It does not automatically produce what people really need; it gives them what they *think* they think they need, and are willing to pay for."

This last statement isn't blatantly false, although it puts the free market in the worst possible light by suggesting that many consumers want "snake oil."

A more balanced approach would have also pointed out that government doesn't automatically provide what people need either; it gives everyone what the majority, or a politically influential few, think they need, whether or not they're willing to pay for it. Such a comment is nowhere to be found. Akerlof and Shiller ignore the problems with the perverse outcomes of government actions.

Sometimes the authors show their bias with the tone of their statements. For example, they state that "[t]he proponents of capitalism *wax poetic* over the goods that it provides" (emphasis added). And they refer to Milton Friedman's "sleight of hand" when describing his analysis of the fallacy behind the Phillips curve—analysis that undermined, at least intellectually,

the fiscal excesses of government that brought us the stagflation of the 1970s.

Akerlof and Shiller use “animal spirits” to consider some important economic issues in different and potentially productive ways. But for this concept to realize its potential it would have to be used to develop hypotheses that are more discriminating and testable than anything found in *Animal Spirits*.

The authors give the impression that they see “animal spirits” as an all-purpose explanation to be trotted out to explain anything that cannot be readily explained with existing economic theory. Indeed, they seem to believe that the strength of their approach is that by explaining almost everything, it cannot be refuted.

“Animal spirits” are ubiquitous and surely play a role in much economic activity. When economic questions cannot be adequately answered with existing theory, however, the way to come up with better answers involves hard work in developing refutable hypotheses, then testing them. That isn’t what Akerlof and Shiller do. They use animal spirits as the answer to the questions they consider in much the same way oxygen can be used as the answer to the question, “What caused the fire?” The answer cannot be refuted, but it’s not very helpful. **REB**

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Black Maverick: T. R. M. Howard’s Fight for Civil Rights and Economic Power

by David Beito and Linda Royster Beito

University of Illinois Press • 2009 • 336 pages • \$35.00

Reviewed by George Leef



Black Maverick is the only biography of Dr. Theodore Roosevelt Mason Howard, whose remarkable life (1908–1976) combined entrepreneurship, medical practice, civil-rights activism against segregation, philanthropy, and high living. He was an irrepressible but flawed character, a man on the make who grew up under Jim Crow and took advan-

tage of the few opportunities that system of repression left open. He then used his wealth and persuasive abilities to combat the system. Howard proved that freedom and capitalism were powerful weapons that could be used against bigotry.

For blacks living in Kentucky early in the twentieth century, life was mostly on the Hobbesian model—nasty, brutish, and short. Segregation limited the work available to blacks largely to exhausting physical labor. They lived under the constant threat of violence by the Ku Klux Klan against those who “got out of their place.” While growing up, Howard heard stories about lynchings and Klan raids against black towns; he also heard that the intended victims had sometimes bought guns and defended themselves. That was one of the lessons young Howard learned well: Later in life, he was usually armed.

One profession open to blacks was medicine, although they were expected to serve “their own kind” in the South. A well-known white doctor who knew Howard as a young man sensed his interest in medicine and decided to help him. The first step was to enroll the 16-year-old Howard in a junior college in Alabama run by the Seventh-Day Adventist Church. After graduating, Howard enrolled in another Adventist school, Union College in Lincoln, Nebraska, where he was the sole black student. His grades were only fair, but he distinguished himself in public speaking, winning a national oratory contest in 1930 before a mostly white audience.

The next step for Howard was the College of Medical Evangelists in Loma Linda, California, where he began medical studies in 1931. He also got involved in politics, civil-rights activism, and even journalism, writing columns for the leading black newspaper in the state. A frequent theme of his was the importance for blacks to enter business and teach their children the virtues of thrift and self-reliance. Howard found great inspiration in the philosophy of Booker T. Washington, and while he did not oppose FDR and his New Deal, he was skeptical that it would do anything to help blacks. He advised blacks to follow the example of the Japanese in California and succeed on their own without looking to politics for assistance.

