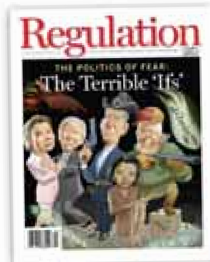
SUSAN EISENHOWER
The end of NATO?
PAGE 4

REP. PAUL RYAN
Repeal AMT. Overhaul the tax code.
PAGE 11



REGULATION
Richard Epstein defends intellectual property
PAGE 3

Cato Policy Report

March/April 2008 Vol. XXX No. 2

As Good As Gold?

BY LAWRENCE H. WHITE

For the first time in many years, the monetary arrangements of the United States have become an issue in the 2008 presidential race. The subprime crisis and the decline in the foreign exchange value of the dollar have raised questions about the performance of the Federal Reserve Board. One candidate has proposed ending the post-1971 experiment with an unanchored fiat dollar issued by the Federal Reserve and returning to a gold standard with private money issue. Critics have raised a number of theoretical and historical objections to the gold standard. Some have called the gold standard a "crazy" idea.

The gold standard is not a flawless monetary system. Neither is the fiat money alternative. In light of historical evidence about the comparative magnitude of these flaws, the gold standard is not a crazy idea.

CONT'D ON PAGE 8

LAWRENCE H. WHITE is the F. A. Hayek Professor of Economic History at the University of Missouri–St. Louis and an adjunct scholar of the Cato Institute. He is the author of *Competition and Currency, Free Banking in Britain,* and *The Theory of Monetary Institutions.* A longer, footnoted version of this article can be found at www.cato.org.

Cato vice president for international programs Tom G. Palmer spoke at universities and think tanks in Shanghai, Ningbo, Beijing, Guangzhou, Shenzhen, Chengdu, and other cities during a three-week lecture tour of China in December. Here he visits a statue of Adam Smith on the campus of the University of Finance and Economics in Chengdu alongside Diqing Jiang, editor of Cato's Chinese project Tiandaocn.org, and Aili Huang of the Beijing-based Cathay Institute for Public Affairs. **PAGE 6**

BY WILLIAM A. NISKANEN

"The huge implicit debts for Social Security and Medicare are the largest threats to the federal budget."

Chairman's Message

Some Major Threats to Limited Government

Federal spending has been a roughly constant 20 percent of GDP since the Korean War; the rapid growth of the U.S. welfare state during this period was financed primarily by a reduction of spending for defense and interest payments as a percentage of GDP. The rapid growth of federal regulation of health, safety, and the environment beginning in the 1970s was substantially offset by a comprehensive reduction of the older forms of economic and trade regulation. And most of the innovative policy proposals in this period were made by the libertarian right.

All of this seems about to change.

Some of the major new threats to limited government in the United States are independent of who is elected to the White House and Congress this November.

An administration and Congress of either party is likely to approve a federal program of universal health insurance. Such a program was endorsed by most of the presidential candidates in both parties, was implemented by former Gov. Mitt Romney in Massachusetts, and has been promoted even by our friends at the Heritage Foundation—despite the prospect that it would substantially increase federal spending, the relative price of medical care, and both price controls and nonprice rationing of medical care. The failure of any presidential candidate or more than a few members of Congress to criticize the $150 billion debt-financed "stimulus" package as ineffective or possibly counterproductive suggests that there is a broad bipartisan indifference to responsible fiscal policy. Another major threat to limited government that will probably be approved next year, whatever the outcome of the November election, is a first-stage national commitment to reducing the emissions of greenhouse gases; this ineffective but potentially very expensive policy is being promoted as a moral obligation, rather than the best of the alternative feasible responses to global warming.

The huge implicit debts for Social Security and Medicare, of course, are the largest threats to the federal budget. This is where the outcome of the November election might make a difference. In his recent State of the Union address, President Bush reminded us that these two programs should be reformed soon to avoid a large annual increase in their implicit debts, a warning that both Congress and the press ignored. In opposition, the Democrats have either denied any problem with these programs or claimed that small technical changes are sufficient and can be deferred. In general, it is politically difficult to reform a program for which the problems will not be broadly apparent for four or eight years. A substantial Democratic victory in November, however, could accelerate this process by giving the Democrats the political margin to control the restructuring of these programs, most likely by tax increases. The opposition Republicans would have a strong case for criticizing the Democrats for the proposed tax increases or for again deferring the necessary reforms of these programs.

Finally, there are several potential threats to a limited federal government that would only be a consequence of a Democratic victory in November. Based on an expectation of a larger Democratic margin in each house of Congress, the Democratic-oriented think tanks have been busy making the case for a substantial increase in the scope of federal powers. Matt Miller, a senior fellow at the Center for American Progress, for example, has made "A Modest Proposal to Fix the Schools: First, Kill All the School Boards" and increase the federal share of expenditures for K-12 schools from 9 percent to 25 or 30 percent!

And Bruce Katz, director of the metropolitan policy program at the Brookings Institution, has claimed that "Chicagoland [and other major metropolitan areas] simply [do] not have the power or resources to achieve meaningful reforms to metro-scale problems such as crushing traffic gridlock and inadequate work force housing on [their] own. . . . The federal government has a powerful role to play in helping metros address these and other issues—through smart investments, market-shaping information and environment-strengthening regulation. This potential is not being realized, since for too long the federal government has been strangely adrift and unresponsive to the dynamic forces at play in our country."

Odd—with all these skills and resources, one might think that the federal government would already have solved the major problems of the programs for which it has a clear constitutional responsibility.

William A. Niskanen

Is Cheney right about the precautionary principle?

Regulation: Epstein v. Menell

How much would you pay to protect your car? Your house? How about your country? In the Winter 2007–2008 edition of *Regulation* (vol. 30, no. 4), Benjamin H. Friedman, research fellow in Defense and Homeland Security Studies at the Cato Institute, examines the effects of the 1 percent doctrine, here recounted by Dick Cheney:

> If there was even a 1 percent chance of terrorists getting a weapon of mass destruction—and there has been a small probability of such an occurrence for some time—the United States must now act as if it were a certainty.

"As rules regarding intellectual property become more complex in a fast-expanding digital landscape, tangible property rights will be weakened by association."

Friedman argues that in matters of national security the one percent doctrine and other instances of the "precautionary principle" inevitably lead to massive overspending by government. Government agencies are the primary—and in many cases, the only—source of information about threats to national security. The incentives of politicians and military personnel lead them to promote threats while no counterbalancing movement exists to contest them. This process of threat promotion, coupled with the principle of taking action to mitigate any risk no matter how small leads to a continually growing military to cope with even the minutest of risks.

Also featured in this issue is a back-and-forth between Richard Epstein of the University of Chicago law school and Peter S. Menell of the University of California, Berkeley, law school. Responding to a critique by Menell from the last issue of *Regulation*, Epstein lays out his case for a system of intellectual property rights derived from tangible property rights. Meanwhile, Menell continues to insist that Epstein's equating intellectual property with tangible property—when the two are fundamentally different—is a "dangerous" move. As rules regarding intellectual property become more complex in a fast-expanding digital landscape, tangible property rights will be weakened by association.

