Regulating the Economy

4 The Framers and the Roots of Economic Prosperity Robert E. Wright discusses the economic beliefs and policies of the founders, focusing on the contrasting views of Alexander Hamilton and Thomas Jefferson regarding the role and powers of a central government. He discusses how Hamilton's views eventually won the day and continue today.

8 The Federal Reserve and the U.S. Economy Bernard Shull traces the history of the Federal Reserve from its establishment in 1913 to current times, documenting the Fed's growing power and influence. He also identifies the key political conflicts and financial crises of the nineteenth century that led to its creation.

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National Standards for Civics and Government
- I-B. What are the essential characteristics of limited and unlimited government? [political and economic freedoms]
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National Content Standards in Economics
- 5. Gain from Trade
- 6. Specialization and Trade
- 10. Role of Economic Institutions
- 20. Monetary and Fiscal Policy

Standards from the National Council for the Social Studies
- VII. Production, Distribution, and Consumption
- IX. Global Connections

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- Supplemental handouts to accompany articles in this issue of Insights;
- Additional lesson ideas from the Council for Economic Education and PBS' NewsHour Extra;
- Free resources from the Federal Reserve Bank;
- Simulations to use with students;
- Primary sources;
- Much more!

Leave comments for Insights editors while you are there!
Director’s Note
During the past year, we have witnessed a severe economic downturn here in the United States and around the world. Beginning with new housing slowdowns and home foreclosures, the crisis spiraled to the credit and financial markets and then to the auto industry, retail sales, and virtually every business. With the national unemployment rate approaching ten percent, the United States is reeling from one of the worst recessions of the past one hundred years. What has been the effect of the law on banking, business, and the global economy?

This issue of Insights seeks to shed light on the current economic crisis by examining the role of government in regulating the economy, from the framers to the reformers of the nineteenth century to the federal government’s responses to economic crises, past and present. Robert E. Wright begins by examining the economic views and policies of the framers—in particular, the long-running conflict between Alexander Hamilton and Thomas Jefferson over the role and powers of the federal government. This conflict, he shows, was a political and philosophical debate that had profound implications for the economic growth and well being of the United States. Bernard Shull picks up the narrative by tracing the rise of the Federal Reserve (Fed), from the ashes of two U.S. national banks to the Fed’s creation in 1913 and its stature today, weaving a story of economic crisis and rebound. In Law Review, Charles F. Williams analyzes the government regulation of banks, by focusing on a recently decided U.S. Supreme Court case involving the state of New York and the fair lending practices of banks.

The United States is no island, either of economic prosperity or distress. We live in a global economy, characterized by the spread of multinational corporations, industry relocation from developed to developing countries, and liberalized trade among countries and regions, some but not all anchored in the rule of law. Pietra Rivoli explores these themes in her discussion of international trade—in particular, the balancing of economic gains and losses with the rise of labor, human rights, and environmental standards in the workplace. In “Perspectives,” Katherine Marshall and Howard Stein address the mission, influence, and strengths and weaknesses of a leading international financial institution, the World Bank. In “Students in Action,” Colleen Danz relates an inspiring narrative of high school students from Las Vegas, who raised more than $25,000 to establish a microbank and make small loans to new entrepreneurs in developing countries.

Don’t forget to visit Insights online at www.insightsmagazine.org. There you will find more resources to use with students as you explore the ways in which the economy is built upon a foundation of law.

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The Framers and the Roots of Economic Prosperity

A story of Hamilton, Jefferson, and the influence of Albert Gallatin

by Robert E. Wright

The founders began the two-centuries-old debate on the role of the federal government in the economy. In this article, economist Robert E. Wright explores the contrasting economic philosophies of Alexander Hamilton and Thomas Jefferson within the broader political climate of both the colonial era and subsequent generations.

Thomas Jefferson loathed Alexander Hamilton, who responded in kind. The men’s dislike for each other is the stuff of legend. Hamilton tried to throw the deadlocked election of 1800 to Aaron Burr. Jefferson eventually won anyway and retaliated by instructing his treasury secretary, the Swiss-born one-time whiskey rebel Albert Gallatin, to mine the Treasury Department’s files for dirt on Hamilton. Jefferson was said to be sorely disappointed when Gallatin returned empty-handed. Although once a staunch critic of Hamilton, Gallatin did more than shield Hamilton’s reputation from Jefferson’s wrath, he prevented his boss from rapidly reversing Hamilton’s economic policies. In so doing, Gallatin saved the nascent American economy from the bane of what economists today call politically motivated policy switching. Jefferson and his followers implemented a few economic policy reforms but typically quickly reversed course and returned to the path blazed by Hamilton.

The Great Reversal

Jefferson and Hamilton first butted heads in the early 1790s while serving as secretary of state and treasury secretary, respectively. The stakes were high because the situation was dire. America’s economy emerged from the Revolution badly battered. The severing of colonial trade connections and wartime hyperinflation conspired to wreck the money supply at the very moment that the national and state governments groaned under the heavy debts they incurred fighting the British. In a desperate attempt to revive public credit by making good on promises to their creditors, some state governments taxed farmers into the ignominy of sheriff sales and debtors’ prison. Other states took the opposite approach and wallowed in bankruptcy and fiscal profligacy. The national government, a clumsy confederation of the states, could barely raise enough revenue to function, much less to repay its huge debts. Few believed the weak national government could protect American trading interests abroad, defend the nation’s boundaries from the incursions of foreign powers and American Indians, or prevent states from fighting trade or even shooting wars with their neighbors. Unsurprisingly, the postwar

“Jefferson, Madison, and Monroe eventually embraced Hamilton’s policies.”

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economy remained mired in the muck with few willing to venture more than a season’s seed or a voyage’s cargo.

Out of the depths of despair sprang hope in the form of the constitutional convention. Nobody thought the document that emerged from Philadelphia in September 1787 was a perfect frame of government. Many of those in the agricultural hinterlands feared the Constitution created a leviathan that would prove as predatory as King George himself. Those more conversant with the document’s numerous checks and balances feared the opposite—a national government too weak and a society too fractured by sectional animosities for life, liberty, or property, the wellsprings of prosperity, to find adequate shelter. Nevertheless, thanks to the persuasive Federalist Papers (co-authored by Hamilton, James Madison, and New York jurist John Jay) and some political hardball, state after state joined the new union. Over the second half of 1788 and 1789, the new national government slowly organized. In September 1789, Congress created the Treasury Department, and soon after the Senate confirmed Hamilton as its first leader.

Hamilton set to work immediately. First, he helped to shore up the government’s revenue by establishing an efficient customs collection system. Hamilton neither advocated nor sought protective tariffs, taxes on imports high enough to protect domestic producers from foreign competition. Rather, for each good he chose the tariff rate that he believed would maximize government revenue, which he correctly understood as the rate at which people would continue to legally import the good in large quantities. To prevent domestic substitution of the most highly taxed items (“sin” items like hard liquors), Hamilton also implemented domestic excise taxes on products like whiskey. Cognizant that the government relied heavily on tariff revenues, Hamilton advocated the policy of trade and diplomatic neutrality most famously laid out in Washington’s Farewell Address, a document he drafted for his beloved erstwhile boss. (For that address, see http://avalon.law.yale.edu/18th_century/washing.asp.)

Under his funding and assumption programs, Hamilton pledged those tariffs and other taxes to interest and principal payments on the national debt and most of the debts incurred by the several states during the Revolution. In the process, Hamilton rationalized the capital markets by converting scores of little traded and less understood government debt instruments into just three types of bonds, each of which traded with alacrity in the nation’s major seaboard cities, including Boston, New York, Philadelphia, and Baltimore. As Hamilton predicted, the new bonds circulated widely, providing widows, orphans, and other long-term investors with a haven for their savings and merchants, bankers, and corporations with a liquid but remunerative form of capital. Also as Hamilton predicted, the government’s Three Percent, Six Percent, and Deferred bonds cemented the union together by tightly tying diverse and geographically far-flung bondholders to the national government. (Students can track early U.S. government bond transactions and owners here: http://eh.net/databases/govtbond/.)

To ensure that the federal government would be able to make the quarterly interest payments on the new bonds even if tax collections fell short, Hamilton pushed for the creation of the Bank of the United States (BUS). Following its highly successful direct public offering of stock on July 4, 1791, the Bank formed under the conservative stewardship of Philadelphia merchant Thomas Willing. The erstwhile partner of Robert Morris, America’s finance minister during the fiscally bleak final years of the Revolution, the staid Willing had successfully run the nation’s first commercial bank, the Bank of North
America (BNA), since early 1782. Like the BNA, the BUS was headquartered in Philadelphia, America’s financial center until 1836. The BUS, however, was much larger than the BNA and soon established branches in Boston, New York, Charleston, and other important commercial centers.

In addition to collecting, holding, transferring, and disbursing the government’s money, the BUS served as a lender of last resort both to the government and to the new financial system that sprang up in the wake of Hamilton’s reforms. (Students can examine the prices of the early financial securities here: http://eh.net/databases/early-us-securities-prices.) In the spring of 1792, the BUS helped Hamilton squelch a financial panic fomented by excessive bank lending and the unprincipled speculations of William Duer, who had once been Hamilton’s right hand man at Treasury. Although largely a private institution, the Bank thereafter acted like a government regulator, dissuading state banks from taking on excessive risks by promptly redeeming their notes for specie, the gold and silver coins that composed the bank reserves of the day. Hamilton also defined the U.S. dollar as a unit of account, and, with the help of Philadelphia businessman and political chameleon Tench Coxe, encouraged Americans to consider attempting industrial pursuits such as textile manufacturing.

By the time Hamilton left office in early 1795, his policies, combined with the political stability provided by the Constitution, had dramatically transformed the U.S. economy. Per capita output and manufacturing activity had begun to grow at modern rates. (For these data, see: http://www.measuringworth.org/usgdp/ and http://www.nber.org/data/industrial-production-index/, respectively.) Farmers still predominated, but corporations—including banks, bridges, canal and harbor companies, insurers, manufacturers, mining companies, and turnpikes—increasingly dotted the countryside. The government’s bonds remained in demand at home and abroad at yields usually only a little higher than those on Britain’s government-funded security, Consols. America wasn’t perfect, but an influx of immigrants suggested that its prospects were brighter than elsewhere.

