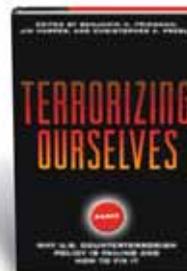




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# Cato Policy Report

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## Stimulus by Spending Cuts: Lessons from 1946

BY JASON E. TAYLOR AND RICHARD K. VEDDER

Many, probably most, Americans are skeptical of the vast stimulus efforts the federal government has undertaken in an effort to alleviate the economic downturn. After all, through early 2010, employment has fallen by 8.4 million jobs despite passage of two stimulus bills totaling nearly one trillion dollars in early 2008 and 2009, passage of the \$700 billion Troubled Asset Relief Program (TARP), and the extraordinary expansionary monetary actions by the Federal Reserve. But now with serious anxiety regarding the impact of the nation's unprecedented deficits and a potential surge in inflation, a second concern is arising: would any nascent recovery be thwarted if the government was to withdraw the stimulus and return to a semblance of financial normalcy? There's good news on that point. Just as history tells us that stimulus packages are ineffective in bringing about recovery, so it also tells us that "de-stimulus"—moving in the direction of monetary and fiscal contraction—likewise need not have severe adverse effects on employment, income, stock prices, and other macroeconomic variables.

The Obama administration projects a \$1.6 trillion budget deficit—almost 11

percent of our GDP—for the 2010 fiscal year. This deficit is the size of total federal spending just 13 years earlier (1997). And this follows a 2009 fiscal year deficit of over \$1.4 trillion. At the same time the Federal Reserve has injected another \$1.5 trillion in liquidity through various lending programs since the Great Recession began in late 2007. We might call this the "Great Stimulus," but those words are terribly misleading. It hasn't been much of a stimulus, given the rise in unemployment to double digits for only the second

time since the 1930s and the general lack of confidence economic agents seem to have in the future economy (the conference board's "Present Situation Index" of consumer confidence hit its lowest level in 27 years in February 2010). Nor is it all that "great": when compared to the size of the economy, the recent stimulus does not even begin to approach that of World War II.

Between 1943 and 1945 government deficits ranged between 21 and 27 per-

*Continued on page 6*



Cato president Edward H. Crane welcomes former congressman Joe Scarborough, now host of MSNBC's *Morning Joe*, to Cato's March 18 conference, "Escalate or Withdraw? Conservatives and the War in Afghanistan." At the conference several Republican House members said that "everyone" now agrees that it was a mistake to launch the war in Iraq. **PAGE 13.**

JASON E. TAYLOR is professor of economics at Central Michigan University. RICHARD K. VEDDER is distinguished professor of economics at Ohio University and adjunct scholar at the American Enterprise Institute.



BY EDWARD H. CRANE

“The political class seems to turn a deaf ear to increasingly vocal expressions of frustration by the American people.”

## Message from the President What We Have Here Is a Failure to Communicate

One of the classic examples of the failure of politicians to communicate with the citizenry is found in a video of Romanian tyrant Nicolae Ceausescu, giving what turned out to be his last speech to the teeming masses gathered in a square in Bucharest.

Oblivious to the mood of the people, Ceausescu is at his bombastic, self-important best until he realizes that the chants from the crowd below are not praise, but something rather to the contrary. The look on his face is, as they say in the MasterCard commercials, priceless.

America is a democratic republic, complete with an excellent Constitution that politicians still feel compelled to acknowledge, if not take seriously. So, the growing communications gap between the average American and the average politician, while worrisome, is not irreparable. Solving it should be a high priority for all involved.

The communication problem involves the accelerating realization on the part of many Americans that the essence of America, namely, a respect for the dignity of the individual, which inherently involves the government leaving the individual alone, has been pretty much forgotten by the politicians in Washington, D.C., the state capitals, and city councils around the nation. Which explains why public employees now make on average 30 percent more than their private sector counterparts—and 70 percent more in benefits. The political class seems to believe they have carte blanche to do as they please. They turn a deaf ear to increasingly vocal expressions of frustration by the American people.

Take, for example, a town hall meeting in Washington state last summer in which a young Marine veteran said to six-term Rep. Brian Baird, “Now I heard you say tonight about educating our children, indoctrinating our children, whatever you want to call it.” The congressman denied wanting to indoctrinate, but the young father simply responded, “Stay away from my kids.” Virtually all of the 400 or so people in the hall rose as one in loud applause. It was a Ceausescu moment. The congressman had no clue the people of his district weren’t interested in the federal government concerning itself with the education of their children.

The politicians simply do not get it. The Declaration of Independence says governments are created to secure our rights to life, liberty, and the pursuit of happiness. In other words, to leave us the hell alone. That is what makes for American exception-

alism, despite President Obama’s claim that all nations are exceptional. No, they are not, not in the way America is.

As I write these words, across my desk comes a press release from Bloomberg telling me that 18-term Rep. Henry Waxman wants Congress to ban the use of smokeless tobacco in Major League Baseball dugouts. This is part of our communications problem. Read my lips, Henry: It is none of Congress’s business if baseball players want to use smokeless tobacco (or any other kind of weed, for that matter). And this is the encouraging thing about the Tea Party movement. It is made up of average Americans who are sick to death of politicians regulating, taxing, controlling, and limiting individual choice.

This bipartisan communications problem is also exemplified by a joint press conference held just before the start of the lamentable 111th Congress by Senate Majority Leader Harry Reid and Minority Leader Mitch McConnell. Said Reid, “Sen. McConnell and I believe . . . that we are going to work in a bipartisan basis . . . to solve the problems of the American people.” Whoa! See how simple the communications problem is? They think we sent them to Congress to solve our problems when we actually sent them there to see to it that we are left alone to solve our own problems.

Add to that the fact that many, if not most, of our problems have been created by Congress in the first place and we have the basis for a healthy peaceful revolution. Some 85 percent of Americans like their healthcare, so Congress shoves a government-mandated system down our throats. Taxes are way too burdensome, so Congress is contemplating a value-added tax to add to our burden. We spend billions of dollars on wars in the Middle East for no rational reason. Climate change proves to be a wildly exaggerated issue, yet Congress still plans on raising taxes on energy to solve this non-existent problem. The list is long, and the frustration grows daily.

Talk about a failure to communicate. According to a recent Pew Research Center Poll, 78 percent of Americans don’t trust the federal government. As Ronald Reagan famously put it, “The nine most terrifying words in the English language are: ‘I’m from the government and I’m here to help.’”

## A deep examination of Social Security

# Defusing the Fiscal Time Bomb

For three decades, Cato Institute scholars have fought to reform the enormous entitlement that is Social Security. This third rail of American politics faces a looming crisis. How to fix it—how to balance the economic realities with political practicalities—is no easy task. Yet it is a crucial one, as Social Security threatens to consume a staggering portion of the country's GDP—a problem exacerbated by our aging population enjoying longer post-retirement life expectancy.

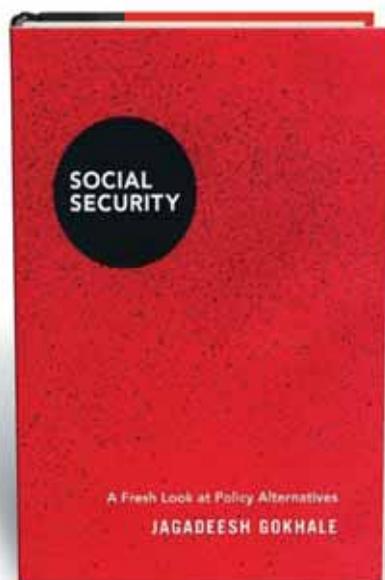
What began in the first issue of *Cato Policy Report* in 1979, with the article "Social Security: Has the Crisis Passed?" by Carolyn Weaver, and expanded a year later with Cato's first policy book, *Social Security: The Inherent Contradiction* by Peter J. Ferrara, continues today with the release of a new book by Cato senior fellow Jagadeesh Gokhale. *Social Security: A Fresh Look at Reform Alternatives* offers a detailed analysis of the fiscal future of this massive entitlement, and does so through the use of a fresh model that offers a considerable increase in accuracy over what came before.

The typical models used to analyze Social Security's future are inadequate, Gokhale argues. Those built by the government are based on broad group averages, whereas models used by nongovernment researchers are more detailed, but are limited to the few details of interest to the particular researcher. In *Social Security*, Gokhale offers an alternative, "a microsimulation of U.S. demographic and economic features" he calls DEMSIM.

The result of running the data through Gokhale's more robust model is grim. "DEMSIM's baseline

assumptions suggest that Social Security's financial condition is significantly worse compared to official projections by the program's trustees," Gokhale concludes. He is also able to examine several reform options.

His goal in writing the book, Gokhale explains, is to "convince the reader that independent checks of



official reform scoring exercises are useful;" that his microsimulation model approach brings advantages over the current practices; and that analysis of reform options should be based on measures of the program's long-term finances, as well as measures of how individuals will fare under both the current Social Security program and potential reformed programs.

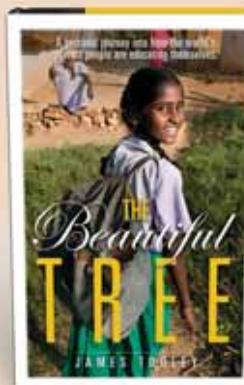
Without taking such measures, Gokhale warns, lawmakers and the public will remain uninformed, lacking the data necessary to make meaningful and effective adjustments to what is otherwise a doomed system.

Gokhale's *Social Security: A Fresh Look at Reform Alternatives*, published by the University of Chicago Press, is a powerful continuation of Cato's long-running mission to correct the mistakes of Social Security.

