

ACCIDENTAL FREEDOM

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The gradual change of England from a weakly mercantilistic state at the time Adam Smith wrote his book to almost pure free trade by 1850 is one of the great examples of the triumph of ideas in history. It is, of course, true that England was already much freer economy than most of the world but, still, the change was very significant. Unfortunately, I am unable to claim similar influence for ideas in the United States.

It is true that the United States was influenced by Smith and that many of our leading officials were under his sway, including a number of presidents and congressmen. Indeed, his influence at various times on our history had considerable effect. Interestingly, Alexander Hamilton -- probably the most brilliant of our economic managers -- understood Mr. Smith perfectly and rejected his advice.

Basically, however, we are more the fortunate product of a series of accidents rather than of careful thought. To explain this, I am going to present a desperately brief and oversimplified account of our history in this area.

In the first place, the colonies themselves were essentially appendages to England. There was an active coastal trade along the coast of the thirteen colonies, but, in general, the trade between England and the colonies was more important than the intercolonial trade. At the time of the American Revolution, there was a very thin layer of settlement running along the coast with few people living very far inland, so they made little use of land transportation. The general population density was not great enough to support canals although a number were built in the early nineteenth century. It was not until the introduction of the railroads that overland transportation in the United States became reasonably good.

There is here, however, a rather important modification, which is that during the winter the northern part of the United States gets very cold. At this time, the muddy roads become hard as rock and a good deal of the movement of heavy objects was carried out by using special equipment for operating in snow and ice. In this respect, the situation was rather similar to that of Russia. The existence of many streams, together with the fact

that in those distant days even a rather small boat was a suitable method of getting things around, meant that inland citizens were not as cut off from the world as one might think.

But to return to the pre-revolutionary situation, the colonies were subject to a good deal of economic regulation from England and almost all of this regulation had the specific purpose of benefiting various English interests. The English, after all, were represented in the House of Commons and the colonies were not. Still, the total volume of such regulation was not gigantic.¹

These regulations were simply abandoned the moment that the colonies broke off from England. No one in Virginia was interested in retaining the monopoly of certain products in Virginia by English merchants. This was particularly true since during the Revolution we were allied with France and Spain and, if anything, would be likely to give their goods priority. Thus, what we had in the way of major regulations were more or less terminated by the Revolution itself, and there were very few such regulations at the time the Constitution was set up. This, again, is not the result of careful thought but the result of historic accident.

Now, this deals with what we may call major regulation. The states and local governments actually followed the custom of

their day by having a very large number of minor regulations such as maximum prices on bread, and so on. Those regulations, however, although certainly uneconomic in their character, do not seem to have done a great deal of damage, partly because they were not very well enforced. The principal enforcement mechanism in most of the United States, after all, was an elected sheriff, who normally would be quite reluctant to imprison a prominent local merchant. Also, the geographic scope was too small.

At that time, the average American citizen was a farmer who, if he was not completely autarkic, nevertheless produced himself a large part of his consumption. Insofar as he was engaged in trade, he was usually trying to sell agricultural commodities, hopefully in Europe. Quite naturally, he was not interested in anything which would depress their price. Undoubtedly, he would have liked price controls on those things that he did buy, but such regulations were likely to simply deprive him of any access to iron, horseshoes, and so on.

In the larger cities, and it must be emphasized that the larger cities were not very large at that time, there was more in the way of regulation, but, again, it does not seem to have been a major matter, not because people were in principle against it (they were in principle in favor of it) but because there was relatively little opportunity.

In addition, there were certain institutions which automatically were going to make rent seeking difficult. First, as Tollison² pointed out, it is, on the whole, harder to make a deal with a legislature of many people than with a hereditary monarch; hence, democratic governments are apt to have less of it than authoritarian governments. The American government was for its day an extreme example of democracy. If we did not have universal manhood suffrage, it was nevertheless true that most men could vote.

A second argument (my own) is that the jury as a method of operating your law is singularly inappropriate for enforcing the type of regulation that rent seekers normally want.³ In the first place, juries are never much impressed by the law when it conflicts with their own ideas of ethics, and, in the second place, juries tend to favor the smaller of the two parties. Lastly, they do not, in general, like monopolies of anything except labor. In sum, they are a weak reed for monopolists to lean on. Of course, if your monopoly cannot be enforced, there is not much point in investing resources in getting one.

But the basic problem which led to a fairly free economy in the United States, without anyone particularly planning it, was simply the federal system. As a general statement, the American states frequently have favored all sorts of rent seeking to benefit various small groups of their citizens. Some of the

western states, settled by Germans and Scandinavians in the late nineteenth century, were actually formally socialist. They set up cooperative or state-owned grain elevators and various types of retail organizations. We had free trade, however, and by that time the railroads were in existence. Their cooperative stores simply could not face the mail order competition of Sears Roebuck and Montgomery Ward.

The collective grain elevators found that their customers were shipping the grain across the state borders to private grain elevators. Internal free trade made all of this quite possible.⁴ Such regulations were not particularly new. The early nineteenth century had the same kind of thing; the states enacting a great deal of mercantilistic regulation most of which promptly broke down because of free interstate trade. Of course, in the early days when internal transportation was very poor, the trade across state boundaries was not very sizable, but those were the days when there literally was not a great deal of trade, and, again, controls by local states were not very helpful.

The federal system here made it impossible for the states to put direct controls on interstate shipments. Further, in general, a given state that attempted to put some kind of indirect restriction on imports would immediately find that several other states were annoyed and these other states had a) a perfect right to sue them in the federal courts under a specific

provision of the Constitution, and b) the right to have their senators and congressmen do various nasty things to the offender in Washington. Under the circumstances, this just did not pay.

