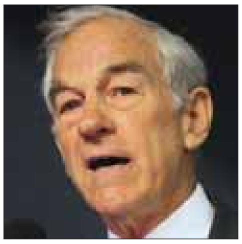

RON PAUL
Auditing the Federal Reserve
PAGE 4

P. J. O'ROURKE
The end of the American automobile
PAGE 14

REGULATION
Debunking the theory of financial contagion
PAGE 19

Cato Policy Report

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The New Deal Made Them "Right"

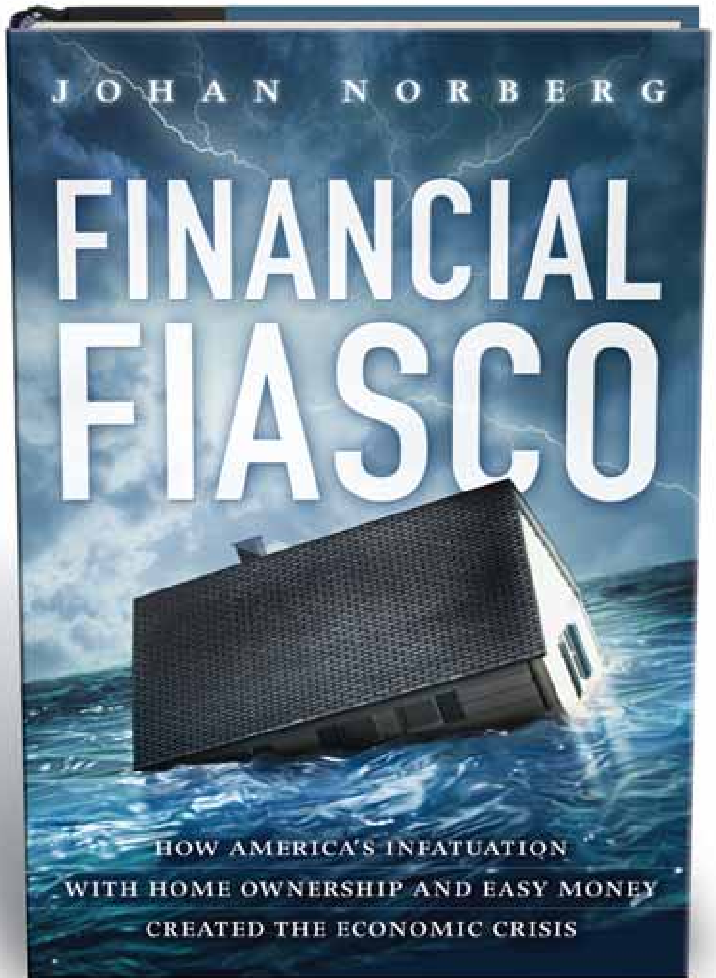
BY DAMON W. ROOT

Toward the end of a mostly sympathetic profile of the great journalist and critic H. L. Mencken, Christopher Hitchens once claimed that Mencken's only "brilliance and verve" occurred during "the period between 1910 and the end of Prohibition." Which is to say, before Franklin Roosevelt's New Deal came along. It's an all too common refrain. Biographer Terry Teachout characterized Mencken as "blinded partly by his hatred of Roosevelt." Mencken scholar Charles A. Fecher—whom you'd expect to know better—declared Mencken's opinion of Roosevelt to be "maniacal—there is no other word to use."

Although it's true that Mencken ended the 1930s as an enemy of what he called FDR's "More Abundant Life," he hardly started out the decade that way. A self-described "lifelong Democrat," Mencken voted for Roosevelt in 1932 and voiced cautious support for the New Deal's first stirrings, writing in March 1933, "I have the utmost confidence in his good intentions, and I believe further that he has carried on his dictatorship so far with courage, sense and due restraint."

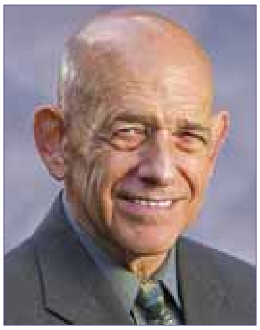
Continued on page 6

DAMON W. ROOT is an associate editor at *Reason* magazine.



"*Financial Fiasco* . . . is a penetrating and frightening analysis of the causes and consequences of the 2008 Financial Panic . . . This is essential reading for everyone who cares about our economic future, but especially for those who are still not sure what caused the crisis. As Norberg makes clear, private forces jumped willingly on a runaway train, but it was government that built the train and drove it off a cliff."

—JEFFREY MIRON, HARVARD UNIVERSITY



BY ROBERT A. LEVY

"In the end, the Second Amendment will very likely constrain state governments as well as the national government."

Editorial
How Gun Litigation Can Restore Economic Liberties

A central mission of both the Cato Institute and the Institute for Justice has been restoration of rights to earn an honest living, make binding contracts, and enjoy private property. Regrettably, courts have routinely rubber-stamped legislative restrictions on economic liberties. Who would have imagined, however, that the Second Amendment—the right to keep and bear arms—could provide the battlefield on which to reinvigorate judicial review of economic regulations? Yet that might be the outcome in *McDonald v. Chicago*, a challenge to Chicago's gun laws, in which Cato and IJ filed a joint brief with the U.S. Supreme Court. Here's the story: how gun rights and economic liberties intersect.

First, the bad news. In 1873, five years after ratification of the Fourteenth Amendment, the Supreme Court upheld a Louisiana law that required all butchering of animals in New Orleans to be done by one private corporation—owned, of course, by politically connected businessmen. Justice Samuel Miller, writing for a 5-4 majority in the *Slaughter-House Cases*, ruled that the law was a valid public health measure and did not violate the right of butchers "to exercise their trade." Along the way, the Court effectively erased the Fourteenth Amendment's Privileges or Immunities Clause from the Constitution. According to Miller, that clause—"No State shall make or enforce any law which shall abridge the privileges or immunities of citizens" —protected only rights of national citizenship, such as access to navigable waterways, not the right to earn a living in a marketplace free of state-chartered monopolies.

Without the Privileges or Immunities Clause, courts turned to other provisions of the Constitution—notably the Due Process Clause of the Fourteenth Amendment—to defend rights from government encroachment. But that doctrine, known as substantive due process, rests on shaky ground. Appellate judge Frank Easterbrook put it this way: "[We] have spent some time looking through the Constitution for the . . . 'due substance' clause [but the] word that follows 'due' is 'process.'" In other words, the Due Process Clause is better suited to guaranteeing procedural rather than substantive rights.

Fast forward to the New Deal. That's when use of substantive due process to secure economic liberties came to a crashing halt. A mere footnote in *United States v. Carolene Products* (1938) did much of the damage. *Carolene* validated a ban on interstate shipment of "filled milk"—a healthful variety of evaporated milk that threatened vested interests in the dairy industry. The Court, in its infamous footnote 4, declared that only those rights specifically enumerated in the Bill of Rights, plus selected rights associated with the political process (e.g., voting) or with protection of minorities, would be judicially safeguarded. The innumerable remainder of our rights, including the right to pursue an honest occupation, would be vindicated or not, at the pleasure of the legislature. Essentially, no legislative infringement of economic liberties, however egregious, would be subject to meaningful constitutional review by the courts.

That's roughly where things stood until June of last year, when the Supreme Court in *District of Columbia v. Heller* overturned Washington, D.C.'s, gun ban on constitutional grounds. And that brings us to the good news.

Because *Heller* affirmed that individuals, not just militia members, have a right to bear arms, the Court will now have to decide whether the Second Amendment can be enforced against state governments. Washington, D.C., is not a state; it is a federal enclave where Congress exercises plenary legislative power. Until the Fourteenth Amendment was ratified, the Bill of Rights applied only to the federal government, not to states. Indeed, in two post-ratification cases—*United States v. Cruikshank* (1875) and *Presser v. Illinois* (1886)—the Supreme Court reiterated that the Second Amendment did not bind the states. But then, beginning in 1897, in a series of so-called incorporation cases, the Court held that the Due Process Clause of the Fourteenth Amendment was intended to "incorporate" most of the Bill of Rights in order to hold state governments accountable for violations. Interestingly, however, the Court has never ruled that the Second Amendment has been incorporated.

