Saving Taxpayers Money through Drug Legalization

State governments face catastrophic budgetary shortfalls while the national debt soars. In **"The Budgetary Impact of Ending Drug Prohibition"** (White Paper), Jeffrey A. Miron, senior lecturer in economics at Harvard University and senior fellow at the Cato Institute, and Katherine Waldock, doctoral candidate at the Stern School of Business at New York University, show how ending the drug war "would reduce state and federal deficits by eliminating expenditure on prohibition enforcement—arrests, prosecutions, and incarceration—and by allowing governments to collect tax revenue on legalized sales." Legalizing drugs would reduce government expenditure by $41.3 billion annually, with $25.7 billion accruing to state and local governments and $15.6 billion to the federal government. Approximately $8.7 billion of the savings would result from legalization of marijuana and $32.6 billion of legalization of other drugs. Assuming that drugs were taxed at rates comparable to alcohol and tobacco, ending prohibition would yield $46.7 billion annually, with $8.7 billion from marijuana and $38 billion from other drugs. Miron and Waldock point out that their analysis does nothing to undermine the civil liberties arguments for ending prohibition. Instead, they write, the budgetary benefit is just another good reason for ending a bad policy.

Cutting the Military, Not National Defense

Nearly one out of every two dollars spent on military forces is spent by the United States. With a defense budget of $700 billion, it's difficult to even refer to the U.S. military budget as "defense" spending. Benjamin H. Friedman, research fellow in defense and homeland security studies at the Cato Institute, and Christopher Preble, director of foreign policy studies at the Cato Institute, in **"Budgetary Savings from Military Restraint"** (Policy Analysis no. 667), write that "our military forces' size now has little to do with protecting Americans." They argue that "a less busy military could be a smaller and cheaper one," and so cuts should focus on reducing the military's size and scope, not on merely increasing its efficiency. Friedman and Preble provide a 19-point proposal that would "reduce military spending by more than $1.2 trillion over 10 years." Among these are cutting the nuclear weapons arsenal and the active-duty Army to 360,000 personnel, reducing the number of Navy aircraft carriers to eight and naval air wings to seven, cutting the Pentagon civilian workforce, and reducing intelligence spending by 15 percent.

Finding Someone to Blame

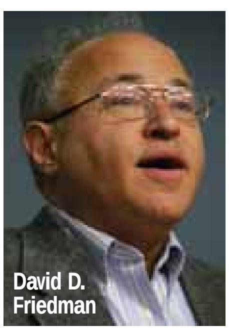
Those who bring word of a crisis, rather than those who caused the crisis, become tempting targets for outrage and legislation. In the wake of the recent financial meltdown, short sellers became this scapegoat. In **"Short Sales Bans: Shooting the Messenger?"** (Briefing Paper no. 119), Laurence Copeland, professor of finance at Cardiff University Business School in Cardiff, Wales, writes that "short sellers and other market participants were expressing their judgment regarding the health of these companies—a judgment that governments wished to suppress." Copeland likens short

CATO POLICY REPORT is a bimonthly review published by the Cato Institute and sent to all contributors. It is indexed in PAIS Bulletin. Single issues are $2.00 a copy. ISSN: 0743-605X. ©2010 by the Cato Institute. • Correspondence should be addressed to *Cato Policy Report*, 1000 Massachusetts Ave., N.W., Washington, D.C. 20001. • Website: www.cato.org, call 202-842-0200, or fax 202-842-3490.

sellers to "no" voters in an election. Regulators want them banned in order to prop up company stock prices and increase bank depositor confidence. CEOs favor high stock prices for their companies, too, and so they often favor bans. But short selling plays an important role in markets because "the act of trading serves to transmit information to the market." He concludes that "banning short selling is a knee-jerk reaction by regulators, often in response to lobbying by corporate management seeking to preserve its freedom to operate without pressure from the market."

Defending the Defenseless

America's criminal defense system is understaffed and overburdened. For many of the accused , being charged means turning to a public defender—an agent of the same government attempting to put the defendant behind bars. Stephen J. Schulhofer, of New York University School of Law, and David D. Friedman, of Santa Clara University School of Law, present a simple means for addressing both these problems. In **"Reforming Indigent Defense: How Free Market Principles Can Help to Fix a Broken System"** (Policy Analysis no. 666), they show how "a voucher model would provide a practical and effective cure for many of the major ills of indigent defense organization, to the ultimate benefit of both defendants and the public at large." They advocate "a free market for defense services, one that would, so far as possible, function in the same way that the existing market functions for affluent defendants who are able to retain their own counsel."


