

Resisting Serfdom: Making the Market Work in a Great Republic

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“No man’s life, liberty, or property are safe while the legislature is in session.”

Anonymous¹

“[T]he knowne certaintie of the law is the safetie of all.”

Sir Edward Coke²

“[T]he vigor of government is essential to the security of liberty.”

Alexander Hamilton³

INTRODUCTION

This discussion endorses Professor Malloy’s call for classical liberal economics and politics to reverse the drift toward statism and communitarianism. Malloy’s preference for market economies and his observations on cities, subsidies, and economic activity are sound.

Malloy has been too harsh on the development policies of cities, however. Land use and transportation policies, among other governmental actions, have tilted the playing field, handicapped the urban players, and crippled urban economics. Urban America’s counterattack, in light of past economic and racial segregation, has some moral appeal,

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1. Anonymous, *quoted in* The Final Accounting in the Estate of A.B., 1 Tucker 247, 249 (N.Y. Surr. 1866).

2. SIR EDWARD COKE, THE FIRST PART OF THE INSTITUTES OF THE LAWS OF ENGLAND, Epilogus, last paragraph, at 395.a (facsimile of 1823 printed for the Legal Classics Library). For many years when I taught at The Wharton School, I would note this famous aphorism by Coke which ennobled the law school at Pennsylvania. It was inscribed in marble at the top of the Rotunda staircase which served as the portal to the Biddle Law Library. I always considered it ironic because in Coke’s times society at least pretended to be rooted in general rules of law. Modern society, as Professor Malloy has pointed out, seems hellbent on abandoning the concept of general rules. Coke and Aquinas would be dumbstruck at our special legislation.

3. THE FEDERALIST No. 1, at 35 (Alexander Hamilton) (Clinton Rossiter ed., 1961) [hereinafter FEDERALIST No. 1].

but the subsidies and politics which sustain it are economically and morally bankrupt. The trick is to stimulate economic growth, intervene when appropriate (health care and education, for example), and sustain the common good in a hostile and unforgiving world without losing sight of the moral objectives of liberty and order. This critique concludes that a revitalized Hamiltonian and Federalist vision embracing a market economy offers the best hope of fulfilling the American promise.

The winds of change are upon the world. The Cold War has ended. Eastern Europe is moving toward democratic institutions and market economies. The democratic movement in the Soviet Union has survived a coup. Collectivism seems to be on the run in many parts of the world. Everywhere democrats and champions of the market economy look to the United States for spiritual guidance and practical knowledge. Ironically, economic and political freedom in the United States may be drifting toward a statist society. Twentieth Century America's attempts to confront the challenges of a post-industrial society may, through good intentions and unconscionable political manipulation, plan many of our liberties right out of existence. That is the threat to our liberties and moral dignity as seen by Professor Robin Malloy.

*Planning for Serfdom: Legal Economic Discourse and Downtown Development*⁴ is a clarion call for Americans to return to classical liberalism to preserve our economic and political freedom. Professor Malloy opens a debate and calls into question the nation's dangerous slide toward a statist-communitarian society.⁵ Modern political and economic life has blurred countervailing centers of power. As the power of both the state and well-connected political groups grows, autonomy is undermined and is responsible for economic and political decisions which threaten to leave the nation poorer and less free. Malloy grasps,

4. ROBIN P. MALLOY, *PLANNING FOR SERFDOM: LEGAL ECONOMIC DISCOURSE AND DOWNTOWN DEVELOPMENT* (1991) [hereinafter MALLOY, SERFDOM].

5. At the outset, I must confess error. Some of my earlier writings on energy and land use policy, Christian C. Day, *A Land Retrenchment Policy for Energy and Resource-Short Times: A Modest Proposal*, 10 *FORDHAM URB. L.J.* 72 (1982), and historic preservation, Christian C. Day, *Federal Income Tax Reform: An Important Tool for Historic Preservation*, 16 *WAKE FOREST L. REV.* 315 (1980), and even more recent ones on corporate finance employing tax credits and other tax subsidies, Christian C. Day, *Corporate Investment in Real Estate Ventures — Special Considerations for Special Allocations Under Section 704: "The Price is Right!"*, 10 *J. CORP. L.* 313 (1985), may call into question the validity of the thoughts and criticisms that follow. I plead guilty of vacillation. Conformity, the hobgoblin of minds, was never my forté. Despite my past wanderings, and probably present ones too, I have always embraced the ideal of a market economy. Politically, I have wandered from Aristotle to Aquinas Burke, Blackstone, Hamilton, Marshall, and Taney. (Taney's nationalist economic ideas can be found in such cases as *Charles River Bridge v. Warren Bridge*, 36 U.S. (11 Pet.) 420 (1837), but his views on slavery cannot).

as did Milton Friedman, that an essential connection exists between economic liberty and political liberty which, in a market economy, serves to check the encroaching power of the state or groups seeking to capture the state or the economy.⁶

Robin Malloy's fundamental concern with the drift of America toward a statist society rightly portrays the political and economic theories which are accelerating that drift. The classical liberal political and economic values he champions offer the nation a moral base from which to build a freer and more productive society. His reliance on natural rights and the market economy to liberate mankind is in accord with my political beliefs. Although I am in agreement with his general propositions and prefer his model to any of the other contemporary alternatives outlined in his book,⁷ I am concerned with how America, as the sole superpower, can continue to provide for the general welfare and common defense within the classical liberal framework.⁸ I take a more expansive, Hamiltonian view of government programs. Thus, I would have a considerably more active liberal classical government than Professor Malloy.

I second Professor Malloy's classical liberal preference for the market economy and its role in the liberation of mankind. Market theory makes the role of individuals central. Individuals are presumed to be rational and are empowered to make critical decisions. It is their hurly-burly counterbalancing power which can stimulate change and reform.⁹ Liberal economics nurtures liberty, natural rights, and human dignity. Unlike neoconservative thought, classical liberalism recognizes that earlier arrangements of power and rights may not have been fair.¹⁰ Classical

6. This is because many sources of ideas, money, labor, and goods exist in a capitalist society. People are free to unite for economic purposes to create opportunities. It is hard to predict from where the next earth-shattering idea will emerge. Invention, enterprise, and industry create many points of economic power which are difficult to cabin. See MILTON FRIEDMAN, *CAPITALISM AND FREEDOM* 14-21 (1962).

7. Professor Malloy refutes conservative theory, liberalism, communitarianism, and libertarianism. MALLOY, *SERFDOM*, *supra* note 4, at 61-79.

8. The major difficulty I have with Professor Malloy's book is that neither he nor Adam Smith tells us how to handle the problems of a large republic. Adam Smith's ideas seem to be more compatible with the relatively small and homogenous state — like England during the late eighteenth century — than with a continental state like the United States or the Soviet Union.

9. This is borne out when the market economies and liberal political states of the industrial West are contrasted with the planned economies of the communist world. Planned economies have failed miserably. With the passing of communism, a tremendous power vacuum now exists because self-generating political and economic structures were not permitted or nurtured under communism.

10. Neoconservatives proceed from the premise that the present status quo resulted

liberalism leaves open rearrangement based upon principled political decisions. Classical liberal thought prefers general to specific rules and prefers spontaneity to planning. Liberal economics seeks to attain a proper relationship among individuals, the state, and the community.¹¹

I. THE PREFERENCE FOR CLASSICAL LIBERALISM

Classical liberalism is founded on a strong belief in individual liberty. Individual freedom is prized, and restrictions are placed upon government power and control.¹² The natural rights championed by Malloy and other classical liberals do not embrace a laissez-faire society.¹³ To the contrary, classical liberals accept restraints on the individual only for significant social purposes.¹⁴

Justice is the protection of individuals within a society governed by general rules and principles.¹⁵ The classical liberal state attempts to treat all equally. Adam Smith and his modern followers advocate re-

from historic transactions free from injustice, prejudice, or taint. Classical liberalism recognizes that many of the present market arrangements are not fair and that the playing field is not level. Racial, ethnic, and religious discrimination have handicapped many Americans, and past injustices contributed to the present scheme of ownership and market opportunities. To overcome extant handicaps and market failures, classical liberalism permits and encourages discrete intervention in order to level the field and advance human dignity. MALLOY, *SERFDOM*, *supra* note 4, at 61-70, 79-83.

