



POLITICS AND INDIANAPOLIS'S WAR ON CRIME

Before he enlists in Mayor Bart Peterson's War on Crime, our man has a question or two. It may be legitimate news that Indianapolis experienced a significant rise in crime between 2000 and 2005, with every crime category showing increases and with some crime rates doubling. Of concern, however, is how politicians are likely to react to that news. History warns that the reaction will have little to do with actually reducing crime. The author provides a common-sense template that can be placed over the various remedies to differentiate between what is sound policy and what is mere posture — or worse, a grab for power and revenue in the name of public safety.

HORNING
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BEYOND 'BROKEN WINDOWS': PRIVATE PROPERTY AND CRIME

Criminologists know that as a neighborhood shows signs of decline (broken windows, overgrown lawns, etc.) crime tends to increase. Criminals, of course, are astute observers of other people's property. If a property doesn't appear to be owned by anyone, then it probably isn't being protected, either. The political solution is to hire more inspectors to zone away the symptom, requiring the repair of windows, to use the classic example, or the mowing of lawns at a precise, legislatively determined height. The author, however, doubts that order can be restored by simply outlawing disorder. Indeed, there may be no substitute for those policies long known to encourage investment in any neighborhood — low taxes, freedom of individual and contract and respect for private property.

GARNETT
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'SHERIFF, I'VE BEEN ROBBED,' A STORY OF FORT WAYNE DECLINE

Joe Squadrito, the no-nonsense Sheriff of Allen County in the 1990s, remembers the plea of an old Marine who had built his home in the central city only to see it overrun by thugs and thieves. As the gang and drug activity increased, the city police, the media and the clergy all seemed paralyzed by conflicting civic and cultural sensitivities. The eventual solution revealed more about the hollowness of city leadership than it did about good police work: The sheriff simply sent SWAT teams into targeted city neighborhoods to arrest the dozens of individuals there already named in warrants. It was too late, though, for the old Marine. A few years of confused crime policy had cost him a lifetime.

SQUADRITO
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PAYDAY LOANS ARE BANKING FOR EVERYDAY PEOPLE

Indiana lawmakers are beginning to address the fast-growing payday loan industry. They had better curb any egalitarian impulses, however, or they will harm the very constituents they seek to protect. The success of the payday loan industry is a testament to the ability of markets to adapt to rising demand for new and untried methods of consumer finance *provided government regulations do not corrupt the process*. The typical payday loan customer does not differ greatly from the average American consumer. Preventing or limiting payday loan services only encourages borrowers to seek out and utilize less attractive alternatives such as informal or "black" markets, alternatives that put the borrower in the weakest possible financial position. In sum, you do not help marginal borrowers by listing their available options and then eliminating the one they actually choose.

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POLITICS AND OUR WAR ON CRIME

Can You Tell Which Side You're On?



Indianapolis's rates of rape, burglary and theft are now worse than that of Washington, D.C., and as of 2005 all of Indianapolis's violent crime rates were worse than those of Los Angeles.

by ANDREW HORNING with TOM LEHMAN

The headlines say that crime is out of control. Of course, the sometimes devious motivation in reporting inherently political, potentially lucrative problems, mixed with some shoddy research and varying criteria, does raise doubts.¹

But let us assume that this bad news isn't intended to erase gun rights, pay off unfunded police pensions, bolster government's image in troubling times, or to otherwise increase the power of politicians.² Let us treat the double-digit-percent increases in many cities' violent crime rates³ as fact. Let's allow that Indianapolis did have terrible increases between 2000 and 2005, with every crime category showing increases, and with some crime rates doubled.⁴

Predictably, people are concerned and looking to politicians for answers. And politicians, of course, are more vigorously doing what they always do anyway: They're making promises to spend more, do more and "get tough."

But how has our trust in government worked so far?

Indianapolis Mayor Bart Peterson was elected partly on the promise to hire 200 more police officers even after evidence suggested that, after a point, hiring more police officers would not decrease violent

crime rates and could increase property crime rates.⁵ Peterson did hire more policemen, and moved an additional 37 from office and other jobs onto uniform patrol duty.⁶

Did Peterson's promise pay?

Well, Washington, D.C. earns its reputation as a corrupt and dangerous city. Its rates of murder, robbery, assault and auto theft are still higher than in Indianapolis. However, Indianapolis's rates of rape, burglary and theft are now worse. And as of 2005, all of Indianapolis's violent crime rates were worse than those of Los Angeles.

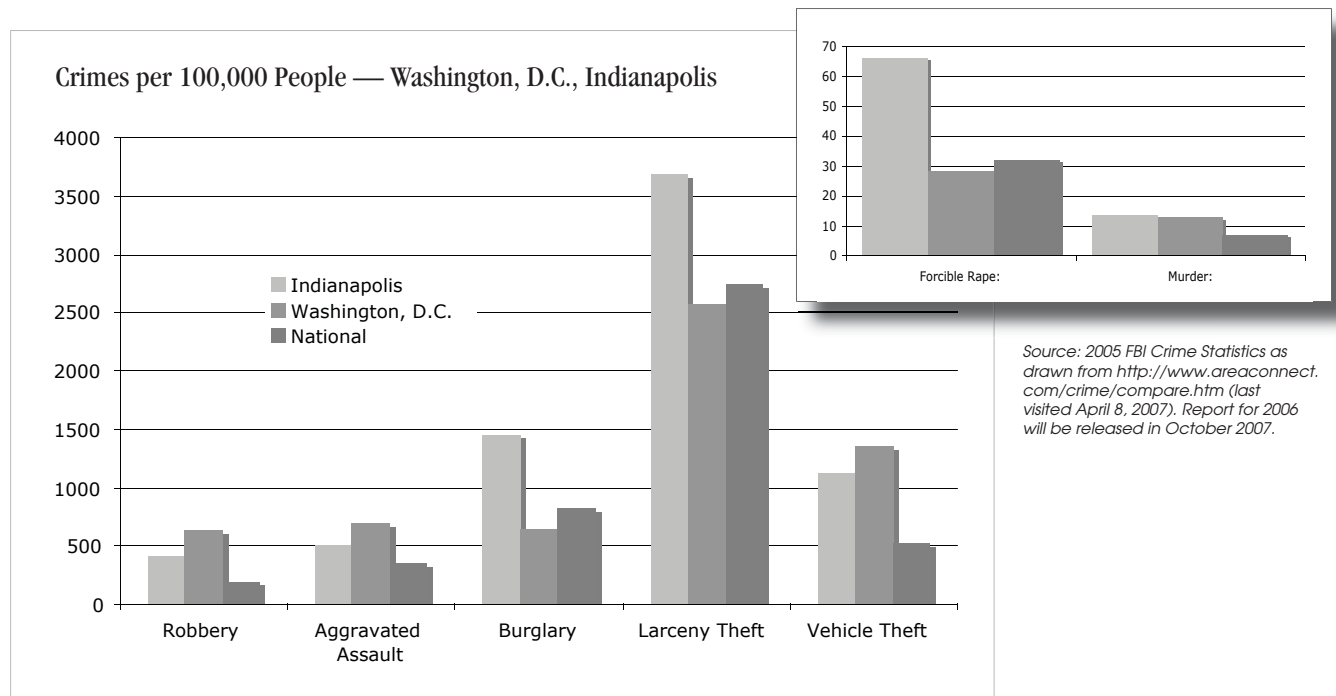
The mayor has responded to this alarming trend with 100 new street lights.⁷ While some studies show that street lights make no positive difference, some studies show that street lights may, in fact, increase crime.⁸ Perhaps criminals don't like to bump around in the dark any more than you do. Maybe that's why most crimes are committed in broad daylight.⁹

Clearly, there's a lot of bunk in crime policy, and not just in Indianapolis.

While many credit former New York City Mayor Rudolph Giuliani's "get tough" policies with reducing crime in his city, others point out that it was really a demographics and economics shift that



Andrew Horning, far left, was the Republican candidate for the 7th District congressional seat in 2004, losing to the incumbent, Julia Carson, with 44 percent of the vote in a campaign where crime policy was front and center. Tom Lehman, Ph.D., an adjunct scholar of the foundation and a professor of economics at Indiana Wesleyan, contributed to the research for this article. Nothing written here is to be construed as reflecting the views of the foundation or as an attempt to aid or hinder the passage of any bill before the legislature or to further any political campaign.



did the trick. Through the period of Giuliani's apparent miracle (a crime rate reduction of 56 percent compared with the 28 percent national average), there was a correspondingly disproportionate reduction in unemployment and of the percentage of youths living in the city¹⁰ to explain the drop in crime.¹¹

Human history is mostly about political folly that ends in disaster. So, in the tradition of *Sankofa*,¹² let us review what our politicians have done for us.

In 1900, with politicians actually doing little, the United States was a safe place to live. Violent crime rates rose noticeably in the early 1900s¹³ in probable correspondence to the Jim Crow Laws; but the overall index crime rate, which includes burglary, larceny and auto theft as well as violent crimes, was fairly low and stable through the 1950s (see chart on page five).

Even during the Prohibition and Great Depression eras, when murder rates were extraordinarily high, the index crime rate was around 600 crime events per 100,000 citizens. But from the 1960s through the 1980s the index crime rate shot up almost 10 times as high, to 5,950 crime events per 100,000 citizens.¹⁴

Whatever the cause, all crime rates rose only slowly until the mid-1960s and early 1970s (an active period for our legislative, judicial and law enforcement systems; e.g., Miranda ruling and the War

on Drugs) when all crime rates shot up severely.¹⁵ According to the latest available Department of Justice statistics, Indiana's violent crime rates (figured as incidents per 100,000 citizens) rose from 1960 (84.6) until they were more than six times greater by 1996 (537).¹⁶

It's apparent that what we've been doing isn't working as advertised.

Recognizing that there's a problem is the first step. Let's take a second step by answering a few basic questions:

- What is crime?
- Can we end crime?
- What are citizens' risks in fighting crime?
- Is there a right way?
- Are we actually willing to do it?

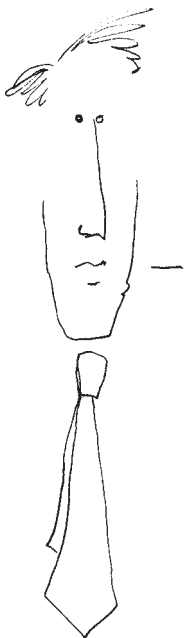
What Is Crime?

This is not a philosophical or academic question. Lately there's been a tendency to redefine the word "crime" as a "sentencing factor," by which courts dispense with many of our constitutional rights.¹⁷ So we need to define "crime" because our high priests of law will, if we let them, toy with even the meaning of the word "is."

But more importantly, defining crime determines the scale and scope of government's most critical role. And here in the Land of the Free, where we have the world's highest percentage of citizens in prison,¹⁸ scale and scope should be our

Indiana's violent crime rates rose from 1960 until they were more than six times greater by 1996. It's apparent that what we've been doing isn't working as advertised.

A simple, unambiguous and non-conditional definition of crime: "The intentional violation or harm of a citizen's body, rights, property or contracts."



"Well, when the president does it, that means that it is not illegal."
(Richard Milhouse Nixon)
May 20, 1977

first consideration. It is a simple question. But it is our first quandary. A Republican may say that gay marriage is a crime. A Democrat may say that poverty is a crime; but then, so is excess profit. Libertarians say that prostitution is OK but most of what government does is a crime.

As a result of this diametric opposition in defining crime, you can be fined for smoking cigarettes in some circumstances, but not all — not yet. Of course killing a human being is a crime, or not, depending upon whether it's called abortion, euthanasia or "hate-based." And theft can be a crime, or it can be "eminent domain," depending upon just who the thief is.

It's hard to define crime now that we are banning trans-fats and "hate speech."

So, in stark opposition to the endless litany of legal offenses now called crimes, and to help concentrate our resources on what's most important, how about a simple, unambiguous and non-conditional definition of crime as "the intentional violation or harm of a citizen's body, rights, property or contracts?" Doesn't such a definition cover all of the problems we really care about?

Certainly, such a definition means that gambling, or voluntarily consuming harmful substances, whether they're pot brownies made with or without trans-fats, should not tax our crime-fighting resources, let alone call for the SWAT (Special Weapons and Tactics) teams.

These morality-personal health issues are of lesser civil importance than are the crimes that cause harm to others.