We should know fairly soon where the Supreme Court stands. In *McDonald v. Chicago*, the U.S. Court of Appeals for the Seventh Circuit denied incorporation of the Second Amendment, stating that *Cruikshank* and *Presser* govern unless and until the Supreme Court holds otherwise. Two months earlier, in *Nordyke v. King*, a three-judge panel of the Ninth Circuit had unanimously ruled that the Supreme Court's incorporation cases superseded *Cruikshank* and *Presser*. Therefore, said the panel, the Second Amendment applied to the states through the Due Process Clause. The Ninth Circuit decision will be reconsidered, however, by a larger contingent of 11 judges.

In the end, the Second Amendment will very likely constrain state governments as well as the national government. The dual criteria under substantive due process are whether the right is implicit in our Anglo-American system of ordered liberty or deeply rooted in our nation's history and tradition. The Second Amendment surely qualifies. Perhaps the more interesting question is whether the Court will expand its selective incorporation via the Due Process Clause, or overturn *Slaughter-House*, as Cato and IJ argue in their brief, and declare that the right to keep and bear arms is one of the privileges or immunities of U.S. citizenship that—along with many other liberties, ultimately including economic liberties—may not be abridged by the states.

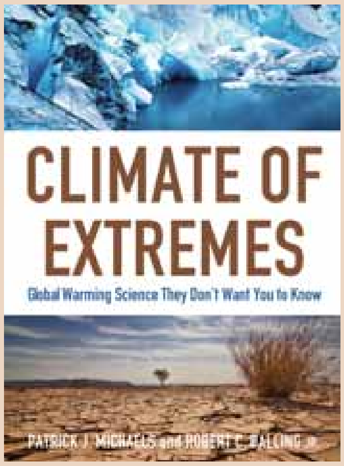
Justice Clarence Thomas, for one, has declared that he would be open to reevaluating the meaning of the Privileges or Immunities Clause "in an appropriate case." *McDonald v. Chicago* may be that case. Harvard law professor Laurence Tribe, a liberal icon, writes that "the *Slaughter-House Cases* incorrectly gutted the Privileges or Immunities Clause." Yale law professor Akhil Amar agrees: "Virtually no serious modern scholar—left, right, and center—thinks that [*Slaughter-House*] is a plausible reading of the [Fourteenth] Amendment."

It's time for the Supreme Court to restore full status to economic liberty. The Constitution demands no less.

Robert A Levy

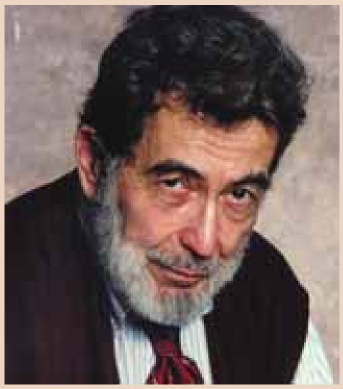
Cato News Notes

CLIMATE OF EXTREMES GARNERS EXTREME SALES



In *Climate of Extremes,* Cato senior fellow Patrick J. Michaels debunks the evidence behind the popular, apocalyptic view of global warming. Michaels's message is finding a wide audience. The book sold out its first printing and has become a top Amazon.com title. In late July its cloth and Kindle ebook editions held the first and second positions on the Internet bookseller's "Climate Changes" bestseller list. Even after falling slightly from the top two spots, *Climate of Extremes* continues to be a strong presence on the list.

NAT HENTOFF RECOGNIZED WITH TWO AWARDS



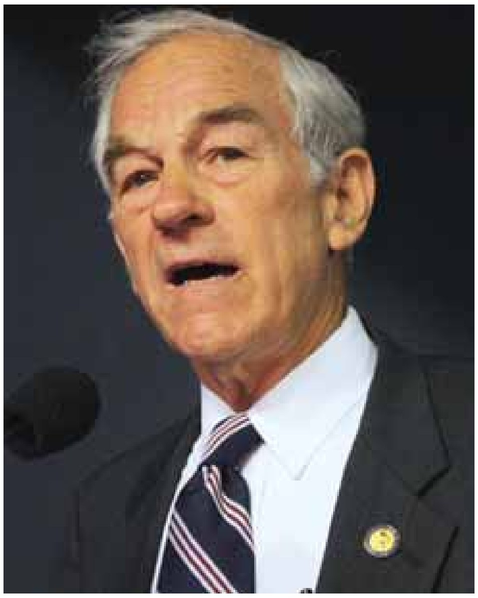
Cato senior fellow Nat Hentoff was recognized for his political reporting and defense of the First Amendment with two prestigious awards. The Shorenstein Center on the Press, Politics, and Public Policy at Harvard's Kennedy School of Government selected Hentoff to receive the David Nyhan Prize for Political Journalism, and the Anti-Defamation League will present him with its Hubert H. Humphrey First Amendment Freedoms Prize.

THE LEGACY OF PETER BAUER REMEMBERED

Peter Bauer, the first recipient of the Milton Friedman Prize for Advancing Liberty and an important figure in development economics who showed how free markets and free trade are key to creating prosperity, is remembered in a new book co-edited by James A. Dorn, Cato's vice president for academic affairs and editor of *Cato Journal*. *Peter Bauer and the Economics of Prosperity*, published by India's Academic Foundation in association with the Cato Institute and the Liberty Institute, gathers over a dozen essays on Bauer's scholarship by such luminaries as Milton Friedman, Thomas Sowell, and James M. Buchanan, along with some of Bauer's seminal essays

Cato scholars testified 11 times before Congress in June and July, speaking truth to power and promoting Cato's message of liberty. MARK A. CALABRIA (top left), director of financial regulation studies, appeared on the Hill three times in July alone, discussing bankruptcy reform, mortgage modifications, and the Troubled Asset Relief Program. Cato's director of the Project on Criminal Justice TIM LYNCH (top right) testified about the overcriminalization of conduct (to his left, former attorney general RICHARD THORBURGH), while DANIEL J. IKENSON (bottom left), associate director of the Center for Trade Policy Studies, addressed the auto industry bankruptcies, and senior fellow RANDAL O'TOOLE (bottom right) examined the link between transit and climate.

The Cato Institute's vice president for research, BRINK LINDSEY, talks to high school students from the St. Albans School of Public Service, a summer program for students around the country who come to Washington to study public policy. This visit was part of Cato's continued commitment to working with student groups.



The Federal Reserve amounts to "legalized counterfeiting," REP. RON PAUL tells a Cato Policy Forum audience on June 24. Paul argued that the Fed, which possesses "the power to create money out of thin air," needs greater transparency, and he discussed legislation that would subject it to audit. Paul's proposal sparked sharp debate on the panel from Gilbert Schwartz, former associate general counsel at the Federal Reserve, and bankruptcy consultant Bert Ely.

With government control over the nation's economy growing, 218 people traveled to the beautiful Rancho Bernardo Inn near San Diego for Cato University 2009: Economic Crisis, War, and the Rise of the State. Over six days, attendees enjoyed the sunny breezes along with lectures and discussions on the history, economics, and politics of freedom. West Point historian Robert McDonald's (above right) speeches were a big hit, covering such topics as the Civil War and its consequences and the American Revolution. McDonald was joined by other scholars of liberty, including Tom Palmer, David Boaz, Robert Higgs, and Veronique de Rugy.

The parallels between FDR's New Deal policies and the stimulus spending of the Obama administration are stark. Randy Barnett, professor of legal theory at Georgetown University Law Center, spoke about the constitutional legacy of the New Deal at a Cato conference, "Brother, Can You Spare a Trillion? Lessons from the New Deal and Great Depression." The half-day event brought together experts on the era, including Amity Shlaes, author of *The Forgotten Man*, and Randall E. Parker, author of *Reflections on the Great Depression*, to analyze the economic and legal impact of FDR's pre-war legacy.

Continued from page 1

It wasn't until Mencken realized the vast size and intrusive scope of that "dictatorship" that he went on the attack, lambasting the New Deal as a "puerile amalgam of exploded imbecilities, many of them in flat contradiction of the rest." Indeed, in a passage that could be recycled and reused in our own troubled times, Mencken denounced Roosevelt for proposing "to lift the burden of debt by encouraging fools to incur more debt, and to husband the depleted capital of the nation by outlawing what is left of it."