After receiving his medical degree Howard first went to a decaying public hospital in St. Louis, where

he developed an excellent reputation as a surgeon. His big break came in 1941, when he was invited to become chief surgeon at a black hospital being built in the all-black town of Mound Bayou, Mississippi, by a fraternal organization. Under Howard's direction, the hospital grew and provided quality medical care to its members. Howard's self-help philosophy dovetailed with that of the fraternal order. Soon it was selling insurance to members; for an annual premium of only \$8.40, they were entitled to up to 31 days of hospital care. The response among poor blacks in the area was overwhelming. They had excellent medical insurance long before such insurance became common, and without any government involvement.

Howard shrewdly invested much of his salary in area businesses and soon was one of the wealthiest black men in the South. In the years to come, he used some of that wealth to aid the fight against segregation. In the early 1950s, for example, he was instrumental in a boycott of filling stations that refused to allow black customers to use the restrooms. That boycott caused the major national gasoline companies to change policies and insist that their franchisees no longer discriminate. They didn't want the bad publicity and loss of customers. Howard understood that under capitalism, profits usually trump prejudices.

After the infamous murder of a black teenager, Emmett Till, in 1955, Howard threw resources into an attempt to bring Till's killers to justice. Unfortunately, he couldn't overcome the segregationist-dominated legal system, and the defendants, guilty beyond doubt, went free.

The Beitos have written a timely and enlightening book. Howard was a fascinating man, and his belief that free enterprise offers poor people (of all races) the path to success needs to be trumpeted as loudly as ever. America today is torn by counterproductive governmental "affirmative action" policies such as quotas for "minority-owned" contractors and racial preferences in college admissions. The book's subtext is that what government needs to do to help poor people and minorities is to get out of their way. **FEE**

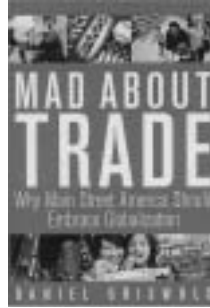
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Mad About Trade: Why Main Street America Should Embrace Globalization

by Daniel Griswold

Cato Institute • 2009 • 205 pages • \$21.95

Reviewed by William H. Peterson



Free trade is the consumer's best friend and a great contributor to peace. Pressing those ideas home is Cato Institute trade expert Daniel Griswold's challenge in this book. He is mad *for* trade, while too many others are mad *against* trade.

As an example of the latter, consider radio host and writer Lou Dobbs, who dismissed concern for consumers in his book *Exporting America*, where he wrote, "I don't think helping consumers save a few cents on trinkets and T-shirts is worth the loss of American jobs." Similarly, then-Senator Barack Obama told a stadium filled with cheering union members in 2007 that "people don't want a cheaper T-shirt if they're losing a job in the process." The idea here is that desire of consumers to save money should be trumped by the supposed need to "save jobs."

Griswold points out that politicians generally favor "the noisy producer interests over the silent, suffering consumer" and reminds the reader that life itself depends on consumption. To that end, he quotes Adam Smith in *The Wealth of Nations*:

Consumption is the sole end and purpose of all production; and the interest of the producer ought to be attended to, only so far as it may be necessary for promotion of the consumer. The maxim is so perfectly self-evident that it would be absurd to prove it. But in the mercantile system, the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production and not consumption, as the ultimate end and object of all industry and commerce.

The problem, of course, is that there is usually political advantage in running a "mercantile system" that benefits some domestic producers at the expense of con-

sumers—and other producers who need the “protected” goods to make their own products.

Griswold’s *tour de force* explores and documents the many ways in which import competition benefits American consumers, enabling them to improve their standard of living with a greater range of choice, lower real prices, and better quality. Those are not insignificant benefits. When the likes of Dobbs and Obama ridicule free trade as merely a matter of saving a small amount on T-shirts and trinkets, they’re giving a deliberately distorted picture of reality.