In Switzerland, this kind of thing goes farther down because the communes have a good deal of independent power. In the United States, local governments -- the cities and counties-- have always done a large part of the total amount of the "governing." From the standpoint of our present discussion, however, the fact that the local governments are the "creatures of the state" legally means that a cartel of all the municipal governments in a given state enforced by the state legislature is possible. But as we have been pointing out, state sponsored cartels could not ban imports from other states; hence, had very little scope.

It might be thought that the adoption of the federal system showed great forethought, but in both the United States and Switzerland, it arose from the pre-existing situation and not from careful thought. The states and cantons both already existed and the federal constitution was, in effect, a treaty among these previously existing governments. In order to get unanimous agreement, it was necessary to find the lowest common denominator, which meant a minimum transfer of power to the central government.

In practice, the state has not enforced cartels on the local governments for more than a limited number of subjects. A small corporation with which I am associated recently decided that it should build a small factory employing about 80 unskilled laborers. It simply solicited bids from 30 small towns in the immediate vicinity of its headquarters. The final arrangement is that we will rent a factory built for us by a town of about 1200 population with advantage for both us and the town."

Let us consider the national government, which is not subject to all of these difficulties. The first thing to be said is that until about 1900, the national government did not do much of anything except run the post office and small military forces. Indeed, it seems likely that the fact that the wars of the French Revolution and Empire broke out almost immediately after the signing of the Constitution, and distracted the European powers, was one of the basic reasons that the United States was able to get off to such a good start.

In a mild way, we did get into those wars. Our first war--
a very minor one -- was fought with France under the republic.
Our second war, a pretty major one, and, in fact, the first war
that we lost, was fought beginning in 1812. We entered that
world war on the side of Napoleon while he was marching on
Moscow. Our objective was essentially to take Canada and we
failed totally, but at the end of the war England was so

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exhausted -- not by fighting us, but by fighting Napoleon -- that she did not feel in the mood to undertake the difficult task of conquering the United States.⁷

In any event, our central government got off to its start as an extremely weak organization. It had little power or revenue. Interestingly, for the first seventy or eighty years of the American independent government, one of our major sources of revenue was not a tax. The western lands were held by the federal government and sold for revenue. This was such a major source of revenue that occasionally the federal government actually could not spend it all and made gifts to the states.

Other than this land sale item, the main revenue was, of course, tariffs on imports, but there were some internal excises, one of which set off what came very close to being the first revolution against the American government.⁸ The small revenues that were derived were used primarily to maintain military forces and to some extent domestic improvements. This was, however, a very minor matter and the domestic improvements were, in general, of a minor character.

Canals and railroads, and what toll roads there were in the United States, were put up primarily by private companies, sometimes with considerable aid from state and local governments and occasionally with aid from the federal government.⁹ It would

appear that the federal government was absorbing 2-3 percent of GNP in peacetime years throughout the nineteenth century. (See Figure 2.) Since the United States was, of course, growing quite rapidly, this does not mean that the absolute size of the federal government was unchanging.

The general lack of central control is perhaps best illustrated by the fact that for the twenty years from 1843 to 1863 there was no centralized money system. Insofar as we were not using gold or silver coins (many of which were privately minted), the circulating medium was notes issued by private banks chartered by the states. The states had very little control over these banks and what rules they imposed were largely perverse.¹⁰ This period has never been thought to be much of an advertisement for free banking, but it was showing signs of becoming more stable towards the end.

The end of this system came because the federal government wanted to make use of the money system as a way of raising funds to pay for the Civil War. The result was a switch to money still issued by private banks but now under fairly stringent federal government control. Until the founding of the Federal Reserve System just before World War II, most paper currency in the United States was issued by individual banks rather than by some central agency.

Insofar as there was central control, it was carried out by a federal government official called the comptroller of the currency and stabilization of the economy; insofar as it was done, it was carried out by J. P. Morgan. It does not seem like a very good system from our present standards, but the economy was more stable during this period than during the first thirty years of the Federal Reserve System. Whether it was more stable than since World War II is currently the subject of a rather complicated historical debate.

But that has been a digression. The basic point here is that there was really little in the way of federal government activity and what there was had to do with such traditional government activities as the military and the road system. The states attempted various rent-seeking activities, as I suppose would be expected, but, in general, were unsuccessful because of internal free trade.

There was one area where the federal government had considerable power and used it detrimentally -- foreign trade. Under the Constitution, export taxes were prohibited but it could charge import taxes. This rule was put through essentially by the Southern states who at that time were already major agricultural exporters to Europe. It seems likely that the problem the Southern states saw when they put this in was not that there would be protective tariffs but simply that the

Congress might put indirect taxes on the South by enacting export taxes on their crops.

Alexander Hamilton, however, saw things differently and he is the source of intellectual backing for what we now think of as protective tariffs. He seems to have all by himself invented the infant industry argument, although I cannot be sure. In any event, List, like Tocqueville, came to the United States to study new methods. In his case, he came for the purpose of studying how the American government was encouraging industry. He very quickly became disgusted with the whole thing because he realized that what the American government actually was doing was simply succumbing to various special interests. It can be said that when he went back and set up the Zollverein in Germany, he also succumbed.

Hamilton wanted to set up a major set of protective tariffs and he had the support from incipient industrial interests in the North. But his problem was the Southern agricultural exporters who very early in the republic became primarily exporters of cotton; thus, they had an interest in preventing import tariffs from rising. Since in those days they were about half of the country, the period from 1788 to 1860 is one of fluctuating tariffs going up or down depending to a large extent on fluctuations in the political power of different parts of the country.