# Cato News Notes

## THE BEAUTIFUL TREE WINS FISHER AWARD

James Tooley's book *The Beautiful Tree* was awarded the 2010 Fisher International Memorial Award by the Atlas



Economic Research Foundation. The award recognizes "think tanks that produce outstanding publications that enhance the public understanding of a free society." Tooley's book, which tells the stories of deeply poor people throughout the world banding together to educate their own children outside

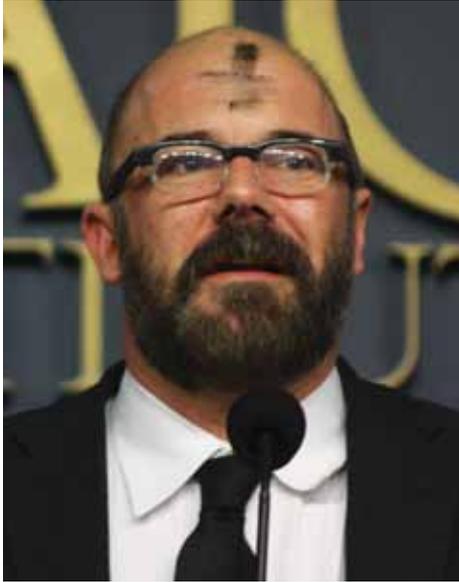
of failing state schools, earned high praise. "Rather than lament what has gone wrong in the developing world," the award announced, "*The Beautiful Tree* is about doing what is right, and demonstrates the power of the educative spirit in all corners of the world."

## OPM CHIEF BLASTS CATO

"It comes straight out of the Cato Institute," said John Berry, director of the Office of Personnel Management, in an interview with Federal News Radio in March. "It is based [on] an anti-government perspective." Berry was referring to the data behind a *USA Today* editorial criticizing the exorbitant compensation of government employees during this time of recession. That data, developed by Cato's director of tax policy studies Chris Edwards, showed that federal workers take home nearly twice as much in compensation as their private sector peers. If the nation's economy is to turn around, perhaps the government would do best to ignore Berry's warnings and take more advice "straight out of the Cato Institute."

## INNOCENT WINS ESSAY AWARD

First place in the *Infinity Journal's* IJ Awards was given to Cato foreign policy analyst Malou Innocent for her essay "The Road to Talibanistan: America's Contribution to Pakistan's Slow-Motion Collapse." Praising the work, the prize announcement said that it "was not only well-written, researched, and analyzed, but also it serves as a prime policy paper that should be read by leaders around the world."



**A**uthor and journalist ANDREW SULLIVAN (left, with his forehead marked for Ash Wednesday) engaged in a vigorous debate with MAGGIE GALLAGHER, president of the National Organization for Marriage, after a speech by NICK HERBERT, then a member of the British shadow cabinet, now a minister in David Cameron's government, on the topic "Is There a Place for Gay People in Conservatism and Conservative Politics?" at a Cato Policy Forum on February 17.



**O**f all the negative consequences that will likely result from President Obama's health care legislation, perhaps none is more pernicious—or less talked about—than the barriers it erects in the path of low-wage workers trying to climb the economic ladder. At a Policy Forum in February, Cato Institute director of health policy studies MICHAEL F. CANNON showed that implicit tax rates would often exceed 100 percent for low-wage workers, trapping millions of Americans in poverty.

**A**t a Capitol Hill Briefing in February, Cato Institute director of foreign policy studies CHRISTOPHER PREBLE outlined how the United States can reform its nuclear weapons programs by abandoning the huge arsenals that are a relic of the cold war and moving toward policies based "not on parochial and political considerations but ultimately on the strategic merit."



Some 150 supporters of the Cato Institute gathered at the Four Seasons Resort in Palm Beach, February 25–28, for lectures by Cato scholars and outside speakers at the annual Benefactor Summit. From top to bottom: “Marilyn Monroe” welcomes Cato president ED CRANE to a reception and dinner at the Ragtops Motorcars Museum in West Palm Beach. Celebrated fund manager SCOTT BARBEE and wife VANESSA talk with BILL BYRD and Cato senior fellow JERRY TAYLOR at the Summit. JOSÉ PIÑERA discusses the fiscal crisis confronting Europe and the United States. P. J. O’ROURKE previews his forthcoming book *Don’t Vote, It Just Encourages the Bastards*, which will be published in October. KAREN GRAY, ELIZABETH MOORE, and WILLETTE KLAUSNER at the Saturday night dinner reception hosted by Cato Board member David Koch at his Palm Beach home. Harvard University psychologist Steven Pinker gave the dinner talk, “A History of Violence,” describing how the world has become far less violent through the course of history. The next Benefactor Summit will be held at the Grand Del Mar near San Diego, February 24–27, 2011.

“The ‘Depression of 1946’ may be one of the most widely predicted events that never happened in American history.”

Continued from page 1

cent of GDP—in comparison to the size of today’s economy this would be the equivalent of annual deficits of around \$3 trillion to \$4 trillion. During these three years, the national debt rose from 50 percent of GDP to over 120 percent. Furthermore, the United States Bureau of the Budget estimated that at the wartime peak 45 percent of the nation’s civilian labor supply was supported by government spending on the war effort while another 12 million citizens (18 percent of the total labor force) were employed directly by the military.

Of course it is often said that World War II provides the empirical proof that a Keynesian-style government stimulus can bring an ailing economy back to full employment. During the 1930s, the argument goes, government simply did not spend enough to end the Great Depression. After Pearl Harbor, policymakers finally put the stimulus pedal to the metal with massive deficit spending and highly expansionary monetary policy—the money supply doubled between 1941 and 1945—to finance wartime production. Unemployment fell from nearly 20 percent in the late 1930s to 3.1 percent in 1942 and 1.2 percent in 1944. John Maynard Keynes himself implied that the return to full employment in the face of massive expansionary policy validated his theory, saying that economic “good may come out of evil” if we heeded the lessons of the wartime stimulus by using the same methods to combat downturns during peacetime.

But the real economic lesson to come out of the World War II era was not that the conscription of nearly a fifth of the labor force into grueling and dangerous working conditions abroad and the imposition of a command economy at home—complete with rationing, price controls, and government allocation of many aspects of life—could bring unemployment down. Soviet-style command economies had many problems, but unemployment was

not typically one of them.

Instead, the true lesson from the period can be ascertained from the events of 1945–1947 when the largest economic “stimulus” in American history was dramatically and quickly unwound, months before most people anticipated it (because the atomic bomb brought a sudden unexpected end to the war). No other episode more clearly supports the notion that the best economic stimulus is for the government to get out of the way.

#### THE DEPRESSION OF 1946

Historically minded readers may be saying, “There was a Depression in 1946? I never heard about that.” You never heard of it because it never happened. However, the “Depression of 1946” may be one of the most widely predicted events that never happened in American history. As the war was winding down, leading Keynesian economists of the day argued, as Alvin Hansen did, that “the government cannot just disband the Army, close down munitions factories, stop building ships, and remove all economic controls.” After all, the belief was that the only thing that finally ended the Great Depression of the 1930s was the dramatic increase in government involvement in the economy. In fact, Hansen’s advice went unheeded. Government canceled war contracts, and its spending fell from \$84 billion in 1945 to under \$30 billion in 1946. By 1947, the government was paying back its massive wartime debts by running a budget surplus of close to 6 percent of GDP. The military released around 10 million Amer-

icans back into civilian life. Most economic controls were lifted, and all were gone less than a year after V-J Day. In short, the economy underwent what the historian Jack Stokes Ballard refers to as the “shock of peace.” From the economy’s perspective, it was the “shock of de-stimulus.”

If the wartime government stimulus had ended the Great Depression, its winding down would certainly lead to its return. At least that was the consensus of almost every economic forecaster, government and private. In August 1945, the Office of War Mobilization and Reconversion forecast that 8 million would be unemployed by the spring of 1946, which would have amounted to a 12 percent unemployment rate. In September 1945, *Business Week* predicted unemployment would peak at 9 million, or around 14 percent. And these were the optimistic predictions. Leo Cherne of the Research Institute of America and Boris Shishkin, an economist for the American Federation of Labor, forecast 19 and 20 million unemployed respectively—rates that would have been in excess of 35 percent!

What happened? Labor markets adjusted quickly and efficiently once they were finally unfettered—neither the Hoover nor the Roosevelt administration gave labor markets a chance to adjust to economic shocks during the 1930s when dramatic labor market interventions (e.g., the National Industrial Recovery Act, the National Labor Relations Act, the Fair Labor Standards Act, among others) were pursued. Most economists today acknowledge that these interventionist policies extended the length and depth of the Great Depression. After the Second World War, unemployment rates, artificially low because of wartime conscription, rose a bit, but remained under 4.5 percent in the first three postwar years—below the long-run average rate of unemployment during the 20th century. Some workers voluntarily withdrew from the labor force, choosing to go to school or return to prewar duties as housewives.

“Government spending fell from \$84 billion in 1945 to under \$30 billion in 1946. From the economy’s perspective, it was the ‘shock of de-stimulus.’”

But, more importantly to the purpose here, many who lost government-supported jobs in the military or in munitions plants found employment as civilian industries expanded production—in fact civilian employment grew, on net, by over 4 million between 1945 and 1947 when so many pundits were predicting economic Armageddon. Household consumption, business investment, and net exports all boomed as government spending receded. The postwar era provides a classic illustration of how government spending “crowds out” private sector spending and how the economy can thrive when the government’s shadow is dramatically reduced.

Employment is closely related to the productivity-adjusted real wage. When the labor costs of making a widget fall, employers find it profitable to make more widgets and hire more widget-makers. Those costs fall when productivity rises (more widgets produced per hour of work), when the price of widgets rises (increasing the margin between revenues received and cost of production), or when money wages fall. In the immediate postwar era, prices and productivity were generally rising, more than offsetting modest increases in money wages.

The data today suggest that the self-correcting and healing forces of markets are beginning to work again. Worker productivity is generally increasing, and money wages are stagnant or rising less than the rate of inflation, meaning real wages are falling. In a productivity-adjusted sense, the wage decline appears to be substantial. After a lag to be sure this trend is real and sustaining, this should lead to an upsurge in new hiring. In other words, unemployment will start falling not because of the stimulus spending, but in spite of it. And just as the stimulus money created few if any new jobs, its withdrawal will destroy few if any jobs. To be sure, some specific jobs will be lost, but others will be gained as the negative effects of government borrowing are eased somewhat.