"That the rebel of the twenties should now become a spokesman of the conservatives of the thirties," observed Mencken scholar Malcom Moos, "came as a shock to many of Mencken's admirers." But was it really so shocking? As America's most famous political journalist for several decades, Mencken routinely championed the individual against the collective, siding with the imprisoned antiwar socialist *Eugene V. Debs*, with the embattled high school science teacher John Scopes, and with the thankless American taxpayer, the sort "who feels that he is being mulcted in an excessive amount for services that, in the main, are useless to him, and that, in substantial part, are downright inimical to him." To put it differently, Mencken didn't turn right, the country lurched wildly to the left.

And he wasn't the only one to feel the shift. By the late 1930s, a handful of prominent liberals suddenly found themselves on the wrong side of the New Deal consensus. Much like Mencken, they joined the "right" almost by default. For the sin of holding fast to certain fundamental beliefs, including the quaint notion that big business and big government should be kept as far apart as possible, they were dubbed heartless reactionaries and "economic royalists." Yet thanks to their principled opposition, some of the New Deal's worst excesses were brought to light or kept at least partially in check.

> "By the late 1930s, a handful of prominent liberals suddenly found themselves on the wrong side of the New Deal consensus."

BRANDED AS A TORY AND A REACTIONARY

Foremost among the members of this new "right" was the muckraking journalist John T. Flynn. Unlike Mencken, whose radical views had always centered on a rugged brand of individualism, Flynn qualified as a progressive liberal until the New Deal drove him away. A graduate of Georgetown Law School, Flynn made his name in the 1920s and early 1930s as a left-leaning financial columnist and author whose books bore such titles as *Graft in Business* and *Trusts Gone Wrong!* He enjoyed identifying and exposing the dirty deeds of big business and, as biographer John Moser writes, "in particular he saw abuses in the banking system and the New York Stock Exchange, and as early as February 1929 he was predicting that the value of corporate securities was about to plummet." Flynn's work earned him a prominent perch at the *New Republic*, then as now one of the country's leading left-liberal publications, where he wrote a weekly economics column from 1933 until he was dropped in 1940 for his increasingly harsh attacks on FDR's policies.

But like Mencken, Flynn started out as a Roosevelt supporter, referring to the New Deal as a "promising experiment." It took the National Recovery Administration to cure him of that. The centerpiece of FDR's first 100 days, the NRA represented the nightmare of central planning made real. Enacted as part of the National Industrial Recovery Act of 1933, which FDR hailed as "the most important and far-reaching legislation ever enacted by the American Congress," the NRA sought to micromanage the economy through more than 500 wage-, hour-, and price-fixing "codes of fair competition," mandating everything from the price of food to the cost of having a shirt hemmed. The NRA's stated purpose was to increase efficiency via military-style organization, yet as historian Arthur Ekirch has pointed out: "Little attention was paid to the fact that it was industry itself that had largely prepared the regulations governing prices and production. Also ignored was the fact that the NRA meant the suspension of antitrust laws along with the whole theory of free competition and free enterprise."

Flynn was among the few who noticed. As a member of the progressive movement, he had long worried about the growing power and influence of the big corporations. Now FDR and his so-called brain trust were climbing into bed with them! As Flynn put it, "Curiously, every American liberal who had fought monopoly, who had demanded the enforcement of the anti-trust laws, who had denied the right of organized business groups, combinations and trade associations to rule our economic life, was branded as a Tory and a reactionary if he continued to believe these things." Thus Flynn found himself on the right.

Using the same muckraking approach that had made him a darling of the left, Flynn denounced the NRA as "probably the gravest attack upon the whole principle of the democratic society in our political history." As for Roosevelt, Flynn argued that although the president proclaimed "his devotion to democracy, he adopted a plan borrowed from the corporative state of Italy and sold it to all the liberals as a great liberal revolutionary triumph."

Nor did these scathing attacks go unnoticed. After reading an article of Flynn's published by the *Yale Review*, FDR wrote privately to the editor, denouncing Flynn as "a destructive rather than a constructive force" who "should be barred hereafter from the columns of any presentable daily paper, monthly magazine, or national quarterly."

THE BANNER OF JEFFERSON, JACKSON, OR CLEVELAND

While Flynn's words certainly stung, the attacks from Democratic hero Al Smith shook the New Deal coalition to its core. A legend among the reform-minded, Smith had long championed leftist causes ranging from minimum wage laws for women to government-built housing for the poor. A child of Manhattan's Lower East Side, Smith rose from Tammany Hall to the state capitol at Albany, where he served four terms as New York governor. In 1928, he received the Democratic Party's presidential nomination, though he suffered a disastrous electoral defeat at the hands of Republican Herbert Hoover. At the 1932 party convention, Smith lost the nomination to FDR.

So it came as a surprise when Smith began criticizing the New Deal. After all, hadn't he supported the same sort of policies in New York? But like Flynn, Smith saw himself as a constructive critic, not as a partisan foe. As one of the country's most famous opponents of alcohol prohibition, a group popularly known as the "wets," Smith had been deeply troubled by the lessons of the Eighteenth Amendment. Prohibition, he wrote in 1933, "gave functions to the Federal government which that government could not possibly discharge, and the evils which came from the attempts at enforcement were infinitely worse than those which honest reformers attempted to abolish." As biographer Christopher Finan put it, Smith "began to believe that the danger of giving new power to the federal government outweighed any good it might do. . . . He was putting himself on a collision course with the New Deal."

That collision came on January 25, 1936, when Smith delivered a fiery anti–New Deal speech before the Liberty League, a mostly conservative group organized in opposition to Roosevelt's policies. As Smith told the capacity crowd gathered at Washington's Mayflower hotel, "this country was organized on the principles of representative democracy, and you can't mix Socialism or Communism with that." Deriding FDR and his brain trust for their "betrayal" of the Democratic party's principles, Smith declared: "It is all right with me if they want to disguise themselves as Norman Thomas or Karl Marx, or Lenin, or any of the rest of that bunch, but what I won't stand for is to let them march under the banner of Jefferson, Jackson, or Cleveland."

Unfortunately for Smith, most Democrats saw things differently. Joseph Robinson, who had been Smith's running mate on the 1928 presidential ticket, derided Smith for addressing the Liberty League's "billion-dollar audience." He "has turned away from the East Side with those little shops and fish markets," Robinson sneered, "and now his gaze rests fondly upon the gilded towers and palaces of Park Avenue."

"Smith 'began to believe that the danger of giving new power to the federal government outweighed any good it might do.'"

Though Smith continued to enjoy hometown popularity in New York, he was basically excommunicated from the party. In 1936 he crossed the aisle to support Republican presidential candidate Alfred Landon, declaring, "I am an American before I am a Democrat." Four years later he campaigned on behalf of Republican Wendell Wilkie. FDR trounced them both.

As Smith remarked of his harsh treatment at the hands of one-time friends and allies, "Unless you're ready to subscribe to the New Deal 100 per cent and sign your life name on the dotted line, you're a Tory, you're a prince of privilege, you're a reactionary, you're an economic royalist." It took his support for FDR during World War II to repair the damage.

THE SWITCH IN TIME

A similar impatience with the New Deal's critics would famously reappear in FDR's war on the Supreme Court, culminating in his failed court-packing bill of 1937, which would have allowed Roosevelt to appoint as many as six new Supreme Court justices. Among other things, that conflict transformed the fiery progressive Sen. Burton K. Wheeler (D-MT) from a longtime friend into a deadly foe.

On February 5, 1937, FDR submitted his plan to reorganize the federal judiciary by allowing the president to appoint one new federal judge to match every sitting judge who had served at least 10 years and hadn't retired or resigned within six months of turning 70. "A lower mental or physical vigor leads men to avoid an examination of complicated and changed conditions," FDR argued. "Little by little, new facts become blurred through old glasses fitted, as it were, for the needs of another generation." In other words, the Court's commitment to such "horse and buggy" notions as property rights and limited constitutional government kept getting in the New Deal's way. Most ominously, in *Schechter Poultry Corp. v. United States* (1935), the Court unanimously struck down FDR's beloved NRA.

So Roosevelt bided his time, waiting until after his sweeping reelection in 1936 to strike against the "nine old men." As historian William E. Leuchtenburg put it, the court-packing scheme "bore the mark of a sovereign who after suffering many provocations had just received a new confirmation of power." Senator Wheeler would have agreed with that description, particularly the sovereign part. Wheeler thought the whole thing reeked of unbridled executive power.