The tariff was, in many ways, an easier type of control than more sophisticated mercantilistic controls. In the first place, the Constitution provided, and then the courts enforced, a number of things that made collecting tariffs easy. For example, it is not necessary to get a search warrant if a customs inspector wishes to search any person in the general vicinity of a dock. It is also not necessary to get a jury to deal with most, although not all, cases where someone has been evading duties. Administratively, it was easier to impose tariffs than other types of activity. The fact that the tariffs were imposed only around the perimeter of the country also meant, of course, that one could have a much smaller tax revenue force than attempting to collect an excise inside the country.

We have pointed out, however, that the federal government was not really collecting or spending a great deal of money and it had an alternative source of revenue in the form of the land sales. Under the circumstances, American tariffs developed a tendency which was unkindly referred to by some Europeans as a prohibited list and a free list. This is, of course, an exaggeration but it is, nevertheless, true that American tariffs have frequently not covered at all items where a lot of revenue could be obtained -- for example, coffee. At the same time in other areas we had taxes so high that no revenue was obtained. It has, of course, never been true that there were no tariffs

that actually raised considerable amounts of revenue.

The result of all of this is that the United States, as of, say, 1855, had an extremely free and open economy. ⁽¹¹⁾ The Civil War raised government expenditures very sharply. In a real sense, the American Civil War was the most severe war we ever fought. At the end of it a number of costs continued. An army of occupation, admittedly a small one, was maintained in the South for a period of time and there were war veteran pensions, particularly for the wounded, and so on.

Further, one of the results of the Republican ascendancy had been the more or less complete abandonment of land sales as a source of revenue. The Homestead Act provided land that could be obtained freely by anyone who simply occupied it. Thus, at the end of the war, the government collected something like 6 percent of GNP in taxes. As shown on figure 2, there was a steady fall in this amount until about 1900, at which time the federal government was absorbing about 2 percent of GNP -- again, for military and rather minor domestic improvements. Even our minor wars with Spain and the Philippines did not have much affect on this very low budget. It is interesting that at this time the sum of local government budgets was considerably larger than the federal budget but still the whole thing did not add up to more than 6 percent of GNP.

But there were some signs of difficulties to come. In many ways, this was the heroic period of American development. The compound and then the triple condensation steam engine lowered the fuel consumption of steam engines to the point where trans-atlantic steamers became a much cheaper mode of transportation than the sail boats that had dominated the traffic up to that time. This led to a tremendous influx of people from Europe, mainly coming from Eastern Europe rather than Western Europe where we had previously drawn our immigrants.

Western Europe at this time was also rapidly growing. In 1870, per capita income was higher in a number of European countries than it was in the United States. From the Russian Empire and from parts of the Austro-Hungarian Empire, however, there was a flood of people seeking improvement in their living standards which, in general, they achieved. Some of them, of course, were also fleeing political repression and a good many of them just did not want to be drafted.

Some of these immigrants settled in the West and others were much of the labor force for the gigantic expansion of industry which led to American economic dominance in much of the world. Looking back on this, we see a gigantic free trade area, the largest one in the world at that time by a wide margin with governments mainly doing things that Adam Smith would have approved of.¹² Much of our present-day world comes out of this

period. Edison, Ford, Bell, and Burbank all were Americans and all true revolutionaries.

Politically, however, we were now moving toward changes which I regard as undesirable but which many people would regard as straightforward progress. Indeed, it was called the "Progressive Movement" at the time. Kolko, a representative of the far left, refers to this whole period as the triumph of capitalism because the government regulations that were enacted were generally for the benefit of special interests. But it should be said that they were mainly sold as democratic efforts to help the poor, a camouflage which has continued.

Now, in all of this, the United States was far behind developments in Europe. Prince Bismarck invented the welfare state and it spread rapidly in Europe. But it was not until the 1930s that it began to have any significant effect in the United States. The amount of government regulation over the economy was massively less in the United States.

With respect to the tariff, the situation at the end of the Civil War was that the tax system had been designed to raise money for the gigantic military establishment maintained by the federal government. As this was disbanded, the taxes were steadily reduced and year after year there were bills to "reduce the revenue" introduced in Congress. The tariff became even more

to resemble a free list and a prohibited list since the congressmen quickly realized they could reduce the revenue just as readily by raising the import duty on something that their constituents produced as by lowering the tax on something that their constituents consumed.

The rise in tariffs in this time was also probably affected to a considerable extent by the fact that the South had lost its influence. The western states, major exporters of grain, do not seem to have ever been as firmly opposed to tariffs as had been the more traditional Southern states which were now under military occupation.

Nevertheless, although there were things happening that were forerunners of developments in the twentieth century, very little was actually done in the nineteenth century. Further, I must repeat my previous remarks about the evaluation of these changes. Most people then and, indeed, until most recently, would simply have said that the United States was rather backward. The new methods of running states for the benefit of the poor or the people, and (especially) the special interests, had not penetrated very thoroughly into the United States.

I have mentioned this was the period in which certain western states attempted to adopt Socialism and failed because of internal free trade. It is also the period in which many other

regulations were established. For a while, the Supreme Court impeded these developments but it eventually gave in.

As an example which has absolutely nothing to do with Socialism, the slaughterhouse case -- a very important case in the history of American constitutional law -- involved a law passed by the Louisiana State Legislature under the cover of concern for public sanitation. In fact, it gave a designated person a monopoly of butchering meat in New Orleans. This was rather typical of the kind of thing that was being done and the kind of thing that still was being destroyed, in essence, by free trade. If we were going to have controls on the economy, if special interest groups were going to get significant gains, it would be necessary for the federal government to come to their aid. In the latter part of the nineteenth century it began to do so.

But although we do have this development of federal government control of the economy in the interest of various special interest, and it should be said to some extent in the public interest, still it was very mild compared to what it was and still is in Europe. Our general tax burden is much lower than that of Europe.