Other articles cover why stockholders ultimately pay the price of class action lawsuits over securities fraud, why CDC estimates of smoking-related deaths do not add up, how a climate of fear has taken hold among corporate executives in a post-Enron world, and how the Endangered Species Act is endangering species.

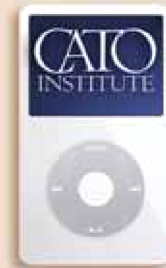
To order *Regulation* magazine, visit catostore.org and click "Subscriptions." The cost of a one-year subscription to the quarterly magazine is $22.00.

NEWS NOTES

The September-October 2006 issue of *Cato Policy Report* noted three young women born in the Soviet Union who had ended up at the Cato Institute. Today we note with even greater surprise that we now have four employees from Kentucky, a region much smaller than Russia and much less known for intellectual achievement.

In addition to DAVID BOAZ, executive vice president and editor of *Cato Policy Report,* and JOHN SAMPLES, director of the Center for Representative Government, Cato's Kentucky caucus has recently added TRAPPER MICHAEL, a health care research assistant, and CALEB O. BROWN, multimedia producer.

Brown previously worked at the Bluegrass Institute for Public Policy Solutions in Bowling Green, Kentucky, and at WHAS radio in Louisville. As host of the Cato Daily Podcast, he elicits from Cato scholars their perspective on the most recent, relevant news of the day. Past issues include Oprah, Obama, and campaign finance reform; the state of the conservative movement, featuring Tucker Carlson; and moral hazard and the Fed, featuring St. Louis Federal Reserve president William Poole. In 2007, 1.65 million podcasts were downloaded, or about 4,500 each day. Brown also narrates Cato Weekly Video, a new offering by the Cato Institute that gives web visitors an inside look at the best moments from events held at Cato's F. A. Hayek Auditorium. In January 2008 Brown took over as full-time host of CatoAudio, a 60-minute monthly CD. To subscribe to the Cato Daily Podcast or to see the Cato Weekly Video, visit cato.org. CatoAudio is available at catostore.org.



Caleb O. Brown

After September 11, 2001, NATO for the first time invoked Article V, its pledge that an attack against one member country would be considered an attack against all. But with NATO forces constantly under siege in Afghanistan, popular support among NATO countries for maintaining troops there is fading. (top) At a January 15 Cato Policy forum, STANLEY KOBER, research fellow in foreign policy at the Cato Institute, said if NATO fails in Afghanistan, the consequences could be as damaging for its survival as the Vietnam War was for the now defunct Southeast Asia Treaty Organization. (below) SUSAN EISENHOWER, chairman emeritus of the Eisenhower Institute, spoke on other potential problems for NATO including a potential flashpoint in Kosovo and ongoing tension with Russia over the proposed deployment of antiballistic missiles in Poland and the Czech Republic. Lawrence S. Kaplan, emeritus director of the Lemnitzer Center for NATO and European Studies, said talk of NATO's demise overlooks the fact that NATO has faced many crises in the past and yet has managed to adapt and prevail in each case.

TRACIE SHARP, president of the State Policy Network, met with ED CRANE, president of the Cato Institute, at a December 4 reception for the State Policy Network held at the Cato Institute. The State Policy Network is a national organization helping to coordinate the efforts of state-based free market think tanks.

How do you balance liberty and security during wartime? How about in a war without end, one where the enemy doesn't play by the traditional rules? When the Bush administration helped pass the Military Commissions Act of 2006, which effectively denied Guantanamo Bay prisoners access to American courts, it made clear its position on the troubling tradeoff. And at a December 3 Cato Policy Forum, (top) TIMOTHY LYNCH, director of Cato's Project on Criminal Justice and author of Cato's amicus brief on the case, made his position clear: holding prisoners of war in jail indefinitely without trial or charges is not only immoral but unconstitutional. Habeas corpus cannot be abrogated in the absence of a "rebellion" or "invasion" according to the Bill of Rights. Lynch has previously defended habeas corpus in the cases of Salim Ahmed Hamdan (2006), Jose Padilla (2004), and Yaser Esam Hamdi (2004). (center) George Mason University's JEREMY RABKIN said whether one likes the consequences or not, foreign enemy combatants are not afforded the same constitutional protections as Americans. (bottom) ILYA SHAPIRO, editor of the *Cato Supreme Court Review,* moderated the event.

DANIEL T. GRISWOLD, director of the Center for Trade Policy Studies, delivered the facts on free trade at a December 5 Capitol Hill Briefing. He told a standing-room-only audience that average real compensation paid to American workers, including benefits, has risen 22 percent over the past decade. Meanwhile, the median net worth of U.S. households has jumped by almost one-third over that time span, from $70,800 to $93,100. Claims of a stagnating middle class form the basis of much protectionist legislation.

Health Care University saw Cato scholars come to Capitol Hill for a week-long seminar series to inform congressional staffers about the forces affecting U.S. health care, the policy options before them, and proposed solutions to health care problems. PETER VAN DOREN, editor of *Regulation* magazine, kicked off Health Care University by laying out the basic economics of health care and insurance markets. He noted that the sickest 1 percent of people account for 30 percent of the nation's health care costs, a per capita figure of about $56,000 per year. Any effort to contain costs in health care must begin by accounting for this population.

Accompanied by Chinese journalist QIUFENG (back row, left), who has translated many of F. A. Hayek's works into Chinese, Cato vice president TOM G. PALMER (center) visits one of a chain of for-profit schools during his tour of China in December. The school's proprietor, LIJIAN XIN (right), is a well-known supporter of civil society in China.

DECEMBER 3: *Boumediene v. Bush* and the Rights of Enemy Combatants in Wartime

DECEMBER 4: Reception for the State Policy Network

DECEMBER 5: The Real Story about Trade, Jobs, and Living Standards

DECEMBER 6: The Simplified Tax: A Bold Plan to End the AMT and Overhaul the Income Tax

DECEMBER 10-14: Health Care University

JANUARY 8: *McCain: The Myth of a Maverick*

JANUARY 11: The Mind of the Market: The Case for Capitalism from an Evolutionary Perspective