Aren't we ready to consider this? It wouldn't be for the first time:

The drys seemingly are afraid of the truth. Why not take inventory and ascertain the true conditions. . . . A complete and honest and impartial survey would reveal incredible conditions, corruption, crime and an organized system of illicit traffic such as the world has never seen.

— Fiorella LaGuardia speaking on the disastrous effects of Prohibition¹⁹

Also, this definition allows no difference between the political and civilian classes. Murder is a crime no matter who does it. Extortion is a crime no matter who does it. Writing bad checks (like the \$2.1 trillion dollars Congress just added²⁰ to the national debt) is a crime no matter who does it.

Without such a definition, Indiana's traffic "Infraction Deferral Program" presents a conundrum. The program, if you haven't yet become acquainted with it, is basically this: You got caught speeding. But instead of points on your license and a jacked-up insurance rate, you pay a lot of money and the episode disappears from your record. The conundrum is this: if speeding is really a crime, why don't we offer an "Infraction Deferral Program" for other crimes like larceny or embezzlement, and spare us all the expense of courts and jails? Is it because the traffic program is actually government-run extortion?

This brings up the question that looms too silently over us: Are government policies that cause poverty, death and suffering crimes, or not? Are politicians who make destructive policies criminals, or not? Certainly, by the numbers and degree of suffering, no ordinary criminals and crimes can compare with the abuse we get from people in high places (see Hitler, Stalin, Mao, *et al.*).

Of course, with this proposed definition of crime, surely war is the most heinous of all crimes. We recognize this as true when we impose "war crimes tribunals" upon those we defeat. But what of ourselves?

Of all the enemies of true liberty, war is, perhaps, the most to be dreaded, because it comprises and develops the germ of every other. War is the parent of armies; from these proceed debts and taxes; and armies and debts and taxes are the known instruments for bringing the many under the domination of the few. No nation can preserve its freedom in the midst of continual warfare. . . . In war, the public treasuries are to be unlocked; and it is the executive hand which is to dispense them.²¹

— James Madison

Perhaps this simple, immutable definition of crime (the intentional violation or harm of a citizen's body, rights, property or contracts) could lead to more lasting peace, freedom, opportunity and plenty. But let's take one thing at a time . . .

Can We End Crime?

Of course not. But in order to set priorities and realistic objectives it is important to comprehend this fully. Along

with the dramatic rise in crime rates there were equally dramatic rises in prison populations. We went from being a nation with few prisoners to being the nation with the most prisoners in less than 40 years.²² While the number of conditional releases from federal prisons increased six-fold from 1970 to 1990,²³ the number of executions increased 300 percent in just the 1990s.²⁴ Interesting, and more than a little frightening, is that about 95 percent of all felonies are now settled through coerced plea instead of the constitutionally guaranteed right of jury trial.²⁵

Yet the rise in violent crime rates over the last century demonstrate, at the least, that criminalizing more behaviors and prosecuting them harshly has not ended any crimes at all. Passing more laws has not only made us lose our priorities, it has clogged our courts and prisons:

*Since 1961, the criminal justice system has been transformed from a law enforcement system into a thicket of criminal rights and make-work projects for nearly two million lawyers, judges, social workers, psychologists, criminologists, prison officials and other bureaucrats. More people now produce less justice.*²⁶

— Morgan Reynolds

It is truly shocking the kind of crimes that go unnoticed now that we focus on “criminals” like Martha Stewart instead of on our more savage tendencies:

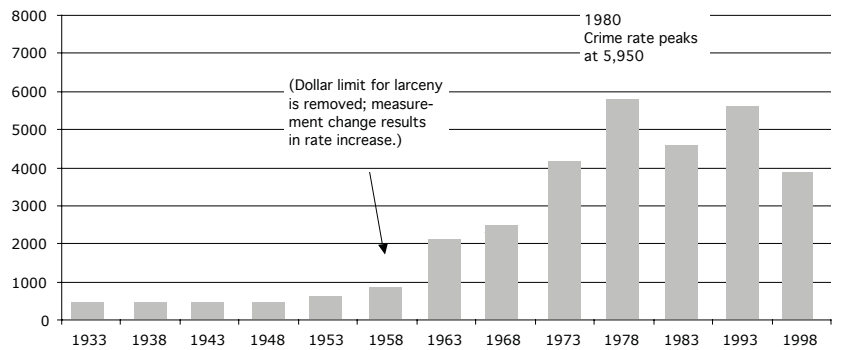
*Two hundred years ago, slaves were relatively scarce, expensive and publicly owned by men holding title deeds to them. Today, they are plentiful and cheap . . . and much harder to spot.*²⁷

— Priya Abraham

And our turn from individual freedom and responsibility to centralized political control has proven worse than ineffective; we’ve been lulled into danger. How could just a few men armed with only box cutters steer a big, relatively slow airplane into the heavily defended Pentagon over an hour after the first strike on the World Trade Center’s North Tower? Didn’t the passengers of Flight 93 prove, at the very least, that citizens can protect government better than government can protect citizens?

Humans are not so different today than in our more peaceful 1900. If we

United States Index Crime Rate — 1933 to 1998



Source: Crime and Justice Atlas 2000, Justice Research and Statistics Association, Washington, DC, June 2000. Changes in the overall incidence of crime are most often measured by examining the Index Crime Rate, which includes the reported crimes of murder, nonnegligent manslaughter, rape, robbery, aggravated assault, burglary, larceny and motor vehicle theft.

quit diverting our attention to seat-belt laws, and if we sufficiently reduce our scale and scope of law enforcement in answering our number one question, then we can substantially reduce the incidence of crimes like theft, rape, murder and slavery.

What Are Citizens’ Risks in Fighting Crime?

Citizens’ risks of fighting crime? What kind of question is that, you may well ask. Starting mostly with Prohibition, the idea that “it takes a thief to catch a thief” became quasi-official policy. “Dirty Harry” had nothing on the famous Izzy and Moe who wore disguises and flouted the law to shut down speakeasies.

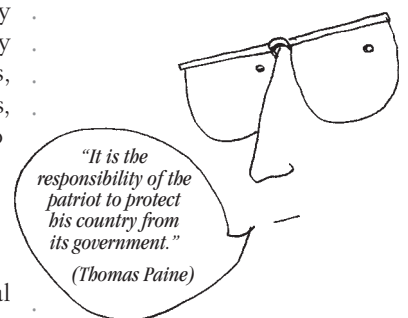
*It is my calculation that at least a million dollars a day is paid in graft and corruption to federal, state and local officers. Such a condition is not only intolerable, but it is demoralizing and dangerous to organized government.*²⁸

— Fiorella H. LaGuardia

Our War On Drugs is essentially identical to that earlier Prohibition; only now, policemen drive pickup trucks, among other unlikely undercover vehicles, not to go after drug dealers but just to catch speeders. They pose as prostitutes to catch prostitutes. And hobnobbing with criminals seems infectious; five Chicago police officers were recently charged with running their own illegal drug ring.²⁹

But it gets much worse than that. Fighting crime is not about policemen. Law enforcement — although policemen do all the heavy lifting and get all the

We no longer have a culture in which Barney Fife asks Andy if he can have a bullet for his gun. We live where policemen have military hardware, body armor and are trained that individuals may be sacrificed to a “law” that isn’t necessarily written anywhere.



For several years Harris County, Texas, police shot, on average, one unarmed person per month. Policeman in Portage, Indiana, tasered, pepper-sprayed and hog-tied a teenager who was choking and needing help. And why does Boone County, Indiana, have an amphibious armored personnel carrier?

blame when things go wrong — is about lawmakers and, increasingly, judges.

In March 1997, Gail Atwater was driving slowly through Lago Vista, Texas, without seat belts on either herself or her two children. So Officer Bart Turek arrested and handcuffed Atwater. A neighbor took the children, and Turek took Atwater away to be partially undressed and thrown in jail. In the ensuing Supreme Court case *Atwater v. Lago Vista*, the court ruled that there is essentially no difference between misdemeanors and felonies in the use of police force. And that force is considerable. We no longer have a culture in which Barney Fife asks Andy if he can have a bullet for his gun. We live where policemen have military hardware, body armor, and are trained that individuals may be sacrificed to a “law” that isn’t necessarily written anywhere. For years now, police forces have been moving beyond SWAT teams and toward standing-army mode. Even so, one must wonder why Boone County, Indiana, would need an amphibious armored personnel carrier.³⁰

Through increasingly aggressive “zero-tolerance” politics, police forces are gradually being pushed from “protect and serve” into an openly adversarial role that goes far beyond speed traps. In fact, we must think of death as the price of any law because, after *Atwater v. Lago Vista*, there are no hard limits as to how far government can go to enforce a law. In other words, if there’s a ban on hydrogenated vegetable oil, can somebody with a fried Twinkie be gunned down, and the judge will say no harm’s been done to our liberty?

And we don’t have to look at the ghastly but rare cases like Ruby Ridge³¹ and Waco³² to find causes for concern.

An Atlanta Associated Press (AP) story dated Jan. 10 of this year said, “A British historian was handcuffed, thrown to the ground and taken to jail after he refused to use a crosswalk as directed by a police officer.” Or how about CNN’s report from Minnesota: “85-year-old man beaten, peppered for not pulling over soon enough”?

Harris County, Texas, detailed 22 inappropriate police-action shootings in which many victims did nothing at all, and the worst alleged crime was shoplifting.

For several years Harris County police shot, on average, one unarmed person per month, yet only five police officers faced disciplinary action of any kind.³³

Sure, accidents happen, and policemen are under a lot of pressure. No policeman really intended to taser, pepper-spray and hog-tie the teenager in Portage, Indiana, who was choking and needed help.³⁴ Police work is not as likely to be fatal as being a logger, waitress or cabbie; but danger combined with authority, body armor and military guns does predispose one to forceful response. And when politicians’ appetites require more police force, police training suffers.

According to a recent AP story, “At least 30 states let some newly hired local law enforcement officers hit the streets with a gun, a badge and little or no training.” Indiana happens to be one of those states.

This brings us to both our definition of crime, and our biggest risk in fighting crime.

Try to think of a civil right, a constitutional law or even a moral custom that isn’t routinely trampled by our government. You may find that there isn’t one. Starting bit by bit since *Marbury v. Madison* and accelerating rapidly since 9/11, we’re increasingly ordered about by what seems to some of us as the blustery whims of an ensconced elite. They are politicians without restraint, power without law; ungoverned government. Hasn’t the Rule of Law been stolen? Isn’t that a crime?

So how do we know when we risk too much?

First, we need to acknowledge that political solutions rarely work as planned. Did the War on Poverty end poverty? Did the War on Drugs end our drug problems?³⁵ Have we had a year of peace since the War to End All Wars? Once we exercise some healthy skepticism, then we must choose our price tag.

Governments always put a price tag on human life. We should be savvy about the price tag of government.

Let’s be blunt about that risk. There is no long-term history of benevolent human government. Freedom is rare. Oppression, slavery, genocide and war

is the human default state. Our nation's founders knew this. It's why we have a Second Amendment. George Mason said, "To disarm the people is the best and most effectual way to enslave them."³⁶

Have we acknowledged the risk of citizen disarmament?

The March 12, 2007, *Indianapolis Star* editorial, "Let's Get Smart About Fighting Crime," contained the usual words about dropout rates, police funding and "quality of life" issues.

But it also proposed: "Honestly examining how violent criminals obtain their weapons — more than 80 percent of the homicides in Indianapolis last year involved the use of a gun — could lead to common-sense restrictions that separate thugs from their deadly tools."

Common-sense restrictions?

Surely we don't suppose we'd end bank robbery by banning ski masks. Does anyone argue that the 31 unarmed students in Norris Hall were better off depending on the judgment of the Virginia Tech president? And we show no concern over the 20 percent of homicides committed with bare hands, knives, clubs or even more ghastly means. Just as a bull falls to the sword because he's fixed on the red cape, we too easily fix our attention to guns and ignore a historically much bigger problem.

The problem with gun restrictions isn't only that they don't work. And the problem is not even that more guns actually mean less crime.³⁷

The real problem is that history shows gun restriction to be a societal disaster — even a Holocaust (see interview below right). The racist, "Black Law" history of gun prohibitions in the U.S.³⁸ is only a foreshadowing of what would happen to civil rights should our politicians become the only power in America.

We should understand that politicians' desire to disarm citizens has nothing to do with what we typically call crime.

Switzerland has for generations been one of the most peaceful and safe nations on earth. For precisely as long, Switzerland has maintained a citizen militia instead of the large standing army.