To better illustrate the crowding out effect of government spending, economists often refer to Frédéric Bastiat’s 1848 essay, “What Is Seen and What Is Not Seen.” The illusion that new employment results from the stimulus package is understandable because the jobs created by it are visible, whereas jobs lost due to the stimulus are much less transparent. When several hundred million dollars are spent building a 79-mile per hour railroad from Cleveland to Cincinnati, we will see workers improving railroad track, building new rail cars, and so on. In fact, we can directly count the number of jobs supported by stimulus dollars and report them on a website ([www.recovery.gov](http://www.recovery.gov) currently reports that 608,317 workers received stimulus monies in the 4th quarter of 2009). At the same time, however, the federal spending invisibly crowds out private spending. This happens regardless of how higher federal spending is financed. Tax financing (not done in this case) reduces the after-tax return to workers and investors, leading them to reduce the resources they provide. Deficit-financing (borrowing) tends to push up interest rates and, more generally, eats up dollars that would otherwise have gone toward private lending and investment. Inflationary financing (roughly the Fed printing money—a fear in this situation) reduces investor confidence, lowers the real value of some financial

assets, and leads to falling investment. Of course we do not register these “job losses” on the mainstream statistical radar because they are jobs that would have been created, absent the government spending, but never were—hence their invisibility.

There are no free lunches in the world. Stimulus efforts of modern times, perhaps most notably that of Japan during the 1990s, which actually led to reduced economic growth and long-term higher unemployment, show the futility of the Obama administration’s current approach. Furthermore, a recent study by Claudia Sahm, Matthew Shapiro, and Joel Slemrod shows that the Bush stimulus policies in 2001 and 2008 had no significant impact on the economy. Other recent work by Robert Barro and Charles Redlick examines long-term macroeconomic data and confirms the notion that government spending crowds out that of the private sector. Barro predicts that the long-term effect of the current stimulus will be negative.

#### DERAILING RECOVERY

Markets, by contrast, have marvelous healing properties. If unemployment is too high, declines in the productivity-adjusted real wage make it attractive to hire workers again, lessening the problem. If investors are slow in borrowing, falling interest rates entice them to take on credit. These sorts of things are happening in the American economy today, but government-imposed shocks can derail any recovery. This happened in the Great Depression as the economy finally began to recover after a major slowdown in government interference in the labor market between mid 1935 and early 1937. However, these gains were reversed by the Supreme Court’s surprise ruling (which followed Roosevelt’s threat to pack the Court) upholding the constitutionality of the National Labor Relations Act. Real wage rates rose sharply in the months that followed. Unemployment, which had fallen to around 13 percent on the day of the court ruling, was

back above 20 percent a year later. When market processes lead us to see light at the end of the tunnel, the government sometimes adds more tunnel.

Recent examples of this phenomenon can be seen in the newly passed health care legislation and the proposal for a cap-and-trade environmental regime. The new health care legislation will enormously increase labor costs, as would cap and trade. Nervous employers, wanting to avoid the possibility of taking on sharply rising labor expenses, demur in hiring workers that they would in a more neutral policy environment. Furthermore, the multitrillion-dollar deficits to finance the stimulus as well as government bailout money from TARP have to be financed, and the possibility that the Federal Reserve would engage in inflationary financing of this new federal debt has clearly unnerved many investors. Since the November 2008 election, the price of gold has risen 50 percent because of growing inflationary fears.

Yet another example is the government's continual extension of unemployment benefits beyond the customary maximum 26 weeks (most recently at the beginning of March). While most would agree that unemployment insurance provides short-term relief to those who must seek new work, many studies confirm what common sense says we should expect—the longer the time frame people are eligible for such benefits, the longer it takes for unemployment rates to fall. In 2009 the average duration of unemployment nearly doubled, and today, well over 40 percent of those unemployed have been out of work over six months. While the poor labor market is to blame for much of this jump in duration, there can be no doubt that incentives to obtain new employment have been, and will continue to be, tempered by governmental action which has extended unemployment insurance to many through the end of 2010.

Finally, it is clear that the government stimulus has not provided any kind of positive placebo-type effect on consumer and business confidence. As mentioned earlier, survey data show that such measures of

“History clearly shows the government that stimulates the best, taxes, spends, and intrudes the least.”

confidence continue to linger around the lowest levels seen in a generation. In fact, a simple econometric model consisting of two explanatory variables—government spending as a percent of total output and the rate of inflation, can explain the vast majority of the changes in stock market prices in modern times—and stock market valuations are a good indicator of confidence. Stock prices fall with growing government involvement in the economy or with rising inflation. The sharp rise in the government's share of output in the last decade and the threat of greater inflation in the next one are important factors behind the 30 percent decline in the inflation-adjusted Dow Jones Industrial Average since 2000. Eye-popping deficits of the past year have lowered optimism about the future, kept stock prices depressed, and reduced key elements in new investment spending. These negative side effects of the stimulus spending are certainly slowing down the recuperative process that market forces are attempting to generate.

#### CONCLUSION

The conversation has begun regarding the nation's exit strategy from the unsustainable fiscal and monetary stimulus of the last two years. Our soaring national debt will not only punish future generations but is also causing concern that our creditors may bring about a day of reckoning much sooner (the Chinese have recently become a net seller of U.S. government securities). There are fears that the Fed's policy of ultra-low interest rates may bring new asset bubbles and begin

the cycle of boom and bust all over again. And unless the Fed acts to withdraw some of the monetary stimulus, many fear a return of 1970s era double-digit inflation. On the other hand, there are widespread fears that if we remove the stimulus crutch, the feeble recovery may turn back toward that “precipice” from which President Obama has said the stimulus policies rescued us. History and economic theory tell us *those* fears are unfounded.

More than six decades ago, policymakers and, for the most part, the economic profession as a whole, erroneously concluded that Keynes was right—fiscal stimulus works to reduce unemployment. Keynesian-style stimulus policies became a staple of the government's response to economic downturns, particularly in the 1960s and 1970s. While Keynesianism fell out of style during the 1980s and 1990s—recall that Bill Clinton's secretary of treasury Robert Rubin turned Keynesian economics completely on its head when he claimed that surpluses, not deficits, stimulate the economy—during the recessions of 2001 and 2007–09 Keynesianism has come back with a vengeance. Both Presidents Bush and Obama, along with the Greenspan/Bernanke Federal Reserve, have instituted Keynesian-style stimulus policies—enhanced government spending (Obama's \$787 billion package), tax cuts to put money in people's hands to increase consumption (the Bush tax “rebate” checks of 2001 and 2008), and loose monetary policy (the Federal Reserve's leaving its target interest rate below 2 percent for an extended period from 2001 to 2004 and cutting to near zero during the Great Recession of 2007–09 and its aftermath). What did all of this get us? A decade far less successful economically than the two non-Keynesian ones that preceded it, with declining output growth and falling real capital valuations. History clearly shows the government that stimulates the best, taxes, spends, and intrudes the least. In particular, the lesson from 1945–47 is that a sharp reduction in government spending frees up assets for productive use and leads to renewed growth.

# Reviving Our Economic Liberties

On May 2, the Supreme Court heard oral arguments in *McDonald v. Chicago*, a case that is likely to extend the Second Amendment rights upheld in *District of Columbia v. Heller* to states and localities. Libertarians were hoping for more, however, seeing this as a chance to revive the debased Privileges or Immunities Clause of the Fourteenth Amendment. Unfortunately, the questions asked by the Justices during arguments indicated they wouldn't embrace this opportunity to expand protections of not just the right to bear arms, but also economic liberties. At a Capitol Hill Briefing the following day, Ilya Shapiro, senior fellow in constitutional studies at the Cato Institute, Clark Neily, senior attorney at the Institute for Justice, and Timothy Sandefur, principal attorney at the Pacific Legal Foundation, offered their reactions to the case and discussed the past, present, and future of the Privileges and Immunities Clause.

**ILYA SHAPIRO:** From a legal perspective, you can't just say "Oh, we'll just decide that the Second Amendment applies to the states." You can't do that because none of the Bill of Rights applied to the states until after the Civil War. The Civil War and the Reconstruction era effected a fundamental change in the relationship between the federal and state governments, and the federal and state governments respectively, with the individual. The Fourteenth Amendment, in particular, has three important sections: the Equal Protection Clause, which says that all laws must apply equally to all persons; the Due Process Clause, which insists you can't be deprived of your life, liberty, or property without the due process of law; and the Privileges or Immunities Clause, which says "no State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States."

You'd think that's a robust protection of our constitutional rights. *No state* shall deny the privileges or immunities. During the Reconstruction Era, "privileges or immunities" was a synonym for natural rights, as well as certain civil and political rights. (It is important, in evaluating what "privileges or

immunities" means in the Fourteenth Amendment, to look at what it meant *during Reconstruction*, not in 1791 or during the Revolution or what have you.) Unfortunately, five years after the Fourteenth Amendment was ratified, the Supreme Court effectively decided, in the *Slaughterhouse Cases*, that the Privileges or Immunities Clause was a null set, protecting the very few things that *federal* citizenship protected (for example, no State shall accost you on the High Seas). The reactionary Court at the time did not want to reconcile itself to the fundamental change that Reconstruction wrought after the Civil War, so they effectively read the Privileges and Immunities Clause out of the Constitution.

Instead, when certain rights started to be "incorporated" against the States, the Court had to do so using the doctrinal contrivance of Substantive Due Process. Now that sounds like a misnomer. What is "substantive procedure"? Because the Privileges or Immunities Clause was read out, constitutional rights—to free speech, freedom of religion, freedom from search and seizure etc.—started to be protected by the Due Process Clause, a strange way of doing things when you have another clause (Privileges or

Immunities) clearly meant to protect all these substantive rights.

Fast forward to *McDonald*. Gun owners are saying that their right to keep and bear arms is being infringed by Chicago. In this litigation Alan Gura raised both Due Process and Privileges or Immunities arguments. In oral argument, however, the Court didn't appear too interested in the Privileges or Immunities angle. Right off the bat, Chief Justice Roberts said that petitioner had a very high burden in trying to overturn the 140 year old *Slaughterhouse* precedents. And it looks like Justice Scalia, who had recently been quoted in the *Washington Post* as calling Substantive Due Process "babble" and Privileges or Immunities "flotsam," values babble over flotsam; he is likely to side with Substantive Due Process. While there are likely five votes in favor of incorporating the Second Amendment via Substantive Due Process, nobody was that favorable to Privileges or Immunities.