11. *Id.* at 3.

12. Classical liberalism can be distinguished from modern liberalism which calls for considerable state intervention and reliance upon planning to overcome "market" or political failures.

13. MALLOY, *SERFDOM*, *supra* note 4, at 18.

14. For example, people may be taxed to provide for the common defense, to educate the public, and to invest in other projects which cannot be produced by the market. I suspect that the scope and depth of these investments and the projects selected would be an area in which Professor Malloy, Professor Friedman, and I might disagree.

15. This requirement, as seen below, is critical. General rules promote equality and a level playing field. They promote competition in the marketplace and avoid the use of the political process to allocate resources and power to groups or individuals who have captured statehouses, the Congress, or the White House. Individuals and associations succeed or fail on their own merits, and not because they have used political power to manipulate resources and opportunities. As seen in Malloy's book, many urban development schemes (his metaphor for the present American economy and polity) rely upon closed processes and special rules where the opportunities and resources are available only to groups and individuals who have captured the political process. Once the regime of special rules is created, priorities are established and resources deployed based upon personal status and political decisions, not the operation of the impersonal market. It should not be forgotten that in the market, everyone's vote counts and many options are present. Once allocations are made along political lines, choices shrink (due to compromises and state economic self-interest), and the solutions become cruder and less responsive.

straining state power and protecting individuals from the coercive power of *both* the state and private blocs of special interests.¹⁶ The individual's natural rights of liberty, freedom, and human dignity are protected by a commitment to equality, justice, and fairness.

II. THE ROLE OF THE MARKET ECONOMY

Classical liberalism supports a market economy which gives rise to commercial activity, releases creativity, and permits the mobility of capital.¹⁷ Market frameworks permit the exchange of information and the coordination of activities.¹⁸ General rules regulate economic activity so that all participants are subject to the same restraints. General rules¹⁹ and liberal government place restraints upon the creation or changing of rules for the benefit of "privileged" individuals or groups.²⁰ This refusal to entertain special rules protects individuals from encroachment by political groups or by the state. Thus, government must be formed to protect individuals from unchecked, coercive private power,²¹ yet it must also avoid becoming a substitute for private coercion.²² In Smith's view, governments exist to protect human dignity and to provide only

16. MALLOY, SERFDOM, *supra* note 4, at 18.

17. In a market economy, all are free to compete to create or sell wares and services. The judgment of the individual is substituted for political judgment. Persons are free to pursue their selfish interests, while the market acts as a check on economic judgment. Capital is mobile as investors shift it rapidly, whenever the market dictates, thus earning the yield they desire. Historically, the creation of the merchant class enhanced personal freedom because the economic power of merchants translated into political power for themselves and their customers. Certainly by the eighteenth century, power and freedom were no longer dependent upon feudal status.

18. MALLOY, SERFDOM, *supra* note 4, at 21.

19. My preference for general rules and laws is founded upon St. Thomas Aquinas's definition of law which, if adhered to, thwarts much mischief. Law is a thing of reason, made by the community for the *common good* and promulgated. THE POCKET AQUINAS 254-255 (Vernon J. Bourke ed. & trans., 1960).

20. "Privileged" individuals or groups could be developers or their political allies, as seen in Professor Malloy's Indianapolis illustration. MALLOY, SERFDOM, *supra* note 4, at 103-12. They could also be minorities or manufacturers and industrialists who have laid political claims upon society's resources to the exclusion of others. What they all enjoy in common is their desire to have resources allocated to them on the basis of personal status, group status, or personal relationship. They are willing to use their political clout to close the market to others and enhance their economic and community strength through political means.

21. The state can also prove to be a mighty foe of freedom if it is unchecked by the private sector. Prostitution of government can promote individual or group goals precisely because it is easier to mobilize politically than to engineer a desired outcome in the autonomous marketplace. *Id.* at 35.

22. *Id.* at 25.

those goods and services that the market will not provide.²³ To accomplish these liberal goals, government must foster a market economy.

The market economy creates opportunities for sharing and increasing wealth. The capitalistic economy expands because it rewards the purveyors of products and services (which may be created by anyone with ability), rather than making allocations determined by status.²⁴ The economic liberation present in the market economy fosters political freedoms as well.²⁵ The market creates power bases which challenge and constrain the state. Capitalist society has many economic power bases beyond the control of the state which ultimately empower people.²⁶ The state facilitation of the market checks the state and prevents it from becoming too powerful. The greater the private growth and diversity, the greater the check on state power.

When government intrudes into the market and rations what individuals produce (or would produce if the government had not appropriated the resources), less wealth is created. There is more competition for scarce resources and greater pressure on the government by interest groups to capture those scarce resources. Classical liberal government avoids these political failures by creating a system of checks and balances which permits spontaneous markets and political activity.²⁷ It also retains

23. *Id.* at 26. In Smith's world, education was a public good to be provided. Education is not provided for all by the market because the market responds to the production of goods and services, not individual needs and desires. Thus, the market would appear to disenfranchise the less fortunate. Smith would answer the unmet need by having government provide for education in support of individual liberty and human dignity. *Id.* at 27. Professor Malloy suggests that modern market "failures" also include lack of housing and health care. Although I agree with Malloy in general principle, it seems that government has tried and failed to provide housing. See Howard Husock, *Lessons from Housing's Not-So-Bad Old Days*, WALL ST. J., Sept. 23, 1991, at A14. Husock makes a compelling argument that many of the housing programs and the housing reform movement have been responsible for the destruction of moderate and affordable housing, as well as the neighborhood social structure which provided a degree of safety and civility to many poorer communities.

24. This is not a call for capitalism qua capitalism. Rather, it is a recognition that the market economy, when coupled with classical liberal values, promotes freedom. See generally FRIEDMAN, *supra* note 6.

25. Adam Smith points out that the pursuit of wealth alone is not an end. The equality of the market permits the harmonizing of individual freedom with social cooperation. MALLOY, SERFDOM, *supra* note 4, at 22.

26. Professor Malloy correctly points out that modern urban economics and planning run counter to the classical liberal model he espouses by relying upon politics and status in the allocation of resources. See generally *id.* at 89-102. The state, as arbiter, grows stronger, as do the groups which capture the state and the political process. This aggrandizement undermines economic and political liberty.

27. The spontaneous urban economy which unleashes innovation, creates capital, and expands liberty, is vividly described in three excellent books by Jane Jacobs. JANE

a healthy skepticism of the ability of a democratic government to restrain the power of the state.²⁸

I second Professor Malloy's observations of the utilities of the competing political/economic systems and their threat to liberty and human dignity. The conscious and unconscious foes of classical liberty are at work, and their doctrines have been accepted by many.²⁹ Oddly, many political leaders are eroding liberties in the name of some social values such as income redistribution and preservation of the status quo.

Professor Malloy's attack on the present system of cross-subsidies is valid. The system makes people politically and economically irresponsible, and it concentrates power while distorting and enfeebling the economy. Subsidies and planning of the sort Professor Malloy disdains are economically and politically dangerous.³⁰ They fail to price goods and services accurately.³¹ Without the market signals conveyed by the

JACOBS, CITIES AND THE WEALTH OF NATIONS: PRINCIPLES OF ECONOMIC LIFE (1984) [hereinafter JACOBS, CITIES]; JANE JACOBS, THE DEATH AND LIFE OF GREAT AMERICAN CITIES (1961); JANE JACOBS, THE ECONOMY OF CITIES (1969).

28. MALLOY, SERFDOM, *supra* note 4, at 30.

29. Liberalism, neoconservatism, communitarianism, and critical legal studies all offer competing models for legal and economic thought, and all, as illustrated by Professor Malloy, have shortcomings which undermine political and economic freedom. *Id.* at 61-76.

30. Professor Malloy is no friend of many modern zoning developments and land use controls such as planned unit developments, inclusionary zoning, special assessment districts, and tax increment financing. I am in accord with his view that these complicated devices are often used to benefit certain developers and other political favorites. At a minimum, special considerations are awarded and barriers are erected which enhance the advantages of some members in the community or communities at the expense of others. This improper allocation of community resources concentrates power, blurs the line between public and private entities, and weakens potential economic and political competitors who have been excluded from the process. However, I am not as sanguine regarding zoning and general rules applied to development as Professor Malloy. On a theoretical level, I would hope that he is correct. However, even traditional zoning (which he touts as a kind of paradigm), may not produce the benefits of the fair play and competition he anticipates. *See infra* notes 45-51 and accompanying text.