But now Switzerland is contemplating disarmament. The Swiss newspaper *Le Temps* says that gun control "should be

more important than emotional aspects and the natural instinct to oppose any state interference in citizens' rights and freedoms."³⁹ Why?

The United States of America was literally born to oppose gun control. "The Shot Heard 'Round the World," the first volley of our Revolution, was the colonist's reaction to the British intent to capture weapons stored at Concord, Massachusetts, on April 19, 1775.

The most effective means of fighting crime in the United States is to outlaw the possession of any type of firearm by the civilian populace.

— Janet Reno, addressing a 1991 B'nai B'rith gathering in Ft. Lauderdale

And now the 110th U.S. Congress has proposed reinstating and expanding the "Assault Weapons Ban" into the "Assault Weapons Ban and Law Enforcement Protection Act of 2007."⁴⁰

This year will go down in history. For the first time, a civilized nation has full gun registration. Our streets will be safer, our police more efficient and the world will follow our lead into the future.

— Adolph Hitler, April 15, 1935, in an address to the Reichstag

What are the risks of fighting crime, you say?

"There is no doubt in my mind that millions of lives could have been saved if the people were not 'brainwashed' about gun ownership and had been well armed."

— A Holocaust survivor, Theodore Haas

A Holocaust Perspective

Q — Did the camp inmates ever bring up the topic, 'If only we were armed before, we would not be here now'?

A — "Many, many times. Before Adolph Hitler came to power, there was a black market in firearms, but the German people had been so conditioned to be law abiding, that they would never consider buying an unregistered gun. The German people really believed that only hoodlums own such guns. What fools we were. It truly frightens me to see how the government, media and some police groups in America are pushing for the same rationale. In my opinion, the people of America had better start asking and demanding answers to some hard questions about firearms ownership, especially, 'If the government does not trust me to own firearms, why or how can the people be expected to trust the government?'

"There is no doubt in my mind that millions of lives could have been saved if the people were not 'brainwashed' about gun ownership and had been well armed. Hitler's thugs and goons were not very brave when confronted by a gun. Gun haters always want to forget the Warsaw Ghetto uprising, which is a perfect example of how a ragtag, half-starved group of Jews took up 10 handguns and made asses out of the Nazis."

— Aaron Zelman interviewing a Holocaust survivor, Theodore Haas, Wilkes-Barre, PA, 1990

*Half of the city of Michoacán
(home town of Mexico's
president, Felipe Calderón) is
illegally in the United States.*

Is There a Right Way?

Human beings haven't changed tendencies since 1900; how can we get back down to 1900's rates of crime? The answer is simplicity itself: Undo what doesn't work, *i.e.*, govern government; reduce the number of crimes; tame the Pharisees; and morality, prosperity and literacy.

*The first maxim of a man who loves liberty should be never to grant to rulers an atom of power that is not most clearly and indispensably necessary for the safety and well-being of society.*⁴¹

— Richard Henry Lee

Govern Government

Constitutions are a leash on politicians, not on citizens. Just as we're not allowed to "interpret" traffic laws, our politicians must be denied the ability to disobey laws that bind them. Evidence suggests that the accelerating trend toward so-called "federal"⁴² law, federal jurisdiction and even federally mandated local policy has increased crime.⁴³ The 1966 Miranda decision, for example, caused a sudden and permanent drop in confessions and arrest clearance rates.

Federal funding and crime grants that divert money from areas with successful crime fighting to areas of poor performance, or from poor areas low in crime to wealthy areas high in crime, inadvertently subsidize crime. And 1974 federal mandates to divert juveniles from the justice system correlate to a doubling of juvenile violent crime rates in just 10 years.⁴⁴

While many federal lawmakers understand the connection between poverty and crime, their attempts to end poverty have backfired terribly causing more entrenched poverty, illiteracy, family breakdown and crime. It has been estimated that the American Families with Dependent Children program itself increased sexual promiscuity and crime among those children raised on it.⁴⁵

All of this is even before considering the crime rate increases caused by border policies over the last 20 years. The number of Americans killed by illegal immigrants every year is almost equal to the total number of Americans killed in Iraq since 2003.⁴⁶ Overall, perhaps a tenth of the population of Mexico is living illegally

in the United States. Half of the city of Michoacán (home town of Mexico's president, Felipe Calderón) is illegally in the United States.⁴⁷

Putting this in perspective; our government is spending hundreds of billions of dollars on the statistically far less significant problem of terrorism, and essentially ignoring the larger problem within our borders. Congress is daily making laws such as H.R. 137, the Animal Fighting Prohibition Enforcement Act, which makes a federal crime out of selling cock-fighting paraphernalia,⁴⁸ while perhaps the largest invasion of all time takes place under their noses.

The solution to this foolishness is simple, and analogous to the advice a flight attendant gives you about putting the oxygen mask on yourself before attempting to assist others. First put the leash on politicians; then we can put one on our criminals.

Reduce the Number of Crimes

Seat-belt laws, anti-gun laws and other distractions sap our resources and divert our focus from real problems. Properly define what "crime" is and call everything else something else on a lesser scale of importance. We have to. Our judicial and prison systems are overloaded. While things may be even worse now, a New Citizenship Project study 10 years ago⁴⁹ showed:

- About one-third of all persons arrested for a violent crime (murder, rape, robbery, assault) are already on probation, parole or pretrial release.
- The vast majority of convicted criminals are not incarcerated.
- Barely one criminal goes to prison for every 100 violent victimizations.
- And most violent prisoners serve less than half their sentence behind bars before being released.

We must simplify, prioritize and focus in order to minimize our risks and maximize the benefits of fighting real crime.

Tame the Pharisees

According to the New Testament, the class of highly legalistic and demagogic priests who twisted God's words to their own ends and persecuted Christ were called Pharisees. Today there are too many lawyers and judges who twist

constitutional law, suppress evidence and confessions, favor criminals over victims, weaken juries, allow legal legerdemain and make justice costly, slow and unlikely.

Pull these people down from their pedestals and make them stick to legal simplicity with as-written laws and processes. They worked in 1900.

We should never allow judicial pronouncements to muddy the words of law. If a law is unclear and needs to be changed, the proper place to handle that is in the legislatures, not in the courts. Instead of referring to “legal precedents” we should just read the law.

If nothing else, this would save a great deal of money and time. Just for example, it takes only a half-hour or so to read the entire U.S. Constitution and all its amendments. How long would it take to read the legal contortions our courts have put us through regarding the single-sentence-long First Amendment? But perhaps most importantly, following laws as written would make laws knowable outside the circle of the legal elite. Ordinary people must know the laws by which we must live. The Latinate incantations and intercessory agents of our current system amount to an oppressive unknown:

Where justice is denied, where poverty is enforced, where ignorance prevails and where any one class is made to feel that society is an organized conspiracy to oppress, rob and degrade them, neither persons nor property will be safe.

— Frederick Douglass (Speech on the 24th anniversary of Emancipation, Washington, D.C., April 1886)

Morality, Prosperity, Literacy

The facts are compelling in this area. Sons of absentee fathers are twice as likely to end up in jail compared with boys raised in a two-parents home. Boys raised by a stepfather are three times as likely to end up in jail as boys raised by their own parents.⁵⁰

Despite upbeat talk about our economy, real wages have dropped significantly since the 1970s, and have correlated to increases in crime.⁵¹ In fact, increased per capita income appears inversely proportional to crime.⁵² Real literacy has plummeted since 1950, and illiteracy contributes to delinquency which correlates to crime.⁵³ A study showed that 17 percent of school children in California believe it’s legal to

break into somebody else’s locker, ten percent think it’s OK to keep stolen goods or break the law for revenge, and half of the children had already knowingly broken the law.⁵⁴

It’s been proven so many times that it should be a motto that socioeconomic health is inversely proportional to crime.⁵⁵ The more prosperous and socially healthy a group of people is, the less crime they will suffer. We know that free-market economics works better than anything else, and that traditional morals work better than any others. Sadly, parenting is not something we can delegate to politicians and teachers, no matter how hard we try. But market freedom and school choice is a matter of public policy.

The Indiana Policy Review Foundation has already done a lot of work on both education and market reform; all we need to do is reject the prevailing nonsense and implement wise policy proven to work.

Are We Actually Willing to Do It?

We Hoosiers devote a lot of time and tax money to professional sports. Our politicians spend a lot of time and our money courting foreign businesses. We’re working on full-day kindergarten, smoking cessation programs, more roads, more spending on pretty much everything from carbon credits to universal health care. Do we have the bandwidth to address crime too?

Almost immediately after swearing into his first term of office, Indianapolis Mayor Bart Peterson issued a press release, “Mayor Makes Police, Fire Pension Relief City’s Top Legislative Priority.”⁵⁶ That pushes an awful lot of important things down the list of priorities; one of them is actually fighting crime.

At the beginning of 2007, Mayor Peterson promised “bold action” and sought \$85 million per year to wage a “war on crime.” A large percentage of that money will go to police and fire pensions because, according to Peterson, “One of the greatest impediments to finding money for the fight against crime is the growth in unfunded pension liabilities for retired police officers and firefighters.”

This is analogous to saying that we must give teachers better insurance policies in

The more prosperous and socially healthy a group of people is, the less crime they will suffer. In that regard, we know that free-market economics works better than anything else, and that traditional morals work better than any others

Mayor Peterson promised
"bold action" and sought
\$85 million per year to wage
a "war on crime." A large
percentage of that money will
go to police and fire pensions.

order to increase our children's test scores.
There may be a relation here, but it's at
best indirect.

The core question is just what do we
think government is supposed to do for
us? Is it to fight crime, or is it to play ball?
Apparently it can't do both.

Maybe it's time to define what
"government" should mean. While that
is itself a deep subject, I'd suggest we
define government as, "Dangerous power
employed solely to protect citizens from
the intentional violation or harm of a body,
rights, property and contracts."

But then the real bravery and action
begins. Because if we're to have Liberty
and Justice for All, we must fight politicians
for it with eternal diligence.

We must, somehow, bravely, thoroughly
and thoughtfully pare away from politicians
what we cannot risk and leave only what
works. The artist, Michelangelo, said, "I
saw the angel in the marble and I carved
until I set him free." Only in this case,
citizens are that angel, and we must carve
ourselves free.

Q

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"The most important consequences of public policy toward crime may be their tutelary, not their direct, effects. How we spend money on schools, job training or welfare programs may be less important than the message accompanying such expenditures: Do we appear to be rewarding the acceptance or the rejection of personal responsibility?"

— James Q. Wilson and Richard J. Herrnstein in the conclusion of *"Crime & Human Nature,"* Simon and Schuster, 1984.

ORDERING (AND ORDER IN) THE CITY

*Beyond "Broken Windows"
Or Can We Zone Away Crime?*



After years of attributing the problems of urban decay and disorder to intractable "root causes," city officials now embrace "root solutions" that seek to eliminate these problems directly, regardless of their causes.

by NICOLE GARNETT

The walls of the Palazzo Pubblico in Siena, Italy, are graced with Ambrogio Lorenzetti's striking frescos contrasting the effects of "good government" and "bad government" on 14th-century city life.

In the city under good government, men work to repair stately buildings, women socialize in the streets, and merchants sell their wares in a busy marketplace.

In the city under bad government, the buildings are crumbling, men stand idle (save one crafting weapons), bandits terrorize the innocent, and the bodies of murder victims lie in the streets.¹

The goals of urban policy, it appears, have not changed in over 600 years.

Over the past two decades, however, the conventional wisdom about how to achieve these goals in American cities has been turned on its head. After years of attributing the problems of urban decay and disorder to intractable "root causes," city officials now embrace "root solutions" that seek to eliminate these problems directly, regardless of their causes.²

A primary catalyst for this change was the articulation in 1982 of the "broken windows" hypothesis by George Kelling and James Q. Wilson.³

This now-familiar theory is that uncorrected manifestations of disorder, even minor ones like broken windows, signal a breakdown in the social order that accelerates neighborhood decline.⁴ The response to this theory, and to a growing disillusionment with modern policing practices generally,⁵ has been a proliferation of policies focusing on public order, such as former Mayor Rudolph Giuliani's "quality of life" and "no-tolerance" programs, as well as ubiquitous "community-policing" efforts.

Broken-windows policies have generated a vast legal literature, most of which focuses on police efforts to restore order by enforcing criminal laws. This scholarship falls into two broad, and overlapping, categories: First, "social norms" scholars argue that order-maintenance policing strategies are needed to shore up important nonlegal social controls.