Big-box retailers, such as Walmart, Home Depot, and Best Buy, that purchase much of their inventory from overseas producers and ship it to stores in the United States, managed to hold their sales fairly steady or even increase them during the current recession. But what was good for those chains and their customers was sour news for organized labor. Unions often demand a “level playing field” and claim that foreign producers enjoy various “unfair advantages” such as a lower wage scale and export subsidies. When they call for tariffs, they say they don’t want special favors but only “fairness.”

Our author begs to differ. He explains to readers David Ricardo’s 1817 insight about comparative advantage—that each nation (or better still, each person or firm) will tend to discover where it has comparatively lower costs and then concentrate on producing those goods. Whether a producer’s cost advantage is “fair” or “unfair,” the best policy, Griswold argues, is for the government not to interfere with trade. Instead of further building up trade barriers, as various special interests advocate, he urges that we drop the barriers that separate us from the peaceful global marketplace.

But what about American manufacturing? Won’t free trade reduce us to a “service economy” consisting of mostly low-paying jobs? Politicians and pundits have been saying that for years, but Griswold replies that it isn’t true. The number of Americans working in manufacturing has indeed fallen, but that is due more to increases in productive efficiency than to “unfair competition.” While protectionists like North Dakota Senator Byron Dorgan wring their hands over the demise of some household name products like Huffy bicycles and Swingline staplers, they neglect to mention that Amer-

ican manufacturing has significantly increased in real terms since 1970.

Furthermore, Griswold explains that the U.S. government is responsible for a huge “swindle” of consumers—our Harmonized Tariff Schedule, filling nearly 3,000 pages. Our sugar tariff, for example, compels Americans to pay two to three times the world price for sugar. In turn, that has caused American food producers to shift production to Mexico or Canada to escape the cost. Protectionist politicians never mention the flip side of their “save jobs!” coin.

The book’s closing paragraph states: “Free trade unites us with other people in an ever-widening ‘community of work’ that provides a powerful alternative to conflict and war.” I strongly recommend *Mad About Trade*. RFB

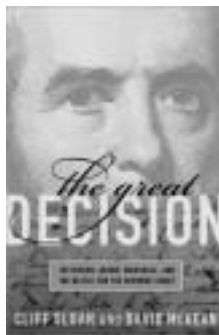
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The Great Decision: Jefferson, Adams, Marshall, and the Battle for the Supreme Court

by Cliff Sloan and David McKean

Public Affairs • 2009/2010 • 269 pages • \$26.95
hardcover; \$14.95 paperback

Reviewed by Kevin Gutzman



The Supreme Court’s decision in *Marbury v. Madison* (1803) is among the most famous in its history. Shrouded in myth and featuring a cast of historical demigods, the story of the case is a staple of biographies of the second, third, and fourth presidents, as well as Chief Justice John Marshall. Constitutional law courses commonly

begin with consideration of Marshall’s opinion in the case, which supposedly established the federal courts’ power of judicial review.

In *The Great Decision*, journalist-lawyer Cliff Sloan and biographer David McKean offer a popular account of this seminal decision. They begin with an extensive discussion of the litigation’s background. The tale will be familiar to anyone with knowledge of American

politics in the early Republic: John Adams's administration is in its closing days. The chief justice is resigning. Multiple candidates have turned down the appointment, and Adams finally decides to appoint Marshall, his secretary of state. Thus did Republican chieftain Thomas Jefferson's Federalist cousin come to rule the judiciary roost even as Jefferson's party dealt the Federalists a fatal drubbing.

Marshall, finding himself both secretary of state and chief justice as the final Federalist administration drew to a close, committed the great gaffe of failing to deliver several judicial appointees' commissions. When his successor, James Madison, found those commissions sitting on his desk, he decided (surely with Jefferson's support) not to deliver them. That laid the ground for William Marbury's lawsuit for possession of his commission.

Counsel for Marbury insisted that presidential nomination plus Senate confirmation entitled him to the office of D.C. justice of the peace. The administration maintained that actual delivery of the commission was necessary.

