Cases and Readings in Business Ethics

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Manufacture and Regulation of Laetrile

By Tom Beauchamp

It has been estimated that consumers waste $500 million a year on medical quackery and another $500 million annually on some “health foods” which have no beneficial effect. Unnecessary deaths, injuries and financial loss can be expected to continue until the law requires adequate testing for safety and efficacy of products and devices before they are made available to consumers. (President John F. Kennedy in a message to Congress)

Let me choose the way I want to die. It is not your prerogative to tell me how. (Glenn Rutherford, cancer patient and Laetrile supporter at FDA hearing)

These quotations express the essence of an acrimonious conflict that raged over the better part of the 1970s in the scientific and popular press, in courtrooms and hearing rooms, in prestigious research institutions, and among drug manufacturers. This debate emerged over the regulation, manufacturing, and marketing of Laetrile, a drug said to be a cure for cancer by its supporters but denounced as worthless by much of the scientific community.

The U.S. Food and Drug Administration (FDA) has a responsibility to determine both the safety and the efficacy of a drug before allowing it to be marketed in the United States. The FDA’s responsibility for drug licensing dates from the passage of the 1906 Pure Food and Drug Act, which primarily addressed safety abuses among patent medicine purveyors. In 1962 new laws were passed (partly in response to the Thalidomide tragedy involving malformed fetuses) that required the FDA to assess a drug’s efficacy as well as its safety before the drug could be approved for marketing.

The FDA examined Laetrile for safety and found no significant problems. However, the FDA could not find evidence of the drug’s effectiveness and became convinced that Laetrile was worthless for the treatment of cancer. Consequently the drug was banned from the U.S. market.

Laetrile supporters reacted with fury to the drug ban. Cancer victims demanded the right to use it. Over 20 state legislatures that opposed the FDA’s decision legalized it for intrastate marketing and consumption. Others felt the FDA was denying the American people their Constitutional right to freedom.
of choice. Many argued that since the drug had not been proven unsafe, people should be allowed to use it pending further tests. But many in the medical and scientific communities opposed this laissez-faire attitude. They argued that patients were drawn toward an inexpensive, painless cure for their disease but failed to realize its ineffectiveness. Critics claimed that numerous deaths had resulted from Laetrile use and that some of these people could have been helped by legitimate alternative forms of treatment.

The debate’s ferocity was new, but Laetrile was not. According to Dr. Charles Moertel of the Mayo Clinic, “Amygdalin had many centuries of use for medical purposes. Usually administered in the form of bitter almonds, it was a common ingredient of herbal prescriptions for a variety of illnesses, and by liberal interpretation of ancient pharmacopeias one might conclude that it was used for the treatment of cancer.” German physicians briefly used amygdalin in cancer treatment in 1892, but they discarded the extract as ineffective and toxic.

Modern proponents of Laetrile therapy attribute the beginning of the Laetrile movement to Ernst Krebs, who began experimenting with the extract of apricot pits in the 1920s, and to his son, Ernst Krebs, Jr., who refined the extract to produce Laetrile in 1949 for use in the treatment of disorders of intestinal fermentation cancer. Since then pro-Laetrile researchers have experimented with a variety of methods and techniques for using Laetrile in cancer treatment, and they claim that Laetrile is in fact effective. According to Krebs, Laetrile is effective because cyanide, which is an active ingredient, attacks the cancerous cells while an enzyme called rhodanese protects the normal cells.

Initially Krebs’s supporters claimed that Laetrile not only cured or controlled existing cancers but could also prevent cancers from forming. They based their claims of Laetrile’s efficacy primarily on patients’ case histories (some published in a volume called Laetrile Case Histories) and on personal testimonials of “cured” cancer patients. However, many in the medical and scientific communities were not impressed with this form of proof. They considered the reported case histories too sketchy and the follow-up times too short to support the claims. Moreover, few patients took Laetrile without first undergoing more traditional forms of cancer therapy. Under these conditions it is virtually impossible to determine which treatment or treatments should receive credit for improvements. Also, the natural history of cancer is not totally understood, and spontaneous remissions can and do occur.

In 1962 the FDA charged Krebs with violating the Federal Food, Drug and Cosmetic Act, on grounds that he could not prove his drug’s effectiveness. In 1963 Laetrile was banned because it was not found to be an effective treatment of cancer or any other health problem. Since then, Laetrile proponents have revised their claims. They no longer proclaim Laetrile an independent cure
for cancer instead emphasizing its role in the prevention and control of the
disease. Laetrile supporters also maintain that the standards of proof for
Laetrile research have been higher than for other cancer drugs and that pro-
Laetrile results have been obtained but suppressed.

The controversy surrounding Laetrile turned largely on the drug’s efficacy
and on one’s right to manufacture, market, and purchase the product. During
the 1970s the FDA suffered criticisms that it was a paternalistic agency after
it attempted to ban the manufacturing and marketing of the popular artificial
sweetener saccharin. The Laetrile problem immediately followed this
unpopular FDA policy. By mid-1977 FDA head Donald Kennedy said his
agency found increasing evidence of Laetrile’s inefficacy. However, criticism
of the FDA was also increasing and efforts were mounted either to allow
free choice of the drug or to test for efficacy in a public trial using human
subjects. Some state legislatures and judges called the FDA’s findings into
question. Some states had legalized its manufacture and sale, and some courts
had criticized the FDA record and policies. Even prestigious physicians and
newspapers such as The New York Times endorsed the right of individuals to
choose to use a possibly inefficacious drug.

Responding to the demands for a Laetrile efficacy trial with human subjects
the National Cancer Institute sponsored a 1981 clinical trial with 178 terminal
cancer patients. The trial results dispelled any lingering doubts in the medical
and scientific communities over Laetrile’s alleged ability to destroy cancer
cells. Of the 178 trial subjects, only one demonstrated a partial positive
response to Laetrile treatment. His gastric carcinoma showed a 10-week
retardation period. However the cancer progressed, and the patient died 37
weeks after Laetrile therapy. In their conclusion, the trial doctors commented,
“No substantive benefit was observed in the terms of cure, improvement or
stabilization of cancer.” According to the study, several patients displayed
symptoms of cyanide toxicity and blood cyanide levels approaching the lethal
range. The report concluded Amygdalin (Laetrile) is a toxic drug that is not
effective as a cancer treatment.” In response, Laetrile manufacturers sued the
NCI in three lawsuits, claiming the study had drastically reduced demand for
Laetrile, thereby inflicting financial damage on the manufacturers. All three
suits were dismissed in the courts.

According to proregulation partisans, it is desirable and necessary to protect
uneducated risk takers who are vulnerable to unsubstantiated medicinal claims:
“The absolute freedom to choose an effective drug is properly surrendered in
exchange for the freedom from danger to each person’s health and well-being
from the sale and use of worthless drugs.” From this perspective, regulation is
not irreconcilable with freedom of choice. If a regulation promotes situations
under which more informed and deliberative choices are made, it does not
constrict freedom; and a choice cannot be free if the product is a fraud.
By contrast, freedom-of-choice advocates claim that the simple restriction of Laetrile violates the individual’s right to autonomous choice and the manufacturers’ rights to market a product. Supporters of this view resent the characterization of cancer patients as people who are incapable of making rational or free decisions because of the stress of illness. They believe that most of these individuals are able to make well-founded personal decisions and should be allowed to do so.

The economic implications of banning Laetrile have also introduced a significant controversy. Each side has accused the other of economic exploitation of cancer victims. Laetrile proponents say that traditional cancer treatments represent an enormous and profitable industry and claim that a cost savings for patients would be achieved if Laetrile were legally marketed in the United States. They note that the American Cancer Society estimated that as early as 1972 the direct costs of cancer treatment totaled over $3 billion (for hospital care nursing home care, physicians’ and nurses’ fees, drugs and other treatments, and research). By comparison, Laetrile supporters claim that legalized Laetrile would cost a fraction of conventional cancer therapies.

Laetrile has been primarily manufactured and marketed in Mexico. In one study it was estimated that in 1977 alone, approximately 7,000 patients were treated in two Mexican clinics at an average cost of $350 per day. The United States represents a large potential market for a legalized, over-the-counter Laetrile. However, due to FDA restrictions, one may neither import amygdalin from foreign countries nor ship it across state lines. Although the FDA does not control intrastate commerce, it would not be profitable for any one state to manufacture Laetrile in all its stages—that is, from the farming of apricot trees to the laboratory synthesis of the finished drug. Furthermore, the FDA has issued an import alert ban on amygdalin and all corresponding brand names, including Laetrile and vitamin B-17. The FDA refuses to permit importation of Laetrile on the grounds that “it appears to be a new drug without an effective new drug application (NDA).” The FDA also classifies the Laetrile issue as a health fraud case. As a senior scientist at the AMA commented, “People took Laetrile, ignored other, more conventional cancer treatment, and died.” Although NDAs for Laetrile have been submitted to the FDA, none has been approved. Consequently, the FDA currently proscribes all importation and interstate transportation and marketing of amygdalin under any brand name.

However, one may still obtain amygdalin quickly and easily within the United States. VitaChem International/Genesis West in Redwood City, California, offers 50 tablets of “Laevalin, a naturally occurring amygdalin” for $47.50. Mexican-based Vita Inc. will ship 100 Laetrile tablets to a United States address for $65.00. To circumvent FDA regulations, U.S. Laetrile marketers have changed the brand name but continue to market amygdalin openly, in violation of the FDA import and interstate commerce ban.
The courts as well as the press have provided the arena for the conflict over the rights of a patient to choose a treatment and the rights of manufacturers to market a product. Although it was not the intent of Congress to impose such restrictions on choice, the patient’s choice is in fact restricted by the 1962 drug amendments. Because these amendments restrict the market to industry-tested and FDA-approved products, treatment by and manufacturing of alternatives are inevitably constricted.

A series of lawsuits have challenged the FDA restrictions, and a number of states have passed laws legalizing its use. In early 1977 U.S. District Court Judge Luther Bohanon (U.S. District Court for the Western District of Oklahoma) issued a ruling permitting Laetrile’s importation under a physician’s affidavit for terminally ill cancer patients. Although overturned by an appeals court in December 1986, Bohanon’s ruling allowed Laetrile treatment for terminal patients. Despite the opportunity to convince the FDA of the drug’s efficacy, Laetrile proponents did not obtain an NDA approval for amygdalin. The judicial and legislative challenges are not, however, without opponents. Lawyer William Curran, for instance, has deplored the action of certain courts in allowing the use of Laetrile for the terminally ill:

It is understandable that judges have had trouble dealing objectively with the legal pleas of plaintiffs who are dying a painful death and whose only wish is to indulge in a harmless, although ineffective, gesture of hope. The courts have tried to dispense mercy. Their error has been in abandoning the protection of law for these patients.

As the arguments have developed, the issues of choice and fraudulent representation by business have moved to the forefront. Franz Inglefinger, the distinguished former editor of the *New England Journal of Medicine* and himself a cancer victim, was convinced that Laetrile was useless. In 1977 he wrote, “I would not take Laetrile myself under any circumstances. If any member of my family had cancer, I would counsel them against it. If I were still in practice, I would not recommend it to my patients.” On the other hand, he said, “Perhaps there are some situations in which rational medical science should yield and make some concessions. If any patient had what I thought was hopelessly advanced cancer, and if he asked for Laetrile, I should like to be able to give the substance to him to assuage his mental anguish, just as I would give him morphine to relieve his physical suffering.” Inglefinger did not view truthful marketing of the drug as involving a fraudulent misrepresentation.