In this connection, turn to Figure 1 and look at government spending as percent of GNP in the years 1890 through, say,

1910.¹³ It will be observed that it is extremely small and, remember, this is a period in which we fought two wars, albeit rather minor ones. Still, foundations for much greater expansion were laid at this time.

As an indication of what was happening, consider the Interstate Commerce Commission (ICC). This was an effort to control the railroads, and it should be said that the railroads at that time did raise some special problems. In general, getting around the United States then depended on the use of railroads, which also shipped the bulk of the produce from place to place. If you wanted to get from one major city to another major city, you normally had a choice of a number of routes run by different companies. These companies regularly attempted to organize cartels but these cartels just as regularly broke down. They were, therefore, interested in some kind of government control which would prevent the undercutting that they found so painful.

More importantly, however, the inhabitants of small towns were important in the political situation at this time. Usually the small towns had only one railroad running through them. Further, the railroad ^{FREQUENTLY} ~~usually~~ was on a route between two major cities. It might well be true in the periods when the cartels were in disarray that the cost of shipping goods from, say, Chicago to New York by way of Evansville, was less than the cost

of shipping them from Evansville to either Chicago or New York. The inhabitants of Evansville naturally objected, and taking the United States as a whole, this still being basically an agricultural country, the inhabitants of these small towns outnumbered the inhabitants of the major cities.

This made possible an alliance between the small town interests and the railroads. The alliance was formed and created the ICC which provided control over railroad rates. Naturally, there is nothing in the act that says the ICC shall enforce cartel arrangements among railroads, and, indeed, in the early years it was not very good at that although certainly there was an improvement. The act purported to have nobler purposes. In addition to these "public benefits", the farmers obtained a ban on higher rates for a short distance on a given rail line than was charged for a longer distance.

Interestingly, although mentioned by the early economists, the cartel aspects of the ICC, and, indeed, of the later government regulatory commissions, rapidly disappeared from the scholarly literature. I think it would be correct to say that by the 1930s, and probably much earlier than that, the general view of most of the regulatory commissions was simply that they were doing good. It was argued that we had natural monopolies and a regulatory commission was necessary to control them. A special branch of law had developed and most of the economists who were

interested in this area regularly testified as experts before various control commissions. In other words, they had been co-opted.

As an example of how thorough this idea had become, let me give a little of my own experience. When I was in law school in the early 1940s,¹⁴ I was given a project on the railroads in an antitrust course. I looked at the voluminous data which the ICC published about the railroads and was greatly shocked to discover that the profits of the railroads had actually increased after the ICC had been formed. This raised questions in my mind about the controlling of natural monopoly argument.¹⁵ The reason I was shocked was simply that I had never heard anything about the regulatory commissions except that they prevented monopolist exploitation.

Still, in the 1930s when the railroad ceased to be monopolies because of the development of the truck and bus line transportation, ICC jurisdiction was extended to cover them. In this connection, my own proposal at the time¹⁶ to abolish all regulation of short railroad trips because the trucks and busses were fully capable of providing competition was regarded with horror by most of my more conventional colleagues.

It is also interesting that about this time, that is in the 1930s, the rapidly developing air transportation system

petitioned for and received the organization of the Civil Aeronautics Board (CAB) with the specific argument that without it there would be destructive competition. The CAB, of course, effectively cartelized a naturally highly competitive industry.

Let us return to the 1890s and the early part of the twentieth century in which a great many other interventions into the market began. I mentioned earlier that the United States had made considerable revenue out of selling its national lands and then under the Homestead Act had abandoned this revenue. As one moves west in the United States, however, rainfall falls off and the areas cease to be suitable for farming on small plots.¹⁷ Land could still be purchased but the minimum price set many years ago when they were thinking of land in the east, was high enough so that the arid western lands were not worth it. Thus, a good deal of land remained in federal hands.¹⁸

Congress and the government made several rather inept efforts to amend the Homestead Act so that people could simply take larger plots of land in hopes that this would solve the problem, but about 1890 the policy itself was changed. Instead of aiming at getting as much land as possible into private ownership, a positive conservation policy was put in hand with timber land, and later range land, being kept in government hands. The history of this, again, is rather like the history of railroad regulation in that the whole thing was announced in

terms of general benefit but was actually run for the benefit of various other parties.

It should be said that in this case from the beginning and to the present, the principal beneficiary from the management of the forest lands has been the forest service whose management of the lands has been, I think, pretty unmitigatedly aimed at increasing the total budgetary revenues of the forest service. Rangeland, on the other hand, was distributed to politically powerful ranching interests in the west until recent years when such organizations as the Sierra Club have shown an ability to generate more votes than the ranchers.

All of this was simply a minor nuisance and I think could reasonably be put down in the period before World War I as essentially trifling. The two figures show expenditures, not degree of regulation. I think they correlate rather well with the degree to which the federal government was regulating the society and you will note that it is not really gigantic until the 1930s. It was, however, slowly growing.

But the growth shown on Figure 1 before 1933 may be an artifact. As can be seen from Figure 2, the period after major wars is one of declining, but high expenditures. Further, 1930-1932 was a depression period and the high end values of this period may be due to that. A line fitted to the data from 1865 to

1929 had a slight downward slant.¹⁷ In any event, Figure 2 proves that Wagner's law is not really general.

There was also growth in regulations. Herbert Hoover, during the 1920s as Secretary of Commerce, and, of course, eventually President, was a great believer in government control of almost everything. Under his leadership, the Department of Commerce grew to the point where it occupied the largest office building in Washington D.C. -- the entire west end of the famed government triangle. Among other things, he is responsible for the development of our present regulatory system for radio (it was extended to television), which we hope will be dismantled in the not distant future.