31. With direct subsidies, voters and their representatives can at least appreciate what a particular program might cost and make an intelligent decision. Thus, if Congress votes to give Syracuse, New York a grant of \$8 million for a new science center, Alabamians can see some of their tax dollars flocking North and protest the pork barrel. Alabamians and their allies might monitor the project to verify its utility. Alternatively, they might demand similar projects for themselves which they are unwilling or unable to fund locally.

Tax expenditures are more difficult to track and check. If New Yorkers were to use investment tax credits or charitable deductions to build a science center and museum, the lost revenue would have to come from someone else's pocket. Yet, as Professor Malloy points out, it is difficult at present to trace the fiscal and economic damage to the "culprits." For example, New York City, Indianapolis, and low-income housing

price mechanism, intelligent and rational allocations are harder for individuals and society to make.³² Consequently, scarce resources are misused and opportunities are lost.

This misapplication and distortion is not without benefits for those involved in politics.³³ As Professor Malloy points out, many profit from public-private partnerships and public entrepreneurship. Developers,

syndicators and investors all profit from hard to trace subsidies. New York profits from rent control which makes greater public housing investment necessary and requires state and federal tax dollars to accomplish its goal. Indianapolis profits from the tax dollars sent and forgiven to spur its renaissance. Furthermore, those who have produced syndicated low-income housing have tax subsidies which dramatically benefit the wealthy and are considerably less efficient than direct payments such as vouchers. These kinds of tax expenditures are politically popular. They inure to the well-heeled and well-organized. They are hard to trace and evaluate, and they benefit those with political savvy and power.

The general population and the truly disadvantaged have little effective claim on resource allocations except when they participate in pork barrel projects and logrolling. This type of horse-trading is politically acceptable and a time honored method of doing business. It may produce some horizontal equity. That is, Alabama may get an unnecessary dam and New Yorkers may get some federally assisted public housing. This pork barrel sharing does not address the vertical equity issues. Those of wealth and power seem to enjoy the lion's share of largess. For example, witness the value of the tax benefits given to wealthy investors in low-income housing prior to the Tax Reform Act of 1986. It also does not confront the squandering of resources and the actual needs and value of the projects when political power determines public and private investment.

32. Sometimes the subsidies produce dramatic and serendipitous consequences. The Pacific Northwest was the beneficiary of massive investments in hydroelectric power which subsidized the land reclamation projects of the New Deal. Inexpensive power facilitated the irrigation of the semi-arid sections of Washington and Oregon. The abundance of hydroelectric power was a godsend during World War II. Inexpensive electricity powered the aluminum and aircraft industries which were so instrumental in defeating the Axis powers. The cost of World War II to the nation and the world would have been dearer without America's ability to gear up in the Northwest. MARC REISNER, *CADILLAC DESERT: THE AMERICAN WEST AND ITS DISAPPEARING WATER* 168-70 (1986). Notwithstanding the indisputable value of the subsidized works in this example, America's system of pork barrel subsidies threatens much of what we as a nation profess to cherish.

33. The morality of the taking of property from some persons (the right to develop one's land) and giving it to others to build a shopping center or hotel is rarely part of the present political argument. This issue has been settled constitutionally in favor of the state and the idea of public entrepreneurship in such cases as *Berman v. Parker*, 348 U.S. 26 (1954) (condemnation of department store in urban renewal area sustained as valid use of police power within purview of public purpose) and *Courtesy Sandwich Shop, Inc. v. Port of New York Authority*, 190 N.E.2d 402 (N.Y.), *appeal dismissed*, 375 U.S. 78 (1963) (sandwich shop taken for construction of World Trade Center). Nevertheless, it is appropriate to consider and debate the ramifications of the doctrine of "public purpose" which sustains many of these intrusions. Although many projects initiated under the guise of having a "public use" or a "public purpose" may be constitutional, many may be economically unwise and morally suspect.

bankers, national politicians, civic leaders, and handmaidens such as lawyers, architects, real estate professionals, and unions may profit from the public/private realignment in urban redevelopment. These special interests and their allies have gained scarce resources³⁴ and grown politically powerful at the expense of other cities with less clout, emerging areas, and even the suburbs.³⁵ This perversion of the economy and the political process is cancerous because illegitimate growth weakens rivals, concentrates power, and undermines competing regions and economic ventures.

III. CITIES, ECONOMIC GROWTH, AND SUBSIDIES

Many cities and regions have pursued a "beggar thy neighbor" policy in an attempt to attract and retain industry and capital. On a local level, cities and counties have used tax forgiveness, grants, and industrial revenue bonds to attract new industry and investment. On a regional level, the Tennessee Valley Authority (TVA) and the federal water and reclamation policies strive to achieve the same result. Professor Malloy's analysis of the failure of urban development schemes demonstrates that present urban policies have been politically dangerous and have failed to expand the market and capital base.

Both the liberal programs of the New Deal and the conservative programs of Nixon's New Federalism failed to produce their economic

34. The cities studied by Professor Malloy illustrate many of the problems present in our political world. A broader-based political issue is water management in the American West, where cross-subsidies and political alignments threaten to yield a devastating harvest. For almost a century, federal and western state water and land management policies have promoted abundant and inexpensive water for much of the nation west of the 100th meridian. This land had been desert or semi-desert for eons, yet the Bureau of Reclamation, the Corps of Engineers, and state water management programs have fostered great development by providing cheap, subsidized water. Agribusiness, powerful corporations, cities such as Los Angeles and Denver, and plain folks formed a powerful alliance with the dam builders and the Congress. The result has been unprecedented growth in the West and Southwest at the expense of the environment and the American public. The water lobby is so powerful that it has taken Herculean efforts to stop the most obviously worthless projects. Congress, because of the power of certain legislators and their supporters, seems to be unable to curb the fiscal and environmental abuses. This unpleasant, yet fascinating tale, is told in the absorbing *Cadillac Desert*. REISNER, *supra* note 32.

35. I have less sympathy for the suburbs in many cases because suburban communities throughout the nation have used zoning to fend off undesirable racial groups and less advantaged persons. Despite a generation of "inclusive zoning" and landmark cases designed to open the suburbs to the poor and minorities, few are open to a degree that is fair or just. Furthermore, suburban communities are not without shame. They, too, have used planned developments for preferred suburban residential development and tax incentives to lure urban, out-of-state, and foreign businesses. Notwithstanding the imperfections everywhere, Professor Malloy's concern about the economic and political distortions are valid.

development and revitalization goals because both schemes sought to allocate scarce resources politically. Neither produced a change in the relationship of the individual to the state.³⁶ Special interest groups with their particular access to resources were substituted, but the national government's control over the economy remained undiminished. These political attempts to create and regenerate wealth have not been successful because the subsidies which produced capital did not create import-replacing activities as evidenced by the examples below.³⁷

Cities and regions have been remarkably successful in garnering subsidies to aid "development." Without producing import-replacing industries, Appalachia remains a desperately poor region despite the magnitude of the subsidies which produced the TVA.³⁸ The TVA subsidy continues unabated because of its beneficent intent and because it is linked to the entrenched Army Corps of Engineers and the Corps' powerful allies in Congress.³⁹ Capital has been transferred from wealthier regions, yet this infusion of capital has been unable to alleviate the conditions that created the poverty.