In January 1987 a Laetrile bill was introduced into the U.S. House of Representatives. H.R. 651 provided that the controversial efficacy requirements of the Food, Drug, and Cosmetics Act would not be applied to Laetrile if a patient were under a physician’s care (see Exhibit 1). The bill’s sponsor, Rep. Bill Goodling (R-PA) asserted that “the legislation does not
state that Laetrile is a cure for pain or a pain reducer.” The bill died in the Health and Environment Subcommittee of the House Energy and Commerce Committee.

The National Institutes of Health and most other health care institutions still discourage the use of Laetrile, preferring conventional methods of cancer treatment. The National Cancer Institute’s official policy is to encourage conventional methods with the explanation that testing has always shown “evidence of Laetrile’s failure as a cancer treatment.” The American Cancer Society holds the position that “Laetrile is not effective in the prevention or treatment of cancer in human beings.” Despite the medical evidence and the FDA’s past efforts to restrict the drug’s marketing, one may still today purchase amygdalin by dialing a toll-free number.

Exhibit 1
H.R. 651: To provide that the effectiveness requirements of the Federal Food, Drug, and Cosmetic Act shall not apply to Laetrile in certain cases, be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That in the administration of section 505 of the Federal Food, Drug, and Cosmetic Act, the effectiveness requirement of such section shall not be applicable to Laetrile when used under the direction of a physician for the treatment of pain.

* * *
Government intervention in the publication and dissemination of news is inconsistent with the notion of a free press. However, the government has a responsibility to ensure fairness in the dissemination of information on matters of community interest. These two obligations often conflict. Until recently, a U.S. government mechanism of media accountability known as the Fairness Doctrine existed. The doctrine attempted to mediate between broadcasters’ First Amendment rights and those of the public by requiring broadcasters to provide balanced coverage of important public issues.

The Fairness Doctrine originated in congressional and Federal Communications Commission (FCC) legislation. The FCC’s 1949 “Report on Editorializing by Broadcasters” outlined the doctrine and stressed the importance of the development, through broadcasting, of an informed public opinion in a democracy. It affirmed the “right of the public in a free society to be informed and to have presented to it for acceptance or rejection the different attitudes and viewpoints concerning these vital and often controversial issues.” In 1959 Congress amended the Communications Act of 1934 to impose, in section 315(a), a statutory “obligation upon [broadcasters] to operate in the public interest and to afford reasonable opportunity for the discussion of conflicting views on issues of public importance.”

The Fairness Doctrine did not require broadcasters to give equal time to contrasting views. However, if “during the presentation of views on a controversial issue, an attack [was] made upon the honesty, character, integrity, or like personal qualities of an identified person or group,” that person or group had to be given an opportunity to respond on the air. The broadcasting company had to bear all presentation costs.

The policy was traditionally confined to broadcast rather than print media, based on a principle of scarce resource allocation. There is a relative scarcity of broadcasting possibilities, because the number of people who want to broadcast exceeds the number of available broadcast licenses. The government allocates this limited resource through a licensing system, designed to protect the public interest through the enforcement of various regulations.

In 1969 the U.S. Supreme Court held the Fairness Doctrine to be constitutional and consistent with the First Amendment’s intent in *Red Lion Broadcasting Co. v. Federal Communications Commission*. The Court ruled that the scarcity
of available frequencies justifies the imposition of a government regulatory system intended to ensure that broadcasters, as fiduciaries, act in the public interest. The Court declared the public’s First Amendment rights to hear differing viewpoints “paramount” to broadcasters’ rights. Justice Byron White expressed the Court’s opinion as follows:

Where there are substantially more individuals who want to broadcast than there are frequencies to allocate, it is idle to posit an unbridgeable First Amendment right to broadcast comparable to the right of every individual to speak, write or publish. ...A license permits broadcasting, but the licensee has no constitutional right to be the one who holds the license or to monopolize a radio frequency to the exclusion of his fellow citizens. There is nothing in the First Amendment which prevents the Government from requiring a licensee to share his frequency with others and to conduct himself as a proxy or fiduciary with obligations to present those views and voices which are representative of his community and which would otherwise, by necessity, be barred from the airwaves.

The Court reaffirmed the scarcity of the radio airwaves and the responsibility of broadcasters as public trustees in subsequent cases. Similar reasoning served to justify the Fairness Doctrine’s application to cable programming.

The Fairness Doctrine was neither strictly enforced nor widely applied. From January 1980 through August 1987, the FCC received over 50,000 complaints of alleged Fairness Doctrine violations. The FCC dismissed the vast majority of the charges. The Fairness Doctrine was primarily invoked to restrict virulent racism and other use of the airwaves to intimidate and attack persons and institutions. The FCC also used the doctrine in 1967 to require broadcasters to give significant time to antismoking messages. It was almost never used to enforce accountability for claims made in documentaries, no matter how hard-hitting or speculative. Although the National Association of Broadcasters (NAB) has reported several cases in which documentaries were accused of violating the Fairness Doctrine, the FCC upheld only one complaint, later overturned in federal court.

The doctrine was usually applied to ensure that the licensed station owners’ political preferences would not control the presentation of candidates for public office. However, these regulations were also loosened over the years. For example, the FCC held that any station endorsing or criticizing a candidate on the air had to give the opposing or criticized candidate air time to respond. In 1983 FCC Chairman Mark Fowler revised the commission’s policy on televised political debates. He announced that broadcasters could schedule political debates with the candidates of their choice without being required to provide air time to excluded candidates. Broadcasters could cover debates as bona fide news events without having to make time available to those who did
not participate.

THE CURRENT LEGAL SITUATION

The Fairness Doctrine has come under fire from both sides of the political spectrum. Conservatives oppose it as an expendable form of government intervention, while some liberals support it as a means of intimidating or even silencing journalists. In October 1981 the FCC recommended that the Fairness Doctrine be repealed. The commission issued a detailed study of the doctrine in 1985. It concluded that the doctrine was “an unnecessary and detrimental regulatory mechanism  [that] disserves the public interest.” The FCC did not at that point repeal the doctrine because it believed that Congress had already codified it. However a September 1986 ruling by the U.S. Court of Appeals held that the Fairness Doctrine was not a statutory requirement. According to the ruling, written by Judge Robert Bork and supported by then Appeals Court Judge Antonin Scalia, Congress had merely ratified the doctrine in amending section 315(a) of the 1934 Communications Act. The decision permitted the FCC to modify or to abolish the doctrine. The commission then did abolish the doctrine’s chief measures in August 1987 claiming that they violated First Amendment rights and stifled controversial programming.

The court of appeals ruling spurred controversy in Congress, where some members have consistently voiced support for the doctrine. There have been several legislative proposals to codify the doctrine and make it an explicit requirement of the Communications Act. Rep. John Dingell (D-MI), chairman of the House Committee on Energy and Commerce introduced an amendment to the Communications Act that would “require expressly that licensees of broadcast stations present discussion of conflicting views on issues of public importance.” President Reagan vetoed the measure, and Congress lacked the two-thirds majority needed to override the veto. In November 1987 Sen. Ernest Hollings (D-SC) chairman of the Senate Commerce Committee, deftly steered a bill through the committee that would have restored the Fairness Doctrine. Although Hollings argued vigorously for the bill, congressional deficit-reduction negotiations eliminated it. Still more recent bills introduced by Senator Hollings and Representative Dingell have either failed to clear their respective committees or died on chamber floors.

THE CURRENT DEBATE

On August 4, 1987, the FCC voted unanimously to eliminate the Fairness Doctrine In a letter to Representative Dingell, then FCC Chairman Dennis Patrick emphasized that although the FCC had abolished the doctrine’s major clauses, several of the doctrine’s regulations remained in force: the political editorial rule, the personal attack rule, the Zapple Doctrine, and the “application of the Fairness Doctrine to ballot issues.”
As stated by the FCC, “The rules on political editorials and personal attacks do not forbid the broadcast of either. Instead, they require broadcasters who carry such editorials or attacks to offer the persons adversely affected by them a chance to state their side of the case in person or through a spokesman.” The political editorial clause currently mandates that TV and radio stations offer political candidates whose opponents have been endorsed by the involved station “a reasonable opportunity to respond” on air to the endorsement. The FCC requires that the opposing candidate be furnished with an editorial transcript within 24 hours of a broadcast. If a station broadcasts a political editorial within three days of the election, the station must provide the transcript and a response-time offer prior to the editorial’s airing.

Personal attacks also require response time. However, attacks “occurring during uses by legally qualified candidates” are not covered by the Fairness Doctrine. Attacks made on “foreign groups or foreign public figures” are also immune from the doctrine’s “personal attack” claims.

Like the political editorial clause, the Zapple Doctrine also involves political campaigning. Should a TV or radio station run an advertisement during a formal campaign period in which political supporters endorse a candidate, an opponent’s supporters have the right to a reasonable opportunity to respond. The Zapple Doctrine may only apply to legally qualified candidates during formal campaign periods. The restrictions “reflect the intent of Congress to confine special treatment of political discussion to distinct, identifiable periods.”

The ballot-issue exception requires broadcasters to permit opposing sides equal air time to discuss and advertise for or against ballot propositions. However, “The [Federal Communications] Commission will not intervene in cases alleging false and misleading statements regarding controversial issues of public importance.”

Although these clauses remain in force, an FCC employee declared that these exceptions “are not vigorously enforced” and have not seen frequent use in recent years. Overall, the FCC has moved away from even the spirit of the Fairness Doctrine, firm in the belief that the doctrine stifled rather than promoted discussion and debate on public issues.

Doctrine opponents have challenged the Supreme Court’s Red Lion decision, claiming that it is based on the mistaken premise of airwaves scarcity and need for improved communication of information, which are no longer valid. From this perspective, the Fairness Doctrine is now an unfair restraint on free market trade; technological advances since the Red Lion case have eliminated the former scarcity. The 1985 FCC report noted a dramatic increase to more than 10,000 radio and television broadcasting stations, a 400 percent growth since 1949. Commercial broadcasters opposed to the doctrine point out that in
many cities listeners and viewers can pick up dozens of radio and television stations and have access to only one significant newspaper. The FCC also observed that the growth of cable television, satellite television, and new telecommunications services offer an almost unlimited number of broadcast options.

The 1985 FCC report noted that the “fairness doctrine in operation thwarts the laudatory purpose it is designed to promote. Instead of furthering the discussion of public issues, the fairness doctrine inhibits broadcasters from presenting controversial issues of public importance.” Broadcasters sometimes hesitate to air controversial materials for fear that they will be forced to use expensive air time to present another side of the issue. For some broadcasters, the loss of advertising time alone prevents them from making room in their broadcast schedule for these materials. For example, there may be as many as 15 candidates running in a presidential primary, which makes the provision of equal time burdensome for many stations.