And Wheeler, much more than Flynn or Smith, was a true-believing New Dealer with impeccable credentials. In 1924, he served as the running mate of Progressive Party presidential candidate Robert M. La Follette. As chairman of the Senate Interstate Commerce Committee, Wheeler played an indispensable role in the 1935 passage of FDR's bill to regulate utility holding companies. And on a personal note, when the Supreme Court nullified the Agricultural Adjustment Act of 1933 in *United States v. Butler* (1936). Wheeler's son-in-law, an economist at the Agricultural Adjustment Administration, was tossed out of work.

But none of that changed Wheeler's low opinion of FDR's court-packing plan. As Wheeler wrote in a letter to the socialist leader Norman Thomas, "It is an easy step from the control of a subservient Congress and the control of the Supreme Court to a modern democracy of a Hitler or a Mussolini." Addressing a national radio audience less than two weeks after FDR introduced the plan in Congress, Wheeler moved in for the kill: "Every despot has usurped the power of the legislative and judicial branches in the name of the necessity for haste to promote the general welfare of the masses—and then proceeded to reduce them to servitude. I do not believe that President Roosevelt has any such thing in mind, but such has been the course of events throughout the world."

Against Wheeler's incendiary rhetoric and crafty legislative maneuverings, the court-packing bill failed to garner the necessary votes and died in the Senate by a final tally of 70-20. Wheeler's "conservative" stand thus helped preserve some degree of judicial independence. (Though FDR did eventually get what he wanted. By the time of his death in 1945, he had "packed" the Court with eight New Deal–friendly justices. And the plan itself is widely credited with influencing swing vote Justice Owen Roberts, whose newfound support was called "the switch in time that saved nine.") Today's pro-Roosevelt liberals might take a moment to contemplate what George W. Bush would have done with those court-packing powers.

SUPERFLUOUS MEN

But outside of the court-packing battle, did the fight against the New Deal really matter? As Smith discovered, the voters didn't seem to have any problem with Roosevelt, and most historians still praise him today for ending the Depression and "saving capitalism." Is there anything to learn from the principled liberals who stood athwart the New Deal yelling stop?

Albert Jay Nock thought there was. An acclaimed journalist, editor, and biographer, Nock remains one of FDR's most intriguing opponents. Though he's normally remembered as a founding father of the modern libertarian and conservative movements, Nock actually championed a unique brand of Jeffersonian anti-statism that has never fit comfortably on the political right. An advocate of free trade and minimal government, he also opposed the private ownership of land, taking his cue from Henry George's 1879 bestseller *Progress and Poverty*, which argued that the government should be funded exclusively via a "single tax" on collectively owned land.

Indeed, Nock's political and economic views owed as much to the progressive historian Charles A. Beard as they did to the libertarian theorist Herbert Spencer. In his best-remembered book, *Our Enemy, The State*, Nock combined Spencer's emphasis on free trade and social cooperation with Beard's thesis that the U.S. Constitution represented an "unscrupulous and dishonourable" coup d'etat waged explicitly by "the speculating, industrial-commercial and creditor interests." As historian Charles Hamilton observed about the *Freeman*, the political magazine Nock edited for its entire 1920–1924 run, readers "couldn't decide if it was liberal, conservative, Bolshevik, revolutionary, anarchist, or Georgist." Hamilton might as well have been writing about Nock himself.

And although Nock was never a New Deal supporter, he was nonetheless shoved to the right by the Rooseveltian juggernaut. As Brian Doherty observed in his definitive libertarian history, *Radicals for Capitalism*, "Nock had never stopped thinking of himself as a radical. He found it bitterly ironic that in the post-New Deal era, conservative businessmen became his primary audience."

As far as Nock was concerned, it was the New Dealers who had forfeited their liberal status. He was the one keeping true liberalism alive so that future generations might bring it back into vogue. "Considering their professions of Liberalism," Nock wrote in a 1934 introduction to Herbert Spencer's *The Man Versus the State*, "it would be quite appropriate and by no means inurbane, to ask Mr. Roosevelt and his entourage whether they believe that the citizen has any rights which the State is bound to respect. Would they be willing . . . to subscribe to the fundamental doctrine of the Declaration? One would be unfeignedly surprised if they were."

Today, a chorus of distinguished economists and legal scholars has joined Nock's lonely voice of New Deal opposition, suggesting that his efforts to preserve classical liberalism paid off in the end—as did the efforts of Mencken, Flynn, Smith, and Wheeler. Though they didn't defeat FDR or even inspire a particularly effective opposition movement at the time, their positions have since been rediscovered by generations of libertarians and conservatives seeking to rein in the post-New Deal state. With President Barack Obama now wielding a similar array of sweeping executive powers in the face of a growing economic crisis, their principled examples have become more important than ever. ■

Crucial Issues in Health Care Reform

The calls for immediate and ill-considered health care legislation resound in Washington with hardly a pause for breath. On June 17, the Cato Institute, in an effort to provide reasoned perspective on this complex issue, held a Conference on Health Care Reform. Among numerous experts, Michael F. Cannon, Cato's director of health policy studies, spoke about the need for competition in payment methods. David A. Hyman, adjunct scholar at the Cato Institute, critiqued the arguments for a public plan. Aaron Yelowitz, Cato adjunct scholar, explored the hidden costs of an employer mandate. And Michael D. Tanner, senior fellow at the Cato Institute, examined the repercussions of an individual mandate.

MICHAEL CANNON: The problems with America's health care delivery system, rather than being the result of market failure, arise because government protects low-quality providers by stifling competition between different ways of paying health care providers. Rather than allow a level playing field between different payment systems, government tips the scale toward fee-for-service payment. The federal Medicare program is the largest purchaser of medical services in the world, and it operates largely on a fee-for-service basis. The federal tax code encourages fee-for-service payment and discourages pre-payment. State level clinician and insurance licensing laws also discourage or place disproportionate burdens on pre-paid health plans. With all of these interventions, government creates a steady stream of revenue for low-quality providers and penalizes innovations, including electronic medical records, bar code scanners for prescription drugs that help prevent medical errors, and surgery checklists that would have the effect of preventing unnecessary services.

The problem is not fee-for-service. Fee-for-service is as legitimate a way of paying doctors and hospitals as pre-payment or any sort of blended payment system. The problem is that we don't have open competition between all payment systems so that we can realize the quality gains that each can provide.

In the face of these government failures, the response from Congress is to keep digging. The reforms currently making their way through Congress would further stifle quality-enhancing competition between different payment systems. For example, the Senate is considering a bill by Sen. Ted Kennedy that would create a new government program with a payment system modeled on Medicare's. It would lock even more of the marketplace into fee-for-service payment, resulting in more of the same rather than the sorts of reforms that would improve the way we deliver care.

Improving the delivery system cannot be done by government dictate because the government's decisions are going to be unduly influenced by those who want to protect the status quo. For example, the government is currently trying to improve health care delivery with rifle-shot reforms, like subsidizing health information technologies, comparative effectiveness research, coordinated care, error reduction, and pay-for-performance. These are all things that open competition between payment systems will promote, but when the government tries to promote them, those efforts are either blocked by incumbent providers or made more expensive than they need to be.

The key to reforming the delivery system is to let consumers' choices and competition do the reforming. Let consumers control their health care dollars. Let them choose their own health plan. Let them buy insurance across state lines and let clinicians take their licenses across state lines, so that even pre-paid plans can compete on a level playing field and consumers can choose a Kaiser or Group Health Cooperative or a fee-for-service plan. It takes Medicare decades to make even minor changes to its payment systems. Consumers who control their health care dollars can change payment systems in a heartbeat. You get what you pay for, and there isn't any better way to ensure that we're going to be paying for quality than if we let consumers control the money.

DAVID HYMAN: I'm going to focus my remarks on the "three Ms" of a public plan: monopoly, monopsony, and maverick.