As Dan Kahan observed in *Between Economics and Sociology*: "(c)racking down on aggressive panhandling, prostitution, open gang activity and other visible signs of disorder may be justifiable on this ground, since disorderly behavior and the law's response to it are cues about



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"Good Government," Ambrogio Lorenzetti, 1337-1340, Palazzo Pubblico, Siena, Italy

Officials schooled in the ideology of Euclidean zoning may naturally tend to equate ordered land uses with the absence of disorder. They also may be wrong.

the community's attitude toward more serious forms of criminal wrongdoing." Second, and in response, criminal-procedure scholars concentrate primarily on the constitutional questions raised by the discretion afforded police officers by order-promoting criminal laws.

Largely missing from the academic debate about these developments is a discussion of the complex and important role of property regulation in order-maintenance efforts. To be fair, broken-windows scholarship concentrates primarily on policing strategies that are, in a sense, property regulations: They seek to restore order by regulating public places—streets, parks, etc.⁶ But traditional private-property regulations also affect order-maintenance efforts in important, and understudied, ways.

In my study of this issue I have attempted to fill that property-law gap in the public-order puzzle by tackling the complicated relationship between property regulation and order-restoration efforts.

Property regulations shape the order of American cities in two different ways. First, some—housing and building codes and nuisance laws—target the physical (and related social) disorders that signal, and contribute to, urban decline. Second, others—zoning laws—define and construct the proper ordering of urban land uses. It is hardly surprising that city officials eager to curb disorder have seized upon the first, "disorder-suppression" function of property regulation. Social

scientists have long linked property conditions with community health. (Put most simply, the presence of an "eyesore" is a negative indicator of neighborhood health, as Wilson and Kelling's precursor to spiraling disorder—the broken window—suggests.) Furthermore, constitutional rules governing police discretion limit, for good or ill, a community's ability to curb disorder through flexible criminal laws such as loitering and vagrancy prohibitions.⁶ Property regulation offers vast enforcement flexibility without raising the same constitutional concerns, making it all the more attractive to city officials.

American property regulations, however, do far more than suppress disorder. Our most significant form of land-use regulation, Euclidean zoning, also reflects a long-standing value judgment that the appropriate way to order different land uses is to separate them from one another into single-use zones. City officials schooled in this ideology may naturally tend to equate ordered land uses with the absence of disorder. They also may be wrong.

As Jane Jacobs observed many years ago in *The Death and Life of Great American Cities*: "There is a quality even meaner than outright ugliness or disorder, and this meaner quality is the dishonest mask of pretended order, achieved by ignoring or suppressing the real order that is struggling to exist and to be served." In other words, as I have suggested elsewhere, when property is over- or misregulated,

"There is a quality even meaner than outright ugliness or disorder; and this meaner quality is the dishonest mask of pretended order, achieved by ignoring or suppressing the real order that is struggling to exist and to be served."

— Jane Jacobs

property regulations may impede efforts to restore a vibrant, healthy and organic public order.⁷ Q

Endnotes

1. Effetti del Buon Governo, Ambrogio Lorenzetti, 1337-1340, fresco, Palazzo Pubblico, Siena; Effetti del Cattivo Governo, Ambrogio Lorenzetti, 1338-1340, fresco, Palazzo Pubblico, Siena. Ironically, while the former remains in nearly pristine condition, large sections of the latter have crumbled away over the years. See Ambrogio Lorenzetti's frescos in the Sala dei Nove, Palazzo Pubblico, Sienna, <http://www.tulane.edu/~tluongo/Lorenz/> (last visited Aug. 10, 2004).

2. See, e.g., Wesley G. Skogan, *Disorder and Decline: Crime and the Spiral of Decay in American Neighborhoods*, pp. 126-27, 161 (1990) (distinguishing between "root causes" of and "root solutions" to urban disorder).

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4. *Ibid.*, at pp. 31-32.

5. The influence of the Broken Windows piece can hardly be overstated. See, e.g., William D. Valente and David J. McCarthy, Jr., *Local Government Law*, p. 835 (4th ed., 1992) (noting that the director of the U.S. Department of Justice's



"Bad Government" (detail), Ambrogio Lorenzetti, 1337-1340, Palazzo Pubblico, Siena, Italy

National Institute of Justice has observed that Wilson and Kelling's article "has had a greater impact than any other article in serious policing"). Still, it would be overly simplistic to suggest that this magazine article alone revolutionized urban policing policy. Rather, the piece grew out of, and complemented, a growing body of literature supporting older, "hands-on," policing practices.

6. For example, the anti-gang-loitering law invalidated by the Supreme Court in *City of Chicago v. Morales* had "zoning" characteristics; it was enforced only in "areas in which the presence of gang members ha(d) a demonstrable effect on the activities of law-abiding persons in the surrounding community."

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Sex Businesses Always Affect a City

Many have said strip clubs are no big deal — people should just 'live and let live.' In today's anything-goes society, it isn't surprising that few see problems with SOBs (Sexually Oriented Businesses). However, is it an act of good citizenship to view strip clubs as merely places where men go for a beer or a bachelor party? Could there be a darker side to SOBs? Over the last 30 years, there have been 40 studies conducted in 17 states studying SOBs. They have such consistent findings that courts have ruled that cities may rely upon them to regulate SOBs. The findings prove that strip clubs and (sex-oriented) bookstores lower property values and increase crime. A study of Indianapolis found a 20 percent reduction of property values near SOBs. — Micah Clark, executive director, American Family Association of Indiana, in the March 23 Fort Wayne News-Sentinel



'SHERIFF, I'VE BEEN ROBBED'

*This Fort Wayne Crime Victim Was Never
Interviewed for the Evening News*

A Fort Wayne Police Department mired in political correctness periodically must ask the Allen County Sheriff's office to conduct saturation patrols (lately formalized as the Metro Squad) to restore order in certain central neighborhoods. The author recalls this profound encounter during an operation of the first such patrol in 1990.

by JOE SQUADRITO

In my 33 years of police work, many experiences haunt my memory. Some were good or humorous; others were sheer horror that even today wake me from my sleep.

I wish they could be separated, remembering the good and casting away forever the ugly. Time does not erase any of these memories. Instead, you learn to cope with it, getting lost in your work or just trying to roll over and get back to sleep. This scenario below began with a rush of adrenaline and words spoken that I'll never forget.

Halfway through my first term as Allen County sheriff I received a request from several Fort Wayne officials to move my officers into a quadrant that had become a battleground for gang violence. The body count had reached an all-time high and the number of drive-by shootings was accelerating at a record pace.

Elected officials, clergy and citizens groups all expressed deep concern that a quadrant of the city would be

lost to gangs and drug dealers. The requests for assistance came from elected representatives, appointed officials, clergy, school officials and parents.

I weighed these requests knowing that I was in a no-win situation politically. As sheriff, I had a responsibility to the entire county and not just the suburbs and rural areas. I also had a staff with the planning and tactical skills required to accomplish this mission.

What I didn't know was whether I had the strength to survive the media and political onslaught. The prospect of critical editorial writers, reporters, complaints of police abuse, second-guessing and petty politics all swirled through my mind. I remember meeting with my staff and city police officials that hot summer morning and then retreating to a nearby park for some solitude, self-evaluation and a good cigar. The question was not if I would do it — I had to, I could not live with myself if I didn't. The real question was could I withstand the fire-storm that my actions would create. The words of one of my most trusted friends and political advisors kept creeping up in my mind:

"Joe, don't do it. The media will crucify you, and if something goes wrong, all those people who begged you for help will throw you to the dogs, right or wrong. Let the d*** place burn to the ground, and then let the mayor ask the governor for help. S**** them." Even today, I smile when I think of this advice, especially

"Joe, don't do it. The media will crucify you, and if something goes wrong, all those people who begged you for help will throw you to the dogs, right or wrong."

— Legal advisor to former Allen County Sheriff Joe Squadrino



Joseph Squadrino, a founding member, served two terms as sheriff of Allen County from 1991 through 1998. One of the county's most popular politicians, Squadrino now is a custom carpenter in Fort Wayne.

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His children finished their education and married. Two had children of their own. And by 1980 the neighborhood changed — encouragingly so. It had become more racially mixed. The principal of the public school there was black and for the first time there was a black on the City Council.

since the advisor was a well-educated, mild-mannered, silk-stocking attorney. I call it his “Irish moment.”

That evening we moved into the city. The quadrant involved was broken down into zones with the majority of my people placed at the biggest trouble spots. I put on my uniform and went with them just to show support for the task at hand and to be there if something went wrong.

Within the first hour, television crews and broadcast journalists began shadowing our patrol vehicles trying to find the sheriff. Our dispatchers kept calling me relaying requests from the media for an on-site interview or, for the lazy ones, a telephone interview. I acknowledged the radio transmissions but ignored the individual requests. A press release was to be transmitted to each news source at 10 p.m. that evening, which was well into our patrol time. This was planned as certain targeted individuals had to be in custody for our plan to succeed. A general media release might have jeopardized this. It also gave us four full hours to get the principal targets off the street.

By 10 p.m. our plan indeed had been fulfilled and the press release transmitted. The remaining hours were spent on specific neighborhood patrols.

I decided to stretch my legs, smoke a cigar and just walk the neighborhood where two drive-by shootings had occurred the night before. I parked my car, reached above the sun visor for a *Cobiba* and just as I started for the curb observed a tall middle-aged black man approach me from the sidewalk. I recognized his face from various veterans’ functions. As we approached each other, he exclaimed, “Sheriff, I’ve been robbed.”

He didn’t look like a victim; he wasn’t excited or visibly shaken. The octave level of his voice, though assertive, was not elevated. “Sheriff Joe, I’ve been robbed just as if someone took a gun to me.” I stood silent for a moment. “I’ve been victimized — lost my money, somebody took it. You see, Sheriff Joe, these dope-dealing punks stole from me and my family just like bandits do.”

At this point, I realized the man was speaking rhetorically and had not actually been robbed on the street. He explained

that he knew me and saw me patrolling his neighborhood earlier that night. “I recognized you from Post 82. You were a Marine, same as me, Korea right?”

I explained that I was in the Air Force, and my war was Vietnam (being ugly makes me look older). “That’s too bad,” he said with a laugh. “I always thought that you were a Mud Marine just like me.” He had fought in the Pacific during World War II and was recalled for Korea.

Both he and his wife had worked at International Harvester. Except for breaks during both wars, he had almost 40 years on the assembly line. His wife had 36 years at the plant. They both retired when the plant closed.

“Sad, sad day — broke my heart — d*** sure did. My heartache now is this house and my neighborhood.” He then explained to me in real-world terms the manifestations of urban decay in a way that no urban theorist, college professor or public official could.

In 1959, he and his wife paid a premium to move into their garrison-style home in a historically all-white, Lutheran neighborhood. He and his wife heard about the year-old house at a church meeting. They were both Lutherans and their children attended their church’s school. The church and school, however, were scheduled to relocate to the suburbs.

Their options were limited but moving from the central city to the far south side seemed like the most viable plan. Their new neighborhood was all white, middle-class and mostly Lutheran. Their three children could walk to school each day in less than five minutes. He and his wife could be at work in 10 minutes.

Again, they paid a premium to buy this house and lost money on their old house. He explained that considering the number of working years he had left, coupled with the appreciation of his new home, his family expected to be ahead in the end.

Things went well. His children finished their education and married. Two had children of their own. And by 1980 the neighborhood changed — encouragingly so. It had become more racially mixed, filling with other Harvester and Fruehoff

employees plus recent college graduates. The principal of the public school there was black and for the first time there was a black on the City Council.

All this changed with three strokes of bad luck. First, the Fruehoff plant closed putting four neighbors out of work. Then Mobile Aerial Towers was sold and relocated to Wisconsin, putting three more bread winners out of work. The final blow came when International Harvest closed its Fort Wayne works and moved to Ohio.

Houses didn't get painted. In fact, some sat vacant or for sale for what seemed like an eternity. Many were sold as rental property. Soon, weed-ordinance signs began to go up and building code violations were posted. Then the gang members began cruising the neighborhood. Next came the drive-by shooters and curb-side dope dealing.

As my new-found friend explained all this on the street that night I noticed that some of the nearby homes were battered but others were still well-maintained. Two houses across the street, however, were boarded up completely. I well remembered what this neighborhood looked like 20 years ago — flower boxes on the windows, a hotdog and root beer stand and a Lutheran school yard filled with running, hopping, screaming children, coats on the fence and shirt tails half out.