Doctrine supporters claim that the relative scarcity of usable airwaves persists. The “scarcity of frequencies should not be measured by the number of stations allowed to broadcast, but by the number of individuals or groups who wish to use the facilities, or would use them if they were more readily available.” They point to the economic value of government licenses as a measure of the relative demand. Independent VHF licenses have sold for as much as $700 million in New York. Also, the number of stations has not increased in isolation, but in proportion to the nation’s population growth. The broadcast medium continues to be more inaccessible to the private citizen than the print medium because the government must allocate the use of airwaves. Finally, the increase in stations does not necessarily correspond to any local increase in availability of diverse views on issues.

The Fairness Doctrine has been the only significant mechanism of control. The House Committee on Energy and Commerce Report on the Fairness Doctrine points out that “numerous case histories demonstrate that the Fairness Doctrine promotes carriage of views that would otherwise not be available to the American public.” Former FCC Chairman Charles Ferris testified before the Subcommittee on Telecommunications and Finance that “in 1979, during [his] watch, the Commission explicitly found that the Fairness Doctrine enhanced, not reduced, speech.” The congressional committee questioned the authority of the 1985 FCC report because it relied solely on broadcasters’ accounts of the doctrine’s effects.

Opponents argue that the Fairness Doctrine violates constitutional principles by allowing the government to intervene and to define how freedom of expression is to be used and practiced. The doctrine, they say, provides a dangerous potential for government abuse. They point to the FCC’s statement that federal law permits government agencies to file Fairness Doctrine
complaints against the media. This ruling (in July 1985) resulted in a complaint filed by the CIA charging that ABC’s “World News Tonight” had three times distorted the news in broadcasting allegations that the CIA had tried to arrange the assassination of Ronald Rewald, a Honolulu businessman who was under indictment for several crimes. These CIA complaints would reverse past precedents and require greater accountability of the media to the government.

Fairness Doctrine supporters face an uphill battle in the judiciary and Congress. A Media Action Project (a DC public interest law firm) employee said that when the Supreme Court declined in 1989 to review the 1986 DC Court of Appeals ruling, a legal review of the case became “extremely difficult.” If the firm decides to re-file a Fairness Doctrine case, it will certainly “seek a more sympathetic court.”

Legislative attempts to codify the Fairness Doctrine appear equally unlikely. Although Congressman Dingell and Senator Hollings have repeatedly introduced bills in Congress to resurrect the doctrine, they have all failed. A House legislative aide maintains that “hearings on [Representative Dingell’s bill] aren’t even likely to be held in this congressional session.” Although chairs of powerful House and Senate committees, neither Dingell nor Hollings has yet managed to convince their colleagues to codify the Fairness Doctrine. Furthermore, the executive branch publicly supports the doctrine’s abolition. If Congress did attempt to override a presidential veto of any doctrine measure, it probably could not muster the two-thirds support needed for legislative approval.

U.S. citizens continue to be wary of government intervention in the private sector. But the Fairness Doctrine has, until recently, been considered a justified exception. Although it is a measure that often intrudes upon broadcasters’ freedoms, the doctrine was traditionally designed to protect the individual’s moral and political right to the presentation of differing views on important issues.

* * *
Fannie Mae Eases Credit To Aid Mortgage Lending

By Steven A. Holmes

The New York Times, September 30, 1999

In a move that could help increase home ownership rates among minorities and low-income consumers, the Fannie Mae Corporation is easing the credit requirements on loans that it will purchase from banks and other lenders.

The action, which will begin as a pilot program involving 24 banks in 15 markets -- including the New York metropolitan region -- will encourage those banks to extend home mortgages to individuals whose credit is generally not good enough to qualify for conventional loans. Fannie Mae officials say they hope to make it a nationwide program by next spring.

Fannie Mae, the nation’s biggest underwriter of home mortgages, has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people and felt pressure from stock holders to maintain its phenomenal growth in profits.

In addition, banks, thrift institutions and mortgage companies have been pressing Fannie Mae to help them make more loans to so-called subprime borrowers. These borrowers whose incomes, credit ratings and savings are not good enough to qualify for conventional loans, can only get loans from finance companies that charge much higher interest rates -- anywhere from three to four percentage points higher than conventional loans.

“Fannie Mae has expanded home ownership for millions of families in the 1990’s by reducing down payment requirements,” said Franklin D. Raines, Fannie Mae’s chairman and chief executive officer. “Yet there remain too many borrowers whose credit is just a notch below what our underwriting has required who have been relegated to paying significantly higher mortgage rates in the so-called subprime market.”

Demographic information on these borrowers is sketchy. But at least one study indicates that 18 percent of the loans in the subprime market went to black borrowers, compared to 5 percent of loans in the conventional loan market.

In moving, even tentatively, into this new area of lending, Fannie Mae is taking on significantly more risk, which may not pose any difficulties during flush economic times. But the government-subsidized corporation may run into trouble in an economic downturn,
prompting a government rescue similar to that of the savings and loan industry in the 1980’s.

‘‘From the perspective of many people, including me, this is another thrift industry growing up around us,’’ said Peter Wallison a resident fellow at the American Enterprise Institute. ‘‘If they fail, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry.’’

Under Fannie Mae’s pilot program, consumers who qualify can secure a mortgage with an interest rate one percentage point above that of a conventional, 30-year fixed rate mortgage of less than $240,000 -- a rate that currently averages about 7.76 per cent. If the borrower makes his or her monthly payments on time for two years, the one percentage point premium is dropped.

Fannie Mae, the nation’s biggest underwriter of home mortgages, does not lend money directly to consumers. Instead, it purchases loans that banks make on what is called the secondary market. By expanding the type of loans that it will buy, Fannie Mae is hoping to spur banks to make more loans to people with less-than-stellar credit ratings.

Fannie Mae officials stress that the new mortgages will be extended to all potential borrowers who can qualify for a mortgage. But they add that the move is intended in part to increase the number of minority and low income home owners who tend to have worse credit ratings than non-Hispanic whites.

Home ownership has, in fact, exploded among minorities during the economic boom of the 1990’s. The number of mortgages extended to Hispanic applicants jumped by 87.2 per cent from 1993 to 1998, according to Harvard University’s Joint Center for Housing Studies. During that same period the number of African Americans who got mortgages to buy a home increased by 71.9 per cent and the number of Asian Americans by 46.3 per cent.

In contrast, the number of non-Hispanic whites who received loans for homes increased by 31.2 per cent.

Despite these gains, home ownership rates for minorities continue to lag behind non-Hispanic whites, in part because blacks and Hispanics in particular tend to have on average worse credit ratings.

In July, the Department of Housing and Urban Development proposed that by the year 2001, 50 percent of Fannie Mae’s and Freddie Mac’s portfolio be made up of loans to low and moderate-income borrowers. Last year, 44 percent of the loans Fannie Mae purchased were from these groups.

The change in policy also comes at the same time that HUD is investigating allegations of racial discrimination in the automated underwriting systems used by Fannie Mae and Freddie Mac to determine the credit-worthiness of credit applicants.

* * *
Pressured to Take More Risk, Fannie Reached Tipping Point

By Charles Duhigg


“Almost no one expected what was coming. It’s not fair to blame us for not predicting the unthinkable.”— Daniel H. Mudd, former chief executive, Fannie Mae

The Reckoning

Inflating the Bubble

When the mortgage giant Fannie Mae recruited Daniel H. Mudd, he told a friend he wanted to work for an altruistic business. Already a decorated marine and a successful executive, he wanted to be a role model to his four children — just as his father, the television journalist Roger Mudd, had been to him.

Fannie, a government-sponsored company, had long helped Americans get cheaper home loans by serving as a powerful middleman, buying mortgages from lenders and banks and then holding or reselling them to Wall Street investors. This allowed banks to make even more loans — expanding the pool of homeowners and permitting Fannie to ring up handsome profits along the way.

But by the time Mr. Mudd became Fannie’s chief executive in 2004, his company was under siege. Competitors were snatching lucrative parts of its business. Congress was demanding that Mr. Mudd help steer more loans to low-income borrowers. Lenders were threatening to sell directly to Wall Street unless Fannie bought a bigger chunk of their riskiest loans.

So Mr. Mudd made a fateful choice. Disregarding warnings from his managers that lenders were making too many loans that would never be repaid, he steered Fannie into more treacherous corners of the mortgage market, according to executives.

For a time, that decision proved profitable. In the end, it nearly destroyed the company and threatened to drag down the housing market and the economy.

Dozens of interviews, most from people who requested anonymity to avoid legal repercussions, offer an inside account of the critical juncture when Fannie Mae’s new chief executive, under pressure from Wall Street firms, Congress and company
shareholders, took additional risks that pushed his company, and, in turn, a large part of the nation’s financial health, to the brink.

Between 2005 and 2008, Fannie purchased or guaranteed at least $270 billion in loans to risky borrowers — more than three times as much as in all its earlier years combined, according to company filings and industry data.

“We didn’t really know what we were buying,” said Marc Gott, a former director in Fannie’s loan servicing department. “This system was designed for plain vanilla loans, and we were trying to push chocolate sundaes through the gears.”

Last month, the White House was forced to orchestrate a $200 billion rescue of Fannie and its corporate cousin, Freddie Mac. On Sept. 26, the companies disclosed that federal prosecutors and the Securities and Exchange Commission were investigating potential accounting and governance problems.

Mr. Mudd said in an interview that he responded as best he could given the company’s challenges, and worked to balance risks prudently.

“Fannie Mae faced the danger that the market would pass us by,” he said. “We were afraid that lenders would be selling products we weren’t buying and Congress would feel like we weren’t fulfilling our mission. The market was changing, and it’s our job to buy loans, so we had to change as well.”

Dealing With Risk

When Mr. Mudd arrived at Fannie eight years ago, it was beginning a dramatic expansion that, at its peak, had it buying 40 percent of all domestic mortgages.

Just two decades earlier, Fannie had been on the brink of bankruptcy. But chief executives like Franklin D. Raines and the chief financial officer J. Timothy Howard built it into a financial juggernaut by aiming at new markets.

Fannie never actually made loans. It was essentially a mortgage insurance company, buying mortgages, keeping some but reselling most to investors and, for a fee, promising to pay off a loan if the borrower defaulted. The only real danger was that the company might guarantee questionable mortgages and lose out when large numbers of borrowers walked away from their obligations.

So Fannie constructed a vast network of computer programs and mathematical formulas that analyzed its millions of daily transactions and ranked borrowers according to their risk.

Those computer programs seemingly turned Fannie into a divining rod, capable of separating pools of similar-seeming borrowers into safe and risky bets. The riskier the loan, the more Fannie charged to handle it. In theory, those high fees would offset any losses.
With that self-assurance, the company announced in 2000 that it would buy $2 trillion in loans from low-income, minority and risky borrowers by 2010.

All this helped supercharge Fannie’s stock price and rewarded top executives with tens of millions of dollars. Mr. Raines received about $90 million between 1998 and 2004, while Mr. Howard was paid about $30.8 million, according to regulators. Mr. Mudd collected more than $10 million in his first four years at Fannie.

Whenever competitors asked Congress to rein in the company, lawmakers were besieged with letters and phone calls from angry constituents, some orchestrated by Fannie itself. One automated phone call warned voters: “Your congressman is trying to make mortgages more expensive. Ask him why he opposes the American dream of home ownership.”