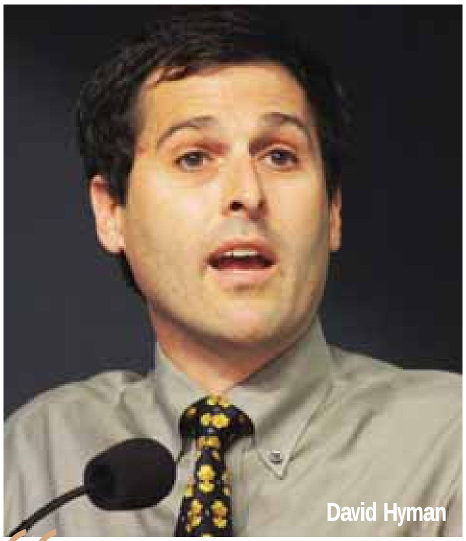
First, monopoly. Proponents of a public plan argue that the market for health insurance is monopolistic and that a public plan will make it more competitive. Both of those claims are deeply problematic as a matter of competition law. The assertion that the health insurance market is monopolistic is usually based on market concentration statistics computed by the American Medical Association on a state-by-state basis along with some claims about the number of mergers of health insurers.

There are a few problems with this approach. The first is that counting up the number of mergers doesn't tell you anything useful. Even if you assume you're dealing with the same product market, mergers across geographic markets don't really raise antitrust issues. Mergers within geographic markets may raise antitrust issues, depending on the particulars, but the particulars are important.

Second, although states are a natural unit to look at, because they're the basis on which we regulate health insurance, the marketplace for insurance doesn't usually track state borders very well. Market concentration ratios for something that isn't a market are just meaningless. They don't help you understand what's going on in the market. Third, concentration ratios or percentages of markets are just a screening tool to tell you "Gee, we shouldn't worry about this market," or, "Gee, maybe we should look closer at this market to try and figure out whether there's in fact an antitrust problem." For the past three decades, among antitrust enforcers from administrations in both parties, nobody's thought that de-concentrating a market in the absence of an actual antitrust violation was a strategy that would go anywhere in court or that had much to recommend itself as a general policy.

None of that is to suggest that there aren't problems with health insurance markets. Nor that some markets might not, in fact, be oligopolistic. But you can't answer these kinds of questions in the abstract. You actually have to go look and try to figure out what's happening. If we conclude that there's actually a monopoly problem in certain markets, we have a way of dealing with it—called the antitrust laws. We file an antitrust suit, we go in to court, we prove our case—or not, if you look at the hospital merger record—and then we use the remedies provided, the principal one of which is structural. You break up the monopoly and restore competition to the market.

As far as I can tell, in the entire history of antitrust, no one has ever thought a plausible response to a monopoly was for the government to go into the business of providing monopolized services. The government is currently investigating Intel and Google, and it previously prosecuted Microsoft for antitrust violations, but I don't know anyone who thought the correct remedy was for the government to go into the business of developing computer chips, web browsers, and search engines. If you want more competition in the market for health insurance, identify barriers to entry and get rid of them. Don't assume that creating a situation where the government is both a competitor and regulator is going to accomplish your intended objectives.



> "In the entire history of antitrust, no one has ever thought a plausible response to a monopoly was for the government to go into the business of providing monopolized services."

The second M is monopsony. If a public plan can rely on Medicare's purchasing power and pricing—and the Commonwealth Fund, as one of its three options for designing a public plan proposes explicitly that—it can probably underprice private insurance. Two observations. If proponents of a public plan are right that it can do that, then private insurers don't have the degree of monopoly power in the market that proponents thought they did. And, the degree of monopoly power was the premise for wanting the public plan in the first place. Leaving all that aside, let me just remind people that monopoly and monopsony are bad things. Setting up a monopsony purchaser of healthcare services is just as bad as having a monopoly seller. You don't want to do that if you can avoid it. Proponents seem to view monopsony purchasing power as a feature when it's actually a bug.

Third is maverick. The claim is that a public plan will discipline the behavior of private plans, although it's not quite clear how that will happen. The difficulty here is that if the public plan is subject to the same set of rules and taxes as a private plan and it can't access government subsidies, it's kind of hard to see why it is going to behave any differently than any other private plan. It's important that we have the same sets of rules, not because we have any particular love for the private insurance market, but because the logic of competition is that the outcome reflects people's actual preferences.

For example, if we subsidized hybrids and tax SUVs, or did the opposite, nobody would think that the resulting purchasing patterns would tell us anything useful about the actual demand for hybrids and SUVs. You need to treat them the same and then look at the outcome and say, "Oh, people really do want a fill-in-the-blank," as opposed to, "I've given you a huge sum of money to buy this and I'm going to tax you heavily for buying that. Which one do you prefer?" Either we have equal treatment on a level playing field or we need to stop pretending this is about competition.

Would a public plan have lower administrative costs? Medicare appears to have lower overhead for a couple of reasons, most of which won't apply to the public plan we're talking about. Medicare has a monopoly on the over-65 population. It doesn't incur marketing or advertising costs. Medicare doesn't form networks and doesn't do much to control utilization. It does not do as much as it should to control fraud. Presumably none of these will be true for the public plan. Medicare also relies on Social Security and the IRS to do some of its bookkeeping and to collect its premiums, which won't be the case with a public plan. So it's hard to see that the kind of magnitude of difference in a public plan will look nearly as big as it does when comparing Medicare to private plans.

The public plan may have some comparative advantage in overhead, but the advantage is not going to be that large. If we wanted to know how large that advantage might be, we ought to look at the overhead in self-funded state plans, which public plan proponents offered as their model. Then we can actually compare apples to apples.

Of course the government plan might not work as hard to avoid high-cost individuals, which means it will probably attract a sicker population, eliminating some of the purported cost advantages—unless you risk-adjust. The problem with risk-adjustment is that it is hard to do right. The challenge is in differentiating whether costs are lower because of favorable risk-selection or because you're delivering higher-quality care to a chronically ill population. f you get that wrong you mess up the incentives. And there's no reason for thinking regulators will favor the "home team," is there?

AARON YELOWITZ: Several arguments are used to convince people to support employer mandates. Let's do a little bit of digging into each of them and try to see whether they hold water.

The first is that very few firms are affected. A quote from the California Medical Association in support of California's "pay-or-play" mandate back in 2003 said that "Senate Bill 2 was actually a moderate and reasonable step that would affect less than 5 percent of California employers." But there is a key difference between employers and the number of workers. There are very few large employers, but they employ a lot of people. In California, the top 5 percent of firms employ 61 percent of workers. There are very few Microsofts and Walmarts, which have tons of employees. So, even though it doesn't affect many firms, a mandate certainly affects a lot of workers, and that will impact costs.

A second argument is that large firms already offer health insurance. Eric Schlosser, author of *Fast Food Nation,* in support of the pay-or-play mandate, said "Among employers with two hundred or more workers, 99 percent already provide health insurance. Among those with 50 to 150 workers, 94 percent do." That leaves the impression that there is maybe one percent or five percent "bad, scoundrel firms" out there that are not doing what they are supposed to do, but that the overwhelming majority of

Aaron Yelowitz

"Even in firms that are already offering health insurance, a mandate would increase their costs for that final one third of employees."

firms wouldn't be affected.

The problem is that offering health insurance to your employees and your employees taking up the health insurance are two different things. Most large firms are offering health insurance, but they don't necessarily offer it to all their employees. If you're part-time or seasonal, the odds of getting insurance are much lower. Offering it to full-time, full-year employees is different from offering it to part-time employees. For most firm sizes, around two-thirds of employees are taking insurance. Even in firms that are already offering health insurance, a mandate would increase their costs for that final one third of employees.

The final point that I want to make about employer mandates is that, in the California debate at least, there has often been a focus on how much it would cost to cover the uninsured. The mandates do not simply say "You must only cover the uninsured," but rather, "You must provide 'Cadillac coverage.'" Imagine that the University of Kentucky, which pays 50 percent of my premiums each month, was forced to pay 80 percent of the monthly premiums for my family plan. That is a new, significant cost to the university. There are lots of employees like that in California, lots of people who already have employer-sponsored insurance but whose expenses are now being raised. In fact, almost half of the cost of the legislation is for people who already have health insurance and who presumably have come to some kind of agreement with their employer on the right compensation package for them, in terms of wages and health insurance.

It takes some work to try to break out of those sound bites that are easy to say, such as, "All large employers are already offering health insurance to their employees and paying for a good share of it." But when you look at the numbers carefully, a lot of the claims don't stand up.

MICHAEL D. TANNER: An individual mandate is a unique and unprecedented violation of individual liberty and choice. But despite its intrusiveness, it is likely to be unenforceable in the long run. The idea that you are going to track down every undocumented alien, every homeless person, every mentally ill person, people who change jobs, people who move in and out of a state, and find out if they have insurance and then penalize them for failing to get it is unrealistic.