Note that what has happened here is not that the popular attitude towards regulation changed. The behavior of the states, and for that matter the local governments, continued to involve much regulation. It was simply that the switch of activity to the federal government meant that this regulation no longer faced "competitive pressure; hence, could, in fact, grow greater.

To name but one example of local regulations, the general adoption of zoning laws in most states and most cities of the United States occurred during this period. Having lived in Houston, one of the few cities which resisted this trend and did not enact zoning laws, I think that I can say fairly certainly

that these laws did no great good. They did, however, greatly increase the power of the local politicians which was sometimes used to solicit bribes. Again, they had very general intellectual support. I remember being taught in high school what a good thing they were.

It is easy to develop good intellectual and economic rationalization for zoning codes since there is no doubt that what you do on your land generally exerts externalities on your next-door neighbor. But that assumes that the zoning is, in fact, well run. There is no reason to believe that that has been characteristic of our zoning in the United States. Indeed, it seems likely that the principal result of these codes is transfer of large site values back and forth among different real estate owners, depending on what zone classification they get. It also created a large industry of specialists in getting zoning changes.

All of this has not been as expensive as you might expect because in practice zoning codes do not bind very tightly. Again, Houston has no zoning code and you cannot tell by simply looking at it that it is any different from any other American city. In general, up-zoning -- that is, moving from one zone category to a more valuable category -- is reasonably easy and very widely practiced. Still, it is a waste. Undoubtedly, the ideal system would be an efficient set of building restrictions

designed to minimize externalities and run by impartial and highly competent people. The second best probably is no zoning at all and the third best is the zoning we, in fact, have.

It is interesting that the period from 1870 to 1929 was the period in which the United States acquired the highest living standard in the world. In other words, it overtook various European countries. England, in particular, had been better off as late as 1900. It is possible that the explanation for this is simply the development of the Bismarckian welfare state in Europe and that this slowed down their growth. Since we did not have it, and England got it late, the data fit.

But having said that this is possible, I should go further and say that it is by no means obvious that this is so. A theory which would imply that this is the explanation for this change would hold that there is a sort of slowing down of growth which occurs when you move from a free market to a highly regulated market and in particular with the kind of thing we associate with the welfare state, but that once your growth rate has fallen for a while, you then get back on the main trend but at a lower base. In other words, a sort of inverted S-shaped growth path.

This would imply that the growth of the United States during this period was normal and the growth of most European countries was retarded and then during the period from the 1930s on, when

the United States was moving into the welfare state and the Europeans already were there, it was the United States whose growth rate was retarded.

This theory which I used to regard as quite sound is lacking in empirical support. The United States as the richest country in the world does have certain disadvantages in growth since it does have to invent new things, whereas other people who are behind us can to some extent copy us, which is cheaper. But, nevertheless, our relatively slow growth in recent years is conspicuous.

In any event, as you can see simply by looking at the size of the federal government sector, the United States had a relatively light government in 1929. It must be emphasized again that there was a great deal of local government. The school system, for example, is very expensive in the United States and before 1930 was paid for almost exclusively²⁰ by the local municipal or county governments. State governments built most of the highways, although in this case there were some arrangements under which the gasoline taxes collected by the federal government was in part rebated to them for the building of highways.

The courts and police were, again, almost entirely local responsibilities with the exact division between the municipal

and county governments on one hand and the state government on the other, depending on where you were. Having said this, we have covered the bulk of the American government in those days. The federal government maintained a military force which was small as far as the army was concerned but which was big in air and sea power. It also maintained a number of minor services such as patents, weather service, and so on, and was developing a control bureaucracy in Washington which was, however, still rather small. The pension system for war veterans and the fairly elaborate research establishment paid for by the federal government, although actually administered by the states for the benefit of agriculture, were also significant to central government expenditures.

We then had a regime shift in the 1930s. The easiest way of explaining this is that the United States intellectuals had followed much the same course as European intellectuals. When I was in law school just before and just after World War II, most of my colleagues were Socialists of one sort or the other. Indeed, that was the reason that I joined the Department of State. I concluded that personally I could have no future anywhere except in government service, and even I, black reactionary that I was, conceded that the government should run foreign policy.

The Great Depression, an incredible catastrophe of which I

have only faint yet nevertheless depressing memories, led to quick internal revolution in which many of these ideas which had been fermenting on the intellectual backboilers of society were put into effect. In essence, what we did was copy the European Bismarckian states and, indeed, in the thirties people would frequently quite consciously refer to Hitler's policies as the kind of thing which we were moving toward. Of course, they referred far more commonly to Russian policies.

Naturally, although this change occurred, the total volume of government was still quite small by European standards. The National Recovery Administration (NRA) and the Agricultural Adjustment Administration, in fact, established government sponsored cartels for much of our economy. The NRA was knocked out by the Supreme Court about the time that almost everyone realized that it was failing, but we still have our agricultural program. As a patriotic American, the only consolation I can find in this is that almost everyone else is messing up their agriculture, too.

Interestingly, the leading lights of the New Deal who had organized the cartels of the NRA almost immediately switched over to radical antitrust policy. Apparently there was no feeling on their part that there was anything intellectually inconsistent, probably because both of these things involved government control of business.

There was also at this time the introduction of national old-age pensions and we very nearly got a medical program, too, although we did escape that and switched instead to widespread private health insurance.

Almost all of this was rationalized in terms of helping the poor, but as a matter of fact, there is no real evidence that it has particularly. Indeed, if it has retarded growth, as I tend to think it has, the poor are probably worse off than they would have been without these programs. There have not been many studies of this particular subject but the studies that we do have indicate that the poor, defined roughly as the bottom 10 percent of the population, were given about as much government aid relatively in 1850 as they were in 1950.²¹ The studies of old-age pensions indicate that the poor older people, again, were about as well taken care of relatively in the 1920s as they are now.²²

Unfortunately, there has not been much research done along these lines. Most people just assume that the program benefitted the poor because the people who advocated it said it did. I would like to have the two sources that I have just footnoted supplemented by at least 100 doctoral dissertations. Those of you who are teachers are in a position to see to it that this particular hard -- in the sense of tedious but not intellectually

difficult -- task is undertaken.