The ripple effect of Fannie’s plunge into riskier lending was profound. Fannie’s stamp of approval made shunned borrowers and complex loans more acceptable to other lenders, particularly small and less sophisticated banks.

Between 2001 and 2004, the overall subprime mortgage market — loans to the riskiest borrowers — grew from $160 billion to $540 billion, according to Inside Mortgage Finance, a trade publication. Communities were inundated with billboards and fliers from subprime companies offering to help almost anyone buy a home.

Within a few years of Mr. Mudd’s arrival, Fannie was the most powerful mortgage company on earth.

Then it began to crumble.

Regulators, spurred by the revelation of a wide-ranging accounting fraud at Freddie, began scrutinizing Fannie’s books. In 2004 they accused Fannie of fraudulently concealing expenses to make its profits look bigger.

Mr. Howard and Mr. Raines resigned. Mr. Mudd was quickly promoted to the top spot.

But the company he inherited was becoming a shadow of its former self.

‘You Need Us’

Shortly after he became chief executive, Mr. Mudd traveled to the California offices of Angelo R. Mozilo, the head of Countrywide Financial, then the nation’s largest mortgage lender. Fannie had a longstanding and lucrative relationship with Countrywide, which sold more loans to Fannie than anyone else.

But at that meeting, Mr. Mozilo, a butcher’s son who had almost single-handedly built Countrywide into a financial powerhouse, threatened to upend their partnership
unless Fannie started buying Countrywide’s riskier loans.

Mr. Mozilo, who did not return telephone calls seeking comment, told Mr. Mudd that Countrywide had other options. For example, Wall Street had recently jumped into the market for risky mortgages. Firms like Bear Stearns, Lehman Brothers and Goldman Sachs had started bundling home loans and selling them to investors — bypassing Fannie and dealing with Countrywide directly.

“You’re becoming irrelevant,” Mr. Mozilo told Mr. Mudd, according to two people with knowledge of the meeting who requested anonymity because the talks were confidential. In the previous year, Fannie had already lost 56 percent of its loan-reselling business to Wall Street and other competitors.

“You need us more than we need you,” Mr. Mozilo said, “and if you don’t take these loans, you’ll find you can lose much more.”

Then Mr. Mozilo offered everyone a breath mint.

Investors were also pressuring Mr. Mudd to take greater risks.

On one occasion, a hedge fund manager telephoned a senior Fannie executive to complain that the company was not taking enough gambles in chasing profits.

“Are you stupid or blind?” the investor roared, according to someone who heard the call, but requested anonymity. “Your job is to make me money!”

Capitol Hill bore down on Mr. Mudd as well. The same year he took the top position, regulators sharply increased Fannie’s affordable-housing goals. Democratic lawmakers demanded that the company buy more loans that had been made to low-income and minority homebuyers.

“When homes are doubling in price in every six years and incomes are increasing by a mere one percent per year, Fannie’s mission is of paramount importance,” Senator Jack Reed, a Rhode Island Democrat, lectured Mr. Mudd at a Congressional hearing in 2006. “In fact, Fannie and Freddie can do more, a lot more.”

But Fannie’s computer systems could not fully analyze many of the risky loans that customers, investors and lawmakers wanted Mr. Mudd to buy. Many of them — like balloon-rate mortgages or mortgages that did not require paperwork — were so new that dangerous bets could not be identified, according to company executives.

Even so, Fannie began buying huge numbers of riskier loans.

In one meeting, according to two people present, Mr. Mudd told employees to “get aggressive on risk-taking, or get out of the company.”
In the interview, Mr. Mudd said he did not recall that conversation and that he always stressed taking only prudent risks.

Employees, however, say they got a different message.

“Everybody understood that we were now buying loans that we would have previously rejected, and that the models were telling us that we were charging way too little,” said a former senior Fannie executive. “But our mandate was to stay relevant and to serve low-income borrowers. So that’s what we did.”

Between 2005 and 2007, the company’s acquisitions of mortgages with down payments of less than 10 percent almost tripled. As the market for risky loans soared to $1 trillion, Fannie expanded in white-hot real estate areas like California and Florida.

For two years, Mr. Mudd operated without a permanent chief risk officer to guard against unhealthy hazards. When Enrico Dallavecchia was hired for that position in 2006, he told Mr. Mudd that the company should be charging more to handle risky loans.

In the following months to come, Mr. Dallavecchia warned that some markets were becoming overheated and argued that a housing bubble had formed, according to a person with knowledge of the conversations. But many of the warnings were rebuffed.

Mr. Mudd told Mr. Dallavecchia that the market, shareholders and Congress all thought the companies should be taking more risks, not fewer, according to a person who observed the conversation. “Who am I supposed to fight with first?” Mr. Mudd asked.

In the interview, Mr. Mudd said he never made those comments. Mr. Dallavecchia was among those whom Mr. Mudd forced out of the company during a reorganization in August.

Mr. Mudd added that it was almost impossible during most of his tenure to see trouble on the horizon, because Fannie interacts with lenders rather than borrowers, which creates a delay in recognizing market conditions.

He said Fannie sought to balance market demands prudently against internal standards, that executives always sought to avoid unwise risks, and that Fannie bought far fewer troublesome loans than many other financial institutions. Mr. Mudd said he heeded many warnings from his executives and that Fannie refused to buy many risky loans, regardless of outside pressures.

“You’re dealing with massive amounts of information that flow in over months,” he said. “You almost never have an ‘Oh, my God’ moment. Even now, most of the loans we bought are doing fine.”

But, of course, that moment of truth did arrive. In the middle of last year it became clear that millions of borrowers would stop paying their mortgages. For Fannie, this raised the terrifying prospect of paying billions of dollars to honor its guarantees.
Sustained by Government

Had Fannie been a private entity, its comeuppance might have happened a year ago. But the White House, Wall Street and Capitol Hill were more concerned about the trillions of dollars in other loans that were poisoning financial institutions and banks.

Lawmakers, particularly Democrats, leaned on Fannie and Freddie to buy and hold those troubled debts, hoping that removing them from the system would help the economy recover. The companies, eager to regain market share and buy what they thought were undervalued loans, rushed to comply.

The White House also pitched in. James B. Lockhart, the chief regulator of Fannie and Freddie, adjusted the companies’ lending standards so they could purchase as much as $40 billion in new subprime loans. Some in Congress praised the move.

“I’m not worried about Fannie and Freddie’s health, I’m worried that they won’t do enough to help out the economy,” the chairman of the House Financial Services Committee, Barney Frank, Democrat of Massachusetts, said at the time. “That’s why I’ve supported them all these years — so that they can help at a time like this.”

But earlier this year, Treasury Secretary Henry M. Paulson Jr. grew concerned about Fannie’s and Freddie’s stability. He sent a deputy, Robert K. Steel, a former colleague from his time at Goldman Sachs, to speak with Mr. Mudd and his counterpart at Freddie.

Mr. Steel’s orders, according to several people, were to get commitments from the companies to raise more money as a cushion against all the new loans. But when he met with the firms, Mr. Steel made few demands and seemed unfamiliar with Fannie’s and Freddie’s operations, according to someone who attended the discussions.

Rather than getting firm commitments, Mr. Steel struck handshake deals without deadlines.

That misstep would become obvious over the coming months. Although Fannie raised $7.4 billion, Freddie never raised any additional money.

Mr. Steel, who left the Treasury Department over the summer to head Wachovia bank, disputed that he had failed in his handling of the companies, and said he was proud of his work.

As the housing crisis worsened, Fannie and Freddie announced larger losses, and shares continued falling.

In July, Mr. Paulson asked Congress for authority to take over Fannie and Freddie, though he said he hoped never to use it. “If you’ve got a bazooka and people know you’ve got it, you may not have to take it out,” he told Congress.
Mr. Mudd called Treasury weekly. He offered to resign, to replace his board, to sell stock, and to raise debt. “We’ll sign in blood anything you want,” he told a Treasury official, according to someone with knowledge of the conversations.

But, according to that person, Mr. Mudd told Treasury that those options would work only if government officials publicly clarified whether they intended to take over Fannie. Otherwise, potential investors would refuse to buy the stock for fear of being wiped out.

“There were other options on the table short of a takeover,” Mr. Mudd said. But as long as Treasury refused to disclose its goals, it was impossible for the company to act, according to people close to Fannie.

Then, last month, Mr. Mudd was instructed to report to Mr. Lockhart’s office. Mr. Paulson told Mr. Mudd that he could either agree to a takeover or have one forced upon him.

“This is the right thing to do for the economy,” Mr. Paulson said, according to two people with knowledge of the talks. “We can’t take any more risks.”

Freddie was given the same message. Less than 48 hours later, Mr. Lockhart and Mr. Paulson ended Fannie and Freddie’s independence, with up to $200 billion in taxpayer money to replenish the companies’ coffers.

The move failed to stanch a spreading panic in the financial world. In fact, some analysts say, the takeover accelerated the hysteria by signaling that no company, no matter how large, was strong enough to withstand the losses stemming from troubled loans.

Within weeks, Lehman Brothers was forced to declare bankruptcy, Merrill Lynch was pushed into the arms of Bank of America, and the government stepped in to bail out the insurance giant the American International Group.

Today, Mr. Paulson is scrambling to carry out a $700 billion plan to bail out the financial sector, while Mr. Lockhart effectively runs Fannie and Freddie.

Mr. Raines and Mr. Howard, who kept most of their millions, are living well. Mr. Raines has improved his golf game. Mr. Howard divides his time between large homes outside Washington and Cancun, Mexico, where his staff is learning how to cook American meals.

But Mr. Mudd, who lost millions of dollars as the company’s stock declined and had his severance revoked after the company was seized, often travels to New York for job interviews. He recalled that one of his sons recently asked him why he had been fired.

“Sometimes things don’t work out, no matter how hard you try,” he replied.

* * *

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Building Flawed American Dreams

By David Streitfeld and Gretchen Morgenson

The Reckoning

Man in the Middle

As the Clinton administration’s top housing official in the mid-1990s, Mr. Cisneros loosened mortgage restrictions so first-time buyers could qualify for loans they could never get before.

Then, capitalizing on a housing expansion he helped unleash, he joined the boards of a major builder, KB Home, and the largest mortgage lender in the nation, Countrywide Financial — two companies that rode the housing boom, drawing criticism along the way for abusive business practices.

And Mr. Cisneros became a developer himself. The Lago Vista development here in his hometown once stood as a testament to his life’s work.

Joining with KB, he built 428 homes for low-income buyers in what was a neglected, industrial neighborhood. He often made the trip from downtown to ask residents if they were happy.

“People bought here because of Cisneros,” says Celia Morales, a Lago Vista resident. “There was a feeling of, ‘He’s got our back.’”

But Mr. Cisneros rarely comes around anymore. Lago Vista, like many communities born in the housing boom, is now under stress. Scores of homes have been foreclosed, including one in five over the last six years on the community’s longest street, Sunbend Falls, according to property records.

While Mr. Cisneros says he remains proud of his work, he has misgivings over what his passion has wrought. He insists that the worst problems developed only after “bad actors” hijacked his good intentions but acknowledges that “people came to homeownership who should not have been homeowners.”