Cities and regions occasionally attempt to spur economic development by offering tax incentives to companies that relocate and by fostering government policies which attempt to hold down labor costs. While on their face these policies do not seem like subsidies, some are in fact subsidies. Often, they also fail to generate the economic growth which was anticipated because they merely capture enterprises without unlocking their potential. Although no one would confuse the prosperous Atlanta region with Appalachia, it too, has benefited from economic policies that have "lured" runaway businesses and industries seeking cheaper labor costs and lower taxes. First came the textile industry, then the military.⁴⁰ Lockheed Aircraft spurred great development in Los Angeles during its corporate youth. Eventually, it grew so powerful and self-sufficient that it could transplant its operations to Marietta, Georgia. As a transplant industry, it did not cause tremendous growth in local Georgian industries because Lockheed was generally self-sufficient. Thus, no import-replacing boom occurred.⁴¹ Georgia was richer and Los An-

36. MALLOY, SERFDOM, *supra* note 4, at 118.

37. For a brief overview of the capital creation cycle through import-replacing activities, see *id.* at 118-21.

38. See JACOBS, CITIES, *supra* note 27, at 110-23.

39. Cf. REISNER, *supra* note 32, at 337-41.

40. Powerful members of Congress who sat on the Armed Services committees made sure that the federal government invested in their districts. Congressmen also saw to it that pork barrel water projects were located in their districts to the delight of the Corps of Engineers and dam building contractors.

41. JACOBS, CITIES, *supra* note 27, at 94-97.

geles poorer. A type of zero-sum game was played between regions without creating large increases in wealth or investment.

IV. A MODEST CASE FOR THE CITIES

A strong case has been made by Professor Malloy that our present urban planning policies have corrupted urban politics and the economy, yet he may be too hard on cities and the states. Cities may have made the best deal possible given the climate of the twentieth century, their historic status as wards of the state, and the errors of liberal politics.⁴² Cities have not been in control of their futures. Jeffersonian, anti-urban bias has been present from the inception of the federal state. Racial discrimination and conflict, crime, poor schools, pollution, and poverty have crippled older cities and regions seeking to revitalize and compete. Federal dollars were drawn from the Northeast and Midwest for military installations in the South and for land reclamation projects in the arid and semi-desert West.⁴³ These dollars subsidized, and continue to subsidize, new cities and suburban development in those "growth" regions.

The New Federalism under President Nixon illustrates this phenomenon. Block grants replaced earlier line item subsidies for urban development projects. Although block grants gave cities greater freedom of action, they also shifted funds to the conservative, Republican, urban and suburban communities that supported the President. These subsidies

42. "American cities today do not have the power to solve their current problems or to control their future development. . . . Under current law, cities have no 'natural' or 'inherent' power to do anything simply because they decide to do it. Cities have only those powers delegated to them by state government. . . ." Gerald E. Frug, *The City As A Legal Concept*, 93 HARV. L. REV. 1059, 1062 (1980). Other scholars have also found the city powerless. See Joan C. Williams, *The Invention of the Municipal Corporation: A Case Study in Legal Change*, 34 AM. U. L. REV. 369, 370 (1985) (citing CHARLES RHYNE, *THE LAW OF LOCAL GOVERNMENT OPERATIONS* 50-51, 69-70 (1980)). It was not always so. Some American cities, such as New York, enjoyed great economic and political power before they were emasculated by jealous and fearful state legislatures and the courts. See generally HENDRIK HARTOG, *PUBLIC PROPERTY AND PRIVATE POWER: THE CORPORATION OF THE CITY OF NEW YORK IN AMERICAN LAW, 1730-1870* (1983). If the Corporation of the City of New York and cities like it had not been destroyed as political and economic entities, how would urban politics and redevelopment have played out in the twentieth century? Had cities controlled their own destinies, they might have been able to solve many of their endemic problems without resorting to begging for subsidies.

43. Military bases were drawn to Georgia and other southern states because of the great political power of Southern Democrats. See JACOBS, *CITIES*, *supra* note 27, at 94. The massive diversion of federal funds for wastrel land reclamation projects is vividly described in *Cadillac Desert*. See generally REISNER, *supra* note 32.

improved life in Phoenix at the expense of New York and Newark. Furthermore, water subsidies in the West nurtured unprecedented urban growth while older cities festered and withered. Throughout most of this century, federal fiscal power has enabled Americans to flee urban problems in older cities and regions. These federal subsidies have massively underpriced the cost of the new urban centers. All the blame cannot be laid on the shoulders of Washington politicians and bureaucrats, however. Cities contributed to their own corruption and economic decline even before Washington intervened with its highway and housing programs.⁴⁴

Urban and community development has not been a fair game in this century.⁴⁵ Zoning does not provide the general rules called for by Professor Malloy. Zoning has created and sustains middle class suburbs. Suburbanites have rejected the urban cores and have used zoning and political power to grab welcome, clean development and to exclude urban problems such as poverty, poor schools, and crime.⁴⁶

44. The Veterans' Administration mortgage made it an economically unsound decision to remain in the city after World War II. The VA program, coupled with other federal mortgage subsidy programs, accelerated the decline and decay of many American cities in the post-war period. See MARTIN MAYER, *THE BUILDERS* 112-13 (1978). The federal highway system facilitated the further dispersion of the American population. ROBERT H. NELSON, *ZONING AND PROPERTY RIGHTS: AN ANALYSIS OF THE AMERICAN SYSTEM OF LAND-USE REGULATION* 177 (1977). See generally Gary T. Schwartz, *Urban Freeways and the Interstate System*, 8 *TRANSP. L.J.* 167 (1976).

Another side effect of the federal policies which encouraged dispersion and urban sprawl is the cost of energy necessary to sustain this lifestyle. Between 1950 and 1980, the U.S. population increased 50% while the number of automobiles increased 200%. KENNETH T. JACKSON, *CRABGRASS FRONTIER: THE SUBURBANIZATION OF THE UNITED STATES* 246 (1985). In 1979, the average American consumed 1.4 gallons of oil per day. Europeans consumed 0.3 gallons and the Japanese consumed 0.2 gallons per day. *Id.* at 297.

The nation has endured several severe energy shocks because of its unwise dependence upon foreign oil. In 1991, the Gulf War was fought to break Saddam Hussein's threatened stranglehold on oil. Nothing has changed since the War ended to reduce dependence upon Mideastern oil. The United States was once the world's largest oil producer. It is now the largest consumer and must import *one half* of its oil supply. This weakens its strategic position and adds to its huge trade deficit. DANIEL YERGIN, *THE PRIZE: THE EPIC QUEST FOR OIL, MONEY AND POWER* 14 (1991). As long as oil remains underpriced and the United States lacks a rational energy policy, the United States will be hostage to foreign adventurers and adventures.

45. Urban development has not always employed the general rule Professor Malloy and I commend. Often it has been more a "game" than a rational and principled process. For two good books on the confounding land development process, see RICHARD F. BABCOCK, *THE ZONING GAME: MUNICIPAL PRACTICES AND POLICIES* (1966) [hereinafter *BABCOCK, ZONING GAME*] and RICHARD F. BABCOCK & CHARLES L. SIEMON, *THE ZONING GAME REVISITED* (1985).

46. Suburbs desire light manufacturing, shopping centers, and research and industrial parks. Heavy industry, mental health facilities, and other unaesthetic land uses are relegated to older suburbs and the central cities.

V. THE ROLE OF ZONING AND HOUSING POLICIES IN URBAN DECLINE

Modern zoning began shortly after the turn of the century with the Fifth Avenue Association's attempt to stop the building of massive skyscrapers which plunged the surrounding neighborhood into shadow. The Association was candid in its efforts to push through the first zoning law. It sought to preserve property values and forestall threatening development.⁴⁷ The landmark case of *Village of Euclid v. Ambler Realty Co.*⁴⁸ established the constitutionality of zoning. Euclidian zoning from the start was designed to protect the single family home from the intrusion and "nuisance" of industry and apartments.⁴⁹ Euclid was attempting to protect the quietude of the suburban environment from unwanted intrusions caused by industrial and commercial uses. Multi-unit apartment houses were also clustered near the commercial and industrial uses (undoubtedly because less wealthy individuals and families resided in them) to protect the property values of the single family homeowners. After the Supreme Court blessed the concept of zoning in *Euclid*, communities seized upon zoning as a device to segregate unwanted land uses such as apartments and industry.

During the twentieth century exodus to the suburbs, zoning preserved residential class segregation and property values.⁵⁰ While ostensibly designed to prevent blight, it created value and protected the white middle class who had fled to the suburbs. Zoning and subdivision controls continue to create suburban residential value by preserving "character" which is frequently translated into large lot requirements that effectively exclude the poor and racial minorities.⁵¹

Federal cooperation and connivance was present. Federal home ownership programs intervened dramatically and subsidized white, middle class home ownership in the suburbs.⁵² Concurrently, federal programs destroyed housing capital and credit in poorer, nonwhite

47. ERNEST F. ROBERTS, *THE LAW AND THE PRESERVATION OF AGRICULTURAL LAND* 7, 13 (1982). See also SEYMOUR I. TOLL, *ZONED AMERICAN* 71 (1969).