In short, while it was a good day for the right to keep and bear arms, it was not a good day for the Privileges or Immunities Clause. That's significant not just because legal scholars want to get the Constitution right, and it is more faithful to the Constitution to use Privileges or Immunities, but also because, if you care about liberty or originalism, Privileges or Immunities is important. This is because the tests applied under the Substantive Due Process Clause—tests of how "fundamental" the rights are—are easily manipulated. The Privileges or Immunities Clause, on the other hand, is tied directly into the text, history, and structure of the Constitution. There is evidence of exactly what it is supposed to cover and what it is supposed not to cover. At the very least, therefore, it would be no worse than Substantive Due Process, and at best it would prevent judges from inventing rights, and allow for the protection of freedom of contract, the right to earn an honest living, and other liberties.

**CLARK NEILY:** The good news first. If you love gun rights and you think they should apply against the States, then you're in luck: that's almost certainly going to happen. But if you love the Constitution, if you love the institution of the Supreme Court, if you love reasoned debate, then yesterday's arguments were a disgrace. None of the eight Justices who spoke (Clarence Thomas kept his customary silence) showed the slightest interest in the history of the Constitution. This is amazing in light of the fact that a year ago, in *Heller*, even the dissenting justices seemed to recognize that the history of the Second Amendment was relevant to the Court's interpretation of what the Second Amendment means.

That is an incredibly stark contrast to what happened in the *McDonald* arguments, where, as I said, all eight justices who asked questions showed literally no interest in the relevant constitutional text and history of the Fourteenth Amendment, ratified in 1868, and, specifically, no interest in the only provision in the Fourteenth Amendment that plausibly protects the right to keep and bear arms: the Privileges or Immunities Clause.

When you try to figure out what rights are protected by any part of the Constitution, to the extent the text is at all unclear (which, in a document with as broad a scope as the Constitution, is inevitable), you get a situation in which you have to bring your understanding of the relevant historical context to whatever provision of the Constitution is at issue. In the case of the Fourteenth Amendment, that is not nearly as hard as the Justices make it seem. There is no doubt that the whole point of the Fourteenth Amendment was to end Southern tyranny in the wake of the Civil War.

In the wake of the Civil War, blacks and white unionists were being systematically disarmed so they could be terrorized and, in some cases, lynched. The Congress that proposed the Fourteenth Amendment had abundant evidence of this, and it made them very angry. This tyranny is why we have the Fourteenth Amendment, and the part of it that was designed to put an end to that conduct was undoubtedly the Privileges or Immunities Clause. It was therefore extraor-

dinary to sit in the Supreme Court during *McDonald* and listen to an hour-long argument in which eight Justices showed not the slightest interest in any of that history, or in the relevant text of the Fourteenth Amendment.

What I am supposed to talk about here is the future of gun rights. But, to be honest, I



“All eight justices who asked questions showed literally no interest in the relevant constitutional text and history of the Fourteenth Amendment.”

am at a loss. Had the Court shown some interest in the text and history of the Fourteenth Amendment, I would say that gun control laws should be held to a very high standard of constitutional review. Historically, people were being stripped of their arms after the Civil War, their guns were confiscated under pretext, and this was all to make lynching easier. In light of this history, were the Court to interpret the Fourteenth Amendment according to the relevant historical context, gun control laws would be held to a very high level of scrutiny.

Protection of other rights specifically identified as needing protection during the

Reconstruction era would also come from a rehabilitation of the Privileges or Immunities Clause. For example, the Civil Rights Act of 1866 contained protections of the right to contract, to testify in court, to give evidence, and so forth.

One of the most important rights that would be protected, which the Court in the *McDonald* arguments gave short shrift, is the guarantee of economic liberty: the ability to go out and earn a living so that you can be economically self-sufficient. In the Reconstruction South, States were trying to keep newly freed black people in a state of constructive servitude, which they did by depriving them of the ability to earn a living and participate meaningfully in economic life. For example, some states made it illegal to be off your employer's property without a note from your employer.

Another example is property rights. Those of you familiar with the Supreme Court's decision in *Kelo v. New London*, in which the Supreme Court effectively deleted the Public Use Clause from the Fifth Amendment, giving to the government virtually unbounded powers of eminent domain, should know that *Kelo* is incompatible with the Fourteenth Amendment. The right to own property was another example of the kind of right being interfered with and taken away from both freed blacks and their white supporters.

These are examples of very bright road signs for the modern Supreme Court to determine what the scope of the Fourteenth Amendment is. If you have doubts about what the Fourteenth Amendment protects, why not go look at the sorts of rights that were being violated at the time it was enacted, and what seems to have prompted and motivated it, and that can help guide you.

Instead, what we've got is a Court that appears determined to continue another hundred years looking at any proposed right and having what amounts to a French salon, in which they sit around and discuss how “fundamental” they think the right is, in complete disregard of text and history. I don't get that, and I'm discouraged by it. But, hopefully, people will realize how unprincipled this approach is to our rights, and demand that either this Court, or new

Justices, use an approach more respectful of history and the text enacted by the people of this country, not just the Justices' personal sentiments.

**TIMOTHY SANDEFUR:** I want to talk about how this case goes beyond the right to possess firearms to involve a conflict between the values of individual liberty and democracy, which was set in place mainly by the Progressive Movement that created the New Deal and the modern administrative state.

The first sentence of the Constitution says, unambiguously, that liberty is a blessing. The word “democracy” is nowhere to be found in the Constitution. The Constitution exists, in fact, for the purpose of limiting democracy: it places all sorts of procedural and substantive restrictions on democracy in order to protect liberty. Unfortunately, the Progressive Movement, which began in the 1880s and reached its height in 1934, with *Nebbia v. New York*, replaced that value with democracy. Thus it is that, today, most intellectuals regard liberty as a *function* of democracy. Your rights aren't *rights*, but privileges, or permissions, that are given you by the government, for the government's own purposes.

The Privileges or Immunities Clause of the Fourteenth Amendment, of course, was written from the opposite perspective. It was written by the early Republican Party, which consisted of classical liberal opponents of slavery who wanted to ensure that, henceforth, there would be no question but that the Constitution protected *liberty*. Among the rights protected by the Privileges or Immunities Clause was, of course, the right to possess firearms for personal protection. But another protected right was the right to earn a living: to engage in trade and support yourself and your family free from government interference. This right had been guaranteed in common law as long ago as 1602, when, in *Darcy v. Allein*, the English Court of King's Bench held that a royal monopoly that gave a trade to one business only, and forbade others from competing, was a violation of Magna Carta.

By the time of the *Slaughterhouse Cases* in the 1870s, the idea that you had a right to earn an honest living, and that government could not create monopolies and make it

illegal to compete against them, was part of the prevailing intellectual atmosphere. But in 1868, the State of Louisiana passed a law saying that if you want to slaughter cattle you had to do it at one, privately owned, slaughterhouse. This put hundreds of butchers out of business overnight. You'd have to imagine if the California legislature



Timothy Sandefur

“What this country needs is a new Civil Rights Act, which makes explicit reference to economic liberty and the right to own a business.”

said that all cars had to be repaired at Aamco—it would put all the other garages out of business. So the competing butchers sued and the case made its way to the Supreme Court. The butchers argued that their right to earn a living without monopoly interference from the government was one of the privileges or immunities of citizenship, but in a 5-4 decision the Supreme Court disagreed, limiting the number of protected rights to a ridiculous degree, while completely ignoring the intellectual triumph—creating federal protection against abuses by state government—that accompanied Union victory in the Civil War.

Unfortunately, because of *Slaughterhouse*, the Court largely switched to using the Substantive Due Process doctrine to protect liberty. Now, Substantive Due Process is something conservatives attack, but let me explain what it actually means. “Substantive Due Process” is a bad term because it leaves out the most important part of the phrase. The Constitution says that you can't be deprived of life, liberty or property without due process of *law*.

Now, let's say Congress was to pass a law saying that Scientology is the official religion of the United States, and you are required to attend its church. And you decide you don't want to. And the policeman shows up and arrests you for disobeying the law. You might reply, “You can't do this because Congress doesn't have the power to pass this Scientology law. You can't even call it a law, for the First Amendment says that ‘Congress shall make no law’ on this subject.” It might be a “command” or a “*diktat*,” but it can't be a “law.” Thus, for you to be deprived of liberty pursuant to this invalid legislative enactment is to be deprived of liberty without due process of *law*.

If you take another step back you can see there are certain things law simply is not allowed to do to you. For example, until the New Deal it was widely believed that government had no power to take one person's property away and give it to another, simply because it liked the other person or group better. Now, of course, that's primarily what government does, but in those days it was held to be an arbitrary action of government, and arbitrariness is the opposite of law. Substantive Due Process barred government from extending economic favors to groups simply because they exercised greater political power than others, or burdening other groups that lacked political influence.

Although it doesn't cover as many bases as Privileges or Immunities, Substantive Due Process is as valid a part of the Constitution as the dormant commerce clause or separation of powers. But, of course, during the New Deal, the Court backed away from that and said, basically, that government can do whatever it wants when it comes to economic freedom and

*Continued on page 17*

# On the Road with Randal O'Toole

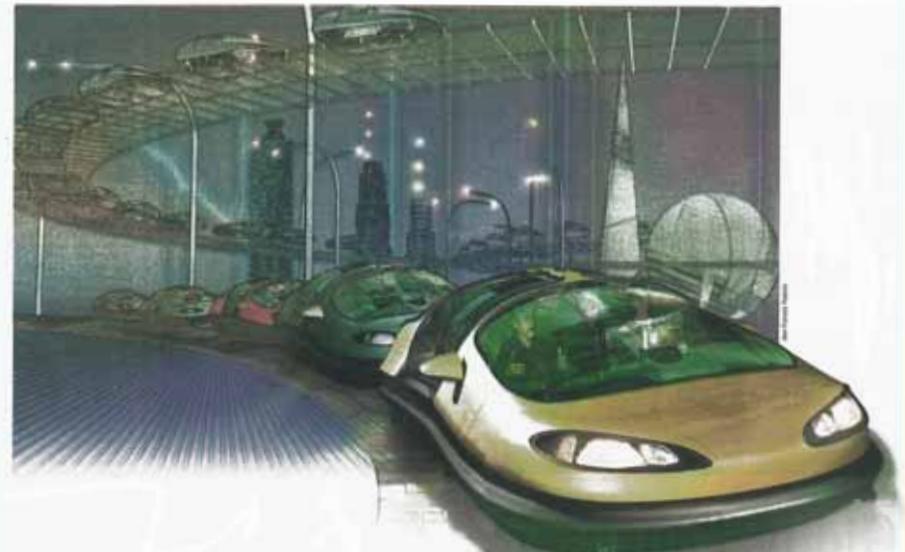
For someone writing about the often lamentable state of American transportation, Cato senior fellow Randal O'Toole spends a lot of time on the road. Between January and May, he spoke at more than 30 engagements from Anchorage to Orlando, presenting the case against high speed rail and smart growth policies and promoting the message of greater mobility found in his new book, *Gridlock: Why We're Stuck in Traffic and What to Do About It*.