The “Revolution” of 1800

Despite the ebullient economy, Jefferson and his Democratic-Republican followers found fault with Hamilton’s policies. They argued that the national government should not have assumed the state’s debts. They believed that enlarging the national debt would give the federal government too much power by providing it with an excuse to increase taxes on the poor in order to satiate the money lust of rich bondholders, grasping placemen holding lucrative government sinecures, and evil securities speculators, leeches that sucked the lifeblood out of civil society by buying securities low and selling them high. For those reasons, Jeffersonians wanted to pay off the national debt as quickly as possible, not over several decades as Hamilton planned to do.

Jeffersonians also disliked the BUS because the mammoth institution appeared to favor rich merchants over poor artisans and farmers. Moreover, they feared the Bank could be used to sway elections in favor of Hamilton’s followers, the Federalists. If left unchecked, the Bank might combine with the Society of the Cincinnati, a hereditary order of Revolutionary War officers formed by Hamilton and others in 1783, to create an American aristocracy. Additionally, they argued that the BUS was unconstitutional and unnecessary for the proper functioning of the government or the economy. Many Jeffersonians also worried about the hundreds of other corporations sprouting up like mushrooms around the country because the economic modernization that they heralded threatened to sap the vitality out of America’s agricultural heritage and the peculiar institution called slavery.

Excise taxes on whiskey and direct federal taxation of slaves and real property, begun in 1798 to help finance an undeclared naval war against France, also irked Jefferson and his followers, who backed revolutionary France in its titanic struggle against Britain. Although actually a strong advocate of neutrality, Hamilton appeared to be an anglophile and francophile to Jefferson’s camp, which felt it morally imperative to help the French to achieve independence from Britain and their domestic feudal overlords just as France had helped America during its Revolution.

Jefferson’s election in 1800, however, was more about civil liberties than economic policy or international diplomacy. Many Americans, including wealthy Franco-Philadelphia merchant Stephen Girard, thought the Federalists had grown too powerful and arrogant, as manifested by their infamous Alien and Sedition Acts, their military buildup, and their apparent refusal to grant corporate bank charters for Democratic-Republican groups in Philadelphia and New York. The election was nevertheless a close one, as many voters worried that Jefferson would undo the Hamiltonian economic policies that were rapidly making America rich.

We’re All Hamiltonians Now

Had Jefferson gotten his way, he would have destroyed the BUS by withdrawing federal deposits from it as Andrew Jackson later would do to the second Bank
of the United States (SBUS). Jefferson also would have weakened the securities markets by imposing heavy transaction taxes and neutralized the national debt by paying it off as quickly as possible. That would have entailed neglecting the armed forces and imposing discriminatory duties against British imports, among other potentially dangerous policies. Worse, such large-scale policy switching would have cast great doubt on the ability of the new government to keep its promises or maintain pro-growth policies over the election cycle. Although by all accounts a rather dull personality, Gallatin managed for the most part to keep Jefferson's animosity toward the financial system in check.

Jefferson and his successors, Madison and fellow Virginian plantation owner James Monroe, eventually embraced Hamilton's policies in fact if not in political rhetoric. By the end of the Jeffersonian Revolution in 1825 (when John Quincy Adams, son of the man Jefferson defeated in 1800, took office), Hamilton’s policies had been vindicated and extended. Hamilton argued that public credit would help America build a mighty empire; Jefferson sold Hamilton-style bonds to buy Louisiana, the single greatest land transaction in history. Hamilton said government bonds would keep the nation together; the two most important secessionist movements before the Civil War occurred at times and in places, New England in 1814-15 and South Carolina in 1832-33, where government bonds were barely present. Hamilton predicted that a trade war against Britain would prove disastrous; Jefferson failed to bring it to terms with an embargo that almost ruined the American economy. The BUS would prove instrumental during war, Hamilton foretold. Jeffersonians allowed its charter to lapse in 1811 and then found financing the War of 1812 so difficult without it that they created the SBUS in 1816. By fighting the war against Britain that Hamilton had wished to avoid, the Jeffersonians ironically had to embrace Hamilton’s system of excise and other internal taxes. The war also greatly increased the national debt and delayed its extinguishment by almost two decades. Soon after, the government found it expedient to create a new national bank.

To this day, the U.S. government remains in debt, financing its deficits by selling Hamiltonian bonds. The country did without a central bank for almost eight decades after 1836. But in the early stages of World War I, the government brought a new one, the Federal Reserve System, into action. The United States also abandoned revenue tariffs for much of the nineteenth century, but today, as a major force in the World Trade Organization, it generally avoids protectionism. Failed attempts to topple undesirable regimes in Cuba, Iraq, and elsewhere through trade embargoes continually remind us that Hamilton was right about the ineffectiveness of most such measures. Finally, corporations have long been the most important form of business organization in America.

Despite occasional tribulations, the U.S. economy is unsurprisingly the largest and most dynamic in the world. The framers of the Constitution—Hamilton, Gallatin, and later policymakers who favored the commonwealth over temporary partisan interests—made it all possible.

For Further Reading


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**FOR DISCUSSION**

1. How do you think Hamilton’s and Jefferson's views about the economy reflected their beliefs about the role of the federal government in our political system? How might Hamilton and Jefferson feel about the current Federal Reserve System?

2. The author asserts that when Thomas Jefferson was elected president in 1800, he attempted to implement “politically motivated” economic policies. What does this mean? Do you think presidents today are politically-motivated in their economic policies? How might politically motivated policies differ from other policies?

3. What is national debt? How is it different from the “deficit”? What do you think are the political consequences of significant national debt? Deficits?

4. Do you agree that we are all “Hamiltonians” today? Why or why not? What does it mean to be a “Hamiltonian?”
The Federal Reserve System (Fed) has been in place for nearly one hundred years. In this article, economist Bernard Shull traces the history of central banking from the early days of the republic, the forces leading to the creation of the Fed, and the growth in the Fed’s power and influence as it grappled with one economic crisis after another for the past century.

In the fall of 2008, the Federal Reserve System, America’s central bank known as the “Fed,” stepped into a breach that it believed threatened economic catastrophe. It adopted new techniques and created massive programs to expand credit. But into the breach is what the Fed’s founders intended. Throughout its history, the Fed has both thrived and almost died in crises that have beset the country. The “how” and “why” of this narrative begin with the periodic waves of financial distress that afflicted the nation before there was a Fed.

Before the Fed

Through the nineteenth and into the twentieth century, the United States was beset by a series of financial crises. Between 1873 and 1907, there were five major crises and numerous minor ones. The National Banking Act of 1863 established national banks to issue a new currency, National Bank Notes, and a new regulator, the Comptroller of the Currency. But these reforms proved inadequate because they did not provide for any central organization from which troubled banks could borrow or obtain additional currency during crises to meet the demands of their depositors.

By 1900, European experience had shown that newly developed “central banks” were useful in forestalling panics. But there were none in the United States. The Second Bank of the United States, chartered by Congress in 1816 (the first had been closed in 1811), might have evolved into a central bank. In the 1820s, under the leadership of its president Nicholas Biddle, it constrained the excessive expansion of credit by state-chartered commercial banks and stabilized the currency.

Upon Andrew Jackson’s election as president in 1828, the Bank became controversial. Jackson saw the Bank as a privileged recipient of government favors, a dangerous concentration of private economic power, and unconstitutional despite a contrary holding by the Supreme Court in *McCulloch v. Maryland* (1819). Jackson vetoed a bill to recharter the Bank in 1832. After his reelection to a second term, he withdrew the government’s deposits. The Senate censured Jackson, terming the withdrawal arbitrary. Biddle tightened credit, thereby causing

“Through its history, the Fed has both thrived and almost died in crises that have beset the country.”

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insufficient to meet the demands of depositors and convert their deposits to currency. Banks, however, did not have and could not obtain enough deposits to readily meet their demands. Banks responded by suspending convertibility. Doing so, in the terminology of today, resulted in a “freezing up” of credit, along with rising interest rates and a stock market collapse.

When the panic finally ended in 1908, Congress established a National Monetary Commission to study the problem. Chaired by Nelson Aldrich, a Republican senator from Rhode Island, the Commission held extensive hearings and published numerous papers. In the end, the chairman submitted a plan for a National Reserve Association, a regionally partitioned central banking organization owned by its commercial bank members. 2

The Commission was at pains to distinguish the checks and balances provided under its proposal from Nicholas Biddle’s singular domination of the Bank of the United States or from secretive foreign central banks seemingly detached from democratic restraints. Democrats, nevertheless, rejected the bill as a product of a Wall Street cabal. “The spectre of Andrew Jackson,” Howard Cowperthwait of the Chamber of Commerce observed, “stood at the portals of Congress to destroy any attempt to centralize banking.” 3

The Federal Reserve, 1913-2000

Woodrow Wilson, the Democratic candidate for president in 1912, recognized the need for an elastic currency. But, he declared, banking is “so much a public business that the government must share with private bankers in making fundamental financial decisions ...” 4 After Wilson’s election, Carter Glass, Chairman of the House Banking Committee, undertook to design a plan that would balance private and government interests.

The result was the Federal Reserve Act that became law on December 23, 1913. It created 12 Reserve Banks in 12 separate districts, each located in a major city. They were to be owned and generally governed by the commercial banks that were members of the system. The Act also established a Federal Reserve Board in Washington, composed of five presidential appointees and both the secretary of the treasury and the comptroller of the currency, ex officio. The Reserve Banks would be the operating arm of the system, lending to banks at a discount rate, clearing checks, and providing a new kind of currency, Federal Reserve Notes, that could expand and contract with demand. The Board would represent the public interest through oversight and supervision of the Reserve Banks. In a burst of optimism, the comptroller of the currency announced in his Annual Report for 1914 that “financial and commercial crises, or panics ... now seem to be mathematically impossible.”

The powers conferred on the Fed were, in fact, modest. The checks and balances afforded by multiple Reserve Banks and the Board were amplified by ambiguity as to who was in charge. At the beginning, it was not clear how the Fed would operate, or, given the history of the two Banks of the United States, whether it would even survive.

The Early Years. The Fed opened for business in November 1914, but with little effect. In 1915, Benjamin Strong, Governor of the Federal Reserve Bank of New York, later to become the de facto leader of the system, wrote “the one discouraging thing about the Federal Reserve System lies in its inability to find a normal and natural place in the banking structure of the country. Just now we seem to be a sort of excrecence.” 5 The system, he added, will not establish itself “... until it has met the test of a real crisis.”