David D. Friedman

Schulhofer and Friedman identify the problems plaguing the current system, categorizing them into incentive, information, and insurance. They argue that increasing public defender resources would ameliorate caseload burdens but would do nothing to increase the freedom of choice so crucial for indigent defendants.

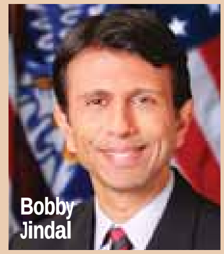
Time to Follow Bastiat's Advice

It's a tale as old as trade itself. Protective tariffs drive up costs to consumers and keep capital and labor from finding more productive uses. In July 2010 Congress advanced the cause of trade liberalization when it passed the U.S. Manufacturing Enhancement Act, suspending duties on hundreds of imported goods of special interest to U.S. manufacturing companies. In **"The Miscellaneous Tariff Bill: A Blueprint for Future Trade Expansion"** (Trade Briefing Paper no. 30), Daniel Griswold, director of the Cato Institute's Center for Trade Policy Studies, calls the bill a "rare step forward in U.S. trade policy in recent years," one that "could provide a template for expanding the freedom of Americans to buy and sell in global markets." But it doesn't go far enough, leaving in place tariffs that protect many domestic producers from competition. When the House begins work on the next miscellaneous tariff bill, he writes, "House republican leaders should put aside their misplaced objections to the process and work with their counterparts across the aisle to expand the reach of the next bill to cover even more categories of imports—for the benefit of consumers, the manufacturing sector, and a U.S. economy struggling to shake off a steep recession."

The Wrong Financial Solutions

Reducing systemic risks in derivative markets is a popular policy prescription for staving off another financial crisis, with much attention focused on counterparty risk in the over-the-counter market. In particular, many call for the federal government to mandate the trading of derivatives over a centralized clearinghouse. "In the debate over financial regulation in the aftermath of the financial crisis, clearing has become a deus ex machina to solve all the problems inherent in derivatives markets," writes Craig Pirrong, professor of finance at the Bauer College of Business at the University of Houston, in **"The Inefficiency of Clearing Mandates"** (Policy Analysis no. 665). Pirrong examines the advantages and risks of clearing mandates and shows how the mandates can, in some cases, actually increase systemic risk. He also looks at counterparty risk in the derivatives market, as well as bilateral markets and clearinghouse mandates. He shows how "economic considerations suggest that a clearing mandate is likely to reduce market efficiency and pose its own systemic risks in a world where information is costly." Pirrong lays out an auction alternative designed to better resolve and displace defaulted trades.

Grading the Governors


Bobby Jindal

Cato's 10th biennial fiscal report card on the governors comes at a time when states face significant budget shortfalls and unemployment. Many governors have responded by raising taxes or spending, while some have taken the responsible route of reducing their states' budgets. In "Fiscal Policy Report Card on America's Governors: 2010" (Policy Analysis no. 668), **Chris Edwards, director of tax policy studies at the Cato Institute, graded all of the governors and awarded four of them an "A"—Mark Sanford of South Carolina, Bobby Jindal of Louisiana, Tim Pawlenty of Minnesota, and Joe Manchin of West Virginia. Seven governors were awarded an "F"—Ted Kulongoski of Oregon, David Paterson of New York, Jodi Rell of Connecticut, Pat Quinn of Illinois, Jim Doyle of Wisconsin, Bill Ritter of Colorado, and Chris Gregoire of Washington. Edwards also offers short analyses of each governor's performance. Recent tax increases have been by far the largest in many years, with states raising taxes even as they received billions in federal stimulus dollars. Edwards finds fiscal patterns and trends across the states, including a push to raise personal income taxes, moves toward increasing corporate taxes, and the proliferation of tax incentives to "create jobs." As the *Wall Street Journal* said, governors "could do worse than look to the A-listers on the Cato report as policy guides."**


Mark Sanford