48. 272 U.S. 365 (1926).

49. "A nuisance may be merely a right thing in the wrong place, like a pig in the parlor instead of the barnyard. . . . Under these circumstances, apartment houses, which in a different environment would be not only entirely unobjectionable but highly desirable, come very near to being nuisances." *Id.* at 388, 394-95.

50. JACKSON, *supra* note 44, at 240-42. Zoning was not the only culprit. Federal housing policies were created and enforced to preserve white, middle class single-family housing and to prevent housing integration.

51. BABCOCK, *ZONING GAME*, *supra* note 45, at 21.

52. JACKSON, *supra* note 44, at 190-218.

communities. The Home Owner Loan Corporation created red-lining.⁵³ Black residential areas were undesirable, and financing became unobtainable for red-lined communities.⁵⁴ Entire neighborhoods were written off.⁵⁵ For whites, Federal Housing Authority programs made it cheaper to buy than rent. This accelerated the decline of older housing stock in the central cities.⁵⁶ FHA underwriting manuals were highly critical of the older neighborhoods. The FHA endorsed restrictive zoning, and its policies expressed concern with "inharmonious" racial groups.⁵⁷ The FHA moved mortgage funds from savers in the cities and the Northeast and Midwest to borrowers in the suburbs and the West and South. The Federal National Mortgage Association (Fannie Mae) and Government National Mortgage Association (Ginnie Mae), two gigantic federally related lending agencies, implemented this massive capital transfer and subsidy.⁵⁸ Ultimately, bankers and other investors saw cities as the physical evidence that the melting pot was a mistake.⁵⁹

America's urban problems do not stop with poor housing and racial segregation. American cities, many built for a concentrated urban economy in the eighteenth and nineteenth centuries, have found themselves economic losers because industry, technology, and commerce have changed. The cities of the eighteenth, nineteenth, and early twentieth centuries were densely built to take advantage of loft factories, railroads, established ports, and municipal service cores. The advent of the automobile and federal housing policies later dispersed the talented, educated, and wealthy middle class. Suburban zoning and federal housing and transportation policies made the suburbs and exurbs ripe for the new service and post-industrial economy which organized horizontal manufacturing and many service establishments. Manufacturers and serv-

53. *Id.* at 197-203. The Home Owner Loan Corporation created the loan rating system in which undervalued districts were dense, had a mixed population, or were aging. Maps were colored to aid the lenders in underwriting. *Id.* The code developed ranges from A (and Green) (new housing stock and homogeneous community) to D (and Red) (neighborhoods which had declined).

54. *Id.* at 197-98.

55. *Id.* at 202.

56. *Id.* at 205. As multi-unit landlords lost their tenants and urban businesses lost their customers, cities became less desirable places to live and capital was harder to acquire. With federal housing policies in effect, whites fled to cheaper, safer, and more commodious environments.

57. *Id.* at 207-08.

58. *Id.* at 216.

59. *Id.* at 217. Federal housing policies did not forget the poor and the cities. There was substantial investment for more than 50 years in public housing. Public housing and urban renewal projects have ghettoized public housing in this nation. *Id.* at 219-30. For a critical review of federal urban renewal programs, see MARTIN ANDERSON, *THE FEDERAL BULLDOZER: A CRITICAL ANALYSIS OF URBAN RENEWAL, 1949-1962* (1964).

ice industries shifted to the suburbs as a result of cheaper land,⁶⁰ better transportation and schools, and government assisted relocation.⁶¹

VI. THE CITIES' COUNTERATTACK

Although Professor Malloy is rightly concerned about market and political distortions caused by modern urban redevelopment policies,⁶² he does not take into account that the market was already distorted by decades of political intervention which stripped cities of valuable resources, physical plants, and human capital. In this climate, city leaders did the best they could. They eventually saw that the redevelopment policies of the 1940s and 1950s had failed. Destroying neighborhoods with the federal bulldozer and shoving the displaced poor into high-rise ghettos did not make cities attractive places to raise middle class families. Therefore, they focused on policies to retain professional and service sector employees. In addition, they could not cheaply build large factories and industrial parks on expensive urban land.

60. But is it cheaper? These uses ignore the high cost of oil dependency and the destruction of prime agricultural land. By the late 1970s, the Department of Agriculture announced that over three million acres of prime farmland a year were being lost to suburban development. JACKSON, *supra* note 44, at 284. At the existing rate of "development," over 100 million acres may be lost by the year 2000. ROBERTS, *supra* note 47, at 43. When farm land is paved and built upon, farmers in urban areas must use less productive land. This requires more intensive farming and more reliance upon chemical fertilizers. Suburbs do not take into account the externality of the permanent loss of good farm land, the environmental costs of greater use of fertilizer, or the loss of prime farmland which might have fed millions of hungry residents on this planet.

61. Government assisted programs include the issuance of industrial revenue bonds, tax forgiveness, and tax credits. MALLOY, SERFDOM, *supra* note 4, at 98-102.

62. Malloy believes that the market is being skewed because cities (through subsidies like tax abatements, grants, guaranteed loans, and tax increment financing) have underpriced certain goods, such as hotels, office buildings, and luxury housing, for which there already is a healthy market. Further, he contends that this type of cofinancing is a public misallocation of resources that blurs investment decisions. Government ownership competes with private capital and eliminates government impartiality in decisions. Thus, the city's investment makes it harder for private competitors to act as a countervailing force against public power. *Id.* at 124-25.

The City of Indianapolis's program illustrates the development mix of hotels and commercial and entertainment facilities. *Id.* at 103-12. Federal and state subsidies (when coupled with city programs such as tax increment financing) reduce the cost of investing in the subsidized city when compared to other projects. *Id.* at 113. There is clearly a robust (if not healthy) market for hotels, office buildings, and expensive housing. This market does not rely on the gimmicks Professor Malloy details. Urban developments on the fringes of metropolitan areas have been thriving without these gimmicks. See JOEL GARREAU, *EDGE CITY: LIFE ON THE NEW FRONTIER* (1991). Yet, "edge cities" are not perfect models of economic health. Their vitality has been founded upon generous (and economically restrictive) suburban zoning and is doubly enhanced by federal highway and housing policies.

Downtown leaders eventually realized that the shift of the manufacturing and service sector to the suburbs could not be halted.⁶³ Eventually, cities aligned with developers and downtown civic and business leaders to staunch the flow and protect the urban commercial and professional market.⁶⁴ Although the cities' cultivation of an office economy did not reduce poverty or residential unemployment,⁶⁵ they did not sell out their residents' interests in craven service to the business community. Jobs left the city for suburban offices and industrial parks. The national economic emphasis changed from heavy manufacturing, which relied on unions and blue collar workers, to service industries, which are dependent upon an educated and mobile work force.

Cities faced a reduction of federal funds and a leadership vacuum at the national level. Funds were no longer as readily available for urgent urban needs such as housing, education, job training, and services for the poor.⁶⁶ Under these circumstances, cities made reasonable political decisions. They fought to obtain funding for the commercial and professional service center, an area where cities could still compete because the advantages of decentralization were less evident. Although the new urban policies were not an uncritical success, they maintained a market share for cities in the commercial and professional sector in a time of intense competition.⁶⁷ These policies also undoubtedly contributed to the strength of the service and cultural core upon which the economically healthy suburbs drew.⁶⁸ Thus, given their choices and the hostile political

63. After World War II, American industry took advantage of cheaper land in outlying areas to build huge, one-story factories. Skilled workers, who moved into FHA and VA subsidized homes, were nearby. Cheaper transportation for labor, raw materials, and products was supplied by federal and state highway funds. The housing and finance subsidies which favored the suburban, white middle class tilted the playing field against the central cities and older areas of the nation.

64. BERNARD J. FRIEDEN & LYNNE B. SAGALYN, *DOWNTOWN, INC.: HOW AMERICA REBUILDS CITIES* 284-85 (1989).

65. *Id.* at 288.