My mind told me how this happened but could not admit to why it happened. Were we blind, lazy, unconcerned or just plain powerless? My thoughts were drifting and I really wasn't focusing on what this man was saying. I put all my thoughts and memories back in their proper place and turned back to the conversation.

The old Marine was explaining further why he considered himself a victim of a robbery. His home in 1992 was worth less than half of what he paid in 1959 in spite of renovations. His children and grandchildren were reluctant to visit after dark, much less stay overnight. In the evening, he and his wife cannot sit on the front porch or walk to church meetings. His grocery store and pharmacy are gone as are the hardware and paint stores. "One's a pawn shop for hoods and thugs; the other is a buy-here, pay-here junk car joint. My Sears store is closed and my barber got

shot dead. I worked hard. I fought twice for my country. I raised my family, paid my mortgage in 16 years, paid my taxes on time every time and now in my senior years I get all this grief. H***, they even shot someone in the parking lot of my American Legion Post a week ago. I've been robbed — just like they held a gun on me — just ain't no difference."

My cigar was just a nub by then and I figured it was time to get back to patrolling. I'll always remember that encounter with the old Marine. It reinforced my decision to move officers into the city. Most of all, it clearly defined the relationship between urban enterprise — or lack thereof — and urban decay.

That old leatherneck put it in its true and vivid perspective. Over the years, we were asked to move into the city three or four more times and each time we responded. The media made of it what they did, never really focusing or perhaps understanding the intrinsic relationship between inter-city jobs and inter-city neighborhoods. Some 14 years later the majority of media outlets still fail to see the complex plight of people trapped within such a combat zone (*see box below*).

I imagine that old Mud Marine is gone now but he taught me a lesson in the classroom of life that I will always remember and he instilled in me a graphic understanding of the relationship between jobs and our neighborhoods. Q

The final blow came when International Harvest closed its Fort Wayne works and moved to Ohio. Houses didn't get painted. In fact, some sat vacant or for sale for what seemed like an eternity. Many were sold as rental property. Soon, weed-ordinance signs began to go up and building code violations were posted. Then the gang members began cruising the neighborhood.

An Alternate (More Sensitive) Force

Police Chief Rusty York) said he wouldn't be comfortable if Metro Squad members become aggressive in dealing with community members. City Councilman Glynn Hines, D-6th, who represents most of southeast Fort Wayne, fears a 'John Wayne' approach could easily lapse into harassment. 'If they're going to be sharing intelligence on gang activity with the police, that's great,' he said. 'But if they're going to be stopping young black men because they're young black men, then that's not good. They need a well-thought-out plan for cooperation rather than a John Wayne approach.' . . . The original Metro Squad's legacy still haunts the law enforcement community. Created in the early 1990s as the crack cocaine epidemic and record homicide rates engulfed Fort Wayne, the Metro Squad comprised primarily county officers, including several reserve officers, who ventured into southeast Fort Wayne in groups, former Police Chief Neil Moore recalled. 'There would be a lot of officers in a car, and one would always exit with a shotgun,' he said. 'Their tactics were reasonably aggressive.' The squad was eventually disbanded. York has made repairing the relationship between police and the minority community a priority during his tenure. — *Editorial (excerpt), the Fort Wayne Journal Gazette, March 19, 2007*

PAYDAY LENDING AND PUBLIC POLICY

What Elected Officials Should Know

*In the last decade in Indiana
there has been a twenty-
fold increase in licensed
payday loan locations*

by **TOM LEHMAN**

The emerging payday loan industry is one of the fastest-growing segments in the broader consumer financial services market. One estimate suggests that the number of payday loan offices nationwide increased from roughly 300 in 1992 to nearly 10,000 by 2001 (Brown, Findlay, Lehman, Maloney and Meehan, 2004). The Community Financial Services Association of America (CFSA), a trade group representing the payday loan industry, currently reports on its web site (www.cfsa.net) that there are over 22,000 payday advance locations nationwide extending roughly \$40 billion in short-term credit annually. By other estimates, there are currently over 22,000 payday loan outlets across the country, possibly extending as much as \$40 to \$50 billion in short-term credit (Stegman, 2007).

In Indiana, trends appear to mirror the nationwide growth in this industry. According to the Indiana Department of Financial Institutions (DFI), there are a total of 563 licensed payday loan locations in the state (Indiana DFI, 2007). Of those, just 27, or less than five percent, were licensed and operational before 1996, an over twenty-fold increase in payday loan storefront locations in the last decade.

This is consistent with the experience of other states. The number of payday

loans in Ohio (1,408) has doubled over the past five years. Over the past 10 years, the number of payday loan outlets has grown twenty-fold in Utah (384) and ten-fold in Kansas. California has grown from zero payday loan stores in 1996 to over 2,300 by 2004 (Stegman, 2007). In my city of Marion, Indiana, the DFI report identifies at least seven payday loan firms operating 10 different storefront locations. Five of those locations, or half of the shops in the city, have been operational only since 2004. Only one location was in operation prior to 1996. Clearly, the demand for short-term credit is booming, and cash-advance firms have responded rapidly to meet this market demand over the last decade.

At the same time, and despite (or perhaps because of) its infancy, payday lending is becoming one of the most heavily regulated segments of the financial services industry. Thirty-nine states, including Indiana, permit regulated payday loan operations, limiting fees that can be charged, setting maximum loan amounts per borrower, limiting the term of loans, and setting limits on the number of times a customer may access multiple or repeated payday loans in a given period. Eleven states explicitly outlaw payday loan operations



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altogether¹ (although payday lending is a *de facto* reality in virtually all states due to the Internet and telephone). Currently, payday loan operations are regulated on a state-by-state basis in compliance with broad federal guidelines set by, among others, the Truth in Lending Act and the Federal Deposit Insurance Act (Brown *et al.*, 2004; Elliehausen and Lawrence, 2001). However, current trends suggest that federal regulation targeting the payday lending industry could be forthcoming, and state legislatures continue to debate proposals for further regulating or even banning the practice altogether (Stegman, 2007).

Given this tenuous environment, it is important for elected officials to have a better understanding of the economics of payday lending, the markets in which these firms operate and the consumers they serve. The general consensus appears to be that payday lending is a practice that offers few benefits and may do harm to unwitting borrowers, thus necessitating government intervention and regulation. This article hopes to counter that view by providing an analysis of the payday lending industry, its history and market characteristics, the profile of its “typical” borrower, numerous criticisms of the industry and, perhaps most importantly, the unintended consequences of policy interventions into this industry that are often overlooked. The message to state officials is: beware of the law of unintended consequences; well-intended policies may end up doing more harm than good for the people you hope to assist.

What Are Payday Loans? An Overview

Payday lending, also known as a “payday advance,” “cash advance” or “deferred deposit” loan, is a short-term two- to four-week loan backed by a postdated personal check that a borrower agrees to cover with sufficient funds out of his or her next paycheck. The typical fee for this service is 10 or 15 dollars per \$100 borrowed. In Indiana, the finance charge is regulated to 15 percent of the first

\$250, 13 percent of the amount between \$250 and \$400, and 10 percent of any amount between \$400 and \$500, with a maximum payday loan limit of \$500 and a minimum term of 14 days (Indiana Code 24-4.5-7).

The process begins when the borrower issues a postdated check written for an amount equal to the sum of the desired loan plus the related fees. The payday lender then issues the borrower a loan equal to the postdated check net of the fee and holds the check until the agreed-upon date. The process ends when the lender cashes the postdated check for payment covered by the borrower’s most-recent payday deposit, or when the borrower redeems the check directly from the payday lender by paying the loan amount plus the finance charge.

To date, Elliehausen and Lawrence (2001), Stegman and Faris (2003), Brown *et al.* (2004) and Hanson and Morgan (2005) offer the most comprehensive studies of the nationwide payday lending industry. Their work indicates that payday loans vary in size from \$100 to \$500, carry an average fee of between \$15 and \$20 per every \$100 borrowed, and have an average duration of between 14 and 30 days (see also Stegman, 2007).

Although a recent phenomenon, the historical seeds of the payday lending industry were planted in the late 19th century. Before organized consumer credit, there were five major sources of consumer loans: pawnbrokers, black market small-loan lenders, retailers offering “store credit,” friends and family, and mortgage lenders. Americans had few places to obtain small amounts of cash in emergencies. Pawnbrokers emerged as the “poor man’s banker” (Brown *et al.*, 2004).

The early and mid-1990s saw a boom in payday lending. At the beginning of the 1990s, payday lending was primarily the domain of small, independent check-cashing outlets and pawnshops. These firms specialized in making loans to borrowers with limited access to alternative credit. The number of payday lenders has

The finance charge on payday loans in Indiana is regulated to 15 percent of the first \$250, 13 percent of the amount between \$250 and \$400 and 10 percent of any amount between \$400 and \$500, with a maximum payday loan limit of \$500 and a minimum term of 14 days.

1. Payday loans are currently not permitted under state law in Connecticut, Georgia, Maine, Maryland, Massachusetts, New Jersey, New York, North Carolina, Pennsylvania, Vermont and West Virginia (Brown *et al.*, 2004).

The typical payday loan consumer does not appear to consist of the chronically poor or underclass.

surged in recent years as the high level of consumer demand for short-term, small-denomination credit has brought more suppliers into the marketplace.

Various factors have given rise to the cash advance industry. Retailers moved away from installment loans and store credit, opting instead for credit cards (which some payday borrowers cannot or will not access), leading to a rise in demand for payday loans.

On the supply side, conventional lenders, such as banks and credit unions, began to specialize in larger secured loans such as vehicle lending and home mortgages, choosing to avoid the smaller loan market due to its higher cost per dollar loaned.² Aside from each other, payday loan firms appear to compete most vigorously with pawn shops (Hanson and Morgan, 2005). In fact, current trends indicate that pawn brokers are branching out and offering payday lending services in addition to, or in lieu of, collateral-based pawning.

Additionally, payday lenders compete with the informal small-loan market which generally lies just beneath the level of pawn shops, usually consisting of unsecured loans from family, friends or “acquaintances.” However, this informal sector (*i.e.*, the black market) is not governed by contract law or enforceable property rights, making such markets potential grounds for abuse between borrowers and lenders.

Payday lending, then, has come to fill a market niche in the consumer finance industry between the informal sector, on the one hand, and conventional but less flexible consumer loan products on the other (Brown *et al.*, 2004).

Who Would Use Payday Loans and Why?

Given the relatively high cost of a cash advance loan (annual percentage yields on these loans range in the triple-digits, as discussed below), many readers may recoil at the notion of using payday loans. In order to understand the growing popularity of the cash advance industry, it is helpful to have a profile of the “typical” payday loan consumer and, perhaps more importantly, examples of the uses to which payday loans are often put. Again, the recent but limited research on this industry offers some guidelines.

Estimates indicate that roughly five percent of the U.S. population has obtained at least one payday loan at some time or another (Stegman, 2007). Studies by Elliehausen and Lawrence (2001)³ and Stegman and Faris (2003) reveal certain attributes about payday lending consumers in terms of their income, employment, age, marital status, race and gender, education level and credit status. Some of these characteristics distinguish payday loan consumers from the broader population. Yet, the striking conclusion is how mainstream payday loan consumers seem to be.

Income — According to Elliehausen and Lawrence (2001), the majority of payday lending customers have moderate family incomes between \$25,000 and \$50,000 annually (51.5 percent). A plurality of these consumers has annual family incomes below \$25,000 (23 percent), while another large minority has family incomes in excess of \$50,000 annually (25.4 percent). Based upon this study, the typical payday loan consumer might have annual family income ranging from \$25,000 (below the national median) to \$50,000 (above the national median). Most

2. The manpower and paper processing costs of issuing a \$200, 30-day small loan are nearly identical to issuing a \$5,000, unsecured 24-month loan. Whereas the former offers comparatively little revenue at the typical bank rate of interest, the latter offers significantly greater revenues relative to cost. Most conventional financial institutions, therefore, have chosen to avoid the small-loan market in favor of larger more profitable loans.