They were lured by “unscrupulous participants — bankers, brokers, secondary market people,” he says. “The country is paying for that, and families are hurt because we
as a society did not draw a line.”

The causes of the housing implosion are many: lax regulation, financial innovation gone awry, excessive debt, raw greed. The players are also varied: bankers, borrowers, developers, politicians and bureaucrats.

Mr. Cisneros, 61, had a foot in a number of those worlds. Despite his qualms, he encouraged the unprepared to buy homes — part of a broad national trend with dire economic consequences.

He reflects often on his role in the debacle, he says, which has changed homeownership from something that secured a place in the middle class to something that is ejecting people from it. “I’ve been waiting for someone to put all the blame at my doorstep,” he says lightly, but with a bit of worry, too.

**The Paydays During the Boom**

After a sex scandal destroyed his promising political career and he left Washington, he eventually reinvented himself as a well-regarded advocate and builder of urban, working-class homes. He has financed the construction of more than 7,000 houses.

For the three years he was a director at KB Home, Mr. Cisneros received at least $70,000 in pay and more than $100,000 worth of stock. He also received $1.14 million in directors’ fees and stock grants during the six years he was a director at Countrywide. He made more than $5 million from Countrywide stock options, money he says he plowed into his company.

He says his development work provides an annual income of “several hundred thousand” dollars. All told, his paydays are modest relative to the windfalls some executives netted in the boom. Indeed, Mr. Cisneros says his mistake was not the greed that afflicted many of his counterparts in banking and housing; it was unwavering belief.

It was, he argues, impossible to know in the beginning that the federal push to increase homeownership would end so badly. Once the housing boom got going, he suggests, laws and regulations barely had a chance.

“You think you have a finely tuned instrument that you can use to say: ‘Stop! We’re at 69 percent homeownership. We should not go further. There are people who should remain renters,’ ” he says. “But you really are just given a sledgehammer and an ax. They are blunt tools.”

From people dizzily drawing home equity loans out of increasingly valuable houses to banks racking up huge fees, few wanted the party to end.

“I’m not sure you can regulate when we’re talking about an entire nation of 300 million people and this behavior becomes viral,” Mr. Cisneros says.
Homeownership has deep roots in the American soul. But until recently getting a mortgage was a challenge for low-income families. Many of these families were minorities, which naturally made the subject of special interest to Mr. Cisneros, who, in 1993, became the first Hispanic head of the Department of Housing and Urban Development.

He had President Clinton’s ear, an easy charisma and a determination to increase a homeownership rate that had been stagnant for nearly three decades.

Thus was born the National Homeownership Strategy, which promoted ownership as patriotic and an easy win for all. “We were trying to be creative,” Mr. Cisneros recalls.

Under Mr. Cisneros, there were small and big changes at HUD, an agency that greased the mortgage wheel for first-time buyers by insuring billions of dollars in loans. Families no longer had to prove they had five years of stable income; three years sufficed.

And in another change championed by the mortgage industry, lenders were allowed to hire their own appraisers rather than rely on a government-selected panel. This saved borrowers money but opened the door for inflated appraisals. (A later HUD inquiry uncovered appraisal fraud that imperiled the federal mortgage insurance fund.)

“Henry did everything he could for home builders while he was at HUD,” says Janet Ahmad, president of Homeowners for Better Building, an advocacy group in San Antonio, who has known Mr. Cisneros since he was a city councilor. “That laid the groundwork for where we are now.”

Mr. Cisneros, who says he has no recollection that appraisal rules were relaxed when he ran HUD, disputes that notion. “I look back at HUD and feel my hands were clean,” he says.

Lenders applauded two more changes HUD made on Mr. Cisneros’s watch: they no longer had to interview most government-insured borrowers face to face or maintain physical branch offices. The industry changed, too. Lenders sprang up to serve those whose poor credit history made them ineligible for lower-interest “prime” loans. Countrywide, which Angelo R. Mozilo co-founded in 1969, set up a subprime unit in 1996.

Mr. Cisneros met Mr. Mozilo while he was HUD secretary, when Countrywide signed a government pledge to use “proactive creative efforts” to extend homeownership to minorities and low-income Americans.

He met Bruce E. Karatz, the chief executive of KB Home, when both were helping Los Angeles rebuild after the Northridge earthquake in 1994.

There were real gains during the Clinton years, as homeownership rose to 67.4 percent in 2000 from 64 percent in 1994. Hispanics and African-Americans were
the biggest beneficiaries. But as the boom later gathered steam, and as the Bush administration continued the Clinton administration’s push to amplify homeownership, some of those gains turned out to be built on sand.

Mr. Cisneros left government in 1997 after revelations that he had lied to federal investigators about payments to a former mistress. In the following years, HUD continued to draw attention in the news media and among consumer advocates for an overly lenient posture toward the housing industry.

In 2000, Mr. Cisneros returned to San Antonio, where he formed American CityVista, a developer, in partnership with KB, and became a KB director. KB’s board also included James A. Johnson, a prominent Democrat and the former chief executive of Fannie Mae, the mortgage giant now being run by the government. Mr. Johnson did not return a phone call seeking comment.

It made for a cozy network. Fannie bought or backed many mortgages received by home buyers in the KB Home/American CityVista partnership. And Fannie’s biggest mortgage client was Countrywide, whose board Mr. Cisneros had joined in 2001.

Because American CityVista was privately held, Mr. Cisneros’s earnings are not disclosed. He held a 65 percent stake, and KB had the rest. In 2002, KB paid $1.24 million to American CityVista for “services rendered.”

‘A Little Too Ambitious’

One of American CityVista’s first projects, unveiled in late 2000, was Lago Vista — Spanish for “Lake View.” The location was unusual: San Antonio’s proud and insular South Side, a Hispanic area home to secondhand car dealers, light industry and pawnshops.

Mr. Cisneros and KB pledged to transform an overgrown patch of land into a showcase. Homes were initially priced from $70,000 to about $95,000, and Mr. Cisneros promised that Lago Vista would be ringed with jogging paths and maple trees.

The paths were never built, and few trees provide shade from the Texas sun. The adjoining “lake” — at one point a run-off pit for an asphalt plant — is fenced off, a hazard to neighborhood children. The houses are gaily painted in pink, blue, yellow or tan, and most owners keep their yards green and tidy.

KB considers Lago Vista a “model community,” a spokeswoman said.

To get things rolling in Lago Vista, traditional bars to homeownership were lowered to the ground. Fannie Mae, CityVista and KB promoted a program allowing police officers, firefighters, teachers and others to get loans with nothing down and no closing costs.
KB marketed its developments in videos. In one from 2003, Mr. Karatz declared: “One of the greatest misconceptions today is people who sit back and think, ‘I can’t afford to buy.’” Mr. Cisneros appeared — identified as a former HUD director — saying the time was ripe to buy a home. Many agreed.

Victor Ramirez and Lorraine Pulido-Ramirez bought a house in Lago Vista in 2002. “This was our first home. I had nothing to compare it to,” Mr. Ramirez says. “I was a student making $17,000 a year, my wife was between jobs. In retrospect, how in hell did we qualify?”

The majority of buyers in Lago Vista “were duped into believing it was easier than it was,” Mr. Ramirez says. “The attitude was, ‘Sign here, sign here, don’t read the fine print.’” He added that some fault lay with buyers: “We were definitely willing victims.” (The Ramirez family veered close to foreclosure, but the couple now have good jobs and can make their payments.)

KB and Mr. Cisneros eventually built more than a dozen developments, primarily in Texas. But the shine slowly came off Lago Vista.

“It started off fabulously,” Mr. Karatz recalled. Then sales slowed considerably. “It was probably, looking back, a little too ambitious to think that there would be sufficient local demand.”

And then the foreclosures started. “A lot of people got approved for big amounts,” says Patricia Flores, another Lago Vista homeowner. “They bit off more than they could chew.” Families split up under the strain of mortgage payments. One residence had so much marital turmoil that neighbors nicknamed it “The House of Broken Love.”

Some homes were taken over and sold at a loss by HUD, which had insured them. KB was also a mortgage lender, a business many home builders pursued because it was so profitable. At times, it was also problematic.

Officials at HUD uncovered problems with KB’s lending. In 2005, about two years after Mr. Cisneros left the KB board, the agency filed an administrative action against KB for approving loans based on overstated or improperly documented borrower income, and for charging excessive fees. Because HUD does not specify where improprieties take place, it is not clear if this occurred at Lago Vista.

KB Home paid $3.2 million to settle the HUD action without admitting liability or fault, one of the largest settlements collected by the agency’s mortgagee review board. Shortly afterward, KB sold its lending unit to Countrywide. Then they set up a joint venture: KB installed Countrywide sales representatives in its developments.

By 2007, almost three-quarters of the loans to KB buyers were made by the joint venture. In Lago Vista, residents secured loans from a spectrum of federal agencies and lenders.
During years of heady growth, and then during a deep financial slide, Countrywide became a lightning rod for criticism about excesses and abuses leading to the housing bust — which Countrywide routinely brushed off.

Mr. Cisneros says he was never aware of improprieties at KB or Countrywide, and worked with them because he was impressed by Mr. Karatz and Mr. Mozilo. Mr. Mozilo could not be reached for comment.

Still, Countrywide expanded subprime lending aggressively while Mr. Cisneros served on its board. In September 2004, according to documents provided by a former employee, lending audits in six of Countrywide’s largest regions showed about one in eight loans was “severely unsatisfactory” because of shoddy underwriting.

HUD required such audits and lenders were expected to address problems. Mr. Cisneros was a member of the Countrywide committee that oversaw compliance with legal and regulatory requirements. But he says he did not recall seeing or receiving the reports.

Nor, he says, was there ever a board vote about the wisdom of subprime lending.

“The irresistible temptation to engage in subprime was Countrywide’s fatal error,” he says. “I fault myself for not having seen it and, since it was not something I could change, having left.”

Mr. Cisneros left Countrywide’s board last year. At the time, he expressed “enormous confidence in the leadership.” In 2003, Mr. Cisneros ended his partnership with KB because, he says, he felt constrained working with just one builder. He formed a new company with the same mission, CityView, that has raised $725 million.

Mr. Karatz has a different recollection of why the partnership ended.

“It didn’t become an important part of KB’s business,” he says. “It was profitable but I don’t think as profitable in those initial years as Henry’s group wanted it to be.”

Troubles in Lago Vista

Today in Lago Vista, many are just trying to get by. Residents say crime has risen, and with association dues unpaid, they cannot hire security. Salvador Gutierrez, a truck driver, woke up recently to see four men stealing the tires off his pickup. Seventeen houses are for sale, but there are few buyers.

Hugo Martinez, who got a pair of Countrywide loans to buy a two-bedroom house with no down payment, recently lost his job with a car dealership. He has a lower-paying job as a mechanic and can’t refinance or sell his house.

“They make it easy when you buy,” Mr. Martinez says. “But after a while, the interest
rate goes up. KB Home says they cannot help us at all.”

Five years ago, Carlo Lee and Patricia Reyes bought their first home, a three-bedroom house in Lago Vista.

After Mrs. Reyes became ill last year and lost her job, they fell behind on their payments. Last month, Mr. Reyes was laid off from one of his jobs, assembling cabinets. He still works part time at a hospital, but unless the couple come up with missed payments and fees, they will lose their home.