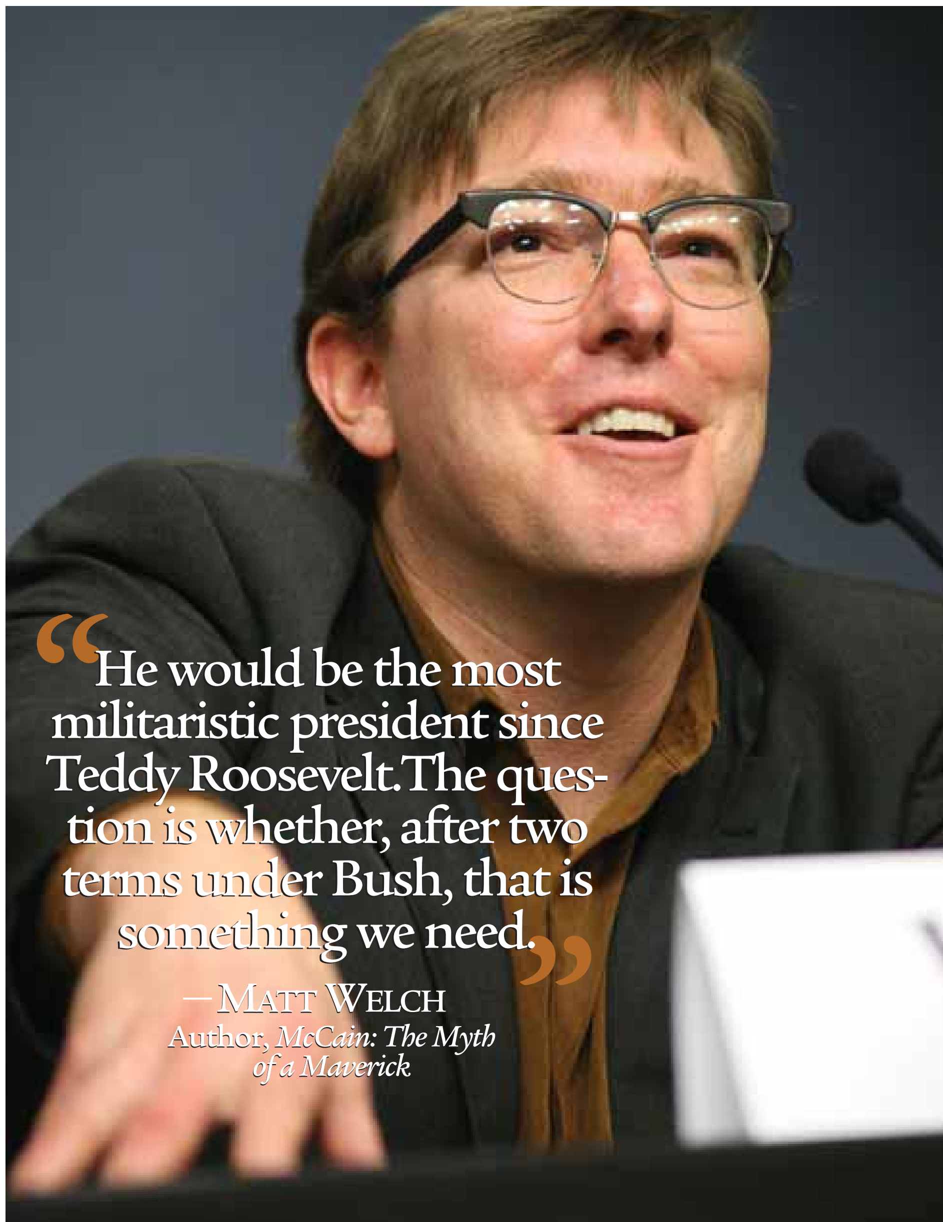
JANUARY 11: State Health Policy Summit, Baltimore, MD

JANUARY 25: The Best-Laid Plans: Congress Should Repeal Planning Requirements in Federal Surface Transportation Law

JANUARY 28: Roundtable luncheon on the deteriorating situation in Mugabe's Zimbabwe, featuring David Coltart, shadow justice minister and member of parliament, Zimbabwe

JANUARY 30: Roundtable luncheon on the ongoing crisis in Venezuela

JANUARY 31: NATO's New Troubles: Afghanistan, Kosovo, and the Future of the Alliance



"He would be the most militaristic president since Teddy Roosevelt. The question is whether, after two terms under Bush, that is something we need."

—Matt Welch
Author, *McCain: The Myth of a Maverick*

CATO CALENDAR

MILTON FRIEDMAN PRIZE PRESENTATION DINNER

New York • Waldorf=Astoria
May 15, 2008
Speakers include Frederick W. Smith.

FREEDOM'S CAMPAIGN IN THE 21st CENTURY

CATO UNIVERSITY SUMMER SEMINAR
San Diego • Rancho Bernardo Inn
July 20–25, 2008

CATO CLUB 200 RETREAT

Kiawah Island, S.C.
The Sanctuary at Kiawah Island
September 18–21, 2008

LESSONS FROM THE SUBPRIME CRISIS

26th ANNUAL MONETARY CONFERENCE
Washington • Cato Institute
November 19, 2008

Continued from page 1

The "gold standard" generically means a monetary system in which a certain mass of gold defines the monetary unit (e.g., the "dollar") and serves as the ultimate medium of redemption. For example, during the "classical" gold standard period (1879–1914), the U.S. dollar was defined as 0.048 troy oz. of pure gold. Inverting the defined ratio, 1 ounce of pure gold was equivalent to US$20.67. Gold coins need not, and historically did not, form the predominant medium of exchange in a financially sophisticated economy. Issuers of paper currency and checkable deposits, normally private commercial banks but also a government central bank if one exists, make their notes redeemable for gold and hold gold coins and bullion as reserves for meeting redemption demands. Because of the banks' contractual obligation to redeem in gold, the volume of paper currency and deposits—the everyday means of payment—is geared to the volume of gold.

So what are the key objections to the gold standard?

"A gold standard leaves the quantity of money to be determined by accidental forces."

There is a germ of truth to this concern. A gold standard does leave the quantity and purchasing power of money to be determined by the forces of supply and demand in the market for gold. There can be "accidental" shifts in the supply and demand curves to which the quantity and purchasing power of money will respond. Our current fiat standard, by contrast, leaves the supply of money to the decisions of a committee (namely, the Federal Open Market Committee of the Federal Reserve System). The practical question is: under which system are the quantity and purchasing power of money better behaved?

As is well known, the stock of gold did not grow at a perfectly steady rate during the era of the historical gold standard. Some increases in gold output—such as the Yukon discoveries and the development of the cyanide process—were responses to previous increases in demand and the purchasing power of gold and thus helped to stabilize the purchasing power of gold over the long run. Other increases resulted from accidental discoveries. The largest such "supply shock" in the 19th century was the 1848 discovery of gold in California. The outpouring of gold from California reduced the purchasing power of gold around the world, or in other words, generated an inflation of the price level. But how large an inflation? The magnitude was surprisingly small. Even over the most inflationary interval, the general price index for the United States rose from 5.71 in 1849 to 6.42 in 1857 (year 2000=100), an increase of 12.4 percent spread over eight years. The compound annual price inflation rate over those eight years was slightly less than 1.5 percent. Twenty-two years later, when the gold standard was finally restored following its suspension during the Civil War, the purchasing power of gold had actually risen slightly (the price level was slightly lower).

> "Growth in the stock of gold has been slower and steadier in practice than growth in the stock of fiat money."

The economic historian Hugh Rockoff, in an examination of the output of gold, concluded that "it is fair to describe the fluctuations in the supply of gold under the classical standard as small and well-timed." He found that supply of fiat money in the postwar United States (1949–79), by contrast to the behavior of gold under the classical gold standard, had both higher annual rates of growth and a higher standard deviation of annual growth rates around decade averages.