Nowadays, Marshall likely would have to recuse himself from the Supreme Court case. After all, what was really at issue was the significance of his own failure to deliver the commissions. Marshall didn't recuse himself.

Also nowadays, a federal court would be expected to structure the explanation of its decision differently than in *Marbury*. As courts of limited jurisdiction, federal courts first ask whether they have jurisdiction over a particular case; if not, the case is at an end.

Marshall structured his opinion the opposite way: First he asked whether Marbury had a right to his commission, then whether there was a remedy, and only then whether the Supreme Court was constitutionally empowered to afford Marbury that remedy. By the time he got to the point in his opinion where he answered no, he had already leveled a powerful political blast at Jefferson and Madison for supposedly having denied Marbury his rightful commission.

Marshall noted that although the Judiciary Act of 1789 granted the Court power to hear suits for writs of

mandamus in the first instance, such suits did not appear among the types of cases over which the Court was granted original jurisdiction by Article III. Marshall claimed that Congress did not have power to lodge original jurisdiction over other types of cases in the Supreme Court. Thus Congress had exceeded its constitutional powers in granting the Supreme Court original jurisdiction over cases like *Marbury*. Judicial review was born.

The authors display a worshipful attitude as they recount the endorsement of *Marbury* offered to them by now-retired Justice John Paul Stevens and the incorrect summary of the case's meaning by ex-Justice Sandra Day O'Connor. Her synopsis—that *Marbury* makes the Supreme Court “the final arbiter of the constitutionality of all acts of government”—is the current wisdom, although it overlooks the people's ability to amend the Constitution. For Sloan and McKean, wide-ranging judicial policymaking is a Good Thing, and whatever laid the groundwork was a Good Development. That is the message underlying the book.

That is not a new message but par for the course. The book offers no new insights or data that will add to experts' store of knowledge; actually, it's peppered with factual errors.

The idea that the Supreme Court is the final arbiter is a severe betrayal of the idea of self-government underlying the American Revolution. Presidents as disparate as Thomas Jefferson, Andrew Jackson, and Abraham Lincoln contradicted it directly. In our day, it has been used to justify forced busing for racial integration, judicial imposition of tax increases, and myriad other unconstitutional social experiments.

Far from this vision of a Grand Council with the Final Say, the Revolution stood for popular sovereignty—for the People as ultimately responsible and finally empowered. While Supreme Court justices' eyes may glisten at the mention of their self-empowering vision, America is about something far better. **FEE**

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The Decline in Civil Liberties

BY DAVID R. HENDERSON



On a flight from Chicago to Washington, D.C., in 1981, I sat beside a U.S. foreign service officer who had just finished a stint in Moscow. He told me that although he had enjoyed the job, he needed to get his family back to America because he wanted his children to grow up understanding what it was like to live in a free country. His children were only aged five and seven. “In what ways would your children have even known they were not living in a free society?” I asked. He answered: “They noticed that when we traveled, we, and those around us, had to show an ID to a government official. You couldn’t travel freely.”

Although he probably doesn’t remember that conversation, I wonder if he remembers the thoughts that caused him to return to the United States. The reason I wonder is that Americans are no longer free to travel by commercial air without showing a government official a government-issued ID. So the freedom that he sought in the United States no longer exists. In an important way, the United States has become Sovietized.

Now before you conclude, “Henderson is off his rocker; he can’t tell the difference between the USA and the USSR,” let me say that I do understand the difference. Governments in the United States don’t oppress us nearly as much as the Soviet government oppressed its citizens. On a scale of oppression where 1 is the least and 10 is the most, the USSR was a 9 or 10 and the United States is, say, a 3. But in 1981, when I took that flight, it was about a 2. Name

the civil liberty, and chances are it has declined over that period.