3. The sample used in the Elliehausen and Lawrence study (2001) is comprised only of customers of payday lenders belonging to the CFSA trade association. CFSA members made up roughly half of all payday lenders at the time of the survey (year end 2000), and CFSA members are among the largest payday lenders. Because of these distinctions, there are concerns that the Elliehausen and Lawrence survey may not be representative. In addition, the survey is likely plagued by non-response bias. That is, many of the payday loan customers surveyed refused to respond, and if the non-responders are significantly different than those who chose to respond to the survey, the survey results may be biased. However, despite these weaknesses, the Elliehausen and Lawrence study remains one of the most thorough studies of payday loan customers to date.

notably, the market for payday loans does not appear to consist of the chronically poor or under-class as is commonly perceived. And, perhaps because of the relatively high variation in incomes among payday loan consumers, findings by Stegman and Faris (2003) suggest that income alone is not a reliable predictor of the use of payday lending. Other factors play a more significant role.

Employment — Because payday lending firms typically require proof of employment before extending a cash advance, almost all payday lending consumers are employed. Although no definitive studies have been done to detect the employment status of payday loan customers, we can conclude that the vast majority have a job. Indeed, the idea of receiving a “payday” loan implies that one is gainfully employed and receives a regular paycheck. Stegman and Faris (2003) find that households with no employed adult are much less likely to use payday lending services.

Age — The majority of payday loan consumers are young adults and typically in the early stages of the financial life cycle. This is consistent with the moderate incomes of most payday loan customers indicated above. Elliehausen and Lawrence (2001) find that 36.4 percent of payday advance customers are younger than 35 years of age, and nearly 70 percent are younger than 45 years of age. Only 10 percent of payday loan consumers are age 55 or over. The payday lending market is dominated by younger consumers, and the use of this type of service tends to decline with age. However, the same can be said of any other type of consumer loan product, so it is not clear that age is able to distinguish payday loan consumers from consumers of other retail lending services. Home mortgage loans, vehicle loans and loans on appliances and other personal property are all likely to be more common among young and middle-aged families, and will tend to decline with age as income rises and the need for debt declines.⁴

Marital Status — The majority of payday loan customers, nearly 60 percent, are married or living with a partner, according to Elliehausen and Lawrence (2001). This compares similarly with the general adult population. A minority of payday loan users (23 percent) are divorced or separated. This is a slightly higher proportion than prevails in the general adult population (13.8 percent). Divorce and/or separation could be an underlying factor explaining the demand for payday advance services among certain groups, particularly divorced or separated women who may have few other credit alternatives.

Race and Gender — One of the weaknesses in the payday lending research to date is the absence of a definitive study on the breakdown of payday loan consumers by race, ethnic group and gender. However, race seems to play a role in explaining the demand for payday lending services, as suggested by Stegman and Faris (2003). Their study of the North Carolina market indicates that the likelihood of using a payday lender goes up significantly for African-American households. In fact, in their study, this is one of the top three predictors of the probability that a household has used a payday lending service in the past. They find the odds that an African-American household has used a payday lending service are over 2-to-1.

This is consistent with other research suggesting that African-American households retain smaller balances in their checking accounts relative to whites, and that African-American households have significantly less wealth, such as financial assets, to draw upon during a financial emergency (Chiteji and Stafford, 1999). This could explain why African-American households are more likely to use payday lending services: they may be the only alternative available in emergency situations when immediate cash is needed. One caveat is in order, here. Critics have charged that payday

The majority of payday loan customers, nearly 60 percent, are married or living with a partner. This compares similarly with the general adult population.

4. This is consistent with the life-cycle theory of income and expenditure which predicts that the consumption patterns of households are fairly stable over their lifetimes. That is, households will tend to spend and consume at similar levels across their lifetimes, borrowing to do so in their early years when income is low, and saving or paying down debt (rather than increasing spending) in their later years when income is higher (Ando and Modigliani, 1963; Friedman, 1957).

Only a small proportion of payday loan customers have less than a high school diploma (6.2 percent). High school dropouts are significantly less likely than any other group to use payday lending services.

loan firms “target” African-American consumers as a means of exploiting them. One recent and well-touted study, analyzing only the North Carolina payday loan market, popularized the notion that payday loan firms intentionally locate in census tracts with a higher proportion of African-Americans (King, Li, Davis and Ernst, 2005). However, upon closer examination, this study was found to be plagued with numerous errors that have since called into question the authors’ conclusions (Lehman, 2005b; Saltes, 2005). In particular, the authors possessed no data on the racial composition of actual customers of the payday loan stores under investigation, and likely confused correlation with causation in their analysis. To date, no credible research has been able to demonstrate that race is a factor in determining payday loan store location, and the charges of critics that payday loan firms “target” minorities should be viewed with skepticism.

Educational Attainment — Most research indicates that use of payday lending services declines with educational attainment. According to the study by Elliehausen and Lawrence (2001), 38.3 percent of payday lending customers have only a high school diploma, 36.1 percent have some college, and 19.4 percent have at least a four-year college degree. Payday loan customers are thus distributed in the lower and middle levels of educational attainment. However, only a small proportion of payday loan customers have less than a high school diploma (6.2 percent) according to Elliehausen and Lawrence, and Stegman and Faris (2003) find that high school dropouts are significantly less likely than any other group to use payday lending services. This could reflect underlying factors germane to this group, such as the higher levels of unemployment experienced by high school dropouts. From the available research, we can conclude that payday loan consumers typically have some modest level of education, perhaps some college or, in limited instances, even a four-year degree. Again, this finding suggests that payday loan consumers do not differ greatly from the general population.

Credit Status and Related Factors — Users of payday lending services

may exhibit below-average indicators of creditworthiness.

In the survey by Elliehausen and Lawrence (2001), over 60 percent of users of payday lending services responded that they had refrained from using a credit card in the past year because doing so would have pushed them beyond their approved credit limits. A significant proportion (18.5 percent) of payday loan customers have consumer debt payment-to-income ratios of 30 percent or higher, which is well above the average for all adults in this category (5.3 percent). A large majority of payday loan customers (73 percent) report having been turned down for credit or not awarded the amount of credit they applied for within the previous five years. And, over 15 percent of payday loan users have filed for bankruptcy in the previous five years, well above the proportion of all adults who have done so (3.7 percent).

In the study by Stegman and Faris (2003), the strongest predictors of the likelihood of using a payday advance service were related to indicators of creditworthiness. Survey respondents who had worked with a credit counselor or who had one or more bounced checks (overdrafts) within the previous five years were significantly more likely to use payday lending services than other groups.

Additionally, Stegman and Faris find that the single strongest predictor of the frequency of use of payday lending services is whether or not the respondent had been called by a collection agency for overdue bills. Households that have received collection calls on overdue bills were more likely to use payday lending services than those who had not received collection calls.

This suggests that when households are pressured for past-due payments on existing balances due, payday advance alternatives may be a viable and useful outlet that helps them overcome short-term financial emergencies or bounced checks. Additional research comparing check overdraft fees with the finance charges on payday loans suggests payday loans are a less costly alternative (Lehman, 2005a).

Payday Loans and Consumer Decision-Making

Contrary to prevailing opinions about the payday lending industry, consumers of payday loans may be quite rational in using this financial service given the alternatives they face. While information as to why people want to take out a small loan prior to payday is somewhat limited, a few common themes are evident in the available research (Caskey, 2003).

Despite annualized interest rates that are high, consumers sometimes choose payday loans to avoid tapping into savings. Often the borrowers are seeking only to solve an immediate emergency need for about \$200, and, as explained above, banks typically do not make such small closed-end loans. Some research speculates that borrowers may prefer self-imposing financial discipline by obtaining a payday loan, forcing themselves to avoid revolving credit or to avoid the temptation to draw down a savings nest egg (Elliehausen and Lawrence, 2001). Others have postulated poor budgeting habits. Some households may have “too much month left at the end of their income,” and a payday loan is a quick and easy way to stem the tide until payday (Caskey, 2002).

Even consumers who can access alternative sources of credit have opted for the relative convenience and speed of a payday loan. The Elliehausen and Lawrence (2001) survey of payday loan consumers found more than half (59 percent) identified the most important reason for choosing a payday loan over another source was “quick, easy process, fast approval, less paperwork.” About 10 percent chose a payday loan because of a convenient location. Interestingly, about 10 percent identified privacy as a critical and most important reason.

One alternative for consumers facing a cash shortfall is to seek a loan from family or friends. However, borrowers often prefer to obtain the cash advance from a payday lender rather than reveal their financial situation to friends or family. They may be ashamed of their current financial circumstance, or may

simply prefer the relative anonymity of a payday loan over a loan from a family member. Additionally, some borrowers may have exhausted their access to such informal alternatives (Caskey, 2002). For many, it is a choice of taking out a payday loan, going without some need in an emergency, or confronting more expensive options. Consumers who may not have access to other forms of credit, nonetheless may have other “alternatives.” For example, they can knowingly write a bad check and incur bank and check recipients’ returned-check fees (which could together amount to or exceed \$50 per occurrence in 2004), while also seeing their credit rating eroded. According to Caskey (2002), many banks have begun to offer a payday-loan-like product described as “Bounce Protection” or “Automated Overdraft Privilege.” This credit product effectively functions like a line of credit attached to a checking account, but the banks offering the service claim that it is not a credit product, and thus do not identify the cost as a finance charge, just an overdraft fee (Stegman, 2007). The overdraft fee is much higher than what the banks would earn in finance charges on a line of credit, and they presumably market the product to borrowers whose credit histories make them ineligible for credit lines. A borrower might, for example, write a check for \$100 drawn on insufficient funds that the bank honors, for a \$20 overdraft fee. If the borrower has two weeks to return the account to a positive balance, one could argue that the effective cost of this credit, expressed as an APR, is 520 percent (Caskey).⁵ As indicated above, when compared with an overdraft charge, the finance charge on a payday loan may be a less costly option (Lehman, 2005a).

Alternatively, consumers can opt to forego the product or service they need. In many cases, consumers need quick cash to pay for automobile repairs. Given the modest incomes of some payday loan customers, they may own only one automobile, and this automobile may be the single means of transportation to and from their place of employment.

When compared with an overdraft charge, the finance charge on a payday loan may be a less costly option.

5. \$20 equals 20 percent of the \$100 bounced check. This 20 percent multiplied by the number of two-week (14-day) periods annually equals a 520 percent APR.

Critics claim usury without evidence. In fact, it is clear that the risk premium on payday loan rates is higher because the risk itself may be higher. This risk premium will be set by the level of competition and the conditions of supply and demand.

Foregoing the auto repair may jeopardize their employment, and a payday loan could provide the only means available to prevent a domino of otherwise unavoidable and undesirable events. Such a scenario is not uncommon, and helps to illustrate the demand for, as well as the rationality of, payday loans. In other examples, the foregone service may be a utility bill. The costs of reconnecting utility services can be significant. Brown *et al.* (2004) provide examples that illustrate the range of such fees:

- Phone (*e.g.*, \$12 to reconnect in Illinois);
- Cable (*e.g.*, \$5 late penalty per month in Virginia);
- Natural gas (*e.g.*, \$78 to reconnect in Maryland);
- Electric (*e.g.*, \$37.80 daytime reconnect fee or \$73.83 at night, in North Carolina); and
- Water/sanitary services (*e.g.*, \$25 in Texas).

In addition to the above illustrative re-connect fees, some states permit their regulated utilities to collect deposit fees from residential borrowers with histories of non-payment. For example, in Illinois, if a borrower makes more than four late payments in one year, gas or electric utilities may require deposits of as much as one-sixth of the estimated annual bill. For water and sewer services in the same state, the deposit amount may be up to one-third of the estimated annual charges (Brown *et al.*, 2005). Against these requirements and costly alternatives, the decision to secure a payday loan appears more reasonable, and could easily be less costly than other alternatives.

The Objections to Payday Lending

The critics of the payday lending industry have raised several objections to cash advance loans, and, on the basis of these objections, pushed for further industry regulation or for banning the practice altogether. While these objections bear consideration, they are often a knee-jerk response to a relatively new consumer finance product. Furthermore, many of the critics who claim to defend

the interests of payday loan consumers neglect the potential damage done to these consumers from proposed regulations. It is important, then, to consider not only the objections to payday lending, but also the alternatives and the unintended consequences of misguided policies.