The crisis arrived with America’s entry into World War I. The Fed took on the job of assisting the Treasury in raising funds. The Reserve Banks became bond-distributing agencies, promoting their sale, providing cheap credit to banks that could then lend to purchasers, assuring the Treasury low-cost funds. After the war, the Treasury and the public acknowledged the Fed’s contributions in the national emergency.
Crises and Growth. Over the next 65 years, the modern Federal Reserve was forged in several episodes of economic distress. In each, critics attributed the distress to the Fed's own misguided policies, calling for radical reorganization or even dissolution. From each crisis, however, the Fed emerged more powerful and influential.7

The first transforming episode occurred shortly after the end of World War I. In 1919, still accommodating the Treasury’s demands for low-cost funds, Reserve Banks held their discount rates too low to prevent inflation. Finally released from their obligations to the Treasury in late 1919, the Reserve Banks raised rates quickly. There followed a contraction of credit, deflation, and depression. Angry farmers blamed the Fed for the plummeting values of their land and crops.

A congressional investigation in 1921 largely exonerated the Fed, while implicating the Treasury for delaying the Fed’s release from “easy money.” The Fed was encouraged to develop its policies independently. In 1922 and 1923, the Fed formulated a new approach to stabilizing economic activity through a new monetary policy tool — open market operations.8 Through the purchase and sale of securities, the Fed found it could better influence interest rates and credit markets.

Over the next five years, the Fed was enormously successful in promoting economic prosperity. It was generally recognized to be in the forefront of the world’s central banks.

However, the stock market crash in October 1929, followed by deflation, financial panic, and a decade of high unemployment changed everything. Unable to stem decline into the Great Depression, the Fed came under furious attack. Some critics called for its dissolution. During his first term as president, Franklin Roosevelt largely ignored the Fed, relying instead on the Treasury for monetary operations.

Ultimately, the president and Congress agreed that the Fed should be reorganized. The Banking Act of 1935 shifted power from the Reserve Banks to a new Board of Governors, no longer including the secretary of the treasury and the comptroller. The shift muted internal conflicts that had plagued the Fed during the 1920s and seemingly provided it with greater independence from the Treasury. The act also gave the Board authority, for the first time, to alter reserve requirements. An earlier act provided the Board with regulatory authority over bank holding companies, eventually serving to establish the Fed as the preeminent federal bank regulator.

During World War II, the system again relinquished conventional monetary policy to assist the Treasury. It pegged interest rates to assure a ready market for government securities at low cost. After the war, the Treasury was again reluctant to release the Fed and did so only under congressional pressure that produced an “Accord” in 1951.

From 1951 through the 1970s, notwithstanding increasing concerns about the international balance of payments, the Fed honed its policies and tools with the principal aim of maintaining full employment and stable prices. In the 1970s, however, the Fed found that it could not have both, and then it found it could have neither.

Beginning in 1973, the Fed tried to jump-start a stagnant economy that had developed alongside accelerating inflation. “Stagflation” inspired economist Arthur Okun to construct a “Misery Index” that added the rate of inflation to the unemployment rate. In 1973, with the unemployment rate at 4.9 percent and the inflation rate at 6.2 percent, the Index stood at 11.1. By 1979, inflation had risen to 11.4 percent, and with unemployment at 5.8 percent the Misery Index had leapt to 17.2.

In October 1979, under the Chairmanship of Paul Volcker, the Fed initiated a vigorous tight money policy in response to inflation. The result was a difficult three years that included two recessions, interest rates reaching unprecedented double-digit levels, and significant damage to real estate, construction, and the savings and loan business. During these years, the Fed was attacked by a wide spectrum of groups and individuals. For example, Nobel award-winning economist Milton Friedman recommended that the Fed either be placed under direct congressional control or made a bureau in the Treasury.9

By the end of 1982, the worst was over. Inflation had moderated, and economic growth resumed. The Fed had survived again. Although Congress established greater oversight of the Fed, it also extended the Fed’s reach. Reserve requirements were imposed on nonmember banks (thereby eliminating a principal reason for bank withdrawals from membership in the System), as well as on savings institutions and credit unions. The Fed found additional success in resisting those who believed it should relinquish its regulatory authority. With passage of a major regulatory reform, the Gramm-Leach-Bliley Act of 1999, the Fed became the umbrella regulator for financial holding companies, which were permitted to own a wide variety of financial businesses, including commercial and investment banks and insurance companies.

The Federal Reserve Today
The Federal Reserve entered the twenty-first century under the leadership of the iconic chairman, Alan Greenspan. In 2006, he retired and was
replaced by Ben Bernanke, a Princeton University economist and a former member of the Board.

In 2008, the Fed confronted a crisis arising from the collapse of the sub-prime mortgage market, a stock market crash, and a steep decline in economic activity. With broad authority under the Federal Reserve Act, it purchased long-term as well as short-term debt, including mortgage-backed securities; loaned enormous sums to banks; provided credit to other lenders under stress; and, in general, flooded the banking system with reserves to reduce interest rates and “unfreeze credit.” It expanded its assets in an unprecedented fashion, from about $900 billion in August 2008 to more than $2 trillion in August 2009.

Just as in the past, in the course of the current crisis, the Fed has been blamed for policies that some believe caused it. The Obama administration, nevertheless, is poised to extend the Fed’s regulatory authority to all financial firms whose failure might jeopardize economic stability — to make it the government’s systemic regulator. As a result, the Fed is likely to grow in this crisis as it has in earlier ones, buffeted by criticism, preserved by necessity, and amplified in the conviction that similar economic crises need not happen again. ■

Notes
7. For a more extensive discussion of these episodes, see Bernard Shull, The Fourth Branch: The Federal Reserve’s Unlikely Rise to Power and Influence (Westport, Connecticut: Praeger, 2005), Chs. 3-5.

For Further Reading
See also current Federal Reserve programs to support credit and liquidity at www.federalreserve.gov/monetarypolicy/ bst.htm

F O R  D I S C U S S I O N
1. How was the Federal Reserve System different from earlier banking systems in the United States? Why do you think that it has survived for as long as it has?
2. Why do you think that the Federal Reserve has grown as it has had to cope with economic crises over time?
3. Why is the chair of the Federal Reserve so powerful today? Is this good or bad? How do decisions made by the Fed affect ordinary Americans?

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Who’s Afraid of International Trade?

Trade policies affect lives, economic well-being, and perceptions of fairness.

by Pietra Rivoli

Globalization raises a set of complex economic and social issues. In this article, economist Pietra Rivoli explores the benefits and criticisms of free trade policies—i.e., international trade without barriers (such as tariffs). In particular, she examines the relationships among free trade, the availability of products (e.g., electronics and clothing) at low cost, consumer choices, and environmental and wage standards.

My normal commute of about 15 minutes stretched to over an hour for a few days earlier this year. The culprit was the annual meeting of the World Bank and the International Monetary Fund (IMF), held in Washington, D.C. But in 2009 it was not the normal logjams caused by lines of limos and taxis ferrying the VIPs about. Most of the traffic problems were the result of widespread street protests targeted particularly against the IMF. These protests had attracted hundreds of participants, turning the streets surrounding the World Bank/IMF meetings into a scene of chaos.

For me, the street protests represented not only traffic jams, but also a déjà vu of sorts. A decade earlier, similar protests had enveloped Washington, and indeed, the protests became a staple of the evening news during about a five-year period beginning in 1999. These protests took place not only in Washington but also around the globe as the far-flung antiglobalization movement gained traction and attention. In addition to the IMF and World Bank, a variety of multinational organizations and corporations were also targets.

On university campuses, the antiglobalization movement was targeted especially at the supply chain practices of large multinational corporations. What was the true price of the cheap T-shirts in the university bookstores? If the clothing was produced using exploitive and unfair labor practices in unsafe, Dickensian sweatshops, then was not the “outsourcing” and international trade behind such a system to blame?

I decided to take a personal approach in investigating this question. I began to investigate the life story of a T-shirt, to see how the biography of this simple product could inform the globalization debate. The result of my investigations was the book *The Travels of a T-Shirt in the Global Economy* (Wiley, 2005, 2009). The T-shirt’s story is a story of trade: Texas cotton is shipped to China, textiles and apparel return to America, and used clothing is sold to Africa. A variety of lessons about international trade emerged—and continue to emerge—from the story of this everyday product.

“Antitrade sentiment has a long and illustrious history.”

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The Antiglobalization Movement

At first, the antiglobalization movement appeared to be something occurring within a radical fringe, rather than on Main Street. However, during the 2004-2009 period, concerns about international trade developed into a significant Main Street phenomenon. Opinion polls showed growing wariness about international trade: The Pew Research Center found that while in 2003 over 78 percent of Americans were generally supportive of international trade, by 2008 barely half of those surveyed were broadly supportive. Americans were also less favorably disposed toward trade than the citizens of any other industrialized country.

The Main Street concerns regarding international trade were crystallized in the 2008 presidential and congressional elections. In the Democratic primary, both Barack Obama and Hillary Clinton sounded fairly strong messages about the dangers of globalization and unfair trade, with camera-ready promises to, for example, “renegotiate” the North American Free Trade Agreement (NAFTA) and “get tough” with China. Whatever the substantive merits of the trade-reticent positions, it was abundantly clear in 2008 that an antitrade message was politically expedient.

Of course, antitrade sentiment has a long and illustrious history. Early Christians, with very few exceptions, thought trade was quite a bad idea. The ancient Greeks, particularly Aristotle, thought similarly. The ideal of self-sufficiency, especially for the Greeks, mitigated against trade, while Christians put forth a variety of arguments in support of the view that commerce in general, and trade in particular, was against God’s will. In his marvelous book, Against the Tide, economist Douglas Irwin presents a history of these arguments, from the ancients to the present.

All of this is to say that while the antiglobalization movement that had stalled my commute at first glance might appear to be limited to a fringe element of protestors on the evening news, the reality is that wariness regarding international trade has both a long history and a solid hold on Main Street public opinion.

Why the Objections to International Trade?

There is a sharp divide between the opinions of professional economists and the general public on the subject of trade. Virtually without exception, economists view the free flow of goods and services across borders as the best economic policies. Indeed, Douglas Irwin (p. 3) writes that free trade might be the best practical idea ever proposed by economists: “The case for free trade has endured because the fundamental proposition that substantial benefits arise from the free exchange of goods between countries has not been overshadowed by the limited scope of various qualifications and exceptions. Free trade thus remains as sound as any proposition in economic theory, which purports to have implications for economic policy, is ever likely to be.”