66. *Id.* at 290-91.

67. *See generally id.* at 287-316.

68. The preservice industry land use and investment pattern created a dense urban core which contains a hard to replace infrastructure. The replacement cost of this core and the social externalities which would be attributed to its abandonment have not been counted by Professor Malloy.

Many older urban cores house the community hospitals, universities, colleges, zoos, museums, and government offices. These are expensive to operate and doubly so for urban centers abandoned by residents. Urban center problems are further exacerbated by the fact that these crucial services and institutions are largely non-profit and tax exempt. In many older urban cities, such as Syracuse, 50% or more of the urban land is devoted to tax-exempt properties, government agencies (local, state, and federal), and infrastructures, such as roads, public transit facilities, and water works. Even newer

and economic forces, many cities made a political attempt to preserve a portion of what they economically and culturally did best.

Although the current wave of programs has had destructive effects, they were caused by an uneven playing field. Present politics suggest that the suburbs and metropolitan regions lack the will and the desire to solve urban problems,⁶⁹ yet these programs may have stopped some hemorrhaging while doing untold damage to the political and moral fabric.

VII. FEDERALISM, ECONOMIC NATIONALISM, AND THE MARKET

Although I agree with Professor Malloy that there must be more market freedom and less political interference than is present today, I am not certain the classical liberal view he endorses addresses the problems of the large continental power. Somehow the factions of *The Federalist Papers*⁷⁰ have to be cabined. Adam Smith's ideas are more compatible with the relatively small and homogenous state, like Great Britain during the late eighteenth century, than for a continental state, like the United States or the Soviet Union.

Madison and the Federalists attempted to provide governmental stability and to protect liberty by the American experiment outlined in *Federalist Paper, No. 10*.⁷¹ The authors of *The Federalist Papers* were champions of vigorous government. They had a clear-eyed view of the troubles caused by class and economic divisions in society and a healthy skepticism of the perfectibility of human nature. America had a unique opportunity to choose its form of government. There was an awareness of the failure of democracies and republics.⁷² To preserve this then-

cities, such as Los Angeles, have a significant portion of land devoted to non-taxable purposes such as highways.

Thus, cities have been faced with a shrinking tax base, a high percentage of land which is tax-exempt, and a population which is poorer, less educated, and in need of social services. Modern land use policies and municipal co-investment schemes have probably contributed to the preservation of the vital core and offset, and to some extent, the cost of suburbanization.

69. Because of the weak economy and the federal deficit, cities and states may lack the resources to solve the problems even if they have the desire. Cf. Howard Gleckman et al., *Pity the Poor Taxpayer: States and Cities are Squeezing Ever Harder*, BUS. WK., Sept. 2, 1991, at 32.

70. THE FEDERALIST PAPERS (1787-1788) (Alexander Hamilton, John Jay, and James Madison).

71. This bold experiment was the attempt of the great republic to dissipate the power of factions. THE FEDERALIST NO. 10, at 77-84 (James Madison) (Clinton Rossiter ed., 1961) [hereinafter FEDERALIST No. 10].

72. The world had little experience with republics or democracies. Athens, the Roman Republic, Venice, and the Dutch Republic were limited experiments in self-government. None of these states attempted self-government on a continental scale.

radical vision of a self-governing people, "the vigor of government [was] essential to the security of liberty."⁷³ A structure was needed to curb factions, however.

Federalist Paper, No. 10 condemns factions as adverse to the rights and interests of citizens.⁷⁴ Madison, the author of *Federalist, No. 10*, despised the poor performance of state governments after the Revolutionary War. Factions, if unchecked, could set debtor against creditor and merchant against farmer. "Enlightened statesmen [were] not always at the helm."⁷⁵ Because democracies could not control the power and volatility of factions, republicanism and federalism were the structures employed to govern the large republic.⁷⁶ With a great number of citizens and large geographic distances, it was much more difficult for factions to capture government and destroy rights. As Madison stated, "Extend the sphere, and you take in a greater variety of parties and interests: you make it less probable that a majority will have a common motive to invade the rights of other citizens"⁷⁷

To bind the great republic, a powerful and energetic government is necessary. Governmental powers must be commensurate with responsibilities, or government will fail.⁷⁸ The strong, nationalist language of *Federalist, No. 23* provided the text for an energetic federal government which survives today.⁷⁹

73. FEDERALIST No. 1, *supra* note 3, at 35. This essential Hamiltonian vision carries forward into the *Report on Manufactures*, the national banks, government assistance to build the transcontinental railroads, and other energetic measures designed to bind the nation into a great commercial republic. See Alexander Hamilton, *Report on Manufactures*, in 10 THE PAPERS OF ALEXANDER HAMILTON (Henry Syrett ed., 1966).

74. By a faction I understand a number of citizens, whether amounting to a majority or minority of the whole, who are united and actuated by some common impulse or passion adverse to the rights of other citizens, or to the permanent and aggregate interests of the community.

FEDERALIST No. 10, *supra* note 71, at 78.

75. *Id.* at 80.

76. *Id.* at 61-62.

77. *Id.* at 82.

78. See generally THE FEDERALIST No. 23, at 152-57 (Alexander Hamilton) (Clinton Rossiter ed., 1961) [hereinafter FEDERALIST No. 23].

79. Compare FEDERALIST No. 23 with Chief Justice John Marshall in *McCulloch v. Maryland*.

Whether there ought to be a Federal Government intrusted with the care of the common defense is a question in the first instance open to discussion; but the moment it is decided in the affirmative, it will follow that government ought to be clothed with all the powers requisite to complete execution of its trust. And unless it can be shown that the circumstances which may affect the public safety are reducible within certain determinate limits; unless the contrary of this position can be fairly and rationally disputed, it must be admitted as

The abuse of factions and other political ills have visited us in the twentieth century despite an energetic federalist government.⁸⁰ The political issue which must now be addressed is how to offset these factions and special interests that would destroy the commonwealth. We must also sustain a powerful government able to protect the citizens and capable of economic intervention for the common good.

I am a Federalist, and I believe that a strong central government is necessary to the survival of the United States.⁸¹ Without the benefits of the federal system, the nation might not have prevailed in the War of 1812.⁸² Certainly, the Federalists' nationalism shaped the pre-Civil War United States and gave the Republicans the vision of the union which prevailed.⁸³

I remain unconvinced that the world is headed into markedly more benign and safe times. Although the Cold War has ended, terrorism

a necessary consequence that there can be no limitation of that authority

FEDERALIST No. 23, *supra* note 78, at 153-54.

Let the end be legitimate, let it be within the scope of the constitution, and all means which are appropriate, which are plainly adapted to that end, which are not prohibited, but consistent with the letter and the spirit of the constitution, are constitutional.

McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 421 (1819).

80. Indeed, the energetic federal government is part of the problem because special interest groups have aligned themselves with friends in Congress to produce legislation which has gratified these interests. The urban schemes Professor Malloy deplores and the water reclamation pork barrels have damaged both the economy and the political soul of the country.

81. Professor Malloy and I have discussed where we would fall in political theory regarding the founding of the American nation state. I have always been a Federalist, while he claims some sympathy for the antifederalists. The antifederalists have appeal because they understood the threat posed by government power. I have a hard time visualizing how the young nation would have survived the foreign threats had the Federalists lost. The federal government also effectively checked internal discord when it suppressed the Whiskey Rebellion, and its economic powers welded the states together.

82. I realize that the Federalist Party in New England was a threat to the Union during the war when many New England Federalists threatened secession because of the damaging Embargo Act. Nevertheless, the vision and theory of a strong federal government protecting all of the states from foes, both domestic and foreign, prevailed.

83. When the North won the Civil War, a second American Revolution succeeded. For a fine new book on the second American Revolution, see JAMES M. MCPHERSON, ABRAHAM LINCOLN AND THE SECOND AMERICAN REVOLUTION (1990). The states' rights, antifederalist, Southern vision of the republic was defeated. The new union was stronger and more centralized. Political and economic power gravitated toward the federal government never to return to the states or the people. Federal power was employed to enfranchise and liberate the former slaves.