In a study covering many decades in a large sample of countries, the Federal Reserve Bank of Minneapolis economists Arthur Rolnick and Warren Weber similarly found that "money growth and inflation are higher" under fiat standards than under gold and silver standards. Specifically, they reported, "The average inflation rate for the fiat standard observations is 9.17 percent per year; the average inflation rate for the commodity standard observations is 1.75 percent per year."

This result was not driven by a few extreme cases; in fact, in computing the average rates of inflation Rolnick and Weber deliberately omitted cases of hyperinflation (which occurred only under fiat money). Still, "every country in our sample experienced a higher rate of inflation in the period during which it was operating under a fiat standard than in the period during which it was operating under a commodity standard." Peter Bernholz of the University of Basel adds that "a study of about 30 currencies shows that there has not been a single case of a currency freely manipulated by its government or central bank since 1700 which enjoyed price stability for at least 30 years running."

The evidence thus indicates that growth in the stock of gold has been slower and steadier in practice than growth in the stock of fiat money. Of course, U.S. inflation is thankfully not as high as 9 percent today, but at 4.3 percent (CPI, year-over-year) it is currently more than twice as high as Rolnick and Weber's figure for commodity standards. Under a gold standard, the price level can be trusted not to wander far over the next 30 years because it is constrained by impersonal market forces. Under a fiat standard, the future price level depends on the personalities of yet-to-be-appointed monetary authorities and is thus anybody's guess.

The blogger Megan McArdle gets things almost exactly backward when she writes, "The gold standard cannot do what a well-run fiat currency can do, which is tailor the money supply to the economy's demand for money." Under the gold standard, market forces do in fact automatically tailor the money supply to the economy's demand for money. The economics of gold mining operates to match world supply with world demand at a stable price level (though

> "A gradual anticipated deflation does not discourage investment, especially not when productivity gains are driving growth in the first place."

admittedly large demand shocks can take years to be accommodated), and the "price-specie-flow mechanism" quickly brings gold from the rest of the world into any single country where demand for money has grown. We can only imagine a well-run fiat-currency-issuing central bank trying to match these properties. We cannot observe any central bank that has actually managed it.

"A gold standard would be a source of harmful deflation."

The inflation rate under the gold standard averaged close to zero over generations, being sometimes slightly positive and sometimes slightly negative over individual decades. Rolnick and Weber, as quoted above, found an average inflation rate of 1.75 percent over the sample of gold and silver episodes reported in the published version of their paper; an earlier version using a different sample arrived at an average rate of -0.5 percent. In 1879 the United States resumed gold redemption for the U.S. dollar, which had been suspended since the Civil War. Between 1880 and 1900 the United States experienced one of the most prolonged periods of deflation on record. The price level trended more or less steadily downward, beginning at 6.10 and ending at 5.49 (GDP deflator, base year 2000=100). That works out to a total decline of 10 percent stretched over 20 years. The deflationary period was no disaster for the real economy. Real output per capita began the period at $3,379 and ended it at $4,943 (both in 2000 dollars). Total real per capita growth was thus a more-than-healthy 46 percent. (Real GDP itself more than doubled.)

Monetary economists distinguish a benign deflation (due to the output of goods growing rapidly while the stock of money grows slowly, as in the 1880–1900 period) from a harmful deflation (due to unanticipated shrinkage in the money stock). The gold standard was a source of mild benign deflation in periods when the output of goods grew faster than the stock of gold. Prices particularly fell for those goods whose production enjoyed great technological improvement (for example oil and steel after 1880). Strong growth of real output, for particular goods or in general, cannot be considered harmful.

It would be possible for the central bank under a fiat money standard to offset productivity-driven declines in some prices by expanding the quantity of money in order to drive others prices upward, thus eliminating deflation "on average." But there is no social benefit in doing so. Falling costs of production in steel (i.e., productivity gains) do not discourage investment in steel. A gradual anticipated deflation does not discourage investment, especially not when productivity gains are driving growth in the first place.

Nor does a deflation penalize debtors once it comes to be anticipated, because nominal interest rates adjust downward to reflect anticipated repayment in dollars of higher purchasing power.

"The gold standard was responsible for the U.S. banking panics of the late 19th century and the monetary contraction of 1929–33 and thereby for the Great Depression."

The U.S. monetary contraction of 1929–33 is the prime example of a harmful deflation. It should be noted that it happened on the Federal Reserve's watch. The episode should be blamed not on the gold standard, but on the combination of a weak banking system and a befuddled central bank. The U.S. banking system was prone to runs and panics in the late 19th century, and continued to be so through the 1929–33 episode in which the Fed stood by and did not supply replacement reserves to keep the money stock from contracting. Other countries on the gold standard—for example Canada—had no banking panic in 1929–33 (nor did Canada have panics in the late 19th century), so the gold standard couldn't have been responsible for the panics. Rather the panics were due to completely avoidable legal restrictions (namely the ban on branch banking, and compulsory bond collateral requirements making the supply of banknotes "inelastic") that weakened the U.S. banking system.

"The benefit of a gold standard (restraining inflation) is attainable at less cost by properly controlling the supply of a fiat money."

Although growth in the stock of fiat money *could in principle* be as slow as (or slower than) growth in the stock of gold under a gold standard, it has not been so in practice, as already noted. Alan Greenspan actually used to recommend controlling the fiat money supply to mimic the price-level behavior of a gold standard. In response to questioning at a 2001 congressional hearing, Greenspan said: "Mr. Chairman, so long as you have fiat currency, which is a statutory issue, a central bank properly functioning will endeavor to, in many cases, replicate what a gold standard would itself generate."

Fiat money regimes have not, however, accomplished price stability as fully as the gold standard did. Although inflation is less severe today than it was 30 years ago, experienced inflation rates, and the expectations of future inflation rates embodied in long-term interest rates, have remained higher than corresponding rates under the classical gold standard.

"A gold standard is no restraint at all, because government can devalue or suspend gold redemption whenever it wants."

A similar claim could be made about any other restraint in the Constitution. And yet constitutional rules are useful. By authorizing only a limited set of government activities, ruling others simply out of bounds, they save the public the trouble of trying to weigh every potential activity on a

cost-benefit basis.

An important problem in fiat money regimes, as famously identified by Finn Kydland and Edward C. Prescott, is the lack of an enforceable commitment not to use surprise monetary expansion and resulting inflation as a temporary stimulus to the economy. When the public knows that the central bank would be tempted to use surprise inflation, the public rationally expects higher-than-optimal inflation. The central bank has to deliver higher-than-optimal inflation to avoid a negative surprise. An unfortunate standoff is reached at a higher-than-optimal inflation rate (which, being fully anticipated, provides no economic stimulus). A gold standard avoids this trap. Like tying Ulysses to the mast, it achieves better results by removing the option (to use surprise inflation) that leads to ruin. Of course, a gold standard is not the only possible rule for constraining the creation of money. Alternatives include a Friedman-type money-growth rule or an inflation-targeting rule. But the gold standard has a longer history and is the only historically tested rule that does not presuppose a central bank.