The growth of the American government is frequently talked about in military terms but actually this is quite unrealistic. As you look at the figures, you will notice that the First and Second World Wars led to gigantic increases in government expenditure which vanished more or less after each war. The Korean War led to a smaller increase (after all, it was not a very big war) but the bulk of that increase remained in position. Thus, from the Korean War to the present, we have had a fairly sizeable land forces as well as maintaining the traditional large navy and air force.

But, although we have maintained sizeable forces, they have not grown as rapidly as the economy, with the result that their share of GNP has fallen irregularly. There have been at least three cases in which new presidents were elected on a campaign of strengthening the military: Kennedy, Nixon, and Reagan. In all three cases, there was a temporary rise in the military budget followed by continuing decrease as a share of GNP. It is, of course, true that the absolute size of the military budget, on the whole, grew over this period. Indeed, it had to because they had to raise the wages of the soldiers in order to keep them in uniform.

Basically, however, the growth has been a growth of

transfers of one sort or the other, old-age pensions, increasing medical programs particularly for the poor,²³ and the bizarre Aid to Families with Dependent Children (AFDC) program which, in essence, rewards women for having illegitimate children.²⁴

The actual expenditures, however, I think are less important in dealing with the freedom of the economy than the regulations. Of course, the two are highly correlated. It is hard to get a good measure of regulation. Things like number of pages in the Federal Register which have been used have the disadvantage that Congress from time to time decides the procedure should be more complicated with the result that everything has to go into the federal regulations again so that many times the same regulation now gets four or five appearances. Still, I think most students would agree that the correlation between these two aspects is good.

In my opinion, the result has been quite depressing for the United States, but if you compare it with the situation in most advanced Western countries, it is fairly easy. Switzerland, another federal state -- in fact, one that is even more federal than we are -- is our only close competitor on share of GNP absorbed by government. Japan, although the government is now growing very rapidly, had a long period with practically no central government controls, essentially because General Douglas MacArthur abolished a large part of the Japanese government

during his reign. In addition, the Japanese corporations seem to have a great ability to control the controllers.

Japan, of course, like the four little dragons, is heavily concerned with the export market where they do not have any cartel power anyway. If one looks at their domestic areas, you will find a very large degree of the standard kind of government regulations providing protection for all sorts of obsolete industries, perhaps agriculture being the extreme example. Interestingly, American efforts to get the Japanese, Koreans, and so on, to benefit their citizens by lowering protective tariffs and hence permitting their citizens to buy things like oranges at a reasonable price, are objected to by populist groups in all of those countries. The same would have been true in the United States in the 1920s.

One can hope that with the development of the Common Market, Europe will go through a similar reduction in rent seeking, although so far it should be said that the Brussels organization has succeeded in partially offsetting reductions in tariffs by a general cartel arrangement over the entire economy.

The Reagan years have not shown any real reduction in the government share of the government expenditures or in the amount of regulations although neither has grown particularly. There are some encouraging areas here, however. We now have free trade

agreements with Canada and Israel, and although in the Israel case I doubt that it will turn out that we have free trade in Israel, I am sure that Israel will have free trade in the United States. I really do not care very much how much Israeli citizens have to pay for things and I am very much interested in getting American prices down; thus, the one-sided nature of the agreement does not bother me. There is also some possibility that we will develop free trade with Mexico.

In all of these cases, of course, the economy that we are opening up for free trade is fairly small compared to ours. But a domestic cartel, even supported by the federal government, would create competitors in these other countries. Thus, we may be moving into a period in which a larger free trade zone will provide for the United States as a whole the kind of protection against rent seeking that in the past was given by the federal free-trade zone. It is, of course, a very old economic chestnut that tariffs are the mother of monopoly. This is true whether the monopolies are privately organized or sponsored by the government.

But the free trade areas are but a small part of the major changes that we have had in tariffs in the United States over the last fifty years. Before turning to that, however, I would like to mention briefly another development which has made internal trade in the United States much less regulated. The invention of

the truck and the development of a large trucking industry in the United States, as I mentioned, was countered by the extension of the ICC regulation to the trucks. Interestingly, from the very beginning there was an exception. The farmers were powerful enough so that they were able to prevent trucks carrying farm produce from being regulated, which would seem to have eliminated the "natural monopoly" argument.

But even a regulated trucking industry provided a great deal of flexibility for shipment within the United States and in recent years the regulations have, for all intents and purposes, vanished. As a sort of corollary of dropping the regulation on the trucks, regulations were also cut back on the railroads with the result that internal transportation in the United States is now much freer than at any time since the foundation of the ICC.

But to return to the important problem of tariffs. The long period between the Civil War and 1929 was, on the whole, a period of rising protection. Indeed, Senator Pine of Oklahoma, trying to get a tariff for his constituents in the Smoot-Hawley tariff said: "We must either build up a tariff on oil or tear down the tariff on steel. The Government cannot deny the equal protection of the law to any of its citizens."²⁵ Politically, these tariffs were essentially pushed by the Northeast and objected to by the South, but the South was, of course, politically weak during this period.