"Congress, the administration, and others are making very important decisions about transportation that will influence how we travel, how we live, and how much we are taxed for many years to come," O'Toole said. "I want people to be aware of what is happening and help members of the public to have an influence on these decisions."

O'Toole spoke at Cato in January and at the National Conference of State Legislatures in April. His audiences ranged from populist to Ivy League. In January, he spoke at Powell's Books in Portland, Oregon, the largest independent bookstore in the world. He addressed a crowd of 250 people at the Racine Tea Party in Racine, Wisconsin, in March. A few weeks later, O'Toole took part in a special panel of the Janus Lecture series at Brown University, where he provided the libertarian perspective to counter co-panelist James Howard Kunstler, a leader in the anti-sprawl movement and author of *The Geography of Nowhere: The Rise and Decline of America's Man-Made Landscape*.

When he wasn't speaking in person to audiences across the country, O'Toole was talking to the media and writing for newspapers. In January and again in March, he was a featured guest on John Stossel's Fox Business program.

In March, O'Toole authored a full-page essay for the *Wall Street Journal*, "Taking the Driver Out of the Car." Addressing a topic familiar to those who have read *Gridlock*, O'Toole extolled the benefits of driverless cars. "Driverless cars and trucks will be safer,"



## Taking the Driver Out of the Car

Why robocars, and not high-speed rail, could revolutionize transportation in the next decade

By Randal O'Toole

**Y**ou grandfathers will reap across the entire continent in 24 hours or in a new kind of driverless car that is controlled by the push of a button. Futurist Herman Hul Godes promised in 1945. Mr. Hul Godes designed Futurama, the most popular exhibit at the 1939 New York World's Fair, which in many ways inspired the construction of the Interstate Highway System.

Driverless cars have as far removed the stuff of science fiction. Seventy years after Mr. Hul Godes's promise, they are finally close to reality.

Consumers today can buy cars that steer themselves, accelerate and brake to maintain a safe driving distance from cars ahead and detect and avoid collisions with other cars on all sides. Making them completely driverless will involve little more than a software upgrade.

Yet the potential for advanced personal mobility is being ignored in debates over surface transportation. These debates come to a head every six years, when Congress debates not how to spend federal gas tax revenues. Congress has increasingly diverted the funds—\$40 billion a year by last count—from highways to transit.

The Obama administration and House Transportation Committee Chairman James Oberstar (D., Minn.) want to go even further in the next reauthorization, now scheduled for 2011. The administration has focused on a new national high-speed rail system, as well as streetcars, light rail and other projects, to reduce driving and congestion.

Yet driverless cars could render the hand-erecting over roads versus rail needless. Driverless technologies were demonstrated in 1987 on a California freeway when eight cars without drivers successfully operated just one mile length apart at 65 miles per hour. In 2007, six cars negotiated the Defense Advanced Research Projects Agency Urban

Challenge, following all traffic rules in an urban environment with other vehicles.

Volkswagen says enhanced global positioning systems can keep cars within two centimeters of their desired location on streets and highways. This summer, the company will demonstrate its technology by running a driverless Audi at racing speeds up the Telety Film Peak road.

At the 2007 event, General Motors vice president of research Lawrence Burns predicted that completely driverless cars would be on the market by 2018. He added that the primary obstacle was legal and bureaucratic, not technical. Because computer reaction times are faster, driverless cars can safely operate more closely together, potentially tripling highway throughput. This will virtually eliminate congestion and reduce the need for new road construction.

Toyota's recent recalls naturally lead to worries that computer glitches could cause serious accidents. Since each car will be independently controlled, a failure in one would simply lead others to avoid that car. Modern cars already have numerous built-in computers that do things, such as anti-lock braking, far more reliably than humans, even those who are not hunting or inebriated. Any serious problems could be quickly corrected through wireless software upgrades.

Driverless cars and trucks will be safer. They will also be greener, first by significantly reducing congestion, and eventually because vehicles will be lighter in weight due to reduced collision risks.

Perhaps most important, driverless vehicles will bring mobility to everyone, not just those able to pass a driver's test. While many people will still choose to own a car, in-

creased numbers may rely on car sharing. Outside of ultra-high-density areas such as Manhattan, driverless cars will render urban transit and intercity passenger trains even more obsolete than they are today.

The American automobile fleet turns over every 15 years, so if Mr. Burns's prediction that driverless cars will hit the market by 2018 comes true, we could have a completely driverless system by 2036. State highway officials could accelerate this timetable by working with auto manufacturers to set standards and a transition path. State and local highway agencies could install wireless communication systems at major intersections and highways—a much less costly undertaking than building new roads, much less high-speed rail.

President Obama's so-called high-speed rail plan mostly consists of moderate-speed trains running at top speeds of 90 to 120 miles per hour at speeds attained by many railroads in the 1930s. This will attract few people out of their cars. The proposals for train running at 300 to 230 miles per hour in California and Florida will cost at least 10 times as much to build as the 200-mph lines, but they are not likely to attract 10 times as many passengers.

As Burlington Northern Santa Fe CEO Matt Rose testified to Congress last April, building a national network of true high-speed rail lines would cost roughly \$1 trillion, more than twice as much as the inflation-adjusted cost of other road user fees, all the capital and billions of dollars of annual operating costs of high-speed rail will be borne by general taxpayers, most of whom will rarely ride the trains.

America's population distribution makes passenger trains

here less effective than in Europe or Japan. Yet even abroad, the average residents of France and Japan ride high-speed trains less than 400 miles per year, making up just 4% to 6% of all passenger travel.

France and Japan have set apart roughly as much per capita subsidizing their high-speed trains as we spent building our interstate highways. Yet the average American travels 30 times as many miles on the interstates as the average French or Japanese travel on high-speed trains.

Austria's high-speed Aelia trains between Vienna and Washington cover most of their operating (but not capital) costs. To do so, fares are some 10 times greater than many relatively unutilized bus services that carry about three times as many passengers in the northeast corridor as the Aelia.

China's train are environmentally friendly may apply to freight trains, but not passenger. A 30-ton railcar can carry 100 tons of cargo, making freight trains highly energy-efficient. However, a 50-ton passenger car carries only about 15 tons (170 people), and more typically carries about 2 to 3 tons (20 to 30 people), resulting in average weights per passenger that are several times greater than for cars or buses.

In January, Secretary of Transportation Ray LaHood eliminated Federal Transit Administration requirements that federally funded streetcars and other rail transit be "cost effective" relative to buses. The FTA then funded costly streetcar projects in Dallas, Detroit, New Orleans and Tucson despite the fact that low-cost investments in traffic signal coordination, buses or many other projects would do far more to relieve congestion and improve mobility.

A return to rails would turn the clock back to a time when only the wealthy had access to easy mobility. The 19th-century streetcars served several amazing transportation breakthroughs, including streetcars, street trolleys and electric streetcars. Yet in 1910 most Americans enjoyed little more personal mobility than they had 200 years ago. Streetcars served only urban areas and were popular with the upper classes.

The revolution that finally brought mobility to the masses was Henry Ford's low-cost Model T, which most factories about 1,000 to sell over 10,000 miles per year. Cars contributed to a seven-fold increase in personal incomes.

Automobiles continue to maintain a huge cost advantage over passenger rail. Counting both individual and personal costs, Americans spend less than 25 cents a passenger mile on auto, nearly 50 cents a passenger mile on Amtrak, and more than 90 cents a passenger mile on urban transit. Its wonder 80% of all our passenger travel is by automobile.

The rail to spend hundreds of billions of dollars is obsolete to build the world's finest, 1930s-era transportation network would benefit the wealthy and those willing to live and work in expensive quarters near rail stations.

In contrast, the driverless scenario relies on new technology, not old, and will largely be self-funded by users rather than paid out of tax dollars. Most important, driverless vehicles will bring mobility to almost everyone.

Randal O'Toole is a senior fellow with the Cato Institute and author of *Gridlock: Why We're Stuck in Traffic and What to Do About It*.

he wrote. "They will also be greener, first by significantly reducing congestion, and eventually because vehicles will be lighter in weight due to reduced collision risks."

For O'Toole, mobility is central to the American way of life. It makes us happier and wealthier. But mobility is threatened by calls for greater government control

over how we travel and live, often in the name of saving the environment. "These policies will prove costly and ineffective at accomplishing environmental goals," O'Toole said. "But most people aren't even aware that they are being proposed or passed. I hope my tour will help publicize these problems."

“Everyone would agree Iraq was a mistake”

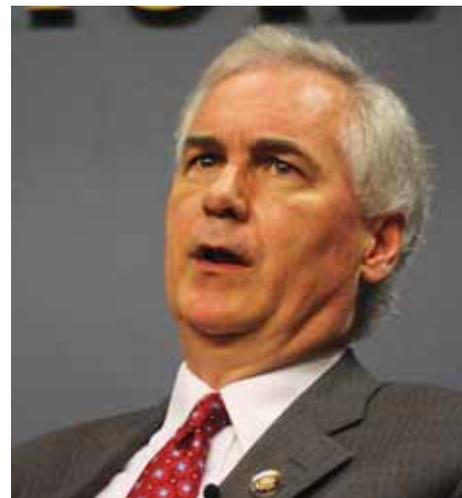
## Conservatives Rethink Middle East Adventurism

It was a half day intended to provoke discussion among conservatives regarding the continuing war in Afghanistan. In December, President Obama more than doubled the number of troops in the country. By doing so, he signaled strongly that the war is no longer about hunting down al Qaeda but has instead become a nation-building adventure—a goal typically eschewed by conservatives but eagerly embraced by George W. Bush.