“Everyone isn’t happy here in Lago Vista,” Mr. Reyes says. “Everyone has a lot of problems.”

Countrywide was bought recently at a fire-sale price by Bank of America. Mr. Cisneros describes Mr. Mozilo as “sick with stress — the final chapter of his life is the infamy that’s been brought on him, or that he brought on himself.”

Mr. Karatz was forced out of KB two years ago amid a compensation scandal. Last month, without admitting or denying the allegations, he settled government charges that he illegally backdated stock options worth $6 million.

For his part, Mr. Cisneros says he is proud of Lago Vista. “It is inaccurate to say that we put people into homes that they couldn’t afford,” he says. “No one was forcing people into homes.”

He also remains bullish on home building, despite the current carnage.

“We’re not selling cigarettes,” he says. “We’re not drawing people into casino gambling. We’re building the homes they’re going to raise their families in.”

* * *
The Subprime Mortgage Crisis

**Initial situation (until 1970s):**
- Lenders have profit motive
  - Lenders establish credit ratings
    - Good-credit people can get loans
    - Poor-credit people can't get loans

**Meanwhile (1980s and 90s):**
- Some politicians push for home ownership and "affordable housing"
  - Poorer people are disproportionately racial minorities
  - Gov't changes incentives for Fannie Mae and Freddie Mac via bailout insurance
    - Lenders can make higher-interest loans to poor-credit people and then sell those loans to Fannie Mae and Freddie Mac
      - Higher-interest loans to poor-credit people become profitable
  - Pressure on lenders to lower standards for poorer-credit people: "Home Mortgage Disclosure Act" & "Community Reinvestment Act"
  - Fannie Mae and Freddie Mac officials lobby hard to prevent oversight
    - Higher-interest loans to poor-credit people become politically necessary

**Then (early-mid 2000s):**
- Poor-credit people begin defaulting on loans in large numbers
  - Congressional oversight limited; warnings suppressed
  - Ripple effect: Fannie Mae, Freddie Mac, and private lenders start losing big money

**Now (late 2000s):**
- Some politicians and pundits blame "greedy lenders" for making bad loans: "The free market has failed."
- The government takes over
Quotations on Money

“No one can earn a million dollars honestly.” (William Jennings Bryan)
“The rich are the scum of the earth in every country.” (G. K. Chesterton)
“Behind every great fortune there is a crime.” (Balzac)

“The love of money is the root of all evil.” (I Timothy 6:8-10)
“The lack of money is the root of all evil.” (Mark Twain)

“The universal regard for money is the one hopeful fact in our civilization, the one sound spot in our social conscience. Money is the most important thing in the world. It represents health, strength, honour, generosity, and beauty as conspicuously and undeniably as the want of it represents illness, weakness, disgrace, meanness and ugliness. Not the least of its virtues is that it destroys base people as certainly as it fortifies and dignifies noble people.” (George Bernard Shaw, Major Barbara)

“If a man runs after money, he’s money-mad, if he keeps it, he’s a capitalist; if he spends it, he’s a playboy; if he doesn’t get it, he’s a ne’er-do-well; if he doesn’t try to get it, he lacks ambition. If he gets it without working for it, he’s a parasite; and if he accumulates it after a lifetime of hard work, people call him a fool who never got anything out of life.” (Vic Oliver)
“A neighbor not long ago told me that her husband was one of eighteen nephews and nieces of a man who at his death had left a trust that gave each of them, when they turned twenty-one, an annual income of $60,000 each. Apart from her husband, who went on to medical school, not one of these legatees finished college. The result of their uncle’s generous benefaction was to breed a set of drug addicts, full-time beach bums, ne’er-do-wells, and other human disasters.” (Joseph Epstein, “Money is Funny,” p. 311)

“It is a socialist idea that making profits it a vice; I consider the real vice is making losses.” (Winston Churchill)

“Economic efficiency consists in making things that are worth more than they cost.” (J. M. Clark)
Martin Luther: “There is on earth no greater enemy of man, after the Devil, than a gripe-money and usurer, for he wants to be God over all men ... . Usury is a great, huge monster, like a werewolf ... And since we break on the wheel and behead highwaymen, murderers, and housebreakers, how much more ought we to break on the wheel and kill ... hunt down, curse, and behead all usurers!”

“There is no money in poetry, but then there is no poetry in money, either.” (Robert Graves)

“Why doesn’t someone write a poem on money? Nobody does anything but abuse it. There’s hardly a good word for money to be found in literature. The poets and writers have been needy devils and thought to brave out their beggary by pretending to despise it.” (John Jay Chapman)

But please do not think that I am not fond of banks,
Because I think they deserve our appreciation and thanks,
Because they perform a valuable public service ie in eliminating
   the jackasses who go around saying that health and happiness are everything and money isn’t essential,
Because as soon as they have to borrow some unimportant money to maintain their health and happiness they starve to death so they can’t go around any more sneering at good old money, which is nothing short of providential.
(Ogden Nash, “Bankers are just like anybody else, except richer”)

* * *
**Zoning: Examples**

**Saginaw, MI:** It’s illegal to park a car on your home’s front lawn. Rod Dixon, city zoning coordinator: “If you allow parking on the front lawn, you have cars right up by the house. That doesn’t look right.”

**Mentor, OH:** “Applebee’s plans for a new downtown restaurant is facing problems from Mentor’s city planners, who fear that its architectural flavor is ‘a bit bland.’ Meanwhile, Chi-Chi’s Mexican Restaurant is being challenged from the opposite direction. ‘I think those canopies might be too gaudy,’ says Municipal Planning Commission Chair Ray Kirchner.”

**Brownsville, TX:** Mary Gunnels is going to trial for a second time. A jury deadlocked in her first trial. Her crime? The city found out that she sells silk chrysanthemums to girls going to high school homecoming games. She sells about 30 each year. For that, she has been charged with ‘knowingly and intentionally operating a flower shop’ in a residential area. If convicted, she will face a $500 fine.

**Birmingham, MI:** Police charged a man with planting a red oak tree in his yard. City tree and shrub regulations allow only locust trees on his block.

**Fountain Valley, CA:** Chuck Haddad and Andre Khalifi thought they’d come up with a winning idea. They wanted to open a cigar lounge with a gourmet menu, a full bar, and Internet access. But when they applied for a business permit, they found that other residents of Fountain Valley, California, had their doubts. They were concerned about those cancer-causing cigars and about parking. But mostly, they didn’t like the idea of mixing alcohol and the Internet. Said one concerned citizen at a public hearing, “How are we going to protect our women after these guys get liquored up, look at pornography, and then roam the neighborhood late at night?, it didn’t help that the police opposed “uncontrolled Internet access.” Said Detective Sgt. Paul McGinnis, “I’ve never actually been on the Internet, but my understanding is that you can get just about anything you want on there.” Haddad and Khalifi’s permit was denied.

**Indiana, Pennsylvania:** City council has voted to bad residents from using furniture outdoors if it is ‘not specifically constructed for outdoor use.’ The law is intended to keep college students from putting an old sofa on their porch to sit on.”

**Livermore, California:** The city has ordered a mother to stop selling handpainted T-shirts from her home. The woman is selling the shirts to raise money to pay her 16-month-old daughter’s medical bills. The girl was born with life-threatening intestinal disorders.
Rockford, IL: Judge backs denial of quarry permit. A judge has upheld Winnebago County’s decision blocking plans for a limestone quarry operation south of Rockford. Gary and Carol Williams filed suit after the county board in July 1996 denied a special-use permit for the proposed quarry at 3710 Baxter Road. Circuit Judge Ronald Pirrello heard lengthy testimony at trial and issued a ruling last week in the county’s favor. In his ruling, Pinello wrote that the Williamses could cite no public benefit to the proposed quarry business—only their own prospects for economic gain. “There was no evidence that the community needed another quarry,” he added.

New Rochelle, NY: Suzanne Levy is ready to go behind bars for feeding the birds. She’s battling City Hall over a birdhouse perched on a 6-foot wooden post in her back yard. After a neighbor complained that pigeons were flocking to the feeder and leaving behind silver dollar-size droppings, the city told Ms. Levy she should have obtained a building permit before she put up the feeder. Now she faces a possible $250 fine or 15 days in jail for putting out the free smorgasbord.

“If they want to make me a spectacle, I would go to jail over this,” Ms. Levy said Wednesday. “I’m divorced, my children are grown, I was lonely and I wanted to see the birds.”

The birdhouse isn’t the most garish or elaborate yard ornament in her Sycamore Park neighborhood. There’s a pink, green and yellow plastic playhouse down the street, and a basketball hoop with “7-Up” on the backboard. Statues of the madonna, plastic basketball hoops and colorful swing sets dot some yards. Ms. Levy’s feeder towers above an overgrown lawn. She put a homemade platform under the feeder after she was ordered to do so by the city Health Department, which warned her to keep seeds and droppings off the ground.

Neighbor Joyce Alfano, a Republican district leader, complained to inspectors about the feeder and Ms. Levy was hauled into court last week for building without a permit.

“A building permit?” Ms. Levy said as a cardinal and some starlings feasted on sunflower seeds at the feeder. “I’m only doing what millions of Americans do. I’m feeding the birds.”

Mrs. Alfano did not answer her phone or come to her door on Wednesday, but she has said that her problem isn’t with the birdhouse but the platform. At least 20 pigeons flock to the table “every single day” and leave droppings, she complained. Ms. Levy insisted that bird droppings are not a problem, and she showed off a grimy old Lincoln in her driveway that she said had not been moved in months and displayed no sign of the pigeons’ leavings.

But Mrs. Alfano said she had to power-wash the side of the house next door. “There were droppings the size of silver dollars on the driveway,” she added. City officials acknowledge that no one else in this New York City suburb of 68,000 has obtained a building permit to put up
a bird feeder. At last week’s trial, the city argued that Ms. Levy’s bird feeder is a structure and as such requires a permit. On cross-examination, a building inspector admitted that “structure” generally means a building. A judge gave both sides two weeks to file written arguments. Neighbor John Kenyon said there’s more to it than a backyard bird feeder. Kenyon, who said he has lived in the same house down the street for all his 86 years, described Mrs. Alfano as “spiteful” and “nasty.” “She’s got pull with the city and she’s picking on somebody,” he said. “It’s just a silly shame.”

Pub Crawling
If the patrons at MacDinton’s Irish Pub in Tampa, Florida, don’t stop drinking so much, the establishment could go out of business. No, really. Customers may consider MacDinton’s a place to toss back a few beers. But the city says it’s a restaurant. And it has to get at least 51% of its revenues from food, or they’ll take away its alcohol license. The pub, er, restaurant, gets 75% of its revenue from alcohol. (No offense, but it’s an Irish Pub, for crying out loud!)

Just Desert (3/30/2004)
When is sparsely inhabited desert “urbanized”? When a city government wants it. When Hyundai wanted to build a test track in California City, California, the local government knew just the site. Unfortunately, other people owned the 700 acres the city had in mind. No problem, it used a state law allowing it to seize land that is “urbanized and blighted.” No matter that the land is mostly pristine desert. Some owners don’t like the city taking their land for less than they think its worth. But Mayor Larry Adams has little patience for their concerns. “I think it’s a matter of one or two (who) probably are true believers in the freedom of mankind, blah blah blah, and they don’t like eminent domain,” he said. “Some have a sentimental attachment to the land they inherited. And some of them are just greedy.”