The economic case for free trade rests on the argument that the free exchange of goods and services will result in higher national income. In other words, if the object of the game is to create the biggest pie of wealth, then free trade is the demonstrably superior means of achieving this goal. Volumes of research have confirmed this conclusion. Countries with fewer barriers to trade clearly outperform those with high barriers on measures of economic growth. By allowing countries to specialize in those goods and services in which they have a comparative advantage, liberal trade is a “win-win” for all countries. Almost by definition, the policy—free trade—that results in the highest economic growth is the best economic policy.

Although the pie may indeed be bigger under free trade regimes, trade produces losers as well as winners within individual countries. The claim that...
The World Bank, the world's leading development institution, works with poorer countries (about 120 in all) on virtually every facet of their development challenges. A multilateral, international organization, the World Bank has many roles including intellectual leadership (helping to set the global agenda and provide analytic support and research), financial support, coordination of external aid programs, and advocacy for development-linked causes. Its bold ambition, that fires many World Bank staff, is on display at the entrance to its Washington, D.C. headquarters: “Our dream is a world free of poverty.”

The World Bank is a specialized agency of the United Nations (UN), created at the 1944 Bretton Woods conference, a year before the UN itself; the International Monetary Fund is often referred to as the World Bank's “twin” because they were established at the same time. The IMF typically focuses on short-term crises and the international monetary system, while the World Bank has a broader mission of reconstruction and development.

The World Bank Group includes the International Bank for Reconstruction and Development nicknamed the “World Bank,” the International Development Association, and affiliated institutions such as the International Finance Corporation; see www.worldbank.org.

As of today, the World Bank has 185 member countries, its owners and masters. Countries subscribe through financial contributions; their voting rights and authority over policies and operations are relative to capital share. One of the dominant and most controversial facts about the World Bank is that voting shares reflect economic strength, so wealthier countries have greater power. While the Bank's efforts extend beyond public authorities, its ultimate responsibility is to governments. It is neither a private bank nor a private charity or foundation, but rather a public-sector institution whose shareholders (governments) have strong influence.

The World Bank is a dynamic institution whose role has changed so much over time that it would be barely recognizable to its founders. Changing understandings of what makes for economic and social progress as well as fundamental changes in international relations have shaped its evolution. When the Marshall Plan in 1947 took over the primary role its creators had in mind (financing Europe's postwar reconstruction), the Bank's core mission evolved towards development. Initially (in the 1950s to 1970s), this was linked to capital investment, especially in infrastructure (e.g., roads, port facilities, power stations and grids, and irrigation infrastructure—financing Japan's Bullet Train is a large and prominent early example). Today, however, human development (education and health), environment, and participation by communities in programs that affect them are considered the leading factors in social change. Investments without a sound policy framework are almost always futile. And the “hows” as well as the “whats” of programs, especially honest and transparent administration (including fighting corruption), make a world of difference. Even so, the Bank never lost its reconstruction role; it responds to financial and social crises, natural disasters, and post conflict reconstruction.

The World Bank was shaped by Cold War politics over its early decades. As a result, 1989 was an important marker in its history. When former Soviet Union nations joined the Bank, it became a truly global institution with a broadened mission. Only a few countries, notably Cuba and North Korea, are not part of the World Bank today.

The Bank is a major source of development financing. Annual loans and grants fluctuate year to year; FY2009 was the largest on record with almost $59 billion in new commitments. When the Bank started operations there were few sources of funding, but that situation continued on page 17.
The crisis we are witnessing today in the global economy is similar to what we have witnessed in poor developing countries for decades under the watch of the World Bank and the International Monetary Fund (IMF). The same flawed body of economic theory that has driven changes such as deregulation of financial systems has also been behind the policies that the World Bank has imposed on Africa, Latin America, and other regions since 1980.

By many social and economic indicators, sub-Saharan Africa has fared the worst over the last few decades compared to other regions. It has also been the region most heavily under the influence of the World Bank and its array of policies that have been imposed on countries as part of the conditions of Bank loans. In this essay, I will point to the failures of the World Bank, focusing on the relationship between the poor performance of developing countries and the policy agenda of the Bank, and offer an alternative approach.

Voting Power and U.S. Dominance
The World Bank has its origins in the Bretton Woods Conference of 1944, which created the structure of the post-war global financial system. In 1960, the International Development Association (IDA) was created to lend exclusively to the poorest countries. The Bank was largely self-financing and like any bank generated income by lending at a rate exceeding the cost of money. In the World Bank case, finance was obtained through floating bond issues. Since the bonds had the backing of the major world powers, they were virtually risk free and paid very low interest by global standards. In contrast, finance for developing countries was much more expensive since it reflected a risk premium associated with a higher probability of default. Developing countries were happy to access World Bank money at a rate that was lower than the interest they would pay and higher than the World Bank bond rate, thus guaranteeing income to the Bank. In contrast, the IDA lent money at subsidized rates financed every three years by member state contributions.

Despite the centrality of this mission, the Bank has always been dominated by the United States and a few other developed countries; it has never operated on the principle of one member, one vote. For example, in 1971, African countries constituted 35 percent of the membership but had only 8 percent of the voting power, an imbalance that has not significantly changed over time. In principle, the distribution of votes is based on a formula comprised of a combination of national income, foreign trade, and foreign reserves. In practice, however, voting allocation is highly political and manipulated by the United States and other developed countries to their advantage. The United States has always maintained a voting share exceeding 15 percent, which has given it veto power over major decisions requiring an 85 percent majority.

The inequities of the past continue in the present. The voting power of five developed countries (United States, Japan, France, United Kingdom, and Germany) that have five of the 24 seats of the ruling Executive Directors (EDs) was 37 percent. In contrast, 46 countries in sub-Saharan Africa have a voting share of only 5 percent and only two EDs. Thus in 2009, a group of poor countries constituting 25 percent of the membership received just 5 percent of the vote. In contrast, the five richest countries constituting just 3 percent of the membership have nearly 40 percent of the vote.

The United States has been dominant inside the Bank in multiple ways. Loans that do not have the approval of the United States are generally not proposed to the Board. Empirical studies have shown a close correspondence between loan recipients and U.S. strategic political and economic interests. The United States...
has always selected the president of the Bank (currently, Robert Zoellick). Organizational changes have generally reflected U.S. interests. IDA, for example, was proposed by the United States, which deemed that strategic aid would be more effective in countering Soviet expansion if it were institutionally separated from U.S. foreign policy mechanisms.

**Policy Agenda**

During the 1950s and 1960s, as a new institution, the Bank needed to establish its credibility on global markets. It built a fairly noncontroversial portfolio and lent more than 60 percent of its funds to low-risk, infrastructural projects. Engineers and finance experts dominated the Bank.

During the 1970s, the focus of the World Bank agenda began to change. Under the presidency of Robert McNamara, the World Bank became more concerned with income distribution, basic needs, and poverty reduction. During the decade, lending to infrastructure fell to 36 percent, while lending to agriculture and social areas such as education and urban development rose from 17 percent to 41 percent.

As the portfolio of the Bank moved into new areas that required greater country-specific knowledge, the Bank became increasingly reliant on economists. Toward the end of the decade, however, there was some concern among Bank economists that too much economic growth would be sacrificed to achieve these social goals. Moreover, the economics profession was becoming increasingly conservative and critical of most forms of state intervention in the economy, including the types historically supported by the World Bank.

In addition, a series of events, including the election of right-wing candidates in the United States (Reagan) and the United Kingdom (Thatcher), the appointment of the staunch conservative A.W. Clausen as president of the Bank, and the hiring of market fundamentalist Anne Krueger as chief economist, led to a major shift in the Bank's agenda. After 1980, the new approach known as “structural adjustment” emphasized conservative fiscal and monetary policy, deregulation, and privatization.

**Critique and Alternative**

In the area of trade, the World Bank in the 1980s encouraged countries to pursue their comparative advantage (export the product they can produce with relatively greater efficiency) through the removal of trade restrictions and the retraction of state support of local production. Local industries could not compete with the inflow of goods from more advanced countries, leading to deindustrialization and unemployment. Countries were forced to increasingly rely on unprocessed raw material exports (their comparative advantage) at a time when the global economy was rewarding innovations in information and technology. Moreover, many of these products—e.g., beverage crops such as coffee—have very low elasticities of demand, leading to declining revenues. Imagine if a number of countries increase supply at the same time and prices drop by 50 percent. People do not start drinking six cups of coffee per day instead of three. More likely, they will consume a similar amount of coffee, leading to a decline in revenues. In addition, while the Bank stopped price supports and subsidies in agriculture on the premise it was market distorting in developing countries, developed countries continued to heavily subsidize their farmers in areas such as cotton, driving the price down at the expense of poor developing countries.

A much smarter approach used in China and other East Asian countries largely independent of the Bank encouraged heavy state support of export-oriented manufacturing. Compared to resource production, manufacturing enterprises are subject to greater increasing returns, have higher income elasticities, generate employment, and are very tradable. Under structural adjustment policies, however, manufacturing in African countries largely collapsed; by 1990, it was only 15 percent of the GDP compared to 24 percent in 1980 (and continued to fall to 7.7 percent in 2006). Overall, structural adjustment led to a rapid deterioration in social and economic conditions in many developing countries. By 1990, per capita income in sub-Saharan Africa (excluding South Africa) fell by 30 percent compared to a decade before. Food production was unable to keep up with population growth. The continent also found itself in a deep financial crisis, as the level of debt tripled while exports actually declined.

Instead of rethinking its agenda, the World Bank adhered to the same core continued on page 28
Perspectives—Marshall

has changed so dramatically that today private financial flows dwarf official development assistance. A major preoccupation is coordinating the large number of agencies at work—non-governmental organizations, foundations, bilateral aid agencies, UN agencies, and private companies among them.

The Bank’s financial independence (both its governance and capacity to raise funds on private capital markets) gives it a flexibility that many other development institutions lack. Financial discipline, at the heart of the Bank’s strong reputation for probity and responsibility, carries both benefits and drawbacks. Among the drawbacks were rigidities that made it difficult to address poor countries’ overindebtedness until a global citizens’ movement (Jubilee 2000) pressed G-8 action and opened the door to new debt-relief mechanisms.