The conference, “Escalate or Withdraw? Conservatives and the War in Afghanistan,” was held at the Cato Institute in March. Through two panel discussions and a keynote speech by former representative Joe Scarborough (R-FL), host of MSNBC’s *Morning Joe*, a series of important questions was addressed. Will conservatives return to their traditional roots and ultimately oppose the war in Afghanistan? Can “nation building” succeed in the midst of that country’s bloody insurgency? What constitutes “success,” and what price should we be willing to pay for it?

But perhaps the most surprising and intriguing moment of the day was about America’s other war. The opening panel, moderated by Americans for Tax Reform’s Grover Norquist, featured Reps. Tom McClintock (R-CA), Dana Rohrabacher (R-CA) and John J. Duncan Jr. (R-TN). Norquist asked the panelists to estimate the portion of Republicans in Congress who would now view the Iraq invasion as a mistake. Rohrabacher responded, “Everybody I know [now] thinks it was a mistake to go in.” McClintock agreed. “I think everyone would agree Iraq was a mistake,” he said. He added, “And, you know, again, I think virtually everyone would agree going into Afghanistan the way we did was a mistake.”

The second panel was a freewheeling conversation featuring Tony Blankley of the *Washington Times*; Donald Devine, editor of *Conservative Battleline Online*; Diana West of the *Washington Examiner*; and Mackenzie Eaglen from the Heritage Foundation. Asked to define what success would look like in Afghanistan, West objected to the term itself, saying that success implies there’s something to win. The more important question, then,



**C**lockwise: DON DEVINE makes a point to MACKENZIE EAGLEN. ED CRANE talks with JOE SCARBOROUGH before the conference opens. REP. TOM MCCLINTOCK and REP. DANA ROHRABACHER tell the large crowd that their colleagues now agree that the war in Iraq was a mistake.

is what would failure look like? Here, the panel was almost uniformly glum. We’re on the brink of failure, Blankley said, and we will, ultimately, fail. He expressed concern that conservatives, who are typically opposed to social engineering at home, have become so willing to attempt it—on an extraordinarily large scale—abroad.

Wrapping up the conference was Joe Scarborough, who lamented the fact that, in 2010, it’s nearly impossible to tell the difference between Republicans and Democrats when it comes to foreign policy. He said that if conservatives are to regain their way, they need to become less radical, to show restraint at home, abroad, and in their rhetoric. Republicans in the 1990s understood that America

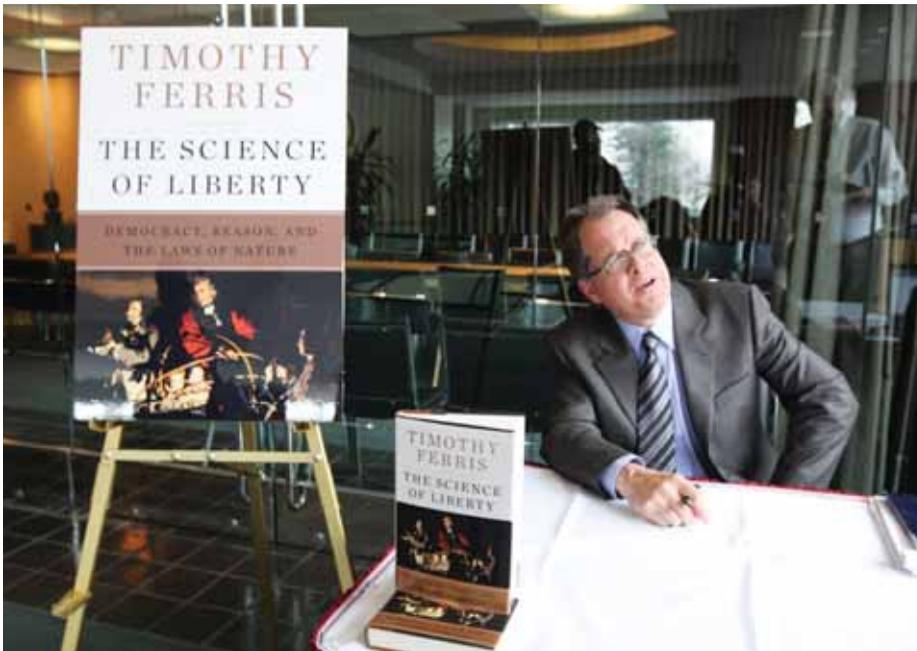
is not the world’s 911 service, Scarborough said, but this crucial conservative insight was lost in the Bush years. “Dogma and rigid ideologies are the enemies of conservative foreign policy,” he said.

By the time the conference ended, and the speakers and attendees went upstairs to the Wintergarden for lunch, it was clear that, while there might not be consensus within the conservative movement for returning to a more prudent foreign policy, there at least exists a large contingent of conservatives ready to abandon nation building and social engineering and return America’s armed forces to agents of national defense.

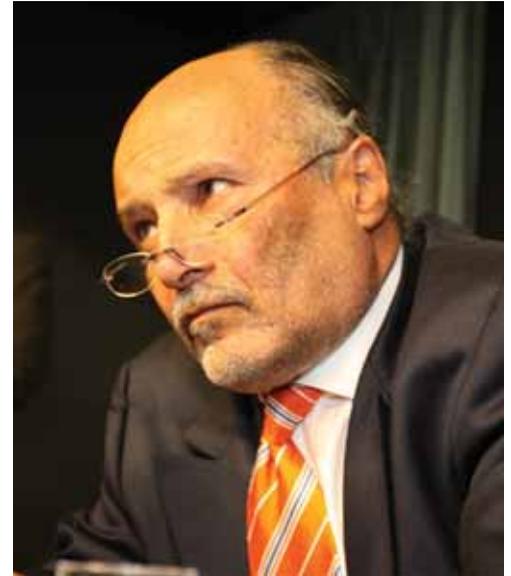
Video of the event is online at [www.cato.org](http://www.cato.org).



Two recent forums looked at the current state of Russia. Left, Cato senior fellow ANDREI ILLARIONOV chats with KARINNA MOSKALENKO, Russia's leading human rights lawyer, and OLEG KOZLOVSKY, coordinator of the Russian youth activist organization Oborona ("Defense"). Moskalenko spoke at a Policy Forum in February about her experiences fighting for the rights of victims of torture, police abuse, and assaults on freedom of association and expression. Right, Russian journalist JULIA LATYNINA exposes the truth behind Russia's claims to superpower status at a Policy Forum in March. Outside of the construction boom in impressive presidential palaces, Latynina said, the country is broken down and obsolete, with a total degradation of its scientific and technology base.



Author TIMOTHY FERRIS signs books after a forum in February for his newest, *The Science of Liberty: Democracy, Reason, and the Laws of Nature*. Ferris, an award-winning science author, said that there is a symbiotic relationship between science and classical liberalism, a combination that has led to dramatically increased global health, wealth, and happiness.



At the film premiere of *10 Rules for Dealing with Police*, hosted by the Cato Institute in March, Judge WILLIAM "BILLY" MURPHY told stories of the law—and law enforcement—run amok. The film, narrated by Murphy, featured common police situations and demonstrated useful techniques, phrases, and behaviors for ensuring that the police respect our constitutional rights during encounters.

**C**HRIS EDWARDS, Cato's director of tax policy studies and creator of the DownsizingGovernment.org website, tries to explain to the Senate Finance Committee just how much taxes may rise in 2011.



**FEBRUARY 2:** Campaign Finance after *Citizens United*: What Now?

**FEBRUARY 2:** The Rule of Law in Russia

**FEBRUARY 4:** *From Poverty to Prosperity: Intangible Assets, Hidden Liabilities and the Lasting Triumph over Scarcity*

**FEBRUARY 5:** Greed, Irresponsibility, or Policy Mistakes: What Caused the Recession?

**FEBRUARY 17:** Is There a Place for Gay People in Conservatism and Conservative Politics?

**FEBRUARY 22:** Would the Senate Health Care Bill Keep the Poor Poor?

**FEBRUARY 22:** Nuclear Weapons Spending and the Future of the Arsenal

**FEBRUARY 24:** *The Science of Liberty: Democracy, Reason, and the Laws of Nature*

**FEBRUARY 25-28:** 22nd Annual Benefactor Summit

**MARCH 1:** *McDonald v. Chicago*: Will the Right to Keep and Bear Arms Apply to the States?

**MARCH 3:** *McDonald v. Chicago*: The

Fourteenth Amendment and the Future of Gun Rights

**MARCH 10:** *The Watchers: The Rise of America's Surveillance State*

**MARCH 11:** *Don't Blame The Shorts: Why Short Sellers Are Always Blamed for Market Crashes and How History Is Repeating Itself*

**MARCH 16:** Did a Lack of Consumer Protection Cause the Financial Crisis?

**MARCH 17:** A Superpower in What? A Look Into the Nature of Russia's Social Order

**MARCH 18:** Escalate or Withdraw? Conservatives and the War in Afghanistan

**MARCH 22:** Health Care Reform: The Way Forward

**MARCH 24:** *10 Rules for Dealing with Police*

**MARCH 25:** Would Universal Coverage Improve Health?

**MARCH 31:** Are Unions Good for America?

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](http://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 UNIVERSITY SUMMER SEMINAR

San Diego • Rancho Bernardo Inn  
July 25-30, 2010

Speakers include Tom G. Palmer, Robert Higgs, Charlotte Twight, Rob McDonald, Robert Levy, and David Boaz.

### CONSTITUTION DAY

Washington • Cato Institute  
September 16, 2010

Speakers include Joan Biskupic, James Bopp Jr., Tom Goldstein, Harvey Silverglate, Roger Pilon, and William Van Alstyne.