P. J. O’Rourke: “When buying and selling are controlled by legislation, the first things to be bought and sold are legislators.”

* * *
Quotations on Politicized Business

1. “In general, the art of government consists in taking as much money as possible from one party of the citizens to give to the other.” (Voltaire, 1764)

2. “I expect all the bad consequences from the chambers of Commerce and manufacturers establishing in different parts of this country, which your Grace seems to foresee. …The regulations of Commerce are commonly dictated by those who are most interested to deceive and impose upon the Public.” (Adam Smith, 1785 letter. In E. C. Mossner and I. S. Ross, editors, The Correspondence of Adam Smith (Indianapolis: Liberty Press, 1987), p. 286)

3. Farm subsidies are “a temporary solution to deal with an emergency.” (Henry Wallace, president Roosevelt’s secretary of agriculture in 1933 when the US introduced farm subsidies.)

4. “There is nothing so permanent in Washington as a temporary government program.” (Milton Friedman, Nobel Prize in Economics, 1976)

5. “Many key businessmen articulated a conscious policy favoring the intervention of the national government into the economy. Important businessmen did not, on the whole, regard politics as a necessary evil, but as an important part of their larger position in society.” (Gabriel Kolko, The Triumph of Conservatism. New York: The Free Press, 1963, p. 5)

6. “Government’s view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.” (Ronald Reagan, 1986)

   - “This year [1990] the USDA is rewarding farmers for not planting on 78 million acres of farmland—equivalent to the entire states of Indiana, Ohio, and most of Illinois.”
   - “With the $160 billion that the government and consumers have spent on farm subsidies since 1980, Uncle Sam could have bought every farm, barn, and tractor in thirty states.”
   - “Farm subsidies—roughly $25 billion a year in handouts, plus $10 billion in higher food prices—are the equivalent of giving every full-time subsidized farmer two new Mercedes each year.”

8. “Capitalism’s biggest political enemies are not the firebrand trade unionists spewing vitriol against the system but the executives in pin-striped suits extolling the virtues of competitive markets with every breath while attempting to extinguish them with every action.” (Raghuram Rajan and Luigi Zingales, Saving Capitalism from the Capitalists. New York: Crown, 2003, 276)

9. “When buying and selling are controlled by the legislature, the first thing to be bought and sold is legislators.” (P. J. O’Rourke, political humorist)
10. Andrew P. Morriss letter to the *Wall Street Journal* (2008): ‘Sirs, Your story “Hedge Funds Coming of Age Politically” (April 19) reports that hedge funds are beginning to form PACs and engage in political activity to protect themselves from threatened regulation. It is no coincidence that this is happening at the same time that politicians are considering regulatory measures that could prove costly for hedge funds. Northwestern Univ. Law Prof. Fred McChesney’s “money for nothing” theory of regulation explains exactly this behavior. Politicians target an unorganized but wealthy industry by holding hearings, calling for regulatory action, proposing legislation, and so forth. Alarmed, the industry organizes interest groups and begins making contributions to the politicians. Miraculously, most of the threatened regulations then vanish from the agenda, leaving the politicians richer and the industry poorer but wiser. Whenever a new round of contributions is needed, another round of hearings on the latest issue can be scheduled.’

Politicized business and the Kennedys http://www.boston.com/business/healthcare/articles/2009/09/01/programs_have_unsure_future_without_kennedy_to_champion/

* * *
Mixed Economy Dysfunctions

1. Free Market
   - Quantity up
   - Price down

2. Political
   - Introduces regulations
   - Price controls
   - Products banned

3. Effect on entrepreneurs
   - Free market slowed
   - Stifled
   - Must become political

4. Entry of politicians
   - Politics as tool
   - Open to lobbying
   - Empire building
   - Some open to bribes
   - Seek special favors
   - Harm competition

5. Effect on politicians
   - "Empire" building

6. Economic inefficiencies
   - Innovation up
   - "Empire" building
   - Some open to bribes
   - Open to lobbying

7. Political corruption
   - Lobbying, bribing

8. Calls for more regulations to fix inefficiencies

Stephen Hicks, © 2008
Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Timber & Lumber Co., 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

KELO ET AL. v. CITY OF NEW LONDON ET AL.

CERTIORARI TO THE SUPREME COURT OF CONNECTICUT


After approving an integrated development plan designed to revitalize its ailing economy, respondent city, through its development agent, purchased most of the property earmarked for the project from willing sellers, but initiated condemnation proceedings when petitioners, the owners of the rest of the property, refused to sell. Petitioners brought this state-court action claiming, inter alia, that the taking of their properties would violate the “public use” restriction in the Fifth Amendment’s Takings Clause. The trial court granted a permanent restraining order prohibiting the taking of the some of the properties, but denying relief as to others. Relying on cases such as Hawaii Housing Authority v. Midkiff, 467 U. S. 229, and Berman v. Parker, 348 U. S. 26, the Connecticut Supreme Court affirmed in part and reversed in part, upholding all of the proposed takings.

Held: The city’s proposed disposition of petitioners’ property qualifies as a “public use” within the meaning of the Takings Clause. Pp. 6–20.

(a) Though the city could not take petitioners’ land simply to confer a private benefit on a particular private party, see, e.g., Midkiff, 467 U. S., at 245, the takings at issue here would be executed pursuant to a carefully considered development plan, which was not adopted “to benefit a particular class of identifiable individuals,” ibid. Moreover, while the city is not planning to open the condemned land—at least not in its entirety—to use by the general public, this “Court long ago rejected any literal requirement that condemned property be put into use for the . . . public.” Id., at 244. Rather, it has embraced the broader and more natural interpretation of public use as “public purpose.” See, e.g., Fallbrook Irrigation Dist. v. Bradley, 164 U. S. 112, 158–164. Without exception, the Court has defined that concept broadly, reflecting its longstanding policy of deference to legislative judgments as to what public needs justify the use of the takings
Syllabus


(b) The city’s determination that the area at issue was sufficiently distressed to justify a program of economic rejuvenation is entitled to deference. The city has carefully formulated a development plan that it believes will provide appreciable benefits to the community, including, but not limited to, new jobs and increased tax revenue. As with other exercises in urban planning and development, the city is trying to coordinate a variety of commercial, residential, and recreational land uses, with the hope that they will form a whole greater than the sum of its parts. To effectuate this plan, the city has invoked a state statute that specifically authorizes the use of eminent domain to promote economic development. Given the plan’s comprehensive character, the thorough deliberation that preceded its adoption, and the limited scope of this Court’s review in such cases, it is appropriate here, as it was in *Berman*, to resolve the challenges of the individual owners, not on a piecemeal basis, but rather in light of the entire plan. Because that plan unquestionably serves a public purpose, the takings challenged here satisfy the Fifth Amendment. P. 13.

(c) Petitioners’ proposal that the Court adopt a new bright-line rule that economic development does not qualify as a public use is supported by neither precedent nor logic. Promoting economic development is a traditional and long accepted governmental function, and there is no principled way of distinguishing it from the other public purposes the Court has recognized. See, e.g., *Berman*, 348 U. S., at 24. Also rejected is petitioners’ argument that for takings of this kind the Court should require a “reasonable certainty” that the expected public benefits will actually accrue. Such a rule would represent an even greater departure from the Court’s precedent. E.g., *Midkiff*, 467 U. S., at 242. The disadvantages of a heightened form of review are especially pronounced in this type of case, where orderly implementation of a comprehensive plan requires all interested parties’ legal rights to be established before new construction can commence. The Court declines to second-guess the wisdom of the means the city has selected to effectuate its plan. *Berman*, 348 U. S., at 26. Pp. 13–20.

268 Conn. 1, 843 A. 2d 500, affirmed.
Kelo v. City of New London
Institute for Justice

Lawsuit Challenging Eminent Domain Abuse in New London, Connecticut

Susette Kelo received notice of condemnation from the NLDC (New London Development Corporation) the day before Thanksgiving 2000.

Susette Kelo dreamed of owning a home that looked out over the water. She purchased and lovingly restored her little pink house where the Thames River meets the Long Island Sound in 1997, and has enjoyed the great view from its windows ever since. The Dery family, down the street from Susette, has lived in Fort Trumbull since 1895; Matt Dery and his family live next door to his mother and father, whose parents purchased their house when William McKinley was president. The richness and vibrancy of this neighborhood reflects the American ideal of community and the dream of homeownership.

Tragically, the City of New London is turning that dream into a nightmare.

In 1998, pharmaceutical giant Pfizer built a plant next to Fort Trumbull and the City determined that someone else could make better use of the land than the Fort Trumbull residents. The City handed over its power of eminent domain—the ability to take private property for public use—to the New London Development Corporation (NLDC), a private body, to take the entire neighborhood for private development. As the Fort Trumbull neighbors found out, when private entities wield government’s awesome power of eminent domain and can justify taking property with the nebulous claim of “economic development,” all homeowners are in trouble.

The U.S. Supreme Court may have ruled but the fight is not over yet.

“The specter of condemnation hangs over all property. Nothing is to prevent the State from replacing any Motel 6 with a Ritz-Carlton, any home with a shopping mall, or any farm with a factory.
—Justice Sandra Day O’Connor

* * *
Greed
John Stossel, ABC News Special (1999)

Theme: What is “greed”? 
- Introduction at Vanderbilt mansion. Financier Milken, hotel magnate Helmsley, dictators Marcos and Duvalier, evangelist Bakker. 
- Ted Turner: private property and competition are good. 
- Contrast rich business person and rich sports figure or actor. Why are rich business people often vilified while rich actors or athletes aren’t? 
- Compare art, sports, etc. Greedy to create, greedy to win, greedy to learn. 
- Psychologist Julian Edney money-in-bowl experiment: Greed means short-range self-interested grasping? 
- Are rich people “Robber Barons”? 

Theme: Zero-sum or win-win? 
- Philosopher David Kelley: Zero-sum is a child’s view. In fact, producers create wealth, and the pie gets bigger. Most of the 19th century entrepreneurs started with nothing. They didn’t steal: they innovated and produced things people voluntarily traded for. 
- Example: Bill Gates got rich by creating value for trade. He persuaded customers. Win-win. 
- Contrast example: Baby Doc and other government dictators get rich by taking from others by force. They created no value. Zero-sum. 
- Example: buy a quart of milk at convenience store. Both parties say “Thank you.” 
- Cheaters? E.g., solar-powered clothes drier. Rarely get rich. 
- Vanderbilt’s achievement in ship transportation and Rockefeller’s achievement in oil: lower prices and higher quality. Luxuries become standard fare. Win-win. 
- Complaints about Vanderbilt and Rockefeller mostly from competitors who weren’t as productive. Lobbied the government for controls on V and R. 

Theme: Motivation of greed versus selflessness and helping others 
- Example: Red Cross non-profit lifeguards versus Jeff Ellis’s for-profit lifeguard company. 
- Ellis’s lifeguards: Better service, innovations, and lower price. 
- Complacence of the established non-profit. 
- Walter Williams: contrast results of caring versus results of self interest: grocery store, computers, FedEx, schools, post office, trash, police services 
- Profit motive as additional motive to serve others’ needs. 