“Usurious” Rates of Interest

The most common objection to payday loans is that they carry a high (some would say “usurious”) annual rate of interest. That is, on an annualized basis, the finance charge on the payday loan relative to the small amount borrowed can easily compute to a triple-digit interest rate. Looked at from this perspective, the cost of a payday loan appears extreme. This has given rise to calls for rate regulation and caps on the finance charges that can be levied for payday loans. Again, in Indiana, the finance charge is regulated to 15 percent of the first \$250, 13 percent of the amount between \$250 and \$400, and 10 percent of any amount between \$400 and \$500, with a maximum payday loan limit of \$500 and a minimum loan term of 14 days (Indiana Code 24-4.5-7). So, for instance, a \$250 14-day cash advance loan would carry a maximum fee of \$37.50 under current law ($\$250 \times 0.15$). This computes to an annual percentage rate (APR) of interest equal to 390 percent⁶ which, for some critics, is evidence of usury.

However, from an economic perspective, this viewpoint is flawed for several reasons. First, a relatively high price for any good or service is not alone an argument that markets have failed or that harm has been done. High prices may be a symptom of monopoly in rare instances, but this certainly does not appear to be the case in the payday loan industry in light of the ease of market entry and the proliferation of competition in this market in the last decade. Prices in competitive markets, including competitive small-loan markets, are set by the prevailing conditions of supply and demand. Given the strong and increasing demand for small loans for reasons documented above, combined with the tremendous growth in the number of payday loan outlets, there

6. $\$37.50$ in finance charges divided by \$250 in loan principle equals 15 percent interest for 14 days (two weeks). Fifteen percent multiplied by 26 two-week periods per year equals a 390 percent APR.

would certainly appear to be no market failure in this industry (*i.e.*, competition appears to be thriving).

Second, because payday lending establishments often deal with a high-risk clientele as documented by Stegman and Faris (2003), the effective annual interest rates charged on these types of small loans are going to reflect increased risk. Available data on defaults suggests that unpaid obligations to payday lenders amount to between 10 and 20 percent of the annual finance charges these lenders levy (Caskey, 2002).⁷ The entrepreneur in this high-risk industry must find a way to recover their investment and earn a positive rate of return. They are drawing scarce financial resources out of some other line of investment, and are committing these resources to a high-risk venture in making unsecured loans to borrowers who may have poor credit histories. Because the risk may be higher, the risk premium on the loan would naturally be higher. And, the level of this risk premium, again, will be set by the level of competition and the conditions of supply and demand.

Third, the fixed labor and capital costs associated with offering and underwriting a small loan are similar to offering and underwriting a larger loan. With a larger loan principle, the lender can cover costs and earn a profit by charging a lower interest rate over a lengthier period of time. Small-principle short-term loans, on the other hand, while costing roughly the same to supply, cannot charge equally low rates of interest and expect to cover costs. (As explained above, this is one of the reasons that conventional lenders such as banks and credit unions avoid making small loans.) By their very nature and quite apart from the risk associated with them, small-balance short-term payday loans must charge a higher rate of return to induce profit-seeking entrepreneurs to provide them.

Finally, although lenders are required by law to disclose the APR at the time of the loan, it may not be a concern to the borrower. In all likelihood, the “effective APR” is irrelevant to the borrower.

According to Brown *et al.* (2004), few borrowers are able to recall the APR of their cash advance loan. The real price signal to which the borrower responds is the flat fee that is charged to hold the postdated check. If the value attached by the borrower to the immediate cash advance exceeds the value of the principle plus the fee two or four weeks hence, then the borrower will undertake the transaction and expect to benefit as a result.

Economic values are subjective. In the case of payday lending, time preferences, a form of valuation between present and future goods, are also subjective. Those with relatively high time preferences are going to be willing to pay more in the future to obtain goods (or cash) in the present than those with relatively low time preferences, all else equal. In this sense, then, there is no such thing as an “excessively high” finance charge. It is entirely subjective to each voluntary participant in the transaction.

In sum, then, justification for further rate regulation or banning of payday lending cannot be supported on economic grounds. Indeed, to the contrary, as economists well understand, heavy regulation stifles entry into these markets, and thus restrains the very competitive forces that serve to bring prices (rates) down naturally. Hanson and Morgan (2005) find that more payday lenders and pawnshops per capita correlate with lower payday loan rates and fees, suggesting that competition is welfare-enhancing in these markets.

Additionally, legislated price ceilings and caps are a prescription for disaster in any market because, to the extent that they are binding, they distort prices and throw supply and demand into permanent disequilibrium. To put it less technically, state regulations that hold finance charges on payday loans below the market-clearing level will lead inevitably to an excess of demand over supply, creating shortages in the small loan market and preventing marginal borrowers from obtaining credit in emergency circumstances. Unfortunately, Indiana has some experience with this type

There is no such thing as an “excessively high” finance charge. It is entirely subjective to each voluntary participant in the transaction. State regulations simply reduce the availability of this popular loan.

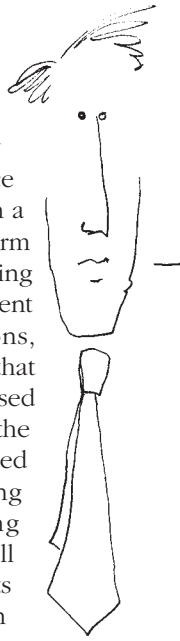
7. On the other hand, and somewhat surprisingly, the Elliehausen and Lawrence survey (2001) reports that over 75 percent of payday borrowers repay their loans on time. Of the remainder who do not pay on time, most are late only once.

Proposals for tightened rate regulation will not only reduce competition but distort markets, reduce efficiency in credit allocation and make circumstances more difficult for those consumers who depend critically upon payday lending in emergency situations.

of scenario. In 2001, the State Attorney General and the Indiana Supreme Court required payday loan firms to limit finance charges to no more than a 72 percent APR to conform to Indiana's loansharking statute (Indiana Department of Financial Institutions, 2001). Subsequent to that date, the number of licensed payday loan outlets in the state of Indiana dropped precipitously according to the DFI, reducing competition in the small loan and pawn markets in 2001 and 2002. In 2002, the state legislature revised the laws governing small loans and raised the finance charge ceiling to its current higher level as expressed in Indiana Code 24-4.5-7, leading to a revival of competition in payday lending in the state.⁸ If the intent is to make legal credit available to the widest possible number of people at the lowest possible price, then critics who argue for more government regulation due to the perceived high price of payday loans are acting at cross purposes with their stated goals. Proposals for tightened rate regulation in this industry will not only reduce competition, but will distort markets, reduce efficiency in credit allocation, and make circumstances more difficult for the very consumers who depend critically upon payday lending in emergency situations.

Predatory Lending and Chronic Borrowing

Another objection to payday lending is that it causes households to fall into a trap of perpetual borrowing, becoming chronically dependent upon payday loans (Stegman, 2007). Critics contend that payday lending impoverishes poor households by encouraging chronic borrowing from paycheck to paycheck, putting them deeper in debt and perhaps forcing bankruptcy. Payday lenders may offer to "roll over" the initial debt by



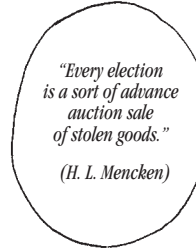
asking the borrower to pay an additional fee to defer the loan or to write a second postdated check in lieu of the original. This "predatory" lending is seen by critics as a way for payday lending firms to increase profits and keep customers in chronic dependency on payday loans (Stegman and Faris, 2003). Although

this is a valid concern, both theory and evidence tell us to be skeptical of this argument.

First, the allegation that payday lending "causes" chronic or habitual borrowing may ignore the old adage that "correlation does not equal causation." As indicated above, payday loans appeal to a clientele that may face numerous financial difficulties quite independent of the payday lending industry itself. Some of these households have failed to establish credit, may have poor credit histories, may pay their bills slowly, frequently bounce checks, frequently change jobs, or may relocate often. In short, it is true that some payday loan consumers are the type of people who are going to be frequently short of cash and who will borrow "chronically" when given the opportunity. Because payday lending institutions provide them with this opportunity to borrow when other institutions deny credit does not mean that payday lenders cause this behavior. They simply provide an opportunity for this behavior to be exhibited more often than otherwise, and bear the added risk as a result.

In any case, as the research by Elliehausen and Lawrence (2001) indicates, the vast majority of payday loan customers pay on time, and over half of customers' longest consecutive sequence of advances was less than a month. More importantly, the "invisible hand" of the market is much better than the "visible fist" of government in restraining excessive payday loan rollovers:

(I)t is not in the best interest of either consumers or payday lenders to permit



8. To the extent that the current caps on payday loans in the state of Indiana are above the market-clearing level for these loans, the caps are benign and have no adverse impact. However, we cannot confidently conclude, based upon research to date, whether these caps are or are not binding at their current levels.

an excessive number of payday loan rollovers. By their very acceptance in the marketplace, consumers have signaled comfort with the benefits of payday loans. Although payday loans are appropriate for short-term use, consumers with sufficient credit histories and financial wherewithal are likely to pursue other options for longer-term loans. In other cases, consumers may simply not have a choice for an alternative loan. *Additionally, lenders too, are compelled by market discipline. Because their loans are unsecured, payday lenders are less likely than secured lenders to make loans they believe will not be repaid from the borrower's cash flow* (Brown *et al.*, 2004, p. 8; italics added).

Additionally, the same allegation of chronic borrowing can and has been used to criticize other forms of consumer debt. Credit cards are alleged to “trap” users in a cycle of revolving debt (perhaps one reason some borrowers prefer payday loans even when credit cards are available). Yet, because of their long history and demonstrated convenience, credit cards are socially accepted forms of consumer credit, and do not elicit the shrill objections often heard against payday lending.

The same could be said of revolving lines of home mortgage credit frequently used by homeowners to tap the equity in their homes whenever they believe real estate prices are appreciating. Default on such lines of credit, combined with misjudgments about the real estate market, could potentially cost borrowers their homes, yet rarely do we hear allegations that such forms of credit “cause” debt traps. Thus, it is not clear how payday loans differ from these other alternatives in their potential to lead to chronic borrowing, other than that they have smaller balances over shorter terms, attributes that would seem to make them more attractive in the eyes of critics.

Finally, the research to date does not demonstrate that payday lending is “predatory” or that it leads to excessive delinquency among borrowers. Morgan and Hanson (2005) define predatory lending as a welfare-reducing provision of credit undertaken by borrowers who are deluded or deceived about their future income prospects. That is, predatory lending is said to occur when borrowers

are encouraged by lenders to over-borrow relative to their future income levels and their ability to repay. Morgan and Hanson test the theory that payday lending is predatory by comparing the delinquency rates between states that prohibit payday lending, states that heavily regulate payday lending and states that lightly regulate payday lending. They do not find that payday lending is predatory:

(Our) findings seem mostly inconsistent with the hypothesis of predatory lending in states with higher payday limits and easier foreclosure. We do find that households with uncertain income (potential prey) in payday states have higher debt, but not higher delinquency. Just the opposite, in fact; households with uncertain income who live in states with unlimited payday loans tend to have slightly *lower* delinquency rates and they are *less likely* to report being credit constrained (*i.e.*, denied credit or too discouraged to apply) (Morgan and Hanson, 2005, p. 4; italics in original).

Conclusion

The message is simple: Policy-makers and critics of the payday loan industry must become more informed about these markets, and must be much more cautious in their advocacy for further regulating or banning the practice lest they do harm to the consumers they ostensibly seek to protect. The recent success of the payday loan industry is a testament to the ability of markets to adapt to rising demand for new and untried methods of consumer finance provided government regulations do not corrupt the process. The “typical” payday loan customer does not differ greatly from the average American consumer, and almost always has a legitimate reason (in their eyes) for using payday loans to cover an emergency cash shortfall.

Payday lending has come to fill a market niche in the consumer finance industry between the informal sector and conventional but less flexible consumer loan products. Preventing or limiting the use of payday loan services only encourages borrowers to seek out and utilize less-attractive alternatives (such as informal or “black” markets) that put the borrower in a weaker financial position. Further regulation or outright banning

The research to date does not demonstrate that payday lending is “predatory” or that it leads to excessive delinquency among borrowers.

If there is true concern about the high finance charges on payday loans, the best method of bringing them down is to repeal the regulations on payday lending that restrict competition and market entry.

of payday lending may have the adverse and unintended consequence of reducing credit options for those who may have few alternatives to begin with (Stegman, 2007). In an age where the "democratization of credit" has been widely celebrated due to new technology, it is unwise to single out and restrict relatively new forms of credit. You do not help marginal borrowers by looking at their list of available options and then eliminating the one they actually choose.