Financing development is often seen as the World Bank’s leading mission, but money is only part of the story. Research, policy advice, and a catalytic role of knowledge sharing are at least as important. Its focus sharply on country realities, the World Bank plays widely different roles. What a middle-income country such as Brazil or Thailand wants and needs is very different from a poor country with severe budget constraints (e.g., Mozambique, Haiti, or Ethiopia). An agricultural economy with low primary school enrollment seeks different support than an Eastern European transition economy. The Bank’s influence is extraordinarily broad in some countries, extending to day-to-day issues and fundamental strategic choices; in others, it acts as a technical advisor in specific fields.

Challenges Today

Three strategic challenges for the World Bank today stand out. First, the plight of the world’s poorest countries (the “bottom billion” people, weak and failing states) is today’s leading development community challenge. Ironically, communities that need help most are hardest to help. Poverty and insecurity, meaning both safety and sustainable welfare, are tightly linked. The World Bank is concentrating on finding ways to help these countries; it will be judged against the results.

Second, with climate change emerging as a leading world challenge, the World Bank’s role is growing. “Green criteria” are increasingly a focus for projects, but still more important is what the Bank can do to help mitigate effects of climate change for poor countries and to contribute to defining and implementing strategies to reverse it.

Third, the Bank is more important for Africa than for any other region of the world. After decades of disappointments, many African countries are now poised for more rapid progress, the change spurred by far sounder economic policies and, in a hardening number of countries, dynamic, more democratic, and poverty-focused leadership. However, the severe blows from the current economic crisis are deeply worrying. Africa still lags, and external support, hopefully well tuned to its needs, will be essential to sustain progress over the foreseeable future. The World Bank will likely remain a key player in many countries’ settings, providing an analytic backdrop for development programs and helping to orchestrate the many players, public and private, who seek to assist and invest.

Taking Stock

The varying perceptions of the World Bank fuel controversy. The Bank is widely respected for its resources, convening power, influence, talented staff, and capacity for action; world leaders look to it in times of crisis, even on matters seemingly removed from its core mandates such as SARS or swine flu. It is also vilified as arrogant and narrowly focused. History explains some of the furor: the Bank responded slowly to environmental issues, and its economic advice and association with unpopular regimes lend themselves to criticism. Bank advice and financial support that come with elaborate and demanding conditions foment controversy and can have long-lasting repercussions. Critics call the Bank a “one-eyed giant” because of its size and tendency to view development primarily through an economic lens to the exclusion of other disciplines, especially politics but also religion and culture.

The World Bank can be a visionary leader, however. Its close, daily ties with member governments give it a unique perspective on public policy. Its growing work on global public issues engages it with public and private partners, companies, religious organizations, and nongovernmental organizations. The Bank is at the center of vital webs. A knowledge-based institution with a highly educated staff, it is privy to an extraordinary body of information and experience, also drawing on the resources of universities and think tanks. Even critics of the Bank agree that, if it did not exist, it would be necessary to create something similar.

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Students at The Meadows School, a K-12 college prep school in Las Vegas, established a microbank and raised more than $30,000 to fund recipients as far away as Cambodia.

A microbank is an institution that provides small loans. While larger banks will not offer a $300 loan to an individual, a microbank is a resource for people who need a small amount to invest in a business or trade. As students at The Meadows School became aware of global issues of poverty through school debates and class electives on social injustices, they wanted to do something to help; a microbank seemed to make sense.

In 2007, student Justin Blau and history department chair and faculty advisor Kirk Knutsen founded The Meadows School MicroBank. More than 60 students support the work of the microbank; it is among the largest organization at the school. “It’s not run like a student club,” says Knutsen. “It’s run as a business in the nonprofit sector.”

Organizing a Microbank

While running any business in corporate America is a challenge, organizing a microbank in a high school, a concept not known to most and with few examples to use as a blue-print, is daunting and seems improbable to many.

Microbank, microcredit, and micro-loan are terms that have recently received a lot of attention in the philanthropic and corporate world as a way to combat poverty. The basic concept has been around since the dawn of trade, while the current use of microbanks, providing small loans to those in poverty to spur entrepreneurship, has flourished with the example of economist Muhammad Yunus. In 2006, Yunus received worldwide accolade when he and his bank, Grameen Bank, jointly won the Nobel Peace Prize for their efforts to create economic and social development from below.

While microcredit and similar terms have become the buzzwords in philanthropy and corporate giving, the concept is still relatively unknown in the high school setting, and certainly not a concept put into practice by many. So it’s quite an accomplishment that the students at The Meadows School were able to organize such a complicated business structure and have such success.

The Meadows MicroBank spent the first year building the seed money through fund-raising efforts, such as lunchtime sandwich sales. The students needed to raise $25,000 initially to invest their money through Pro Mujer, a microfinance and women’s development organization that would have assisted the students by distributing the loans. The students have since decided to work with two microfinance brokers—Kiva, which does not have a minimum financial entry requirement, and MicroPlace.

“The Meadows MicroBank gives all students really good experience in learning how to fund-raise and manage finances,” explains current CEO and junior, Nick Young. “Kids also learn a lot about the causes they support.”

In addition to working through the financial logistics of fund-raising and distributing loans, students also
research prospective recipients and the countries in which they live, thus gaining a better understanding of the problems associated with poverty.

Young cites a documentary on combating poverty through microcredit, *Small Fortunes*, which was shown at a school assembly during his freshman year as a motivator for him to get involved in The Meadows MicroBank. “[The film] really got the kids interested,” Young notes. “You saw how small loans could make such a huge difference in a person’s life.”

In December 2008, The Meadows MicroBank started distributing its first loans. One of its recipients was Reveca, a mother of four, who sold flowers on the streets in Peru to earn a living. After receiving a loan of $325 from The Meadows MicroBank, she was able to expand into a small retail operation and repay the loan in a timely manner.

To date, The Meadows MicroBank has distributed nearly $5,000 through 17 loans. A key element of the microbank is ensuring that the seed money is constantly moving in a circular motion—loans are distributed to entrepreneurs; entrepreneurs use the money to start a business and earn a living; and the recipients repay the loan to the microbank, which then loans to new entrepreneurs.

While the microbank is a student-run organization led by one faculty advisor, the students receive direction throughout the process from such faculty members as economics professor Dr. Scott Kristensen, who advises the students on risk management and how to manage the flow of money going out through loans and coming back through payments.

“One of the challenges for the students is how to place the loans with terms that allow all students to have hands-on experience with the microbank,” cites faculty advisor Knutsen. “Timing is key on when the loans are distributed and when the loans will be repaid. They don’t want all the money to be tied up in any particular year.”

In this aspect, the students gain valuable firsthand experience in business and finance. Working at the microbank appeals to many students because of the control they have over all elements of the process.

The more than 60 students involved in the microbank rarely meet all at once; instead, smaller committees meet on a frequent basis to discuss the details of loan repayment, ways to increase the funding of their bank, and how to distribute the loans.

The microbank was originally structured with two main areas of operation: the Finance Committee, which focuses on dispersing and managing the loans, and the Fundraising Committee, which focuses on ways to increase the asset value. Recently, students founded the Legislative Affairs Committee, which focuses on lobbying the federal government to support bills to fully fund microfinance.

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**Medal of Freedom Recipient: Muhammad Yunus**

On August 12, 2009, President Barack Obama awarded Muhammad Yunus the Presidential Medal of Freedom, the top civilian honor, for his pioneering microbanking efforts to combat poverty. Dr. Yunus, an economist by training, invented the concept of microeconomics, when he realized that very small loans could make significant differences to poor people. His first microloan was for $27, out of his own pocket, to 42 women in his village who each returned a two percent profit. Yunus then founded the Grameen Bank in 1983 in his native Bangladesh to provide small, low-interest loans to the poor to help better their livelihood and communities. Despite its low interest rates and lending to poor individuals, Grameen Bank is sustainable and 98% percent of its loans are repaid—higher than other banking systems. It has spread its successful model throughout the world. Dr. Yunus received the Nobel Peace Prize in 2006 for his work.

President Barack Obama awards Bangladeshi economist Muhammad Yunus the 2009 Presidential Medal of Freedom for his efforts in pioneering the use of microloans to people around the globe, August 12, 2009.

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Learning Gateways

Antitrust Laws and You!

Much government regulation of the economy centers around antitrust law, with the guarantees of competition, capitalism, and fair practices in the commercial world. This lesson is designed to provide an introduction to students of the broad concept of antitrust law and how it connects to their everyday lives. Teachers may lead this lesson, but are encouraged to invite an antitrust lawyer into their classrooms. This lesson was developed in partnership between the ABA Division for Public Education and the ABA Section of Antitrust Law.

Objectives

This lesson will:

- Introduce students to competition, capitalism, and the commercial economy.
- Engage students in antitrust and commerce concepts.
- Help students understand the broader concepts of antitrust and competition laws.
- Allows students to see the connections between antitrust law and their everyday lives.

Materials

A complete overview of the lesson is included here, but free downloads of both student and facilitator versions of this lesson, complete with scenario answer keys and concluding discussion points, are available in PDF format at: www.insightsmagazine.com.

Curriculum Standards

This lesson addresses content standards in Economics (Standards 1, 9, 10, 14, 15, and 16); Civics and Government (Standards 1, 2, and 3); and United States History (Eras 6, 9, and 10).

Warm-Up Activity

The following questions are meant to get students thinking about how they play a role in the economy, as well as the larger ideas behind antitrust, competition, and capitalism and the roles that the government and the law play.

1. Write the following questions on the board before the students enter the room, or ask them aloud: What is the last thing you purchased? Where did you purchase it?

2. Ask three or four students the following questions about their most recent purchases:
   - Could you have made this purchase in other stores?
   - Why did you select this store? (Try to get students to list several reasons.)
   - Why did you make this purchase when you did?
   - What would you have done if the store you went to didn’t sell what you wanted?
   - What would you have done if that store wasn’t there in the first place?

3. Use these debriefing/talking points to help the students focus before reading the short introductory reading:
   - Each of us and the members of our community make decisions about participating in our economy every day. Even when you buy a bag of chips at the local store, you are making a decision about where to spend your money, what to spend your money on, and to spend your money in the first place.
   - The combined decisions each of us make have an impact on local business owners. Add in the decisions of the rest of the school, of our community as a whole, and of our entire city or state, and the decisions have a national impact.
   - We aren’t the only ones making decisions that affect our ability to participate in the economy—think about how the actions of local, state, and federal governments, as well as corporations and store owners, can affect your ability to make purchases.
**Introductory Reading: A Short Introduction to a Long History**

Capitalism and the United States economy is premised on free and fair competition. It is through reliance on these principles that the United States economy has been able to grow and flourish and, ultimately, what has led to the United States being among the most prosperous nations in the world. The United States’ antitrust laws help enable this success by ensuring a level playing field for all competitors.