In this century, the federal power has been used extensively to redress the hideous wrongs of centuries of enslavement and to eliminate other forms of odious discrimination. This has been a major accomplishment. Centralization and, in this century, the susceptibility to special interest politics and the attempt to solve many of society's problems in Washington threaten to erode liberties, however.

is a constant, and nationalism rears its ugly head. Famine, poverty, national rivalries, and economic competition remain serious threats to peace, freedom, and prosperity. The threat of deliberate or accidental nuclear or biological war remains. During the recent Soviet coup attempt, the idea of breakaway units in the Republics armed with nuclear weapons was a scary proposition.⁸⁴

Therefore, I would maintain a strong national defense even with the thaw.⁸⁵ For me, and for many others, the threat of foreign enemies, while diminished, is still apparent and real. It can be countered in part by a strong military. The military must be well managed, however, lest it undermine the liberty it intends to protect. The military also requires planning and, to a large degree, a planned economy with huge subsidies given to certain contractors and suppliers. This has been part and parcel of our national experience.⁸⁶

84. See, e.g., Patrick E. Tyler, *Gorbachev and Yeltsen Move to Secure Nuclear Weapons*, N.Y. TIMES, Aug. 29, 1991, at A22; Patrick E. Tyler, *Troubling Question: Whose Finger Was on Nuclear Trigger?*, N.Y. TIMES, Aug. 24, 1991, at A9; Douglas Waller, *Nuclear Codes and the Coup: Weapons in the Wrong Hands?*, NEWSWEEK, Sept. 2, 1991, at 57.

85. In his farewell address, President Eisenhower warned about new dangers brought on by the Cold War. "The first was 'the conjunction of an immense military establishment and a large arms industry' which he termed 'the military-industrial complex.' The second was the federal government's domination of research which threatened the future of free, disinterested intellectual inquiry." GEOFFREY PERRETT, *A COUNTRY MADE BY WAR: FROM THE REVOLUTION TO VIETNAM — THE STORY OF AMERICA'S RISE TO POWER* 480 (1989).

The military-industrial complex poses a difficulty for my classical liberal tendencies. If unchecked, it can become a threat to political and economic freedom. In this modern era, however, a large capital plant and large military establishment must be maintained to protect the nation. Armies cannot be created overnight to fight the Redcoats from behind the trees. Surge capacity for the armed forces is required if the nation is to protect its vital interests abroad. Surge capacity is also needed with defense contractors and the defense industry. Billion dollar plants cannot be created in months to build tanks, planes, and ships. A gigantic physical plant and research capacity is needed to support our national defense. Since the end of World War II, government subsidies have been needed to maintain this surge capacity. These subsidies distort the economy, are anticompetitive, and may stifle economic development. Yet, they seem to be necessary to sustain the large military establishment the United States requires to protect its interests.

86. Modern military requirements mandate that great nations maintain surplus manufacturing capacity and subsidize weapons producers. This permits the nation to gear up and develop new weapons systems. Without this subsidized, sometimes wasteful, and structured economy, the surplus capacity would not remain because manufacturers, contractors, and researchers could not afford to provide the human and physical capital resources. What is often forgotten is that the nation's system of procurement has been based upon the notion of dual technologies. Technologies serving both the civilian and military sectors flourish side by side, create wealth, and spur innovation. For example, jet liners trace their heritage to military jets and the electronics industry that was developed for military applications during World War II. *Id.* at 556-57.

VIII. HAMILTONIAN ECONOMICS — YESTERDAY, TODAY, AND TOMORROW

My modest disagreement with Professor Malloy is a difference in degree with respect to the scope and magnitude of government intervention into society and the economy. In addition to the need for planning and government intervention to promote national defense, significant intervention has promoted the nation's economic welfare. Several historic examples illustrate permissible intervention: the Hamiltonian economic policies which founded the commercial republic, the economic nationalist policies before the Civil War, and the Civil War and post-Civil War economic policies which created the transcontinental railroads and fostered industrial and commercial development at the expense of the agrarian interests.⁸⁷

87. The second American Revolution, as Charles Beard viewed it, involved not only the destruction of the southern plantation gentry but also the consolidation of the northern entrepreneurial capitalist class in national power, supported by its rural and urban middle-class allies.

Legislation passed by the Union Congress during the war promoted this development. The Republican party had inherited from its Hamiltonian and Whig forbearers a commitment to the use of government to foster economic development through tariffs to protect industry, a centralized and regulated banking system, investment subsidies and land grants to high-risk but socially beneficial transportation enterprises, and government support for education. By 1860, the Republican party had also pledged itself to homestead legislation to provide farmers with an infusion of capital in the form of free land. Before 1860, the southern dominated Democratic party that controlled the federal government had repeatedly defeated or frustrated these measures. During the war, Republicans passed a higher tariff in 1861, a homestead act, a land grant college act, a Pacific railroad act providing loans and land grants for a transcontinental railroad in 1862, and a national banking act in 1863, which along with the legal tender act of the previous year authorized the issuance of a federal currency. The famous greenbacks gave the national government effective control over the nation's currency for the first time. In addition, to finance the war, the government marketed huge bonds to the public and passed an Internal Revenue Act which imposed a large array of federal taxes for the first time, including a federal income tax.

This astonishing blitz of laws, most of them passed within a span of less than one year, did more to reshape the relation of the government to the economy than any comparable effort except perhaps the first hundred days of the New Deal. This Civil War legislation, in the words of one historian, created a "blueprint for modern America." It helped to promote what another scholar termed "the last capitalist revolution" whereby the Civil War destroyed the "older social structure of plantation slavery" and "installed competitive democratic capitalism" in unchallenged domination of the American economy and polity.

MCPHERSON, *supra* note 83, at 39-40.

National economic development usually requires labor, natural resources capital, and management.⁸⁸ In 1800, America had unlimited natural resources and a scarcity of the other ingredients. Hamilton's *Report on Manufactures* provided *the model* for our economic development.⁸⁹ Hamilton's seminal report capitalized upon American resources, exploited the inflow of capital, and used immigration to spur development.

Hamilton proposed policies which would import labor and capital⁹⁰ and create capital through publicly funded debt.⁹¹ Hamilton realized that in a capital-scarce economy, the functional equivalent of investment capital could be created through publicly funded debt if investors and lenders had confidence in the national debt being serviced.⁹² The funding of the national debt was accomplished through the national government's assumption of the states' war debt. Although this created a large national debt, it forced capitalists to speculate with the federal government. Prior to the refunding, the states' debts were heavily discounted. Farmers sold these instruments to merchants and speculators in cities. The refunding created great wealth when the obligations were redeemed at face value. This establishment of credit also restored the nation's credit, which had been threatened by defaults by the states. It also created an interregional transfer of wealth from Virginia and the South to New York, Philadelphia, and Boston. When the Southern states paid their taxes, they transferred funds to the federal government to retire the

88. There are some remarkably successful exceptions such as Japan and the city-state of Hong Kong. Neither is blessed with natural resources, but both societies are imbued with the spirit of entrepreneurship.

89. See Hamilton, *supra* note 73, at 230-340.

90. Foreign capital was imported throughout much of the nineteenth century and was instrumental in creating America's network of railroads, turnpikes, and canals. It also funded the steel industry. Capital surpluses

existed in the maturer economies of Western Europe, where returns were less attractive than in areas of capital deficit such as the developing American economy. In consequence, net capital flows into the United States, set in motion primarily by English investors, amounted to \$1.5 billion between 1870 and 1895. Most of the investment went into municipal and other local bonds and into railroads and public utilities, although manufacturing firms were among the beneficiaries.

STUART W. BRUCHEY, *ENTERPRISE: THE DYNAMIC ECONOMY OF A FREE PEOPLE* 312 (1990).

91. Hamilton, *supra* note 73, at 277, 280.

92. In 1786, the United States was bankrupt. It was unable to service its public debt and was unable to provide necessary funds for garrisoning its borders. BRUCHEY, *supra* note 90, at 118-19. Hamilton's genius in funding the national debt not only created capital (through a multiplier effect), but also provided the means for maintaining the union and protecting property. *Id.* at 119.

debt and at the same time subsidized the commerce and manufacture of the North by payment of import duties which protected new industries. This set the pattern for nearly a century of intersectional wealth transfers.