Leaving money issue in the hands of private banks rather than a government institution, as the United States did before 1913, removes the option to use surprise monetary expansion one step further. It remains true that government can suspend the gold standard in an emergency, as both sides did during the U. S. Civil War, but the spirit of the gold standard calls for returning to the parity afterward, as the United States did. Judging by long-term interest rates and the thick market for long-term bonds under the post-bellum classical gold standard, the risk of permanent devaluation or suspension was considered small.

"Fiat money is necessary so that a lender of last resort can meet liquidity needs of the banking system."

History shows that a lender of last resort would hardly be needed with a stable monetary regime and a sound banking system (again it is instructive to contrast the United States with Canada in the 19th century). In the rare cases such a lender might be needed, bank clearinghouses can play the role.

> "Growth in the stock of money is governed by market forces rather than by government fiat."

"The gold standard is an example of price fixing by government."

The gold standard doesn't fix a price between dollars and gold any more than the traditional British measurement system fixes a price between pints and quarts. The fixed relationship is a matter of definition. A gold standard defines the dollar (or whatever the name of the monetary unit) as a specified mass of gold. Dollars are not a separate good from gold.

"The United States can't recreate the classical international gold standard by itself."

I have saved for last what I think is the strongest objection to unilateral return to the gold standard. The United States would not enjoy the benefits of being on an international gold standard if it were the first and only country whose currency was linked to gold. At least two major benefits would be missing: (1) the United States would not enjoy fixed exchange rates with the rest of the world (of course, we're already living with that disadvantage today), and (2) the purchasing power of gold would not be as stable. The purchasing power (or relative price) of today's demonetized gold has been much less stable than that of gold under the 19th century's global gold standard, because the demand to hold gold today is largely a speculative rather than a transactions demand. With only one economy on gold—albeit a large economy—monetary use of gold would likely remain the tail rather than the dog. Thus even in the unlikely event that the United States were to elect a president committed to a pro-gold policy, that president would be prudent to try to cultivate similar commitments from the governments of the other leading economies of the world before taking the United States down the yellow brick road alone.

Conclusion

Under the gold standard the issue of common money by banks is restrained by the cost of acquiring gold, which is determined by impersonal supply-and-demand forces in the gold mining market. Because of the issuers' contractual obligations to redeem in gold and the corresponding prudential need to hold gold reserves, the dollar volume of paper currency and deposits—the stock of money—is geared to the volume of gold. Growth in the stock of money is governed by market forces rather than by government fiat. A gold standard does not guarantee perfect steadiness in the growth of the money supply, but historical comparison shows that it has provided more moderate and steadier money growth in practice than the present-day alternative, politically empowering a central banking committee to determine growth in the stock of fiat money. From the perspective of limiting money growth appropriately, the gold standard is far from a crazy idea.

Historical problems of U.S. banking instability, sometimes blamed on the gold standard, turn out on closer inspection to have had been rooted in banking regulations that inadvertently weakened U.S. banks. Gold standard countries like Canada that avoided the peculiar banking restrictions of the United States also avoided the instability. As we discovered in the greatest banking panic, that of 1929–33, having a Federal Reserve System capable of overriding the gold standard did not eliminate the problem of weakness in the U.S. banking system.

Other supposed historical problems, like price deflation due to goods production outgrowing gold production, turn out not to have been actual problems.

A gold standard does entail resource costs of mining the gold that is lodged in bank vaults. But so too does a fiat standard entail resource costs, primarily in the form of the deadweight costs of inflation. All in all, because the costs of a gold standard are reasonably small in relation to its benefits, the gold standard is not a crazy idea.

Repealing AMT, Reforming the Tax Code

Thanks to a last-minute "patch," 23 million Americans were saved from paying an average of $2,000 in additional taxes under the Alternative Minimum Tax in 2007. But the debate over AMT, which is poised to strike again in 2008, continues. On December 6, 2007, on the eve of the AMT patch, Rep. Paul Ryan (R-WI) spoke at a Cato Capitol Hill Briefing on his proposal to repeal AMT and overhaul the current income tax code with a simplified, two-rate plan. He was joined by Cato senior fellow Daniel J. Mitchell and Chris Edwards, director of tax policy.

REP. PAUL RYAN: This is about more than just the Alternative Minimum Tax or what kind of tax policy we ought to have. The AMT debate we are in right now is the beginning of an enormous fight we are going to have in this country. We are talking about whether we sanction an ever-higher trajectory of federal spending. Fundamentally, we are talking about how big our government is going to get.

The AMT is a federal income tax that is imposed on top of the existing income tax system. In 1969, AMT was passed to go after 155 rich people who were using deductions and loopholes to avoid paying any taxes. And while subsequent tax reform closed those loopholes, the AMT remained. Most critically, the AMT was never tied to inflation, so that today the AMT is targeting an ever-increasing fraction of the middle class.

About 20 million Americans were subject to AMT in 2006; 23 million in 2007. Their estimated increased tax liability was about $2,000 per person. According to the Congressional Budget Office, by 2010, if nothing is changed, one in five taxpayers will have AMT liability. Nearly every married taxpayer with income between $100,000 and $500,000 will owe the alternative tax.

So the AMT represents an enormous tax hike on the middle class. Going forward, it will represent an even larger tax increase. That is a major reason it must be repealed. But more centrally, the AMT would massively expand government revenue, which would in turn allow increased government outlays, increased government involvement in the economy, and increased government control over our lives. Meanwhile, many of the proposals to reform AMT come with additional tax hikes that would also mean continued government growth.

Rep. Paul Ryan

> "The AMT would massively expand government revenue, which would in turn allow increased government outlays, increased government involvement in the economy, and increased government control over our lives."

Federal revenues as a share of GDP have been about 18.5 percent historically. How much money has the federal government taken out of the U.S. economy, U.S. income, U.S. productivity? About 18.5 percent on average for the past 40 years. The AMT puts a new tax system on top of the current one, bringing us to a historically unprecedented level of taxation in the not so distant future. Of course, most people in Washington think that that's fine.

That's why the debate until recently has not just been about getting rid of AMT. It has been about how to replace the supposed "lost revenue." Congressional Democrats don't like the AMT because it targets mainly the middle class. Although they want to repeal it, they want to replace it with another revenue machine. For instance, Rep. Charles Rangel (D-NY), House Ways and Means Committee chairman, introduced a major piece of tax legislation in October that, while repealing AMT, would "offset" it through a host of new taxes on high-income households and on the private equity industry.

If you want to see what the future of taxation will look like under a Democratic president and Democratic Congress, look no further than Charlie Rangel's tax bill. It is what he believes in. It is his philosophy. It puts the top federal marginal tax rate in this country at 44.2 percent. That's the rate small businesses will pay. Meanwhile it raises the rate paid by private equity, venture capitalists, and hedge fund managers from 15 percent to 35 percent.