The three most important laws are:

- **The Sherman Act, Section 1**: This law prohibits agreements that restrain trade. This means competitors must fight for business in the marketplace, rather than cheating and creating restraints among themselves to deprive consumers of fair competition. For example, competitors are not permitted to set prices for their products together. Instead, they must work independently to determine their prices, thus creating opportunities for customers to buy from a number of competitors at various prices.

- **The Sherman Act, Section 2**: This law prohibits monopolization and attempts to monopolize. This means that very large companies will not be permitted to use wrongful means to dominate or try to dominate the market. In other words, they cannot use their size to hurt smaller competitors and therefore hurt consumers in the process.

- **The Clayton Act, Section 7**: This law prohibits mergers or acquisitions that would likely lead to a substantial lessening of competition. A merger, for example, between the two biggest competitors for a product in an industry with only a few competitors would be prohibited because the elimination of competition between these two companies would likely mean higher prices and less product selection.

But why is competition essential? What does it mean to be free and fair? And how is this fairness and freedom ensured? In 2007, the Antitrust Modernization Commission, a bipartisan commission established by act of Congress, explained this very point:

> **Competition in free markets—that is, markets that operate without either private or governmental anticompetitive restraints—forces firms to lower prices, improve quality, and innovate. Businesses in competitive markets develop and sell the kinds and quality of goods and services that consumers desire, and firms seek to do so as efficiently as possible, so they can offer those goods and services at competitive prices.**

> **In free markets, consumers determine which firms succeed. Consumers benefit as firms offer discounts, improve product reliability, or create new services, for example, to keep existing customers and attract new ones. The freemarket mechanism generally provides greater success “to those firms that are more efficient and whose products are most closely adapted to the wishes of consumers.”**

> **Competitive markets also drive an economy’s resources toward their fullest and most efficient uses, thereby providing a fundamental basis for economic development. Competition facilitates the process by which innovative, cutting-edge technologies replace less efficient productive capacity. Market forces continuously prod firms to innovate—that is, to develop new products, services, methods of doing business, and technologies—that will enable them to compete more successfully. The ongoing churning of a flexible competitive economy leads to the creation of wealth, thus making possible improved living standards and greater prosperity.**

Thus, without antitrust laws to ensure free and fair competition, consumers would have less choice, prices would be higher, and there would be far fewer new products and ideas.

**Activity: Making Choices**

Ask students to read, think about, and make a decision with each of the following scenarios. Students should write down answers as well as justification for their decisions. As they are thinking about the scenarios, they should keep the following questions in mind:

- What would make financial sense for you?
- What are the values you hold as important?
- In choosing your answer, what made it right in your mind?
- Why might someone else consider another answer to be right?

**Scenario 1A:**

You are a very talented singer who won third place in a television talent show competition. Your passion is music, and you really want to be famous. You plan to record an album and even find a recording studio that will let you use its facilities for free. You record two songs and are very proud of your work. You are excited! Now you want to share the songs with the world. You think about your options, and as best as you can tell, you have two:

1. You can post the song and a video of you singing it on YouTube for free.
2. Or, you’ve just figured out a way to post the songs on iTunes, and you will get paid every time someone downloads it.

What are the benefits of posting your songs on YouTube? What are the benefits of posting them on iTunes?
**Scenario 1B:**
Now imagine that when you entered the competition, the producers of the TV talent show made you sign a contract saying that for ANY song you EVER sold, they would receive nearly ALL of your profits except for a small amount you get to keep. Also imagine that the same contract says you MUST perform when and where they tell you, even if you don't want to do that. Does that seem fair? Appropriate?

**Scenario 2A:**
Imagine you own a jewelry store on an island. You have the only jewelry store on the island and you sell all kinds of jewelry: rings, necklaces, earrings, bracelets, etc. If anyone wants to buy any kind of jewelry on the island, they must buy from you. Does this make you happy? Why? What kind of prices would you charge?

**Scenario 2B:**
Now let's say another jewelry store is going to open across the street. How would it make you feel? Would you think about buying that store, too?

**Scenario 2C:**
Now let's say that you are a resident on the island—living the dream, swimming, surfing, fishing, and lying in the sun. And you love jewelry. How do you feel about the possibility of there being only one jewelry store on the island?

**Scenario 2D:**
As a resident of the island, would you be happy if a new jewelry store opened up across the street from the first store? How would you feel if the first store then bought the new jewelry store?

**Scenario 3:**
You are a chemist who, years ago, left the corporate world in an effort to “help the world.” You spent your life savings

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**Development of Antitrust Law**

- **1776** Adam Smith publishes *An Inquiry into the Nature and Causes of the Wealth of Nations*, in which he introduces the “invisible hand theory,” which relies upon economic competition to govern markets.

- **1890** Sherman Act prohibits agreements in restraint of trade, monopolizations, and attempts and conspiracies to monopolize.

- **1898** President William McKinley appoints members to the U.S. Industrial Commission on Trusts, which questions business leaders such as Andrew Carnegie, John Rockefeller, and Charles Schwab about their respective companies’ business practices.

- **1901** Theodore Roosevelt assumes the office of President of the United States and makes antitrust legislation a priority in his administration. He earns the nickname “trust-buster” and oversees the dissolution of approximately 40 trusts that were part of American companies.

- **1909** William Howard Taft is inaugurated as President and continues Roosevelt’s antitrust efforts. He oversees the separation of approximately 90 trusts—twice as many as Roosevelt.

- **1911** U.S. Supreme Court rules in *Standard Oil Co. v. United States* that the Standard Oil Company is an “unreasonable” monopoly under the Sherman Act, engages in “numerous and flagrant unfair practices” against competitors, and “enjoy[s] unfair advantages” over competitors. The Court orders Standard Oil broken into 34 independent companies, one of which is today’s ExxonMobil.

- **1914** President Woodrow Wilson announces his antitrust initiative to Congress.

- **1914** Clayton Act strengthens antitrust enforcement powers by outlining compensation for financial losses, prohibiting price discrimination, and restricting anticompetitive mergers between companies within a given industry.

- **1914** Federal Trade Commission Act establishes the Federal Trade Commission, which works to promote consumer protection and prevent and eliminate anticompetitive business practices.

- **1918** In its decision in *Chicago Board of Trade v. United States* the Court articulates the Rule of Reason, which has become the standard by which any company’s restraint activities are determined to be in violation of the Sherman Act. The Rule of Reason dictates that the law consider the circumstances of restraint activities, and whether, on the whole, it promotes or suppresses competition.

- **1945** U.S. Court of Appeals for the Second Circuit rules in *United States v. Aluminum Company of America* that the
and the last ten years setting up a research lab in your garage. In the last year you have, amazingly, found a cure for cancer. With one simple pill, anyone diagnosed with cancer will, “poof,” have a clean bill of health. You want to get the pill out to people, but you have gone into serious debt creating the medicine. Would you sell the pill at a high price or a low price? For how long? Is that fair?

**Remember This**

Spend some time answering the following questions after students finish the discussion of the various scenarios. Think about whether views of antitrust and competition laws and individual roles in the economy have changed.

1. What is the role of antitrust laws in our economy?
2. What are the benefits of competition in business? Can competition harm business? If so, when?
3. Should government have a role in regulating the economy? Why? What can happen if the government doesn’t do anything? What can happen if the government over-regulates the economy?

**Working with a Legal Professional**

This introductory lesson can be a great way to integrate legal professionals into the classroom. The legal professional may lead students through the scenarios and discussions; talk to students generally about antitrust and competition laws; answer questions about competition and the legal system; help students understand how to participate in a civil discussion; and conduct debriefing sessions. Local and state bar associations may offer assistance in matching lawyers to classrooms.

Visit www.insightsmagazine.org to download student and facilitator units, including answer keys, of this lesson for use in the classroom.

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Aluminum Company of America, now Alcoa, violated the Sherman Act after it monopolized the aluminum bauxite mining and production industries, even though the company did so without restricting market access to competitors, as in *Standard Oil*. Alcoa did not deny access to aluminum bauxite mines or their patented manufacturing techniques once patents expired. The company argued that they “served [consumers] at degrees of excellence, prices, and profit rates that no one could equal or exceed.” Judge Learned Hand rules that the United States government did not “condone good trusts and condemn bad ones, it forbade all.”

1948 The decision in *United States v. Paramount Pictures, Inc.*, forever changes the movie industry and how everyday Americans viewed movies. The U.S. Supreme Court rules that movie studios could no longer own the theaters in which their movies are shown, thus controlling every aspect of movie production, distribution, and exhibition.

1962 In *Brown Shoe Co. v. United States*, the court articulates the definition of a “market” as considered in antitrust cases to determine a party’s presence and relationship to competitors in any industry. The Court defines markets to include geographic markets as well as “relevant product markets” to include not only the products or services offered by the company in question, but also any other products or services offered by other companies that could be reasonably substituted for the products or services in question.

1982 *United States v. AT&T* affects everyday Americans when the telephone service giant AT&T, “Ma Bell,” is ordered split into seven independent regional companies known as “Baby Bells.” The case from the U.S. District Court in Washington, D.C., ultimately deregulates the telecommunications industry.

2001 U.S. Department of Justice reaches an antitrust settlement with Microsoft (*United States v. Microsoft*). The company was accused of unfairly restricting the market for competing web browsers when it bundled the Windows operating system with Internet Explorer and then sold bundles to computer manufacturers for use by consumers. In what some, however, criticized as a “slap on the wrist,” Microsoft agrees to share programming interfaces with third-party companies, as well as appoint a three-person panel to ensure compliance with antitrust laws.

2008 U.S. Department of Justice rules that the proposed merging of two major U.S. air carriers, Delta Airlines and Northwest Airlines, does not violate antitrust laws.