An individual mandate is also the first in a series of dominos that would almost inevitably lead to greater government control of health care. If you are going to have a mandate for insurance, it will have to be heavily regulated and heavily subsidized. You have to define, for example, what insurance meets the mandate. Once you start down this road to mandating what this product that everyone has to buy will be, you create a special interest bonanza, as every interest group, provider, and disease

Continued on page 17

Solutions through freedom, not control

Cato Ads, Conference Highlight Health Care Battle

The nation's health care system is in desperate need of change. Costs are growing to unsustainable levels, and millions of Americans are without health insurance. President Obama and Democrats in Congress have a plan to address this, one they are pushing with all their political capital. But theirs is not the only voice.

The Cato Institute is undertaking nationwide outreach on how free-market reforms, increased consumer choice, and energized competition—not more government control—will improve the quality and affordability of health care.

On July 23, full-page newspaper ads ran in the *New York Times*, the *Washington Post*, the *Washington Times*, the *Chicago Tribune*, and the *Los Angeles Times*. The ad (pictured opposite) provides information on a "uniquely American solution: freedom. Freedom to

The Cato Institute's July 17 Conference on Health Care Reform brought together health care experts from across the political spectrum for a day of debate and discussion. Rep. Paul Ryan proposed an alternative path to better health care, one that embraces the market rather than government control. Harvard Business School's Regina Herzlinger discussed greater provider specialization as a solution to the problem of health care delivery.

choose your doctor and health plan. Freedom to spend your health care dollars as you choose. Freedom to make your own medical decisions. Freedom to keep a health plan you are satisfied with."

Spearheaded by full-page ads in the *New York Times,* the *Washington Post,* the *Los Angeles Times,* and other major newspapers, the Cato Institute is undertaking nationwide outreach on how free-market reforms, increased consumer choice, and energized competition—not more government control— improve health care's quality and affordability. Beyond the newspaper campaign, Cato is running ads on radio stations and has launched a new web site of key resources at healthcare.cato.org.

In addition to its print campaign, Cato is reaching out to the American public through radio stations and a new website (healthcare.cato.org) featuring key health care resources.

Although the outreach campaign is intended to bring the message of freedom-based reform to a national audience, Cato has not lost sight of the need to educate specialists, as well. On June 17, the Cato Institute hosted a day-long conference on health care to provide a platform for ideas from across the political spectrum. The conference opened with remarks from Cato president Ed Crane and closed with a discussion of free-market alternatives to the calls for greater government control. Between were five addresses and panels made up of nearly two dozen speakers and experts. Among these were Rep. Paul Ryan (R-WI), who discussed the impacts of various health care reforms, and Rep. Michael C. Burgess, M.D. (R-TX), and Rep. Jason Altmire (D-PA), who laid out their visions of the path health care should take.

Panel discussions addressed such important questions as whether Congress should mandate coverage, how the health care delivery systems could be reformed, and the need—or lack of it—for a government health insurance program. Michael D. Tanner, senior fellow at the Cato Institute and coauthor of *Healthy Competition: What's Holding Back Health Care and How to Free It* (a book given out to all conference attendees), called individual mandates a "unique and unprecedented violation of individual liberty and choice," while Jon Kingsdale, executive director of the Commonwealth Health Insurance Connector, argued that mandates have functioned well in Massachusetts.

Karen Tumulty, Gail Wilensky, and Karen Davenport answer audience questions during a panel discussion on the government's proposed public option plan at the Cato Institute's Conference on Health Care Reform on June 17.

After a full day of discussion, debate, and the exchange of ideas, it was clear that health care is a more complicated issue than politicians in Washington would have us believe. If we are to improve America's health care, we need to be aware of that complexity. Cato's health care conference did just that. And if we are to build a health care system we can live with, we need to examine all the reform options—options Cato's nationwide outreach program is bringing to the attention of the American public.

The newspaper and radio ads, video of the conference, and other information on health care reform can be found at healthcare.cato.org.

U.S.News & WORLD REPORT

Some say Americans use **too much healthcare**, that even if reform is achieved, universal access should not mean unlimited access. Tough choices must be made. Others worry that the most needy or least able to fight for themselves will be left waiting. **Should healthcare be rationed?**

Not Enough Care to Go Around

Pro

The only way to spend less on healthcare is to consume less.

USA TODAY

Plan undercuts competition

Opposing view: 'Public option' is fast lane to government health care takeover.

NEW YORK PO

HEALTH-REFORM MALPRACTICE:

IT'S A JOB KILL

MICHAEL TANNER

NEW YORK POST

ObamaCare Kills Health Competition

MICHAEL TANNER

In July, the debate over health care reached fever pitch, and no one was hotter than Cato's own Michael Tanner. While politicians in Washington argued about how best to expand government control over the health decisions of all Americans, Tanner penned op-eds in major newspapers across the country—four in the *New York Post* alone—keeping alive the important message that it is liberty, not federal control, that will improve America's health.

Zimbabwean prime minister MORGAN TSVANGIRAI talks with Cato senior fellow STEVE H. HANKE at a breakfast on June 9. Cato brought Tsvangirai and other ministers from Zimbabwe together with libertarian-minded policy analysts to discuss libertarian solutions to Zimbabwe's economic and social problems.

Cato's executive vice president DAVID BOAZ speaks to a large crowd at FreedomFest in Las Vegas, Nevada, on July 10. He discussed the crisis of freedom in the face of growing government control and compared it to historical periods when liberty was under attack. Boaz gave three speeches and appeared on four panels and two television shows during five days in Las Vegas, and participated in the Free Minds 09 and Liberty Editors conferences as well. Senior fellows Randal O'Toole and Dan Mitchell also made multiple appearances during the conferences.

P. J. O'Rourke, H. L. Mencken Research Fellow at the Cato Institute, brought humor to his lament of the decline of the American automobile at a Cato Book Forum on June 9, highlighting his new collection of essays, *Driving Like Crazy*.

Judge ANDREW P. NAPOLITANO signs copies of his new book, *Dred Scott's Revenge: A Legal History of Race and Freedom in America*, following a Cato Book Forum on June 18. Napolitano spoke about the book, which traces the history of the United States government's involvement with African Americans from colonial times to the election of President Obama. In doing so, it seeks to answer the question of how the same people who wrote "all men are created equal" could participate in the terrible institution of slavery.

JUNE 1: Brother, Can You Spare A Trillion? Lessons from the New Deal and Great Depression

JUNE 2: Will Cost Containment Derail Health Care Reform?

JUNE 3: Cato Institute Policy Perspectives 2009, Santa Barbara

JUNE 4: Cato Institute Policy Perspectives 2009, Los Angeles

JUNE 8: The Financial Fix—Limited Purpose Banking

JUNE 8: Lunch with Moeletsi Mbeki

JUNE 9: *Driving Like Crazy*

JUNE 9: Breakfast with Zimbabwean prime minister Morgan Tsvangirai

JUNE 10: Who Are the Real Free Traders in Congress?

JUNE 11: Fusion Centers: Domestic Spying or Sensible Surveillance?

JUNE 15: Restoring the Pro-Trade Consensus

JUNE 16: A New Course for Antitrust

JUNE 17: Cato Institute Conference on Health Care Reform

JUNE 18: *Dred Scott's Revenge: A Legal History of Race and Freedom in America*

JUNE 22: Massachusetts—Three Years Later

JUNE 22: *It's Our Turn to Eat: The Story of a Kenyan Whistleblower*

JUNE 23: Pakistan and the Future of U.S. Policy

JUNE 24: Bringing Transparency to the Federal Reserve

JUNE 24: Roundtable luncheon with Suffolk University's Ben Powell

JUNE 25: Is This Socialized Medicine?

JULY 7: Federal Drug Policy: Time to Shift Priorities

JULY 14: Engaging China to Solve the North Korea Problem

JULY 15: What Government-Run Health Care Really Means

JULY 20: Who Are the Uninsured?

JULY 24: Assessing the Options: REAL ID, PASS ID, or No National ID at All

JULY 26–31: Cato University

JULY 30: Venezuela's Assault on Freedom of the Press and Other Liberties

Audio and video for all Cato events dating back to 1999, and many events before that, can be found on the Cato Institute website at www.cato.org/events. You can also find write-ups of Cato events in Ed Crane's bimonthly memo for Cato Sponsors.