Now that is what you have to do to the tax code to replace the revenue from an AMT repeal. But as a conservative, I believe

we shouldn't replace that revenue. Let's agree to keep government where it is. A lot of us could make a good argument for cutting taxes to below where they are now. But let's at least agree to keep government at about 18.5 percent of GDP, after which we can focus on cutting spending, in particular on entitlement programs.

Because if we buy into this notion that we should have an ever-higher revenue baseline, we will take more freedom away from individuals, raise taxes, and make ourselves much less internationally competitive. And it will also lull us into a false sense of having a balanced budget or even a small surplus.

Along with Rep. Jeb Hensarling (R-TX), Rep. Michele Bachmann (R-MN), and Rep. John Campbell (R-CA), I've introduced the Taxpayer Choice Act, a bill that would not only eliminate the AMT and the massive tax hike that would come from its automatic expansion. It would also establish a highly simplified alternative to the current income tax system that individuals could choose. Under the current tax system, you fill out an income tax form and an AMT form, and you are obligated to go by whichever is the higher figure. By contrast, our bill gives people the choice of whether they want to pay taxes under the regular income tax or a much simpler and transparent tax system.

The plan woud raise approximately the same amount of revenue that we raise today under the current tax code. It also spreads the income tax burden basically the same as it does today. For those who are concerned about distributional tables, at the recent historical average of 18.5 percent, this is what we call distributionally neutral and revenue neutral.

Now, I want you to think about all the tax expenditure lobbyists who come to get members of Congress to promise not to touch their pet preference in the tax code. From a political perspective, it's going to be hard to get members of Congress to vote against particular deductions or exemptions given the influence these lobbyists have. It will be much easier to get members of Congress to vote for a clean bill, one that puts that decision in the hands of individual taxpayers.

What would the effect of my plan be on those taxpayers? If they already have their affairs arranged to deal with the exemptions and deductions in the current code, they may opt to continue filing under the current system. But if they prefer a simplified tax form, one with two rates of 10 and 25 percent and little more than that to worry about, then they can opt for that.

At the heart of this is a pro-growth, pro-family, pro-entrepreneurial tax system. We're putting a stake in the ground and saying we don't want government to grow beyond its current size. We do not accept this Washington doctrine—this Washington dogma—that we have to keep growing government at this ever higher rate.

If my three kids, who are three, four, and five years old, want to have this government for them when they are my age, they will have to pay twice the level of taxation that we have today. Take today's government, add no new programs to it, take none away, and look ahead 40 years to when my three children will be approximately my age. At that point, they will have to pay 40 percent of GDP in taxes to the federal government just to keep it afloat. This is basically due to entitlement spending.

You can't have a free and prosperous America with levels of taxation like that. You can't have an internationally competitive country that can compete with China and India with levels of taxation like that. Yet that is the path we are on right now. And the left is trying to make it worse by proposing new entitlements on top of the ones we have already today.

Let's recognize the path we are on right now and let's put out an alternative that is bold but doable to prevent that from happening, so that we can preserve the American legacy: leaving your kids and the next generation with a country and a standard of living that is better than what you have now. That is what this is all about. That is what we hope to achieve.

Chris Edwards

"If a sales tax started moving through Congress, there is no doubt in my mind it would end up being an add-on tax to the income tax system, which would be a disaster."

CHRIS EDWARDS: There is no doubt that tax reform has been stuck in a rut for a while. This year, Congress has been more focused on raising taxes than doing anything about tax reform. A flat tax hasn't been championed in over a decade when Steve Forbes and Dick Armey did so.

One alternative to our current system is the national sales tax. One version of this, the FairTax has lately been endorsed by Arkansas governor Mike Huckabee to much press and praise. A national sales tax would in principle replace all current federal income with a single national retail sales tax, levied once at the point of purchase of new goods and services. The income tax, the payroll tax, the Medicare tax, capital gains tax, estate taxes, and even the AMT would go in favor of this national sales tax. But in my judgment it's too dangerous in today's political climate to even think about moving ahead with the idea of a national sales tax. If a sales tax started moving through Congress, there is no doubt in my mind it would end up being an add-on tax to the income tax system, which would be a disaster.

Rep. Charles Rangel (D-NY) has his own problematic proposal to reform the tax code. On the plus side, his bill would abolish AMT. It would also cut corporate tax rates, an area where the U.S. woefully lags behind the rest of the world. But it would replace this "lost revenue" with new tax hikes. In effect, this would amount to a trillion dollar tax hike, because the ever-expanding AMT represents a new, additional tax on top of the current system. Congress should consider the pro-growth elements of Rangel's package such as the corporate rate cut, without imposing new taxes on individuals and businesses.

Paul Ryan's plan is by far the best of the bunch. It is a very credible, very pro-growth proposal, a way of moving ahead with tax reform, and a big step toward a Dick Armey or Steve Forbes flat tax.

Let me just give you a couple of things that I think are interesting about the Taxpayer Choice Act. I'm all for a flat tax. A flat tax would be optimal in terms of efficiency and fairness, in my view. But unfortunately, the current static revenue estimation methods up here on Capitol Hill provide easy fodder for opponents of a flat tax, who claim the flat tax is unfair.

So to move ahead with tax reform, I think a good idea is to enact essentially a flat tax but with two rates. The Taxpayer Choice Act has two tax rates, one at 10 and one at 25 percent. Those aren't picked out of the air. If you look at people at the very top of the income distribution, they pay an effective rate of about 25 percent. That is to say, their total taxes divided by income comes to about 25 percent.

If you look at the broad middle class, people making from about $50,000 to $100,000, they have an effective tax rate currently of about 10 percent. This plan hits the same sort of distribution, in a static sense, as the current tax code.

Some folks looking at the details might criticize dropping the top rate from 35 to 25 percent. They might claim that it is a giveaway to the rich. But, again, the effective rate of those at the top of the distribution is 25 percent currently.

What's interesting about the current tax codes is that the 25 percent tax rate starts at a very low income level. If you're single and you earn an adjusted gross income of $40,000, you start getting hit by the high 25 percent tax rate. Under Ryan's plan, that 25 percent tax rate doesn't start until about $66,000. So there is a big chunk of people in the middle who would have a sharp marginal tax rate cut under the plan.

I think that the Taxpayer Choice Act is an excellent plan. Admittedly, one of the reasons why I think so is that I introduced something similar a few years ago in a February 2005 Cato Tax & Budget Bulletin, "A Proposal for a 'Dual-Rate Income Tax.'" One thing that I included in my plan was a sharp corporate tax rate cut as well. If I were to add one thing to Ryan's plan it would be to lower the corporate rate 35 percent down to 25 percent—at the least.

Daniel J. Mitchell

"Lots of empirical data shows that once you get tax rates at 20 percent or below, people aren't really going to worry about evasion and avoidance; they are going to focus on being productive."

There has been a lot of discussion this year about corporate tax rate cuts. As mentioned before, even Rangel's proposal includes one. Bear in mind that in Europe right now the average corporate tax rate is just 24 percent. At 35 percent, the United States has the second highest corporate tax rate in the world. And yet despite this, we have fairly low corporate revenues. Indeed, according to my analysis, we are in the Laffer curve range for the corporate tax rate, where cutting the rate down to 25 percent would mean no revenue loss for government at all.