2010 The U.S. Supreme Court is scheduled to hear arguments in the case *American Needle v. National Football League*, which will determine whether or not the 32 NFL teams function as a “single entity” rather than multiple “separate entities” governed by antitrust laws.
The Supreme Court’s sole banking case last term prompted spirited reactions across the political spectrum. The Wall Street Journal responded to the Court’s decision with the editorial headline: “Spitzerism Revisited: Scalia invites assaults on national banks.” Consumer advocacy groups and the Center for Responsible Lending, however, issued a press release that exulted, “Cuomo vs. Clearing House Represents Victory for Taxpayers.”

As suggested by the Wall Street Journal headline, Justice Scalia stood at the center of the controversy that was addressed in Cuomo v. Clearing House, decided on June 29, 2009. First, he walked over to the more liberal wing of the Court, and then he led it to a 5-4 decision that reversed lower court rulings—decisions that barred states from enforcing their fair-lending laws against national banks (i.e., banks that are chartered by the federal government rather than by a state government).

The case, which on the surface was merely asking the Court to review an obscure regulation issued by the Office of the Comptroller of the Currency, turned out to be quite lively indeed. For starters, and to the consternation of conservative commentators, Justice Scalia’s surprise move parried Justice Kennedy’s swing to the conservative bloc. And although Scalia’s majority opinion didn’t give the state of New York all it wanted, he did—to the delight of numerous consumer and civil rights organizations—endorse its main arguments.

Turf War

Established in 1863 as a bureau of the U.S. Department of the Treasury, the Office of the Comptroller of the Currency (OCC) charters, regulates, and supervises all national banks. The OCC’s staff conduct on-site reviews of national banks and supervise bank operations. The agency also issues regulations interpreting federal laws governing national banking, including the National Bank Act (NBA).

At issue in this case was an OCC regulation interpreting a provision of the NBA that provides:

No national bank shall be subject to any visitorial powers except as authorized by Federal law, vested in the courts of justice or such as shall be, or have been exercised or directed by Congress or by either House thereof or by any committee of Congress or of either House duly authorized.

In American law, the term “visitorial powers” refers, at a minimum, to the governmental power to inspect a bank’s financial books and records. Less clear is what else the term might encompass. The OCC sought to clarify this state of affairs by issuing a regulation defining the visitorial powers that the NBA says only the federal government may authorize. Visitorial powers, the agency ruled, include the: (1) examination of a bank; (2) inspection of a bank’s books and records; (3) regulation and supervision of activities authorized or permitted pursuant to federal banking law; and (4) enforcing compliance with any applicable federal or state laws concerning those activities (emphasis added). Thus, the OCC declared that only the federal government may enforce laws concerning national banks. On this view, the NBA bars states from enforcing even their valid, nonpreempted banking laws, including laws designed to ensure banks do not discriminate against minorities.

As noted above, however, the NBA does contain an exception for visitorial powers that are “vested in the courts of justice.” Might this exception allow states to enforce their fair-lending laws against a national bank? The OCC answered this in the negative as well, providing in the same regulation that:

National banks are subject to such visitorial powers as are vested in the courts of justice. This exception pertains to the powers inherent in the judiciary and does not grant state or

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other governmental authorities any right to inspect, superintend, direct, regulate or compel compliance by a national bank with respect to any law, regarding the content or conduct of activities authorized for national banks under Federal law.

Thus in 2005, when then-New York Attorney General Eliot Spitzer sent letters of inquiry (“in lieu of a subpoena”) to various national banks seeking more information about their lending practices, the banks and the OCC brought suit, claiming the OCC’s regulation forbids this form of state law enforcement against national banks.

Both the federal trial court and the U.S. Court of Appeals for the Second Circuit upheld the OCC’s interpretation of the National Bank Act and ruled that New York could not enforce its fair-lending laws against the national banks. In October 2008, Spitzer’s successor in office, New York Attorney General Andrew Cuomo, asked the Supreme Court to review those decisions. The Court granted Cuomo’s petition and heard oral arguments at the end of April 2009.

“Chevron Deference”

In the Supreme Court, both parties agreed that the outcome of the case depended on the proper application of a judicial doctrine known as Chevron deference—which refers to the Supreme Court’s 1984 decision in Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc. In that case, the Court explained that courts should defer to an agency’s reasonable interpretation of a statute that it is charged with administering—hence, “Chevron deference.”

This poses a very substantial hurdle for anyone (in this case, the state of New York) trying to get a court to interpret a federal law differently from the way a relevant federal agency has already interpreted it. It is not enough to persuade the court that your interpretation of the law is better than the agency’s. Instead, as the Supreme Court spelled out in a 2005 case, National Cable & Telecommunications Assn. v. Brand X Internet Services, “if a statute is ambiguous, and if the implementing agency’s construction is reasonable, Chevron requires a federal court to accept the agency’s construction of the statute, even if the agency’s reading differs from what the court believes is the best statutory interpretation.”

To prevail then, New York needed to persuade at least five justices that the OCC’s interpretation of the NBA was unreasonable. And, surprisingly, that’s just what the state proceeded to do. While acknowledging that “there is necessarily some ambiguity as to the meaning of the statutory term ‘visitorial powers,’” Justice Scalia agreed with New York that “We can discern the outer limits of the term ‘visitorial powers’ even through the clouded lens of history.” These powers do not include, “as the Comptroller’s expansive regulation would provide,” ordinary enforcement of state laws, the Court held.

After surveying the Supreme Court’s jurisprudence before and after the adoption of the National Bank Act, Justice Scalia deemed it “unmistakable” that a state’s visitorial powers and its power to enforce the law “are two different things.” There is no credible argument to the contrary, he wrote,

As an amicus curiae (“friend of the court”) brief filed in this case by the NAACP Legal Defense and Educational Fund explains, the Cuomo case actually arose out of an investigation into data that suggested national banks in the state of New York were engaging in racial discrimination with regard to mortgage loans.

While federal civil rights legislation has largely wiped out the overt lending discrimination that unfairly denied minorities access to any credit, the NAACP brief notes that discriminatory practices have taken new forms: “National banks and other lenders have recently targeted minority borrowers for high-cost, predatory subprime loans that commonly are provided in discriminatory ways. The result is a system that disproportionately relegates minorities and minority neighborhoods to high-risk loans while offering similarly situated white borrowers prime interest rates and more favorable terms.”

In 2005, new data became publicly available under the federal Home Mortgage Disclosure Act (HMDA) relating to the race of loan applicants and the interest rates they are charged. These data seem to indicate racial disparities, but because they do not include all the information that lenders must rely upon in setting their loan pricing, the data do not conclusively establish that the loan practices actually violated New York law. It was for this reason that the New York attorney general’s office sent “letters of inquiry” asking a number of national banks to provide additional, nonpublic information that could be used to prove or disprove the suspected illegal discrimination. The banks and the OCC responded by suing to bar New York’s investigation. New York counterclaimed, and the case of Cuomo v. Clearing House was born.
“and contrary to what the Comptroller’s regulation says, the National Bank Act pre-empts only the former.”

Justice Scalia explained that, contrary to the OCC’s interpretation, the state attorney general did have the right to bring a civil suit (or to obtain a judicial search warrant based on probable cause) to enforce New York laws against national banks located within New York. Those actions would constitute the exercise of the law enforcement power “vested in the courts of justice,” which the NBA exempts from its ban on states exercising visitorial powers.

New York Attorney General Cuomo’s demand for information “in lieu of a subpoena” went too far, however. Here, Scalia said, the attorney general was threatening to issue an executive subpoena against the banks on his own authority, not as an exercise of the enforcement power vested in the courts. Thus, the majority affirmed the lower court’s decision to enjoin the attorney general’s threatened issuance of executive subpoenas. But on the big question regarding states’ abilities to enforce their own banking laws, he vacated the court of appeals decision insofar as it prohibited New York from bringing judicial enforcement actions.

“The Cuomo case permits dual enforcement of fair-lending laws.”

Concurring in part and dissenting in part, Justice Thomas (joined by Chief Justice Roberts and Justices Kennedy and Alito) flatly disagreed with the latter ruling. After an exhaustive survey of scholarly treatises and relevant jurisprudence (including pre-NBA common law), Justice Thomas concluded that the OCC selected a permissible construction of a statutory term (“visitorial powers”) that was susceptible to multiple interpretations.

Especially in the wake of the regulatory failures evident in the recent home foreclosure crisis, Cuomo v. Clearing House is a remarkable case. It permits dual enforcement of the nation’s fair-lending laws, an issue of great concern to the vast majority of the nation’s states who wish to safeguard their own sovereignty and who question whether the OCC has the resources or expertise to be the sole enforcer of 50 different state banking laws. It clarifies lingering questions concerning the deference actually owed federal agencies under the Chevron doctrine.

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trade increases national income is not to say that trade increases everyone's income. Under a free trade regime, industries in which the United States does not have a comparative advantage—for example, textiles and apparel—will wither, and unemployment in these sectors will result. Countries as a whole will become richer, but some firms, individuals, and communities will lose.

Traditionally, we believed that most of the objections to international trade came from the losers. Of course, if your factory closed because of cheaper imports from China, then trade was not your friend and you were likely to vote and to answer surveys as a foe of trade, not a friend. If the antiglobal sentiment in society was the result of those who had been harmed by trade, however, then there was also a relatively simple solution: compensate the losers. In other words, if those who lost from liberal trade could be compensated, then perhaps they would come on board with a free trade agenda, or at least not be such angry obstructionists.

“Compensate the losers” has been the policy of the United States since at least the end of World War II. For example, by extending health benefits or unem-ployment insurance, by providing tax credits and retraining, the losers could be quieted so that we could get on with the business of free trade, the best policy for the country as a whole.

Not the Whole Story
For approximately 10 years I have been writing, researching, and speaking about the lessons that the simple T-shirt brings to bear on the debate over international trade. One of the most significant lessons has been that “compensating the losers” is at best a partially effective response to addressing concerns about trade.

Winners also have concerns about trade. There is little doubt that the vast majority of Americans are economic beneficiaries of globalization and expanding trade; that is, most of us are winners. Global competition is a boon for consumers, bringing cheaper TVs, computers, cars, and T-shirts. Many of us work for foreign companies or make a living selling products and services to the rest of the world. Though the “losers” dominate the news, they are far outnumbered by the winners.

Listening carefully to concerns about trade over the past decade, I am convinced that the focus on the “losers” has missed a wide range of objections or reservations about trade that are shared by a broader swath of the population. Some of these concerns are valid, and some are not, but their sources are more complex than the lost paycheck of a laid-off factory worker.