Finally, as the evidence indicates, the arguments by payday loan critics are largely unfounded and their policy proposals misguided. If there is true concern about the high finance charges on payday loans, the best method of bringing them down is to repeal the regulations on payday lending that restrict competition and market entry. Rather than preventing or discouraging the proliferation of payday loan outlets, policy-makers should instead make laws that encourage an open and level playing field in the small loan market, permitting competition to put downward pressure on rates and fees.

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Will Your School Corporation's Debt Exceed Capacity?

by JEFF ABBOTT

(March 28) — It is often difficult for patrons of an Indiana public school district to determine from media reports or even from the districts' web sites whether their school board has enough information to consider in sufficient depth the economic impact of a bond issue on its community.

For example, in my hometown the board of school trustees attempted to examine a proposed building project. Although the task force was a distinguished panel of local residents well-versed in financial matters, and notwithstanding that the report was well done, its 60 pages did not mention that Moody's or Standard and Poor's rating services for bond issues were consulted on the issue of whether the school district had the capacity to pay for a compromise bond issue, much less the initially proposed issue, which was twice as large. The report stated only that:

"(T)he bond market generally considers acceptable a combination of direct and overlapping outstanding property tax-supported debt not exceeding 12 percent of the assessed or market value of real estate in a given geographic area to be acceptable."

That same report provided information as to federal government guidelines for debt capacity for communities, where the task force stated:

"This document suggests that if the combination of outstanding property-tax supported long-term debt issued by a municipality and by other units issuing overlapping debt exceeds five percent of the market value of real estate within the given jurisdiction, then the unit's financial capability for this factor should be considered as 'weak.'"

The task force also reported that direct and overlapping debt between two percent and five percent is considered by the U.S. Environmental Protection Agency to be

"mid-range" and that less than two percent is considered to be "strong" capability. It went on to conclude that the district could issue an additional debt of \$172,500,000 before hitting the five percent "weak" benchmark. The task force did not make any recommendation as to what the community could afford, although a boosterish press hinted otherwise.

Although the complete data was not provided in the task force report, it was possible to interpolate using algebra and information available on the Indiana Department of Education website.

According to my calculations, this particular bond issue (\$500,000,000) would result in an incurred debt of 9.36 percent of assessed value, or 4.36 percent beyond the federal government's threshold for the "weak" classification. If you use the full billion-dollar bond issue figure, as appears to be likely that the district would need within the next five years or so, then the incurred debt rises to 16.03 percent of assessed valuation.

This not only exceeds the federal government's five percent threshold by 11.0 percent, but also exceeds the bond market's threshold by 4.03 percent, resulting in fewer bidders and higher interest rates according to the task force. It would have been helpful to have seen data showing any increased interest cost if the bonds exceed these thresholds.

In fact, a school board that does not fully reveal the impact on the entire community of its proposed bond issue can leave a community asking a lot of financing questions:

Will the district be able to issue bonds in the future for future needed projects? What will be the impact on other governmental entities in the county if the school district exceeds these threshold measures? Will they be able to issue any bonds in the foreseeable future if the district exceeds the federal government's and bond market's limits on debt capacity? And will exceeding these thresholds jeopardize the economic health of city and county governments, business, and citizens of the county? Q

A school board that does not fully reveal the impact on the entire community of its proposed bond issue can leave a community asking a lot of financing questions.



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Test scores have jumped impressively since the Indiana Public Schools switched textbooks.

A Chance to Improve Reading Instruction

by ANDREA NEAL

(Feb. 21) — In the 2001-2002 school year, Indianapolis Public Schools (IPS) launched a reading initiative that used a lot more phonics in the early grades. The switch wasn't easy on teachers. They had to change the way they did things: A different textbook, extra training, a more formulaic way of teaching.

Their new text, Open Court published by SRA/McGraw-Hill, wasn't all that changed. Specialists came in and demonstrated strategies for urban children who have vocabulary deficits. The school day was altered to give pupils more language arts time.

Though test scores in the state's largest school district still lag behind state average, there's no denying they've jumped impressively since the reading program began. In the 2000-2001 school year, 44 percent of third graders passed the language arts portion of ISTEP. In 2006-2007, 61 percent did. In the 2000-2001 school year, 21 percent of sixth graders passed the language arts test. In 2006-2007, 57 percent did. Those students were in first grade when the textbook change occurred.

Math scores went up, too. Third grade passage rates rose from 55 to 62 percent. Sixth grade scores increased from 30 percent passing to 70 percent. What's math got to do with reading? ISTEP has a lot of story problems in it. "A significant percentage of the variance observed on math tests is determined by reading comprehension strategies," one study notes.

The IPS experience is worth considering as school districts across Indiana go through the reading textbook adoption process. Every six years, the state invites publishers to submit books for a state-approved list from which local school districts must choose. This adoption cycle is critical because it's the first to occur under No Child Left Behind, a federal law that requires reading instruction in

our schools be supported by scientifically based reading research.

School districts are reviewing textbooks and have until July 1 to tell the Indiana Department of Education which product they choose. Unfortunately, the department won't single out the best so it's up to school systems to figure out which are scientifically based.

All of the publishers have modified their textbooks and are touting changes, but some pay lip service to the elements of instruction that experts say are essential to a solid program of reading instruction. These are: phonological and phoneme awareness, phonics, vocabulary, fluency and comprehension. A few publishers remain predominantly whole language in approach.

If you thought the reading wars ended in 2000 with the release of "Teaching Children to Read," by the National Reading Panel, it's not so. "Despite the scientific evidence, despite the flat-line reading scores. . . many teachers and school systems continue to embrace whole language" over phonics-based systems, according to Chester E. Finn Jr. and Martin A. Davis Jr. of the Thomas B. Fordham Institute.

Whole language is the philosophy that children should learn to read by reading and figuring out words using context clues. Phonics advocates insist on step-by-step instruction in sound-symbol relationships.

The institute's January report, "Whole-Language High Jinks," notes that commercial products can make an impact if they are designed properly. "While no program is perfect, some do a reasonably good job, including SRA's Open Court and Scott Foresman's Reading Street," it says. Both are on the Indiana adoption list and "are definitely in a category of their own," says Tory Callahan, a reading specialist who has reviewed the textbooks and is advising a few Indiana school corporations.

With a new textbook policy, Indiana schools have the opportunity to make a profound change toward better reading instruction. Q



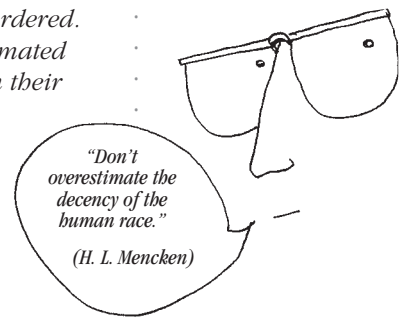
How's the Governor Doing?

	Disappointing	Satisfactory	Commendable	(No Opinion)
Colts Stadium	35	10	6	9
Bonded Indebtedness	16	15	12	17
Individual Liberty	19	19	16	6
Ivy Tech	12	19	4	24
City-County Consolidation	16	16	5	24
Cigarette Tax	24	12	17	7
State Health Care	22	15	11	12
Right of Private Property	17	24	12	6
Size of Government	26	16	16	2
Leadership Style	11	30	19	1
Full-Day Kindergarten	41	5	11	4
Public-Employee Unions	12	21	16	12
I-69 Collector Road	20	15	15	10

The quarterly "Barber Poll" was conducted March 31 through April 6 among the foundation's corresponding members on the question: "Please rate the performance of Gov. Mitch Daniels on the following issues."

■ 'Make a Stand on Darfur: Support Divestment'

"Entire villages have been destroyed. Women and children have been murdered. The ongoing genocide in the Darfur region of Sudan has claimed an estimated 200,000 lives. The fighting has chased more than two million people from their homes, with about 200 of them making their way to Indiana. In the face of these atrocities, a state Senate committee had the opportunity this week to make an important gesture by passing a bill that would have required state pension managers to stop investing in companies that do business with the Sudanese government. The committee failed. The reasons why are shamefully lame, even by Indiana General Assembly standards. Senate Pension and Labor Committee Chairman Dennis Kruse, R-Auburn, worried that the bill would set a bad precedent regarding legislative meddling in fund managers' investment decisions. He refused to allow a vote on House Bill 1484, even though the legislation passed the House 97-0 last month." (Indianapolis Star editorial, March 31)

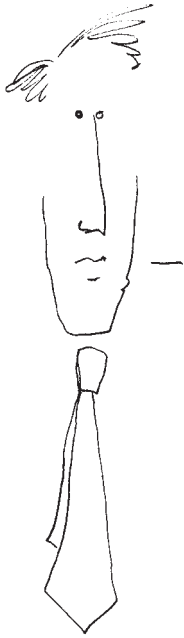


▲ Before we join *the Star* in lumping Senator Kruse with abettors of slavery and massacre, we will want to spend a few moments imagining a stock portfolio in complete sympathy with the global morality of a Hoosier General Assembly.

■ Indiana a Top Loser of Jobs in February

"Despite the wave of companies moving to and expanding in Indiana, the state is having a hard time hanging onto jobs, according to figures released Friday by the U.S. Bureau of Labor Statistics. Preliminary statistics show Indiana lost more jobs in February than any other state except Ohio. About 7,400 non-farm-related positions vanished, compared with 9,700 in Ohio and 6,200 in New Jersey." (Erika Smith in the March 31 Indianapolis Star)

▲ Perhaps we need more daylight . . . or roomier sky boxes to watch more NFL championships . . . or more architecturally pleasing warehouses for our full-day kindergartners . . . or more expensive cigarettes for the unemployed . . . or, ultimately, a progressive income tax to compensate for the lost payroll taxes.



"The cause of America is in a great measure the cause of all mankind."
(Thomas Paine)

■ Truancy Sweep Nets 80 in Indy

"Scores of students walking down sidewalks in Marion County on Wednesday got a wake-up call from metro police asking them: Why aren't you in school? Parents of children can find themselves in trouble, too, over their son or daughter missing school (six months in jail and a \$1,000 fine)." (Rob Schneider in the March 29 Indianapolis Star)

▲ Students who overslept or missed the bus are taken into custody by the Indianapolis police. A sudden desire to salvage the at-risk? Perhaps, but a formula that determines funding for government schools is based in part on a statistic called the ADM or Average Daily Matriculation. The more children who darken the door of the government school, the higher the ADM, the more money the school gets and the happier is the teachers union. (Thanks to Kenn Gividen)

■ Terre Haute Transit "Doing Better"

"Terre Haute's bus system is doing better than ever these days. With the new Mall Express and Saturday Service, officials tell News 10 they've seen an all-time high in ridership. And that means an increase in revenue by nearly 50 percent." (April 6, WTHI television)

▲ The tease line for the television news story was that the public transit

system is "doing better than ever." The real story for the Terre Haute Transit system, however, is quite the opposite. The bus system there did indeed increase revenues. Unsaid was that it increased expenses more. In government-speak, this is "doing better." (Thanks to Ryan Cummins)

■ German Town Scraps Traffic Signs

"A German town has scrapped all its traffic signs as part of an EU backed project to encourage responsible driving. (http://www.ananova.com/news/story/sm_2200098.html, last linked March 30)

▲ Let the words "responsible driving" roll around in your head. Don't almost all of our regulations discourage personal responsibility? Wow. Could this be a paradigm shift? (Thanks to Andy Horning)

■ Poor Behavior Linked to Day Care

A much-anticipated report from the largest and longest-running study of American child care has found that keeping a preschooler in a day care center for a year or more increased the likelihood that the child would become disruptive in class. (New York Times, March 26)

▲ Is this what the governor had in mind? Full-day kindergarten, on the one hand, only wastes tax revenue. Unruly children, on the other hand, create more dues-paying members for the Indiana State Teachers Association.

He will take your sons and appoint them to his chariots and to be his horsemen, and to run before his chariots; and he will appoint himself commanders of thousands and commanders of fifties, and some to plow his ground and to reap his harvest, and to make his implements of war and the equipment of his chariots. . . . He will take the best of your fields and your vineyards and olive orchards and give them to his courtiers . . . the best of your cattle and donkeys, and put them to his work. He will take one-tenth of your flocks and you shall be his slaves. And in that day you will cry out because of your king, whom you have chosen for yourselves; but the Lord will not answer you in that day. — Samuel's speech to the Israelites in 1 Samuel, Chapter 8, relaying God's warning against kings and, it may be assumed, idolization of centralized government power in all of its political forms.