A corporate tax cut is long overdue. We should add a corporate rate cut to the Paul Ryan tax plan, after which we would have a real winner for businesses and, frankly, for the government, which would probably get more revenue.

DANIEL J. MITCHELL: What is good tax policy? Rates should be low. You shouldn't double tax. There should be no special loopholes. It's that simple.

Why have a low rate? Because that's the price on productive behavior. Politicians understand this, whether they admit it or not. For instance, they institute higher cigarette taxes to diminish smoking. While I may not think that is government's job, they get an A+ for economics. The higher the tax on something, the less you get of it. But I get frustrated by the fact that they don't apply this same lesson to work, saving, investment, and entrepreneurship.

Meanwhile, lots of empirical data shows that once you get tax rates at 20 percent or below, people aren't really going to worry about evasion and avoidance; they are going to focus on being productive. That's another reason to keep rates low.

Now, why should income only be taxed one time? Because even if you have low tax rates, if you cycle income through the tax code more than once your effective tax rate can be very high.

Every economic theory agrees that capital formation via saving and investment is the key to long-run growth. Even radical socialists who believe government should do the saving and investing agree on this point. But in America there are four different

Continued on page 16

ElCato's editor tries to keep Ecuador out of Chavez's orbit

Gabriela Calderón: Saying "No" to the Venezuelan Model

That Hugo Chávez has celebrity admirers like Sean Penn and Naomi Campbell is a troubling, if mostly harmless phenomenon. But when Chávez can count fellow Latin American leaders as allies, there is a serious problem.

Welcome to the world of Gabriela Calderón, editor of ElCato.org, Cato's Spanish language website. In 1998, when ElCato.org was born, Gabriela Calderón was still in middle school. Today, at the age of 24, she is on the frontline of the struggle against Hugo Chávez's "21st century socialism," which is threatening to engulf all of Latin America.

Shortly after finishing her master's degree in International Commerce and Policy at George Mason University, Calderón left Cato's Washington, D.C., headquarters for Ecuador, the latest nation to fall sway to a populist president in the mold of Hugo Chávez. Only a year after Evo Morales was named president of Bolivia, promising a "Bolivarian revolution," on January 15, 2007, Rafael Correa assumed the presidency of Ecuador promising a "civilian revolution." Both are close Chávez allies—"three sides of the same coin," quips Calderón.

But there was also a personal reason for the move. Calderón is a native of Guayaquil—Ecuador's largest and most prosperous city.

Since taking office, Rafael Correa has kept very busy. In addition to the usual array of populist nostrums—ratcheting up government spending on education, health, and welfare—Correa has launched a "microcredit" program in which $350 grants are distributed to "needy recipients" among the public at the government's discretion. He has upped the "windfall profits" tax on the oil industry to 99 percent, effectively nationalizing the industry.

Calderón has been keeping busy too. In an October op-ed published in *El Universo,* Ecuador's largest newspaper, Calderón pointed out that Correa was following the Chávez formula to a T—"only three times as fast." The facts were on Calderón's side, as Correa's political maneuverings—whereby he sacked half of Congress, shifted power to a smaller assembly of loyalists, and is slated to rewrite the nation's constitution—follow the Chávez (and Evo Morales) script precisely. But Calderón's larger point was that poverty is solved not by government handouts but by robust economic growth. She warned against efforts to reduce inequality—which would make everyone poor. She made her case again on Ecuavisa, a channel that is rebroadcast throughout the Spanish-speaking world all the way to Miami.

Her article also earned her the ire of some powerful Ecuadorians. Both the minister of education and the minister of social welfare responded in letters to the editor, and one of her fellow television panelists accused her, and the Cato Institute, of being well-funded members of the reactionary right.

Calderón responded that if anyone is on "the reactionary right," it is the person pushing for greater state control over the economy and people's lives. By contrast, she—and ElCato.org—advocates for individual freedom.

Today, Calderón has more avenues through which to make her case, but the battle over the future of Ecuador—and much of Latin America—remains a difficult one. In her now-weekly column at *El Universo,* Calderón remains unwavering critic of the Correa administration. In early January, Calderón spoke to members of the Constituent Assembly of Ecuador, a body that is writing the nation's new Constitution. Though trying to fight poverty in Ecuador was a laudable—and indeed, necessary, goal—their past actions risked making the nation far poorer than it already is. She urged them to think twice before further weakening property rights and stability of contract, the foundations of a market economy and future economic growth.

Calderón's latest project is a weekly political roundtable television program on Cable Noticias—"Spanish-speaking C-SPAN," says Calderón. Now five months running, it is introducing a generation of Ecuadorians to the economic way of analyzing problems—"a point of view missing from the political debate here."

But Calderón's favorite outlet remains ElCato.org. In her capacity as editor, she ensures that the site is constantly stocked with the freshest Cato scholarship with application to Latin American policy problems. ElCato.org, which celebrates its 10th anniversary this year, offers not only the classics of Hayek and Mises, but also translated analysis from current Cato scholars. ElCato.org's newest effort is Libremente, a blog in which Calderón takes on bad policy proposals as they are advanced. There she is joined by distinguished co-bloggers such as Cato senior fellow José Piñera, the architect of Chile's successful social security privatization.

Latin Americans are paying attention. Last month, ElCato.org brought in 122,441 unique visitors—or, about 4,000 visitors per day. After Mexico, the second greatest source of visitors to ElCato.org is Venezuela. Ecuador comes in at number five.

100 essays from David Boaz on politics and policy

A Timely Book: *The Politics of Freedom*

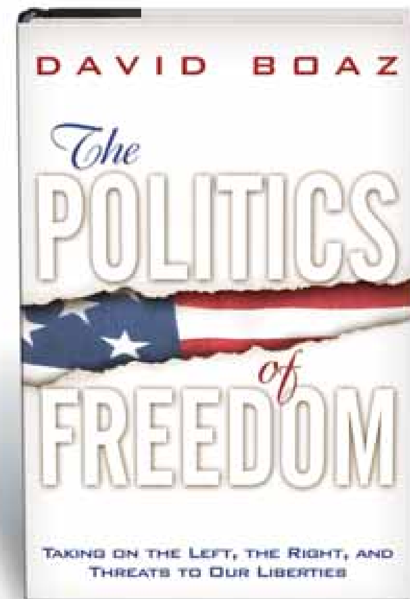
David Boaz likes to begin many of his speeches with a question. He asks: "Are we less free today than we were in the past?" Libertarians and fiscal conservatives—nursed on titles like *The Road to Serfdom* and witness to massive expansion of government influence over the last eight years alone—almost uniformly answer that we are less free.

They have a point. Government spends more than ever. It has grown well beyond its constitutional limits. It interferes in every aspect of our lives through endless regulation. The American economy is constantly subject to the whims of the officials who control fiscal and monetary policy. Education, health care, and retirement are either significantly impacted or completely controlled by government.