During the antiglobalization protests of a few years ago, it was common for protestors to dress up as sea turtles or other endangered species. The costumes point to one of the most significant concerns about globalization today: Is rapidly expanding trade and globalization threatening our planet? Though emerging research suggests that in fact the reverse might be true (trade, for example, allows clean technologies to spread across borders), environmental concerns are not directly addressed by compensating the factory workers who have lost their jobs. The widespread worry that liberal trade might result in a “race to the bottom” in environmental standards, with production flowing to countries with the most lax standards, is a concern that must be addressed if the growing numbers of citizens with environmental concerns are to be brought on board with a free trade agenda.

More broadly, consumers are increasingly concerned with “process” in addition to “product.” If consumers are only concerned about getting the best product at the best price, then free trade is an easy sell. If, however, consumers and citizens are also concerned with process attributes, then trade presents a more complicated picture. Many are concerned about conditions, for example, on coffee plantations in developing countries (hence the growing demand for “fair trade” coffee); others are concerned about labor abuses in overseas factories (hence the demand for “sweatshop free” clothing). It was, for example, concerns about the alleged “race to the bottom” in wages and working conditions that spurred much antiglobalization sentiment in the early part of the decade. Again, if peoples’ concern about international trade relates to issues such as “sweatshops” overseas, they will not be brought on board with compensation to laid-off factory workers in the United States.

Finally, the economic case for trade, strong as it is, does not recognize other complex motives of human beings. Regardless of the economic outcome, we judge trade against a standard of fairness. Numerous studies show that we will be quick to give up financial gains if we do not believe the process delivering the gains is fair. Do we want more and cheaper goods? Of course, we do. But we also want to believe that the trade arrangements delivering the goods are fair. For example, China engages in a number of practices that at least some people believe to be “unfair.” These practices include tight controls on the value of its currency (rather than a market-determined exchange rate), extensive piracy, and a variety of subsidies
for state-owned industries. Leaving aside the question of how to judge “fairness” in this instance, even “winners” in the United States—that is, all of us who benefit from inexpensive Chinese imports—object to trade practices they believe to be unfair.

A similar point applies to the burgeoning “free trade agreements” championed by the previous George W. Bush administration. These agreements were negotiated on a case-by-case basis with many countries. The result was not necessarily “free trade” but instead a complicated set of rules that varied by country, often written with undue influence from certain industries or constituents. I am convinced that at least some objections to “free trade agreements” such as NAFTA and the Central America Free Trade Agreement (CAFTA) reflected concerns not so much about trade per se but about the process by which these agreements came about.

There is no doubt that “compensating the losers,” job retraining, enhanced safety nets, and other such policies will help to dampen some “main street” concerns about international trade. However, other concerns such as those over fairness, process, and environmental issues require a broader response. Recent commitments to include labor and environmental protections in all future trade agreements address some of these concerns, but they may not go far enough. In the future, globalization will generate more winners in the economic sphere but also create more complex policy challenges.

For Further Reading


For Discussion

1. What is anti-globalization? Why do you think there have been organized protests against globalization? What are the protesters seeking?
2. What are some of the arguments in favor of global trade? What are some of the arguments against global trade?
3. Do you think international trade partners should seek to regulate “processes” involved in the production of goods for trade—e.g., working conditions and wages for workers? Why or why not?

Perspectives—Stein

economic policies through the 1990s. New loan conditions such as improving governance were used to rationalize the failure of the earlier World Bank strategies by blaming impediments on the recipient side. New policies used the same problematic theoretical tools underlying structural adjustment. Between 2000-2006, state spending from years of World Bank and IMF-imposed austerity had fallen to an extremely low 13 percent of GDP, which is well below the level needed to sustain health, education, and other public goods.

Social and economic development is a dynamic process that requires the transformation of institutions and structures that cannot be conceptualized by the economic theories underlying the agenda of the World Bank. These theories use flawed models that assume full employment, though most developing countries have at least double-digit unemployment rates. They assume that little regulation is needed once everything is privatized. They also assume the existence of perfect competition and well-developed markets, when the global norm is one of oligopoly and poorly formed markets. The economics used by the World Bank has no theory of institutions, yet institutional development is at the very core of the transformation of economies.

In contrast, when people are seen as social beings, development becomes synonymous with new forms of behavior arising from new rules, roles, and relations. Entrepreneurship and investment, and ultimately employment generation, thrive best in a fostering climate with strong state support of the private sector through research and development, access to inexpensive finance, expanding human capital, subsidizing public health, providing tax incentives for investment and trade, and improving infrastructure. All of these areas have been badly neglected by the failed strategies of the World Bank.

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The Future

Having been in operation for three short years, students with The Meadows MicroBank are constantly infusing new ideas; the Legislative Affairs Committee is just one example. In addition, the students are preparing to launch a website this year that will enable them to reach people all over the world and enhance their presence and fundraising efforts.

Another development for the microbank this year is its geographic outreach. When the microbank started, its first loans were disbursed in South America, specifically Peru. Now, the students have expanded the microbank beyond South America, providing loans all over the world, including such places as Ghana and Cambodia. “Almost immediately, the microbank went global in focus,” points out Knutsen. “It was important to diversify the business structure and go beyond one country.”

CEO Nick Young described another new initiative, the student store. Located on campus, the store will be staffed by the students in the microbank but will sell items, such as snacks and school supplies, to all students and also rent calculators and uniforms. The store will serve as a revenue stream for the microbank.

“The store is part of the company, and proceeds will go towards the bank,” Young says. “The store will also serve other groups at the school by selling their items and providing them with a percentage of their sales. This year, we really want to focus on getting the store to the point where it’s a one stop shop for all.”

Reaching out to other schools in the community is also on the agenda for 2009-2010. Young would like the microbank to expand to other schools in neighboring communities, sharing with more students the knowledge and experience of operating The Meadows MicroBank. “I’d like to see a county-wide microbank board,” Young says, “a community group with all other schools that have microbanks to discuss ideas and expansion.”

As The Meadows MicroBank continues to expand, others are taking note, and the push for similar programs at secondary school levels will increase. Recently, The Meadows MicroBank was invited to attend the Global Microcredit Forum in Spain to discuss how students can get involved in such initiatives. In 2008, the microbank was featured in a New York Times article, “Turning Around the Idea of Student Loans.”

Microcredit and microbanks have already found a place in programs such as the Brigham Young University (BYU) Economic Self-Reliance Center and the Bellevue High School (Washington) Microfinance Club. The Bellevue club has made more than 1,000 small loans to people in the Caribbean, and its students traveled to the Dominican Republic in 2008 to meet with their loan recipients.

The Meadows MicroBank, and the examples at BYU and Bellevue High School, demonstrate the profound effect that a small group of people can have on a global issue. By empowering those in need with the resources to better their situation, microbanks are proving to be creative and successful solutions to poverty. In simplistic terms, the solution can be broken down to the often quoted Chinese proverb, “Give a man a fish and you feed him for a day. Teach a man to fish and you feed him for a lifetime.”

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Antitrust Government policy to regulate or break up monopolies in order to promote competition and attain the benefits that such competition can provide to the economy and to society as a whole.

Bank of the United States Bank chartered by the United States Congress to handle the financial needs and requirements of the central government of the newly formed United States. The first bank was chartered in 1791, and the second bank was chartered in 1816.

Bond Written and signed promise to pay a certain sum of money on a certain date, or on fulfillment of a specified condition.

Comparative advantage Ability of one business entity to engage in production at a lower opportunity cost than another entity, which determines what goods are best manufactured domestically or best acquired through trade.

Competition A market environment in which no single market participant has enough influence to determine the going price of the good or service.

Deflation Decline in general price levels, often caused by a reduction in the supply of money or credit.

Deregulation Removal of government controls from an industry or sector to allow for a more free and efficient marketplace.

Duty Tax on imports and exports.

Embargo Government prohibition against the shipment of certain products to a particular country for economic or political reasons.

Excise tax Federal or state tax imposed on the manufacture and distribution of certain nonessential consumer goods, such as environmental, communications, and fuel taxes.

Fair lending Practice of loaning money to individuals or businesses without discriminating on the basis of race, ethnicity, age, gender, or religious affiliation.


Globalization Ongoing process by which regional economies, societies, and cultures have become integrated through a globe-spanning network of communication and exchange.

Gramm-Leach-Bliley Act of 1999 Also known as the Financial Services Modernization Act of 1999. Opened the market for consolidation among banking, securities, and insurance companies.

Hyperinflation Condition in which prices rise rapidly as the value of currency falls, often producing inflation rates in excess of fifty percent.

Inflation General increase in prices.

International Monetary Fund International organization formed with a stated objective of stabilizing international exchange rates and facilitating development.

McCulloch v. Maryland United States Supreme Court case, decided in 1819, in which the Court ruled that the United States Congress did have the power to establish a national bank and states could not tax instruments related to the establishment of the bank, such as bank notes.

Microbank Bank that extends microcredit.

Microcredit Extension of very small loans to those in poverty. Designed to spur entrepreneurship.

Microlonan Very small loan made to someone in poverty as a means to spur entrepreneurship.

Misery Index Index combining the unemployment rate and inflation rate. Often used to measure the political significance of the condition of the economy, as well as consumer confidence.

Monopoly Condition in which an individual, one business, or one organization has complete control over the sale of a commodity, enabling them to raise prices and control quality.

Office of the Comptroller of the Currency U.S. federal agency established by the National Currency Act of 1863. Serves to charter, regulate, and supervise all national banks and the federal branches and agencies of foreign banks in the United States.

Oligopoly Market form in which a market or industry is dominated by a small number of sellers (oligopolists).

Recession General slowdown in economic activity over a long period of time, or a business cycle contraction.

Security Interest or a right in property given to the creditor to convert property into cash in case the debtor fails to meet the principal and interest on loan. Could include stocks, insurance policies, bullion, or promissory notes.

Tariff Tax on imported goods.

United States Department of the Treasury Executive department and the treasury of the United States federal government established by an Act of Congress in 1789 to manage government revenue.

World Bank International financial institution that provides loans to poorer countries for capital programs, with the stated goal of reducing poverty.
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As you complete your census, Insights is taking a moment to explore the legal issues and implications surrounding the decennial enumeration mandated by the Constitution. Since 1790, controversies have ranged from the representation of slaves, to counting population to determine Congressional districting, to changing racial and ethnic classifications.