### CATO CLUB 200 RETREAT

Stowe, Vermont • Stowe Mountain Lodge  
September 23-26, 2010

### CATO INSTITUTE POLICY PERSPECTIVES 2010

New York • Waldorf-Astoria  
October 29, 2010

### ASSET BUBBLES AND MONETARY POLICY

28th Annual Monetary Policy Conference  
Washington • Cato Institute  
November 18, 2010

Speakers include Jerry L. Jordan, Charles Plosser, Lawrence H. White, Steve Hanke, Gerald P. O'Driscoll Jr., and Carmen Reinhart.

### 23RD ANNUAL BENEFACTOR SUMMIT

San Diego • The Grand Del Mar  
February 24-27, 2011

Spring/Summer 2010 Cato Journal

## Restoring Global Financial Stability

The new Spring/Summer 2010 issue of the *Cato Journal* is the first of two special issues collecting the papers presented at Cato's 27th Annual Monetary Conference. Nobel Laureate James M. Buchanan opens the issue, titled "Restoring Global Financial Stability," with "The Constitutionalization of Money," in which he seeks to answer the question, "If anarchy in money fails along with politicization, how can the market economy ever be expected to function effectively?" His answer—a rules-based approach through the "constitutional establishment of a monetary authority"—is both intriguing and controversial.

Allan H. Meltzer, of Carnegie Mellon University, author of *A History of the Federal Reserve* (University of Chicago Press), presents the history of the Federal Reserve and faults the central bank for not adhering to a clear rule for guiding monetary policy. Cato senior fellow William Poole, past president of the Fed-

eral Reserve Bank of St. Louis, answers the question raised in his article's title, "Is a Benign Dollar Policy Wise?" with "a resounding 'yes.'" He argues that the Federal Reserve should stay out of setting exchange rates, instead leaving it up to private markets.

Peter J. Wallison of the American Enterprise Institute discusses housing policy's role in the financial crisis, while Benn Steil, director of international economics at the Council on Foreign Relations, analyzes debt and systemic risk. George Melloan, author of *The Great Money Binge: Spending Our Way to Socialism*, looks at financial markets and finds that, "It is the nature of governments to first interfere with market forces and then make the problem worse by addressing the resulting confusions and dislocations by interfering still more."

The issue concludes with three book reviews. Mark Calabria looks at *Economic Contractions in the United States: A Failure of Gov-*



ernment, by Charles Rowley and Nathanael Smith. Chris Edwards reviews *Plunder: How Public Employee Unions are Raiding Treasuries, Controlling Our Lives, and Bankrupting the Nation*, by Steven Greenhut. And Jason Kuznicki reviews *Mind vs. Money: The War between Intellectuals and Capitalism*, by Alan Kahan.

All of these articles, as well as subscriptions to the *Cato Journal*, are available online at [www.cato.org](http://www.cato.org).

### Bite-sized libertarianism

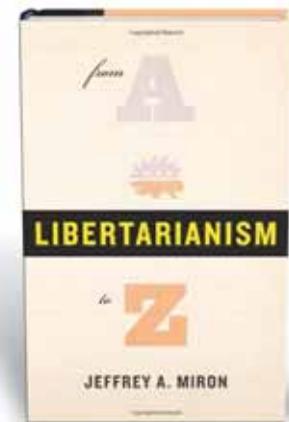
## A Dictionary of Freedom

Libertarian solutions to policy problems are often so different from the boilerplate of liberals and conservatives that those unfamiliar with the philosophy have a hard time understanding just what libertarianism is. To remedy this confusion, Cato senior fellow Jeffrey A. Miron offers his new book, *Libertarianism, from A to Z*.

Covering everything from "arbitrary redistribution" to "zoos," Miron's chapters bring brevity and clarity to often complicated topics. For example, in an entry on the somewhat daunting subject of "asymmetric information and adverse selection," Miron writes: "If health insurers cannot tell who is likely to remain healthy and who is not, they must charge everyone the same premium. If this premium reflects the average health of the population, only unhealthy persons find the insurance worth purchasing. In economics lingo, the insurer ends up with an adverse selection of insurees, so the insurance company goes broke."

Later, addressing a question surely familiar to most libertarians, Miron explains what the difference is between his political philosophy and conservatism. After saying that "conservatism and libertarianism tend to overlap regarding economic issues but not on social or foreign policy issues," Miron further distances himself from the conservative camp by showing how "the conservative desire for government intervention regarding a broad range of social issues suggests that conservatives do not believe people can make good choices on their own and that government should intervene to improve those choices." Conservatism thus differs from libertarianism in its willingness to embrace paternalism.

Several more letters into the alphabet, Miron draws a related comparison, this time between liberalism and libertarianism. "Roughly, liberalism and libertarianism tend to overlap regarding social and foreign policy issues," Miron writes, "but not eco-



nomics issues." Like conservatism, liberalism differs from libertarianism in its support for paternalism, for liberals "assume government knows better than the people being governed."

The publication of *Libertarianism, from A to Z* by Basic Books, a major publisher, shows a growing awareness of, and interest in, the ideas and politics of liberty. Jeffrey Miron has written a concise and accessible introduction to many of the issues most important to libertarians.

The book is available from major bookstores and online retailers.

## The failure—and future—of counterterrorism policy

# Not Letting Terrorism Terrify Us

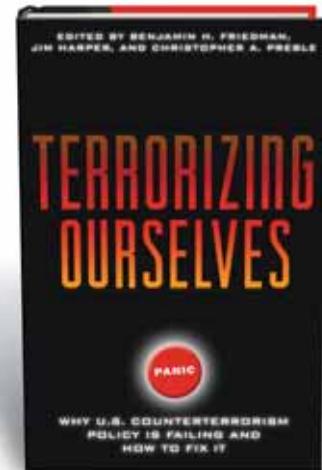
**T**errorism's greatest impact is the terror it creates. Responding rationally to attacks—and the threat of attacks—demands eschewing irrational fears, a feat often at odds with politics. In their new book, *Terrorizing Ourselves: Why U.S. Counterterrorism Policy Is Failing and How to Fix It*, editors Benjamin H. Friedman, Jim Harper, and Christopher A. Preble have assembled a dozen essays by major counterterrorism scholars. Taken together, the articles are an antidote to the common problem that, “rather than dispassionately addressing true threats, our national leaders often hype implausible threats and jockey for political advantage in anticipation of terrorist strikes.”

Among the essays is “Don’t You Know There’s a War On? Assessing the Military’s Role in Counterterrorism” by Paul Pillar, a 25-year veteran of the CIA, and Christopher Preble, the Cato Institute’s director of foreign policy studies. Pillar and Preble examine the possible military responses to terrorism and conclude “that the risks of military action outweigh its benefits.” They also criticize the metaphor of “war” behind our ongoing War on Terror. “Given the need to carefully manage public expectations, and

to calm anxiety, we conclude that it is inappropriate to cast such efforts as synonymous with warfare,” they write.

Benjamin H. Friedman writes that “Americans want more homeland security than they need” in “Managing Fear: The Politics of Homeland Security.” In the essay, Friedman proceeds to show why this is the case and how more careful cost-benefit analysis can improve the wisdom of our policies. “Fear of terrorism,” Friedman writes, “is a bigger problem than terrorism.” He offers specific policy suggestions for better handling the irrational fear terrorism breeds.

The book also contains a fascinating article from Priscilla Lewis, “The Impact of Fear on Public Thinking about Counterterrorism Policy: Implications for Communicators,” which uses psychological findings about the response of the brain to frightening thoughts and situations to predict how people are likely to react when faced with various counterterrorism policies. “Morality reminders,” as she calls them, “seem to trigger disdain for other races, religions, and nations; a preference for strong, traditional leaders and for authoritarian rather than pragmatic leadership; a heightened fidelity to one’s own



group; and increased stereotyping and suspicion of other groups.”

Also included are articles by James J. F. Forest, Mia Bloom, James A. Lewis, John Mueller, Veronique de Rugy, Milton Leitenberg, and William Burns.

Lewis’s article neatly summarizes why a book like *Terrorizing Ourselves* is so important: the threat of terrorism and the impact of terrorist attacks have effects far beyond the violence they entail. Terrorism often leads to irrational responses, both by citizens and their governments, and so thoughtful and impartial analysis is needed here at home perhaps more than anywhere else.

Visit [www.cato.org](http://www.cato.org) or dial 800-767-1241 to get your copy of *Terrorizing Ourselves* today; \$24.95 hardcover.

*Continued from page 11*

private property rights.

Let me give you an example of the kind of cases that we have seen as a result of the currently existing judicial paradigm. I represented a guy named Alan Merrifield. He was in the pest control business in California, putting up spikes on roofs to keep pigeons from landing on them. He didn’t use pesticides, preferring, instead, structural devices like spikes and screens. In California, in order to do what he did, you had to get a “Branch 2 Structural Pest Control Operator” license. And to get such a license requires two years of training learning how to handle *pesticides*. And then you have to take a 200-question multiple-choice exam testing your knowledge of pesticide use. This despite the fact that my client didn’t use pesticides. And the law gets

even better, because it only applies to pigeons. If you put the exact same spikes on the exact same building to keep seagulls off it you don’t need any license at all. So we went to court, and we lost. The state’s expert witness even admitted *under oath* that the law was irrational, designed only as a barrier to entering the profession, and we still lost the case because the law is currently tilted so dramatically against businesses, economic freedom, and private property rights.

Fortunately, we won on appeal in the Ninth Circuit. The Court of Appeals said government may not use occupational licensing laws simply to create these kinds of monopolies. That’s very gratifying, but that’s only the *second* court that’s ever said this. The Tenth Circuit, by contrast, has said it is perfectly fine to use occupational licens-

ing laws purely for protectionist purposes. This, needless to say, is the kind of nonsense that would not go on if the Court overturned *Slaughterhouse* and enforced the Fourteenth Amendment as it is written.

Whether or not the Court overturns *Slaughterhouse* in *McDonald*, what this country needs is a new Civil Rights Act, which makes explicit reference to economic liberty and the right to own a business. These are fundamental human rights that are ignored and violated by state and local governments every day. And the people who hurt the most are the low class, immigrants, and inner-city residents, who don’t have the political power they need to defend themselves. That’s why they rely on the Constitution. When courts refuse to uphold the Constitution, these people are left at the mercy of a capricious political process.