Theme: Cooperation and self interest. 
- Supermarket and steak. Iowa ranch. Propane, packaging, trucking, and the hundreds of other functions involved in getting the steak from Iowa to New York. Do all of those people work hard and efficiently because they care about you, or do they work hard out of self interest? 
- Revisit bowl-in-money experiment: self interest and the profit motive leads people to learn how to cooperate.
Theme: Education and business education
- Example: Steve Mariotti as high school teacher at a traditionally weak school.
- What motivates the students? Prepare for business: see money-making possibilities, entrepreneurial ideas.
- Former students who are now successful: sports store owner, hot dog stands, music business.
- Kelley: Capitalism is the great equalizer: The poor need capitalism most. They need the opportunities that capitalism generates. They need the freedom from stifling regulations.

Theme: Executive pay and inequality
- Workers lost jobs because of high executive salaries? Aren’t large inequalities and disparities unseemly? Should we put limits on profits and salaries?
- Example: T. J. Rodgers and Cypress Semiconductor: started a one-man operation and was in debt and created a $1.5 billion company. “I earned it.” “I created value.” “I am a good guy.” “The world is better off when I make a buck.”
- Michael Eisner’s take home pay. Under Eisner’s tenure as CEO, Disney’s worth went from $2 billion to $53 billion. Eisner received one-half billion dollars (equals about one percent).
- Ben and Jerry’s ice cream: CEO pay experiment. Pay CEO only six times as much as line worker. Had to fire and hire another CEO at ten times. Same thing again.
- Union rally on Wall Street: Union leader John Sweeney. Ever turn down a raise?
- Counter-examples. CEOs who are paid much even when their companies are doing poorly.

Theme: “Giving back”—Philanthropy and charity
- Vanderbilt University
- Turner: billionaire Warren Buffet is a Scrooge because he doesn’t give more of his money away.
- Rodgers: Turner is saying something stupid: Business professionals are good at making money, and their making money helps those less well off by creating jobs. So to help others most, we should encourage successful businessmen invest their money rather than give it away.
- Kelley: making money is harder than giving away. He respects Turner more for his building CNN than he does for his donating money to the UN. Business is more humane than charity: it treats people as self-supporting instead of treating them as helpless mouths that need a handout.
- Who did more for the world: Michael Milken or Mother Teresa? Both helped people, but Milken helped more people and he helped them become self-supporting rather than as charity cases. Teresa suffered and was selfless; Milken got rich and was self-interested. But suffering is not the point; the point is to create value.

Summary:
- Greed as good versus greed as evil
- Self interest versus selflessness
- Private property *versus* public
- Competition *versus* regulation
- Win-win *versus* zero-sum
- Liberty as primary *versus* equality as primary
- Productivity *versus* charity

* * *
A 1975 Sears Catalog

Donald Boudreaux

Donald J. Boudreaux is Chairman of the Department of Economics at George Mason University in Fairfax, Virginia. He's held this position since August 2001. Previously, he was president of the Foundation for Economic Education (1997-2001); Associate Professor of Legal Studies and Economics at Clemson University (1992-1997); and Assistant Professor of Economics at George Mason University (1985-1989). During the Spring 1996 semester, he was an Olin Visiting Fellow in Law and Economics at the Cornell Law School. His Ph.D. in economics is from Auburn University (1986) and his law degree is from the University of Virginia (1992).

I just made my first purchase using eBay: I bought a Fall/Winter 1975 Sears catalog. (I paid $2.99 for the catalog and $13-something to have it shipped to me by FedEx.)

This catalog was issued at the start of my senior year in high school. I have decent memories of the mid-70s. Perusing this Sears catalog confirms my sense that my recollection of those days is pretty good.

The days themselves, however, were—compared to today—not so good.

Other than the style differences, the fact most noticeable from the contents of this catalog’s 1,491 pages is what the catalog doesn’t contain. The Sears customer in 1975 found no CD players for either home or car; no DVD or VHS players; no cell phones; no televisions with remote controls or flat-screens; no personal computers or video games; no food processors; no digital cameras or camcorders; no spandex clothing; no down comforters (only comforters filled with polyester).

Of course, some of what was available to Sears’ customers in 1975 is also quite noticeable to those of us looking back from 2006: typewriters, turntables for stereo systems, 8-track players, black-and-white television sets. And lots and lots of clothing and bedding made from polyester.

The lowest-priced electronic calculator available in this catalog set the citizen of 1975 back $13.88—it had a whooping six digits and could add, subtract, multiply, and divide.

Also available were microwave ovens, ranging in price from $189.95 to $439.95.

Of course, there’s been a good deal of dollar inflation since 1975. Judged by changes in the consumer-price index, what $100 bought in 1975 takes about $354 to buy today. So that six-digit calculator would today cost about $49. Sears lowest-priced microwave oven in 1975 would today set you back $672.
Here are some other 1975 products and their 1975 prices (along with their inflation-adjusted 2006 prices):

Sears Best kitchen range, $589.95 ($2,088).

Sears Best television, $749.95 ($2,655)

Sears Best black and white television, $137.95 ($488)

Sears Best typewriter, $278.99 ($988)

Sears Best motion-picture camera (no sound; but it did have 8X zoom!), $197.00 ($697)

Sears lowest-cost telephone answering machine, $99.50 ($352)

Sears highest-priced tent for four adults, $84.88 ($300)

But inflation is difficult to calculate. In a later post, I’ll take a page from the work of Michael Cox and Richard Alm and ask: how many hours did the American production worker have to work in 1975 to buy things from the Sears catalog? And how many hours must the average production worker today work if he were to buy 2006 versions of these things?

* * *

Café Hayek, January 30, 2006
http://cafehayek.typepad.com/hayek/2006/01/working_for_sea.html
We commonly read or hear reports to the effect that “If trend X continues, the result will be disaster.” The subject can be almost anything, but the pattern of these stories is identical. These reports take a current trend and extrapolate it into the future as the basis for their gloomy prognostications. The conclusion is, to quote a character from a famous British sitcom, “We’re doomed, I tell you. We’re doomed!” Unless, that is, we mend our ways according to the author’s prescription. This almost invariably involves restrictions on personal liberty.

These prophets of doom rely on one thing—that their audience will not check the record of such predictions. In fact, the history of prophecy is one of failure and oversight. Many predictions (usually of doom) have not come to pass, while other things have happened that nobody foresaw. Even brief research will turn up numerous examples of both, such as the many predictions in the 1930s—about a decade before the baby boom began—that the populations of most Western countries were about to enter a terminal decline. In other cases, people have made predictions that have turned out to be laughably overmodest, such as the nineteenth-century editor’s much-ridiculed forecast that by 1950 every town in America would have a telephone, or Bill Gates’s remark a few years ago that 64 kilobytes of memory is enough for anyone.

The fundamental problem with most predictions of this kind, and particularly the gloomy ones, is that they make a critical, false assumption: that things will go on as they are. This assumption in turn comes from overlooking one of the basic insights of economics: that people respond to incentives. In a system of free exchange, people receive all kinds of signals that lead them to solve problems. The prophets of doom come to their despondent conclusions because in their world, nobody has any kind of creativity or independence of thought—except for themselves of course.

A classic example of this is a problem that was getting steadily worse about a hundred years ago, so much so that it drove most observers to despair. This was the great horse manure crisis.

Nineteenth-century cities depended on thousands of horses for their daily functioning. All transport, whether of goods or people, was drawn by horses. London in 1900 had 11,000 cabs, all horse-powered. There were also several thousand buses, each of which required
12 horses per day, a total of more than 50,000 horses. In addition, there were countless carts, drays, and wains, all working constantly to deliver the goods needed by the rapidly growing population of what was then the largest city in the world. Similar figures could be produced for any great city of the time.* (*See Joel Tarr and Clay McShane, “The Centrality of the Horse to the Nineteenth Century American City,” in Raymond Mohl, ed., The Making of Urban America (New York: SR Publishers, 1997), pp. 105–30. See also Ralph Turvey, “Work Horses in Victorian London” at www.turvey.demon.co.uk.)

The problem of course was that all these horses produced huge amounts of manure. A horse will on average produce between 15 and 35 pounds of manure per day. Consequently, the streets of nineteenth-century cities were covered by horse manure. This in turn attracted huge numbers of flies, and the dried and ground-up manure was blown everywhere. In New York in 1900, the population of 100,000 horses produced 2.5 million pounds of horse manure per day, which all had to be swept up and disposed of. (See Edwin G. Burrows and Mike Wallace, Gotham: A History of New York City to 1898 (New York: Oxford University Press, 1999).

In 1898 the first international urban-planning conference convened in New York. It was abandoned after three days, instead of the scheduled ten, because none of the delegates could see any solution to the growing crisis posed by urban horses and their output.

The problem did indeed seem intractable. The larger and richer that cities became, the more horses they needed to function. The more horses, the more manure. Writing in the Times of London in 1894, one writer estimated that in 50 years every street in London would be buried under nine feet of manure. Moreover, all these horses had to be stabled, which used up ever-larger areas of increasingly valuable land. And as the number of horses grew, ever-more land had to be devoted to producing hay to feed them (rather than producing food for people), and this had to be brought into cities and distributed—by horse-drawn vehicles. It seemed that urban civilization was doomed.

Crisis Vanished

Of course, urban civilization was not buried in manure. The great crisis vanished when millions of horses were replaced by motor vehicles. This was possible because of the ingenuity of inventors and entrepreneurs such as Gottlieb Daimler and Henry Ford, and a system that gave them the freedom to put their ideas into practice. Even more important, however, was the existence of the price mechanism. The problems described earlier meant that the price of horse-drawn transport rose steadily as the cost of feeding and housing horses increased. This created strong incentives for people to find alternatives.

No doubt in the Paleolithic era there was panic about the growing exhaustion of flint supplies. Somehow the great flint crisis, like the great horse-manure crisis, never came to pass.

The closest modern counterpart to the late nineteenth-century panic about horse manure is agitation about the future course of oil prices. The price of crude oil is rising, partly due to political uncertainty, but primarily because of rapid growth in China and India. This has led
to a spate of articles predicting that oil production will soon peak, that prices will rise, and that, given the central part played by oil products in the modern economy, we are facing intractable problems. We’re doomed!

What this misses is that in a competitive market economy, as any resource becomes more costly, human ingenuity will find alternatives.

We should draw two lessons from this. First, human beings, left to their own devices, will usually find solutions to problems, but only if they are allowed to; that is, if they have economic institutions, such as property rights and free exchange, that create the right incentives and give them the freedom to respond. If these are absent or are replaced by political mechanisms, problems will not be solved.

Second, the sheer difficulty of predicting the future, and in particular of foreseeing the outcome of human creativity, is yet another reason for rejecting the planning or controlling of people’s choices. Above all, we should reject the currently fashionable “precautionary principle,” which would forbid the use of any technology until proved absolutely harmless.

Left to themselves, our grandparents solved the great horse-manure problem. If things had been left to the urban planners, they would almost certainly have turned out worse.

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