Cato Calendar

CATO CLUB 200 RETREAT
Santa Barbara, California
Four Seasons • October 8–11, 2009
Speakers include Vladimir Bukovsky and Gary Johnson.

CATO INSTITUTE POLICY PERSPECTIVES 2009
Chicago • The Drake
October 29, 2009

CATO INSTITUTE POLICY PERSPECTIVES 2009
New York • Waldorf-Astoria
November 6, 2009

RESTORING GLOBAL FINANCIAL STABILITY
27th Annual Monetary Conference
Washington • Cato Institute
November 19, 2009
Speakers include Richard Fisher, Allan Meltzer, Kevin Murphy, Judy Shelton, Luigi Zingales, and James Grant.

22nd ANNUAL BENEFACTOR SUMMIT
Palm Beach • Four Seasons Resort
February 25–28, 2010

THE MILTON FRIEDMAN PRIZE FOR ADVANCING LIBERTY,

named in honor of perhaps the greatest champion of liberty in the 20th century, is presented every other year to an individual who has made a significant contribution to advance human freedom

The Friedman Prize went to the late British economist Peter Bauer in 2002, the Peruvian economist Hernando de Soto in 2004, former prime minister of Estonia Mart Laar in 2006, and Yon Goicoechea pictured above, leader of the pro-democracy student movement in Venezuela, in 2008.

The prize, a cash award of $500,000, is presented at the Milton Friedman Prize for Advancing Liberty's Biennial Dinner. In 2010, the Dinner will be held on May 13, 2010, at the Washington Hilton in Washington, D.C.

For additional details about the Friedman Prize, and to submit nominations for the 2010 recipient, visit www.cato.org/friedmanprize. Email inquiries: lalbanese@cato.org or yvinnikov@cato.org.

THE MILTON FRIEDMAN PRIZE FOR ADVANCING LIBERTY

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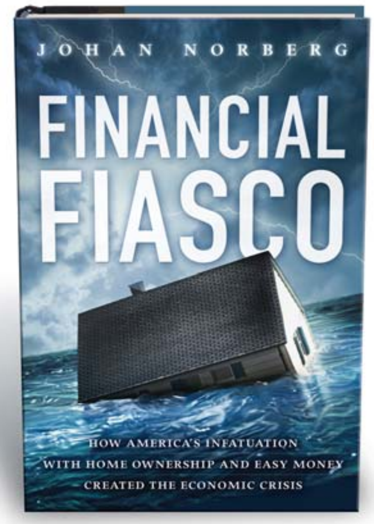
Johan Norberg tells the story of the financial crisis

Setting the Record Straight



"What exactly happened?" Johan Norberg, author of *In Defense of Global Capitalism*, asks in his new book on the recent financial crisis. "How could overenthusiastic home buyers in the United States sink the global economy?" Banks collapsed and thousands of Americans lost their homes. Two of the "big three" auto makers are reduced to beggars and wards of the federal government. Pundits and politicians attach blame to myriad actors, from the Federal Reserve to greed on Wall Street, from a Congress desperate to increase home ownership to reckless financial innovations. Understanding how we arrived at this recession means walking through a maze of regulation and deregulation, capitalism and corporatism. The task is daunting.

But with *Financial Fiasco: How America's Infatuation with Home Ownership and Easy Money Created the Economic Crisis*, Norberg acts as an articulate and insightful guide. In six short chapters, he tells the story of the crisis. The first three address monetary policy, housing policy, and financial innovations—the key components that combine, a chapter later, to create financial catastrophe. The final two chapters describe the government's mismanagement of the crisis and how we are repeating some of the very mistakes that caused it. Norberg calls his book a detective story and, as he carefully traces the clues, the causes of the crisis become clear. Understanding those causes is crucial for every American who has felt the recession's effects—and an understanding is exactly what *Financial Fiasco* provides.

It was government intervention, not laissez-faire capitalism, that created the recession. But that's not what the folks in Washington would have us believe. From the earliest days of the recession, "politicians who had never hesitated to claim credit for each one-tenth of one percentage point of growth or for each new job created . . . immediately went to great pains to pin the blame for the downturn on their lack of influence."

How does reality differ from the fantasies of politicians and pundits? "The story of this storm in the global markets is the story of how government intervention to solve previous crises laid the foundation for a new one," Norberg argues. He shows how housing policy—a desire by politicians to help more of us realize the American dream of home ownership—encouraged private sector financial innovations, innovations that misrepresented risk and, eventually, lead to the crisis. And it was the poor management of this crisis by federal regulators that exacerbated the recession.

Norberg ends the book with a warning. "After government authorities had helped create the worst financial crisis in generations," he writes, "the climate of ideas has now shifted dramatically in the direction of bigger and more active government." *Financial Fiasco* sets those ideas on their proper course and shows how liberty, not greater government control, is the true path to recovery.

Visit www.catostore.org or dial 800-767-1241 to get your copy of *Financial Fiasco* today; $21.95 hardcover.

Continued from page 11

constituency demands to be included in the product. As they are included, the costs rise both in terms of premiums and the subsidies necessary to keep this affordable for people. As the premiums and subsidies rise, the public demands cost controls, and you begin to put in premium caps or other forms of cost control containment.

The primary reason we're told we need to have an individual mandate is to get people insured to deal with the problem of uncompensated care. But let's keep it in perspective. The cost of uncompensated care is actually about 2.5 percent of total health care spending. It is a much more manageable problem than is commonly believed. We should also note that the imposition of mandates does not necessarily eliminate uncompensated care. We haven't seen an elimination of uncompensated care in Massachusetts. In fact, the hospitals there say that they still need their subsidies for uncompensated care.

We are also told that we need to have an individual mandate in order to bring more young and healthy people into the pool, which will lower premiums for everyone. That's true only in so far as you prohibit actuarial underwriting of insurance. If people are underwritten on the basis of their health, it doesn't matter whether you have young and healthy people or old and sick people in the pool. Everybody's premium is based on their own health.

If we want to bring young and healthy people into the pool, reducing the cost of health insurance by eliminating things like community rating—which drives up the cost of insurance—might help. You would think that if you want people to buy a product, creating legislation that drives up the cost of that product isn't a good way to do it. Yet we do things that make insurance more expensive for young, healthy people to buy, and then we're surprised when young, healthy people don't buy insurance. New York State was a classic example. When they introduced community rating, some 500,000 people, mostly young and healthy, dropped their insurance because of the increase in premiums. There are ways we can do this better.

It's Not What You Have That Matters, But What You Can Do with It

News reports and op-eds are filled with warnings about increasing inequality. The income gap between the rich and the poor is growing, resulting in a shrinking middle class. This inequality poses a genuine threat to democracy and freedom, we are told. But "the public discussion of inequality in the United States," writes Cato Institute research fellow Will Wilkinson in **"Thinking Clearly About Economic Inequality"** (Policy Analysis no. 640), "is marked by a lack of clarity and care." To rectify this fuzzy thinking, Wilkinson offers arguments in favor of an alternative way of considering equality, one more nuanced in its moral vision than the debates in the op-ed pages, on talk radio, and from television punditry. He begins by distinguishing equality of income from equality of consumption, arguing that the latter is more meaningful and that "the weight of the evidence shows that the run-up in consumption inequality has been considerably less dramatic." Wilkinson uses data from happiness research to show that satisfaction with life's conditions has failed to show growing inequality, either. This is partly because the goods the rich buy, such as luxury cars, are functionally more similar to those bought by the poor, such as a used Toyota, than was the case just decades ago. Therefore our focus on income means we aren't paying enough attention to more legitimate forms of inequality, such as in education. We need to evaluate policies on the basis of how much they actually help the poor, and not on how they impact abstract metrics. Equally important, it is not at all clear that increased income inequality leads to a breakdown of democracy, as the wealthy tend to support redistributive policies at least as much as they do pro-market reforms. This lack of clarity and care in thinking about economic inequality is a "dangerous distraction," one that takes attention away from the much more legitimate problems facing America's poor. Wilkinson's report drew widespread and immediate attention from such media outlets as *The Economist*, the *Wall Street Journal*, *Instapundit*, and *National Review*.