# Law School Costs Less than Kindergarten

The first step to getting out of debt is knowing how much you're spending. But in K-12 education, which consumes on average a third of each state's budget, accurate figures for per-pupil spending are difficult to come by. Cato policy analyst Adam B. Schaeffer uncovers the truth of educational spending in **"They Spend WHAT? The Real Cost of Public Schools"** (Policy Analysis no. 662). Schaeffer calculated actual spending for five of the biggest metro areas, Washington, D.C., and several other districts. "Through these examples," he writes, "we demonstrate that the most widely reported per-pupil spending figures give a grossly inaccurate impression of the resources that Americans devote to public education." For example, Los Angeles claims to spend \$10,000 per student. The real cost is 90 percent higher at \$19,000. Washington D.C.'s actual spending of \$22,400 is 34 percent higher than the reported \$16,000. What schools actually spend matters greatly, Schaeffer writes, because "American citizens are being kept

in the dark on education spending, and this imposed ignorance affects the policy and political environment." He closes his paper with sample legislation, the "Financial Transparency in Education Act," that would require school districts to make their real spending immediately accessible.

## Measuring Globalization's Impact

The power of economic globalization to raise the standard of living of vast numbers of people is profound. But the current economic crisis also shows that, in a global economy, crises aren't localized. A downturn in one country can have huge negative repercussions for its trading partners and any other nation connected to it through the web of globalization. Cato senior fellow Jagadeesh Gokhale provides a broad survey of the economic



effects of globalization in **"Globalization: Curse or Cure? Policies to Harness Global Economic Integration to Solve Our Economic Challenge"** (Policy Analysis no. 659). He also shows the economic policy recommendations those effects imply for developed countries to achieve long-term economic goals. He examines the challenges that globalization presents in the context of domestic labor markets, education, financial integration, trade policies, social insurance policies, and population aging. Gokhale presents a nuanced picture of globalization, including such surprising findings as "openness to trade is associated with larger governments." Globalization has the power to create great wealth, but also can bring uncertainty for nations taking their first steps into the global market.

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## Educational Conformity from Sea to Shining Sea

The next step in "fixing" American education—at least for those unwilling to take the obvious step toward school choice—is

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national standards. If the federal government can set standards high enough, the argument goes, and if schools can be made to meet them, then the nation's students will be successfully educated. But this solution is neither feasible nor



desirable, writes Neal McCluskey, associate director of the Cato Institute's Center for Educational Freedom, in **"Behind the Curtain: Assessing the Case for National Curriculum Standards"** (Policy Analysis no. 661). He unearths the strong political pressures in the way of truly robust standards. There is no reason to think the process will be any easier at the national level. Conflicts between cultural, ethnic, and religious groups will further complicate the process, as will the general American aversion to the sort of hard learning necessary to score well on easily testable subjects. Even if these difficulties didn't exist, however, McCluskey shows that national standards are not the panacea their proponents claim. Instead, "the road to successful education reform appears to go in the opposite direction of greater top-down control." Choice, rather than monolithic standards constructed by bureaucrats in Washington, D.C., is the way forward for America's students and schools.

### Why Science and Politics Shouldn't Mix

The leak of internal e-mails from the Climate Research Unit at the University of East Anglia exposed science in the grip of political manipulation. Researchers excluded data counter to their interests, colluded to prevent journals from publishing skeptics, and otherwise tainted the quest for objective truth that is the cornerstone of science. This ought to be deeply concerning, writes George Avery, assistant professor of public health in the Department of Health and Kinesiology and the Regenstrief Center for Health Care Engineering at Purdue

University, in **"Scientific Misconduct: The Manipulation of Evidence for Political Advocacy in Health Care and Climate Policy"** (Briefing Paper no. 117). "Increasingly," he argues, "science is being manipulated by those who try to use it to justify political choices based on their ethical preferences, and who are willing to act to suppress evidence of conflict between those preferences and the underlying reality." Avery demonstrates this politicization's pernicious effects with two examples, the climate policy e-mail scandal and the encroachment of federal agencies into health science. A bill recently passed by the Senate "would allow federal agencies to punish organizations whose researchers publish results that conflict with what the agency feels is appropriate." This trend of politics usurping science threatens great harm. "Democracy depends," Avery writes, "not on the preference of elites, but rather on a functional marketplace of ideas and vigorous debate between contending viewpoints."

### A Billion Here, a Constitutional Violation There

It's quite clear in the text of the Constitution: all "legislative" powers are vested in Congress.



The Supreme Court has allowed Congress to skirt this language by delegating its authority to executive agencies, provided it can do so with the guidance of an "intelligible principle." This is exactly what Congress failed to do when it enacted the Emergency Economic Stabilization Act of 2008, writes John Samples, director of the Cato Institute's Center for Representative Government, in **"Lawless Policy: TARP as Congressional Failure"** (Policy Analysis no. 660). Instead, the legislative branch gave the secretary of the treasury the authority to spend \$700 billion of the taxpayers' money in the furtherance of 13 fuzzy and unprioritized goals. The result, argues Samples, is

that Congress unconstitutionally delegated its powers to the treasury secretary and is no longer meeting its obligation to act as a check on the other branches of government or to be accountable to the American people. Samples writes that these congressional failures show a deeper problem with the Supreme Court's delegation doctrine, which should be revised to better protect the Constitution's call for the rule of law and separation of powers.

### On the Fast Train to Nowhere

One hundred billion dollars were spent by cities over the last 40 years in construction costs alone, and still there are calls for greater spending on rail transit systems.



Before we heed those calls, however, it might be worthwhile to decide if such systems have been successful. Cato senior fellow Randal O'Toole shows, in **"Defining Success: The Case against Rail Transit"** (Policy Analysis no. 663), that, by nearly every measure, rail is a failure. Using the latest government data to evaluate rail's usefulness, he concludes that more spending is the wrong path to improving mobility. Do rail fares cover their operating costs? he asks. Do new lines significantly increase ridership? Are trains cost-effective compared to buses? Are rail transit systems more productive than the most costly land transit system in the nation, the San Francisco cable car? Do they stimulate economic development? And do rail lines add to or place stresses upon existing transportation networks? To the chagrin of rail advocates, no rail system passes all of these tests—and few of them pass even one. "Instead of providing cost-effective transportation," O'Toole writes, "rail transit mainly transfers wealth from taxpayers to rail contractors, downtown property owners, and a few transit riders who prefer trains to buses."

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## “To Be Governed...”

### POT PROTECTIONISM

If California legalizes marijuana, [illegal growers] say, it will drive down the price of their crop and damage not just their livelihoods but the entire economy along the state's rugged northern coast.

“The legalization of marijuana will be the single most devastating economic event in the long boom-and-bust history of Northern California,” said Anna Hamilton, 62, a Humboldt County radio host and musician. . . .

Many agreed with the sentiment on a sticker plastered on a pizza joint's cash register: “Save Humboldt County — keep pot illegal.”

—*Associated Press*, March 24, 2010

### SIGN UP TODAY FOR OTHER PEOPLE'S MONEY!

Your response is important. Results from the 2010 Census will be used to help each community get its fair share of [federal] government funds for highways, schools, health facilities, and many other programs you and your neighbors need. Without a complete, accurate census, your community may not receive its fair share.

—*Letter from U.S. Census Bureau*, March 2010

### THE FEDERAL GOVERNMENT BOOM

Walking around the District, Abel Lomax can't help but look around and think: What recession?

After a stint abroad, it took the 27-year-old just four months to find a job with the government—not bad for the Great Recession. And the neighborhoods where he spends his time sport new restaurants crowded with patrons enjoying Czech Pilseners and Wagyu beef brisket. . . .

With thousands of new federal and

government-related jobs, Washington has benefited from some of the circumstances that have caused Main Streets to go dark elsewhere. The government has taken a greater oversight role on the financial sector, and companies have been drawn to the area because of its economic stability.

—*Washington Post*, February 15, 2010

### EMINENT DOMAIN, CELEBRITY DOMAIN

In a land dispute pitting Madonna against African villagers, Malawi's government has sided with the pop star who has pumped millions into the impoverished Southern African country and adopted two of its children.

Villagers have been refusing to move from a plot of land near the capital, Lilongwe, where Madonna wants to build a \$15-million school for girls. The government, however, says it had originally planned to develop the plot, and only allowed the villagers to live there until a project was identified.

Lilongwe District Commissioner Charles Kalemba, accompanied by other government officials and representatives from Madonna's Raising Malawi charity, on Thursday met with about 200 villagers and told them they would have to move. The villagers have been offered other government land.

“Government allowed you to occupy this land because there was no project yet. But now that Madonna wants to build you a school you have to give way,” Kalemba told the villagers.

—*Associated Press*, February 13, 2010

### LEGISLATIVE SAUSAGE-MAKING

A major test of whether Obama's new strategy will yield legislative results could come when the Senate takes up a job-cre-

ation bill, which Senate Majority Leader Harry M. Reid (D-Nev.) had hoped to introduce last week but which was sidetracked by a snowstorm. . . .

The proposed package is expected to cost about \$85 billion and would include a payroll tax break for companies that hire new employees, extensions of a variety of expiring tax breaks, and help for small businesses seeking loans. The measure also would extend unemployment insurance and COBRA health benefits by three months and provide a temporary adjustment in Medicare payment rates to physicians to prevent a scheduled cut.

The bill being crafted would reauthorize the Highway Trust Fund for one year, provide money for Build America Bonds and extend the USA Patriot Act, which is scheduled to expire at the end of February. The package also is expected to include \$1.5 billion in agriculture assistance sought by Sen. Blanche Lincoln (Ark.), one of the most endangered Democrats facing reelection in November.

—*Washington Post*, February 10, 2010

### THEY'RE IN CHARGE OF OUR HEALTH CARE AND FINANCIAL SYSTEM

Rep. Hank Johnson (D-Ga.) is afraid that the U.S. Territory of Guam is going to “tip over and capsize” due to overpopulation.

Johnson expressed his worries during a House Armed Services Committee hearing on the defense budget Thursday.

Addressing Adm. Robert Willard, who commands the Navy's Pacific Fleet, Johnson made a tippy motion with his hands and said sternly, “My fear is that the whole island will become so overly populated that it will tip over and capsize.”

Willard paused and said: “We don't anticipate that.”

—*The Hill*, March 31, 2010