With the rise of the Democratic control in 1932, however, this particular situation changed. As you can see from the figures, this was a period of greatly increasing government control. But President Franklin Roosevelt chose as his Secretary of State a congressman from Tennessee who had been all of his life a free trader. Cordell Hull immediately began a program of reducing tariffs by way of something called the Reciprocal Trade Act. In the thirties, these reductions were rather small. I think that perhaps the reason that Hull was able to get away with it was at least partially the fact that they seemed to fit in with the general antibusiness climate of that government. Another reason that they were successful was that Hull and his colleagues at the Department of State simply lied about the consequences of such agreements. They alleged that we won on each and every trade in the sense that our exports were benefitted more than our imports.

Hull remained Secretary of State during most of World War II and continued talking about free trade and succeeded in getting it built into some of our objectives at the end of that war. Further, there seems to have been a genuine intellectual conversion to free trade on the part of many high government officials, although it is difficult to argue there was much on the part of the common man. We were prosperous after the war and the rather obscure connection between lowering tariffs and

keeping the Communists in check was pushed hard by the Department of State and various other groups. The result was international negotiations and the fall of tariffs everywhere.

This was, of course, accompanied by a continuing fall in the costs of international shipping which probably, in absolute quantity, was at least as important as the fall in the tariffs.

In recent years, it has become more difficult for the government to resist the common man's view here. Indeed, Congress seems to be pretty thoroughly under control of it and we depend upon the president to resist. Both Presidents Carter and Reagan have done pretty good jobs at resisting congressional pressure but in neither case were they totally successful.

Politically, this is interesting because, of course, the president in this matter acts essentially as a third house of the legislature. Apparently the political motives of a person appealing to the entire United States populace for reelection are different than the political motives of a body of people in the House of Representatives and the Senate, each of whom appeals to a segment of it. As the author of the original logrolling model,²⁴ I find this readily explicable, but at the moment this particular model is not all that popular among my fellow Public Choice students.

In any event, this fall in the total costs of international trade, whether it came from reducing tariffs or from the fall in transportation costs, has once again had an immense effect inside the United States. Export industries, of course, are relatively uncontrolled and one of the results of the increase in our imports is an increase in our exports, even if not quite so big. Imports, however, also are subject to relatively little government control provided they can get into the country. It seems likely that the very sharp shrinkage in the American labor union movement has occurred simply because the monopoly they formerly held over various products disappeared when imports became possible.

I remember hearing an official of the steel union, visiting Virginia Polytechnic Institute and State University for a public lecture, explain that things had changed very sharply in the steel industry and now, instead of simply pushing hard for increase in wages, the union was pushing hard for efficiency to keep Japanese steel from closing down all of their plants. Indeed, they were willing to accept wage cuts if that were necessary to retain jobs. Without the tariff, ^{CUTS} I doubt if this would have occurred. 27

The tariffs, again, are the mother of monopoly. The United States, because of the fact that it has a very large internal trading area, always was less monopolized than other countries.

The shrinkage in tariffs reduced monopolies even further. Again, the situation in the United States is, and almost always has been, much freer for the economy than elsewhere. I do not believe that this is because we economists have succeeded in convincing the voters that free trade is a good thing. I think it is the byproduct of other matters.

Nevertheless, there is everything to be said for us continuing vigorously to push the arguments for a free economy. My own experience in this area is that I never lose an argument and I never convince anyone. William Niskanen, ~~Chief~~ Director of Economics for Ford Company being compelled to resign because he was not willing to sign a statement saying that a high tariff on the import of foreign cars was for the benefit of the American people, is representative of the kind of problem we actually face.

Nevertheless, I think we should continue pushing this issue and hope that in time we will prevail. At the very beginning of the paper I pointed out that, in the early nineteenth century, free trade arguments had worked in England. Perhaps we can get them to work in the United States. Tariffs are actually a fairly simple situation in which each individual tariff injures a lot of people and benefits a few. The structure of tariffs, as a whole, injures everyone. We succeeded in getting a very considerable reduction in the special privileges in our Tax Act by stressing

this point a few years ago and it is possible we may be able to do it again with tariffs.

The benefits, of course, will fall much more strongly on non-American countries than the United States because as I have pointed out, we already have more economic freedom than most other countries.

NOTES:

1. Indeed, I have always wondered why the Revolution occurred. The view that the colonies were severely repressed by England is absurd, even though, of course, there are various ways our condition could have been improved.
2. Need cite.
3. "Why Did the Industrial Revolution Occur in England?" in Charles K. Rowley, Robert D. Tollison, and Gordon Tullock (eds.) The Political Economy of Rent-Seeking (Boston: Kluwer Academic Publishers, 1988), pp. 409-419.
4. They also had a trial at regulating the railroads but after a rather short bit of experience they came to the conclusion that unregulated railroads were better than no railroads.
5. Whether such deals are actually desirable from society's interest is a much disputed point. They do show rather well, however, the competition between government units which makes government cartel management difficult.
6. I am not counting our difficulties with the Barbary pirates as a war.
7. It is not obvious she could have won. Her failure in the war of the American Revolution came not from the hard fighting of the colonists but because she was fighting France, Spain, and the armed neutrality, with the American fighting very much of a sideshow. By 1815, however, the population of the United States was nearly as large as that of England and conquest would have been extremely difficult. A joint project of England, France and Spain to partition the colonies in, say, 1795, would have been completely different. It was apparently fear of such a coalition which led to the Constitution.
8. Washington marched out personally in charge of the militia to put the uprising down but it was successfully suppressed without significant fighting.
9. After the Civil War, the federal government made some rather large land grants to railroads crossing the Rocky Mountains. Since several of these railroads proceeded to go bankrupt, one can assume that these grants were not all that generous.
10. The banks were compelled to keep reserves in state bonds which were highly unstable. This led to numerous bankruptcies.

11. The Southern slaves may not have thought of it as free but economic freedom in this case means something different from political or human freedom. From present day standards, it is ironic that Southern slaveholders like Jefferson and Jackson were the principle defenders of low tariffs and Northern abolitionists normally favored protection.