Consider a basic freedom-of-speech issue, the right to organize and petition the government. In parts of the United States that right is under assault. When two or more people in Colorado, for example, join to speak out about a political issue and spend more than \$200 to do so, they must register with the state and report all their contributions, even if only in kind, and expenditures. They must also disclose the identities of anyone who contributed money. Better-organized political activists have used this law as a club to go after their political opponents. In 2006, for example, the supporters of annexing the town of Parker North to the town of Parker filed a campaign-finance complaint against the six most vocal opponents and threatened to go after anyone else with a yard sign opposing annexation. Similar legal assaults have occurred against opponents of increased gasoline taxes in Washington state.

Or consider the drug laws. In the 1970s, when police raided a home for drugs, they often knocked on the door and waited for someone to answer. Then they entered and looked for drugs. Today, it’s much more common for them to show up in heavily armed and armored SWAT teams, ready to shoot if any-



You aren’t necessarily free to move about the country.

flickr.com/mtsl

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one in the house makes a false move. *Reason* writer Radley Balko has written often about the outrages of the drug war. In a May 2010 *Reason* article, he writes: "I've been writing about and researching these raids for about five years, including raids that claimed the lives of innocent children, grandmothers, college students, and bystanders. Innocent families have been terrorized by cops who raided on bad information, or who raided the wrong home due to some careless mistake."

Enforcement Victims

Fortunately, such incidents are still relatively rare, but that they happen at all is intolerable. Enforcing the drug laws requires such raids because the violators are people engaged in mutually beneficial exchange. In murder or burglary there is clearly a victim, or a victim's friend or relative, who objects to the crime and therefore has an incentive to report the crime to the police. But when illegal drugs are bought or sold, there is no victim. Whatever the wisdom or folly of exchanging illegal drugs, those who do so believe they benefit. Otherwise, they wouldn't do it. So one way to catch people who trade in illegal drugs is to surprise them by invading their homes.

The drug laws have also led to other violations of people's civil and economic freedom. When President Ronald Reagan stepped up the drug war, he started requiring people making purchases with \$10,000 or more in cash to fill out a federal form. The government also seizes property that police suspect has been used or earned in the sale of drugs and has carved out an exemption to the Constitution's prohibition on illegal search.

It's not as if we get a big benefit from enforcement of the drug laws. Just as the prohibition of alcohol helped create criminal gangs, so does the prohibition of drugs. The nice thing about freedom is that it allows people to either use or avoid using the drug(s) of their choice. And among the tragedies of the drug war are the consequences it imposes on innocent people caught in the crossfire.

As for government restrictions on our freedom to travel by airline, the simple fact is that commercial airlines, even with the risk of terrorism, are by far the safest way to travel. According to Michael Sivak and Michael Flanagan in an article in *American Scientist*, your chance of being killed in one nonstop airline flight, even with the increased threat from terrorist attacks, is about one in 13 million. To reach that same level of risk when driving on rural interstate highways, which are America's safest roads, you need travel only 11.2 miles. In other words, you are in about as much danger driving to the airport as in flying from the airport.

Reduced Safety

Why is driving relevant? Because when the government invades our privacy, as it systematically does when we fly, it causes some, especially those who would have traveled less than 500 miles each way, to travel by car instead. What is the unintended, but totally predictable, consequence of this loss of freedom whose stated goal was to make us safer? Less safety. Adding to the irony is the fact that since 9/11, passengers have been quite good at restraining those terrorists who try to blow up airlines. When Richard Reid, the shoe bomber, tried to blow up a flight, passengers restrained him. Ditto with Umar Farouk Abdulmutalab, the underpants bomber on the Christmas 2009 flight heading into Detroit.

Fortunately, there's some good news, both here and in Great Britain. The Real ID Act, which Congress passed in 2005, requires drivers' licenses and other state government-issued identification cards to conform to tight federal standards. Many state governments, in a fit of federalism, have said no. That part of the Real ID Act looks to be *really* dead. And in Britain in May the newly formed coalition government announced that it would scrap a similar plan.

Let's not stop there. Let's be able to say, like the Southwest Airlines ads, "You are now free to move about the country." **FEE**

Government's
invasions of privacy
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