Another prong of the Hamiltonian plan constituted a tax policy which used revenue protective tariffs and the inland revenue tax. Again, this program promoted an intersectional transfer of wealth from the agrarian West and South to the commercial and manufacturing North.

The third important Hamiltonian strategy was his fiscal policy which argued for the establishment of the Bank of the United States. This national bank and the expansion of credit from secondary, private credit sources augmented the credit created by the funding of the public debt. This newly created capital benefited the Northern cities and their commercial and manufacturing enterprises.

The Hamiltonian policies were remarkably interventionist. They relied on an expansive reading of federal economic powers. They created capital and wealth for the commercial and industrial Northeast at the expense of agrarian interests, and they provided the model for the expansionist policies of the nineteenth century.

The National Bank battles of the Jackson Age were intersectional as was the struggle over protective tariffs.⁹³ New York and New England industries lobbied for tariffs to protect their small manufacturers in the international marketplace. Southern states fought the tariffs in order to permit their farmers to purchase cheap, quality foreign goods. Senator John C. Calhoun of South Carolina protested that the tariffs were a "compulsory tax on agricultural interests everywhere in the nation to support a form of enterprise from which they would receive no benefit. Indeed . . . southern planters were convinced they were subsidizing an interest and a section that were positively inimical to their prosperity."⁹⁴ The West saw the tariffs as offering the opportunity of creating internal improvements in roads and canals to link the East and West into a giant market. Henry Clay unceasingly promoted this economic nationalism.⁹⁵

93. For a brief synopsis of these struggles, see SAMUEL E. MORRISON, *THE OXFORD HISTORY OF THE AMERICAN PEOPLE* 430-40 (1965).

94. JOHN NIVEN, *JOHN C. CALHOUN AND THE PRICE OF UNION* 134 (1988). Calhoun saw protection as detrimental to the Union and a "force of class and sectional plunder." MORRISON, *supra* note 93, at 432.

95. The American system of Henry Clay and Daniel Webster used the protective tariff to stimulate industrialization. Industrialization benefited all segments of the economy. Agriculture was its home market. Commerce was stimulated with imports and exports. Manufacturing expanded and reaped profits. Wages rose and more jobs were created. Additionally, the American system relied on internal improvement of transportation such as waterways, railroads, and highways which depended heavily on government subsidies. MAURICE G. BAXTER, *ONE AND INSEPARABLE: DANIEL WEBSTER AND THE UNION* 504 (1984).

The Tariff of 1832 led to South Carolinian resistance and an armed federal response. After the Nullification Crisis abated, the rates were lessened and peace was restored.⁹⁶ After the Civil War, tariff rates were raised to their original levels by Northern Republicans who no longer faced effective opposition from the South. These tariff and internal works projects, like canals, turnpikes, and railroads, favored the commerce and industry of the North and East and created a modern and expanding industrial economy. It is hard to imagine the rapid industrialization of the United States without the use of open immigration, tariffs, and internal improvements.

Methods of finance created by the North during the Civil War and federal assistance to the railroads accelerated capital formation and growth in the North. The North used a variety of techniques: tariffs, excise taxes on consumption, and income taxes. The main instrument was the massive issuance of debt, bonds, and circulated currency in the form of greenbacks.⁹⁷ The monetary policy issue of greenbacks accounted for about sixty-two percent of the debt issued. The reliance on greenbacks caused inflation while real labor wages lagged significantly. Excise taxes fell unevenly, affected the poor and the laborers, and transferred wealth to savers and investors. The federal government's decision to rapidly retire the debt had profound ramifications because this retirement pushed interest rates downward. Lower interest rates and a stable, conservative system of credit encouraged investment.⁹⁸

Although the West would have been settled eventually without the building of the Union Pacific-Central Pacific transcontinental railroad, large scale development and capital formation would have been considerably less. Transcontinental railroads, like other national infrastructure improvements such as canals and turnpikes, needed government subsidies to create what the market was incapable of producing.⁹⁹ Demand constraints justified the federal subsidy, and land grants guaranteed the construction of the transcontinentals.¹⁰⁰

96. ROBERT B. REICH, *THE WORK OF NATIONS: PROGRAMMING OURSELVES FOR 21ST CENTURY CAPITALISM* 22 (1991).

97. BRUCHEY, *supra* note 90, at 258-59.

98. *Id.* at 259-60.

99. Folklore often deplores the behavior of capitalists in the construction of the Union Pacific and other western railroads. See MATTHEW JOSEPHSON, *ROBBER BARONS: THE GREAT AMERICAN CAPITALISTS, 1861-1901* (1934). Although there were some abuses by speculators and venal politicians, the financing of the railroads seems much less scandalous when the whole story is understood in terms of the actual finances and options available at the time. See generally 1 MAURY KLEIN, *UNION PACIFIC: THE BIRTH OF A RAILROAD 1862-1893* (1987).

100. BRUCHEY, *supra* note 90, at 271.

Railroads contributed to the nation's growth by cutting transportation costs. These savings, in the range of ten percent of the Gross National Product, were released for other ventures. Railroads tied together the national market. Price competition and price equilibrium ensued as the East was bound to the West and Midwest. Railroads encouraged large scale Western agriculture and the shipment of bulk goods of all types. The railroad industry and its industrial and commercial offshoots accelerated commercialization and regional specialization.¹⁰¹

The post-Civil War industrial policy that preferred industry over agriculture and the Eastern bankers over the West was correct because it led to massive formation of capital and the development of new markets. Productivity was elevated, and the national standard of living rose dramatically. Consumer and political choices abounded. Today, we still need government intervention and subsidies in projects for areas of the economy where there is a market failure or an urgent societal need, such as transportation, education,¹⁰² health care,¹⁰³ the space program, and national defense.

IX. CONCLUSION

Classical liberal economics and politics are predicated upon freedom, rational choices, and principled decisions.¹⁰⁴ The ideal liberal world of Adam Smith's market, like the Cave of Plato,¹⁰⁵ did not exist even in

101. *Id.* at 269.

102. I favor a voucher system because it encourages better schools through competition and gives families freedom of choice.

103. In addition to creating a rational health care system to get costs under control and provide decent medical care for all citizens, I am in favor of income assistance for the poor. Senator Moynihan's Negative Income Tax is my preferred model. It would be easy to administer, and it would give the poor the greatest control over their economic lives. See U.S. DEPARTMENT OF LABOR, OFFICE OF POLICY PLANNING AND RESEARCH, *THE NEGRO FAMILY: THE CASE FOR NATIONAL ACTION*, 89TH CONG., 1ST SESS. (1965). For more information on negative income tax schemes, see GEORGE H. HILDEBRAND, *POVERTY, INCOME MAINTENANCE, AND THE NEGATIVE INCOME TAX* (1967).

104. The general rules to which classical liberals subscribe and the restraint they exercise in the political arena promote liberty and personal freedom.

105. See generally PLATO, *THE REPUBLIC OF PLATO* (Alan Bloom trans., 1968). *The Republic* is not commended as a model of good government or good society. Its authoritarianism is anathema of classical liberal thought. The idealism espoused by Plato and his adherents creates standards which are intentionally unattainable. This can be contrasted with the concrete political and moral thought of Aristotle in Blackstone's *Commentaries*. See generally ARISTOTLE, *THE POLITICS OF ARISTOTLE: A TREATISE ON GOVERNMENT* (William Ellis trans., 1947). WILLIAM BLACKSTONE, *COMMENTARIES ON THE LAWS OF ENGLAND* (1983) (1765).

Ideal virtues cannot be checked by reality, and idealism has often been used by tyrants and religions to enslave mankind. Nevertheless, the Cave and the Republic, fictions that they are, remain intellectual lodestones for humanity, notwithstanding their mischief.

Smith's time. Smith's observations, morality, and sentiments are timeless, however. Nevertheless, they have proven difficult to apply in the continental state that was and is America.

I do not have answers to all the issues Professor Malloy raises. He intelligently discusses the crucial relationship of the market to political freedom and personal liberty, and he exposes the fallacies of the movements which have caused the nation's drift.

How do we unleash the market forces with so many arrayed against them? We can start with Smith's insight to release the market energy to create enterprises, sustain growth, protect the commonweal, and preserve liberty and order.