12. The Other Path by Hernando de Soto (New York: Harper and Row, 1989) is a translation of his El Otro Sendero, which is sweeping Latin America. It not only points out the disadvantages of mercantilistic regulation, but it also emphasizes the necessity of proper legal institutions.

13. The reason Figure 1 starts in 1890 is that it was compiled for another purpose.

14. Before I was drafted.

15. It should be said that the gains were almost entirely in the early days. Eventually the ICC transferred the bulk of the profits from the owners of railroad stock to the railroad employees. By the 1930s, most of the railroads no longer could pay interest on the bonds which had been used to build their roadbeds.

16. Not to the government, just around in my class and friends.

17. 160 acre.

18. Indeed, some 40 percent of the land area of the United States.

19. In all line fittings, the wars were dummed out.

20. Some of the Southern states were the major exceptions.

21. Stanley Lebergott, The American Economy (Princeton: Princeton University Press, 1979), p. 57.

22. Carolyn Weaver, "The Emergence, Growth and Redirection of Social Security." When I read this, it was an unpublished dissertation presented to VIP in 1977. I believe it has since been published.

23. Who also received free medicine before these programs were instituted.

24. It should be emphasized that by no means are all the women receiving AFDC are the newspaper teenagers fully dependent on AFDC. They do, indeed, exist but there are a good many people who receive this money because, say, a husband has died and who are dependent on it only for a rather brief time.

25. Proceedings, Tariff Act of 1929, p. 361.

26. "Problems of Majority Voting," Journal of Political Economy
67 (December 1959), pp. 571-579.

27. Possibly it would. The introduction of the so-called minimills, which are mainly non-union in the United States, conceivably could have destroyed the power of the steel workers even without the Japanese threat.

Figure 2

GOVERNMENT SPENDING AS A PERCENT OF GNP 1790 - 1989

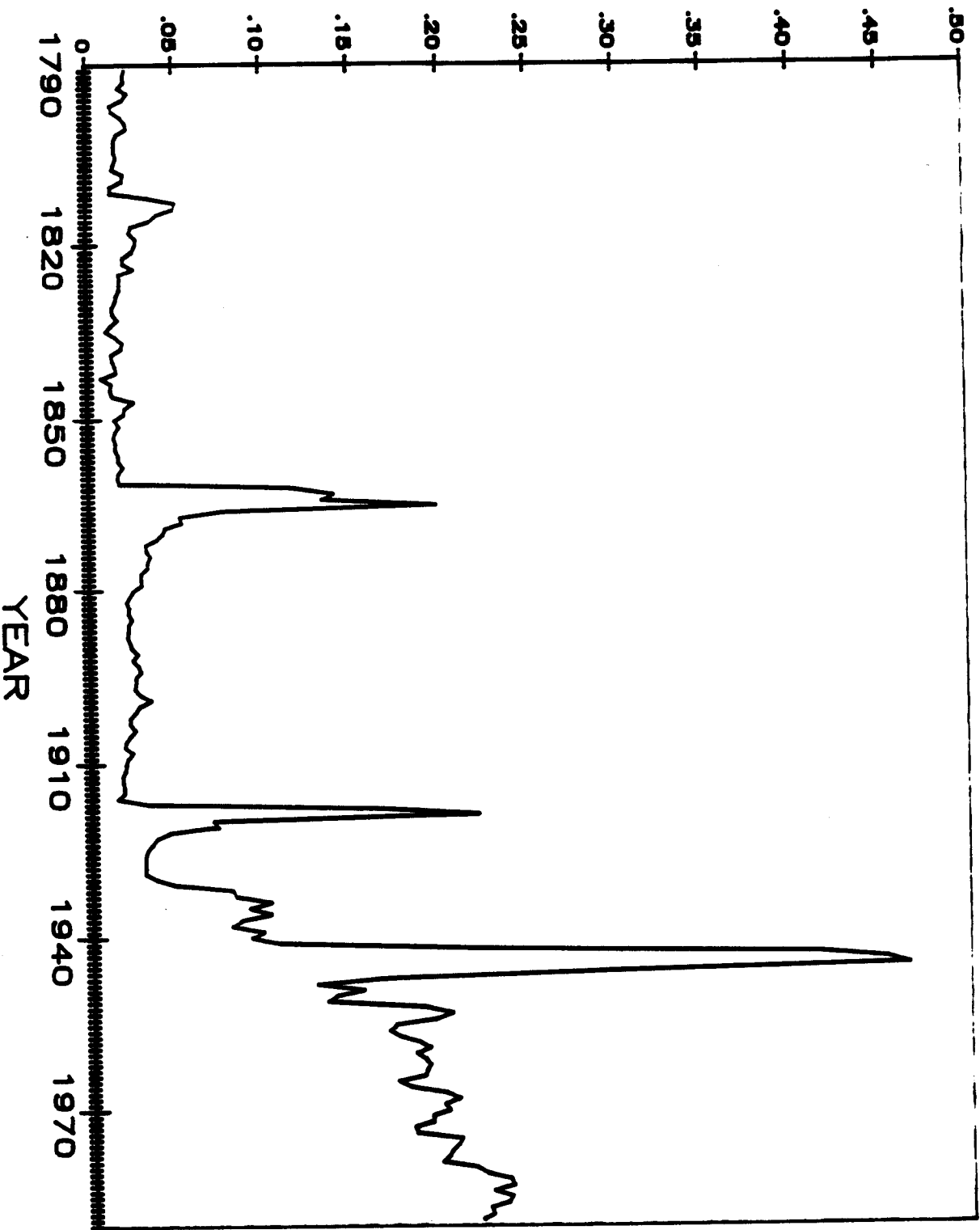


Figure 1

Government Spending as Percent of GNP