Special Drawing Rights: The IMF's Imaginary Global Currency

The International Monetary Fund recently allocated $250 billion in Special Drawing Rights to its member nations. These SDRs are being hailed by some as a new global currency. Yet this vision of an alternative to the dollar is flawed, argues Swaminathan S. Anklesaria Aiyar, research fellow at Cato's Center for Global Liberty and Prosperity, in **"An International Monetary Fund Currency to Rival the Dollar? Why Special Drawing Rights Can't Play that Role"** (Development Policy Analysis no. 10). Rather than being currency in their own right, SDRs are only shorthand for a basket of U.S. dollars, euros, yen, and pounds sterling—and so have no intrinsic value themselves. Thus the SDR is nothing more than a unit of account and a line of credit, not a currency. Questions about the IMF's role in issuing Special

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CATO POLICY REPORT

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Drawing Rights obscure the actual threat to the dollar, Aiyar says. The Chinese yuan is positioned to become a true international currency. "As an issuer of reserve currency," Aiyar writes, "China will finally get the political stature and clout that it has long sought." It can accomplish this by moving from its status as creditor to one of hard-currency, provided it can abandon its current soft-currency mindset. Paying attention to China, therefore, is of much more value than worrying about whether SDRs are the new global currency.

Paying for Health Care by Soaking the Poor

That President Obama's health care plan will be expensive is a foregone conclusion. How to pay its expected $1.5 trillion cost over the next decade remains an open question, however. Cato senior fellow Michael Tanner and Chris Edwards, director of tax policy studies, examine five methods that congressional Democrats are considering in **"Will Obama Raise Middle-Class Taxes to Fund Health Care?"** (Tax & Budget Bulletin no. 57) Taxing employer-provided health insurance would raise $2.3 trillion over the next ten years, but would amount to a huge tax increase on the middle class. Ending health savings accounts and flexible spending accounts would raise only $11 billion, and would hit low- and middle-income earners the hardest. More than $200 billion could be raised by limiting the deductibility of medical expenses, but nearly three-quarters of those deductions are taken by households earning less than $75,000. Higher corporate taxes could bring the government a similar amount over the next decade, but risks driving jobs overseas. Finally, increasing alcohol and beverage taxes would target primarily lower-income Americans. No matter what method Congress uses to pay for any changes that it makes in health care, it's likely that middle- and low-income Americans will be hurt the most.

Where Massachusetts Goes, the Country Should Not

Health care reformers on the left and the right frequently point to Massachusetts as a model of success. The plan signed into law by governor Mitt Romney in 2006 is far from a good solution, however, writes Cato Institute senior fellow Michael Tanner in **"Massachusetts Miracle or Massachusetts Miserable: What the Failure of the 'Massachusetts Model' Tells Us about Health Care Reform"** (Briefing Paper no. 112). Instead, the plan is an example of how not to fix the nation's health care system. Looking at the results of three years of the "Massachusetts Model," Tanner finds a less-

than-expected reduction in the number of uninsured, with 58 percent of the newly insured being paid for by the government. Counter to the governor's promises, health care spending did not decrease but actually increased dramatically—an increase the state is having serious trouble affording. "Nearly all observers agree," writes Tanner, "that without a concerted effort to control costs, the program is unsustainable." This has raised the fearsome specter of price controls and rationing. The increase in the number of insured has also created shortages in health care services, with 4.8 percent of residents reporting not being able to find a doctor or make an appointment, up 1.3 percentage points from before the "Massachusetts Model" became law. When these reforms were first proposed, the Cato Institute warned that they would result in low-quality, government-run care. Three years later, those predictions have come true.

Regulation, Summer 2009

Bailing Out the Banks? Not So Fast.

A key justification for bailouts of large firms is the threat of "contagion." Allow one to fail and it will drag others down with it, perhaps collapsing the entire banking industry or ending the American automobile industry. Jean Helwege of Penn State University examines this premise in the Summer 2009 issue of *Regulation* and finds it wanting. The threat of "counterparty contagion," where a failed firm impacts an otherwise healthy firm through financial obligations it owes, rarely applies in an industry where investors carefully diversify their risks. This leaves only "information contagion," where the failure of one firm reveals the instability of similarly positioned firms.Yet this form of contagion would demand bailing out the entire industry, not just the first firm to fail—and such bailouts mean rewarding poorly run companies and preventing their more efficient competitors from gaining market share.

The empty threat of contagion is not the only problem with the theory of "too big to fail." Adam Smith of George Mason University and Bruce Yandle of Clemson University show how the concept will lead to bailout legislation too big for lawmakers to read and understand, money distributed until it's too much to count, and interest groups driving it who will be too powerful to stop.

The Summer issue of *Regulation* also includes articles on the costs and benefits of auto recalls, reform of the patent system, the CDC's recommendations for anti-tobacco spending, Canadian satisfaction with health care, hospital accountability, and several book reviews, with David R. Henderson on *The Case for Big Government*, Jeremy Lott on Margaret Thatcher, Richard A. Epstein on Robert Bork, William A. Niskanen on *Corporate Governance*, and Walter E. Williams on *Minimum Wages*.

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"To Be Governed..."

LICENSES FOR EVERYTHING

The men were turned away because they did not have a permit to sell the shark, said Martha Longueira, who handles purchasing for the Casablanca market [in Miami].

"We do get fish peddlers, and people assume that if they go out fishing, and have 20 pounds of fish, they can just sell it . . . but we can't accept it," she said. . . .

Nurse sharks are not protected species, so it is not against the law to possess one, [Jorge Pino of the Florida Fish and Wildlife Conservation Commission] said. Investigators are looking into whether the men were selling the shark without a license.

—**CNN.com,** July 22, 2009

TURNING TIDE?

- "I Love My Country; It's the Government I'm Afraid Of"
- "Don't Blame Me; I Voted for McCain and Palin"
- "Where's My Bailout?"

—**T-shirts on display, Dulles Airport,** July 2009

PUT THEM IN CHARGE OF HEALTH CARE SAVINGS

Ten years ago, Congress created a new system of government credit cards for federal employees booking work-related travel. The cards were meant to curb waste and abuse. But since their introduction, charges have doubled—from $4.39 billion in 1999 to $8.28 billion last year.

Among the expenses flagged in a new report from the Congressional Research Service: $3700 for laser eye surgery, $4100 for a first-class trip to Hawaii, and $100 million in unclaimed refunds for airline tickets that were purchased but never used.

—***Parade,*** July 5, 2009

JUST SAY NO

Conservatives are accused of being a party of "no." Fine. That is an indispensable word in politics because most new ideas are false and mischievous. Furthermore, the First Amendment's lovely first five words ("Congress shall make no law") set the negative tone of the Bill of Rights, which is a list of government behaviors, from establishing religion to conducting unreasonable searches, to which the Constitution says: No.

—**George F. Will, *Washington Post,***
June 28, 2009

DID THE VOTERS VOTE FOR TAXES?

[A] $550 billion income tax increase . . . is perhaps the clearest expression yet of the mandate that Democrats believe they won last November, when voters expanded Democratic majorities in Congress and sent Barack Obama to the White House.

—***New York Times,*** July 11, 2009

THE GOVERNMENT IS NOT THE ECONOMY

The Obama administration has turned back pleas for emergency aid from one of the biggest remaining threats to the economy—the state of California. . . .

"This matters for the U.S., not just for California,"said U.S. Rep. Zoe Lofgren, who chairs the state's Democratic congressional delegation. "I can't speak for the president, but when you've got the 8th biggest economy in the world sitting as one of your 50 states, it's hard to see how the country recovers if that state does not."

—***Washington Post,*** June 16, 2009

"THE AMERICAN PEOPLE ARE TIRED OF A WASHINGTON THAT'S ONLY OPEN TO THOSE WITH THE MOST CASH AND THE RIGHT CONNECTIONS," SENATOR OBAMA DECLARED

Sen. Daniel K. Inouye's staff contacted federal regulators last fall to ask about the bailout application of an ailing Hawaii bank that he had helped to establish and where he has invested the bulk of his personal wealth.

The bank, Central Pacific Financial, was an unlikely candidate for a program designed by the Treasury Department to bolster healthy banks. The firm's losses were depleting its capital reserves. Its primary regulator, the Federal Deposit Insurance Corp., already had decided that it didn't meet the criteria for receiving a favorable recommendation and had forwarded the application to a council that reviewed marginal cases, according to agency documents.

Two weeks after the inquiry from Inouye's office, Central Pacific announced that the Treasury would inject $135 million.

—***Washington Post,*** July 1, 2009