All of which is chronicled in *The Politics of Freedom: Taking on the Left, the Right, and Threats to Our Liberties,* a new book by David Boaz. Boaz is executive vice president of the Cato Institute (and editor of *Cato Policy Report*), a formidable television pundit and op-ed writer, and the author of *Libertarianism: A Primer.* In *The Politics of Freedom* he delves into a wide array of topics of interest to libertarians, including (but certainly not limited to) the welfare-warfare state, abortion, the influence of special interest groups, obesity and public health, immigration, "the cult of the presidency," smoking bans, public broadcasting, gated communities, Social Security's insolvency, the drug war, drug war journalism, as well as Ronald Reagan, Pat Robertson, Boris Yeltsin, Franklin Delano Roosevelt, both Bushes, Bill Clinton, Hillary Clinton, Rudy Giuliani, and John McCain.

The Politics of Freedom is a great collection of bite-size essays to give to friends who need a short dose of libertarianism. The measuring stick for people and policies in *The Politics of Freedom* is freedom—specifically, the Founders' original vision of an American society based on individual rights, dignity, toleration, rule of law, and peace. Boaz defends gated communities against charges of elitism by reminding readers that government is not properly protecting homes and people in the first place. He criticizes a proposed constitutional amendment banning gay marriage in Virginia because it is "unworthy of a state that was the birthplace of American freedom." He continues to say what a "cruel irony" it is that this amendment—which restricts individual and contract rights—should be proposed in a place where the precursor to the Bill of Rights was first penned—Virginia's Bill of Rights, by the noted Founder George Mason. Boaz reminds readers that there is no authority in the Constitution for federal intervention in education. Nor for public broadcasting, federal drug laws, publicly financed art, wiretapping, or regulating marriage. And the things the Constitution does give government the power to do—like enforce the rule of law and maintain the nation's infrastructure—government is often woefully unable or unwilling to do.

> "Are we less free today than we were in the past?"



The Politics of Freedom is also about the things freedom-loving Americans can be thankful for. America is the freest nation in the world, and probably the freest nation in the history of the world. In the final chapter, Boaz takes up his own question on whether Americans are less free today than in the past, and determines that indeed, Americans have much to celebrate in that regard. He provides powerful reasons for Americans not to fret about the state of liberty. For one, the world is getting significantly freer and more prosperous—the Soviet Union has collapsed, allowing many of Russia's former colonies to significantly and successfully liberalize. China and India's powerful pushes toward market liberalism have lifted hundreds of millions out of abject poverty. In America, yes, government growth continues—and yet Americans are freer in many ways despite that. Liberty and equality have been extended to people of all races and religions, to women, and to gays and lesbians. Remember the days of 90-percent income tax rates, wage and price controls, airplane monopolies, Jim Crow laws, and public indecency laws? Meanwhile, material wealth, the product of a relatively free market, has given us ever-expanding options like inexpensive transportation, internet access, iPods, mobile phones, and Wikipedia—which is completely free.

The Politics of Freedom **is available at catostore.org for $22.95.**

Lessons from Russia, India, Brazil, and Katrina

Cato Journal: De Jasay Takes on Anti-Market Fallacies

China's economic growth has been miraculous. Over the last 25 years, China has featured a breakneck 10 percent per annum growth rate, and 400 million people have been lifted out of poverty. But the real miracle is that China has gone from a Soviet-style command-and-control system to a market-oriented economy fully integrated into the global economy.

In the Winter 2008 edition of *Cato Journal* (vol. 28, no. 1), Deepak Lal, renowned development economist and senior fellow at the Cato Institute, asks: Could India be next? On the one hand, since sweeping pro-market reforms were introduced in 1990, India's economy has seen rapid expansion. But only in certain sectors: the "Green Revolution" of new tools and technologies in agriculture has seen rice yields triple since 1970, turning formerly famine-prone India into a net agricultural exporter. India's service sector is similarly booming. Meanwhile the manufacturing sector—long subject to state industrial policy—has seen only anemic growth thus far. India's continued economic development depends on the growth of this lagging sector, and of continued integration into world markets. Lal sees India's liberalization continuing, and makes a bold prediction: 8.5 percent to 9 percent per annum growth for the next 20 years.

Meanwhile, Erich Weede, professor emeritus at the University of Bonn, Germany, surveys India's pre-1990 past and uncovers what was ultimately at fault for India's slow growth to that point. Extensive government interference and involvement in the economy yielded the expected results: weakened incentives for investing and entrepreneurship, distorted hiring and firing decisions, and diminished output. Further, he cites these interventions as the major reason behind India's sectoral disparities in economic growth. In a word: Indian call centers flourish while "Made in India" products are rare due to government's uneven intervention in the economy.

Also in this issue, Anthony de Jasay debunks some popular anti-market fallacies. Among them: the notion that the production and distribution of economic goods are divisible from one another; the notion that property rights are a protected by the state rather than emerging endogenously; and the idea that equality of outcome should be privileged over equality of opportunity.

Meanwhile, Andrei Illarionov, senior fellow at the Cato Institute and former chief economic adviser to Vladmir Putin, asks whether Milton Friedman could have made it if he had been a Russian economist. Without freedom, Friedman's opportunities to engage in pathbreaking research and to report his results to the world would have been nonexistent.

To get your copy of *Cato Journal,* visit catostore.org and click "Subscriptions." The cost of a one-year subscription is $22.00.

Continued from page 13

layers of taxes that a single dollar of income may be hit with: the capital gains tax, the corporate income tax, personal income tax, and the estate tax.

So even if you get all those rates down to 20 percent, by the time the IRS gets four different bites at the apple, your effective tax rate can be very, very high. The government should not punish the very thing that everyone agrees is critical to long-run growth.

Why should the tax code be neutral? Because the government should not be in the business of picking winners and losers. Issues of fairness aside, this leads to the misallocation of resources.

If you do everything right, you wind up with a postcard-size tax form. And even if you do a few compromises with it, like Congressman Ryan does, you can just have a bigger postcard. But if you go to the IRS Web site and you go to "Forms and Publications," there are more than 1,100 different forms and publications you can download. Wouldn't a postcard-size form be better?

Now, let me bring it back to some of the things that are relevant to policy work on Capitol Hill. Some people make the interesting argument that the AMT is like a flat tax. After all, it doesn't have many of the exemptions and deductions of our current tax code. Meanwhile, it taxes income at, alternately, 26 or 28 percent depending on income, which is pretty close to a single tax rate.

But a flat tax isn't just about having one rate. It's also getting rid of double taxation. And the only thing similar between the tax base of an AMT and the tax base of a flat tax is you get rid of state and local tax deductions. That's actually privately one of the reasons I'm amused by the AMT. You have all these high-tax states, like California and New York, complaining about it.

Now, what about Mr. Ryan's plan? It's not a flat tax either. It too has two rates. But marginal tax rates are going down. Productive behavior is not being excessively penalized. Government will be prevented from growing as it would under an all-encompassing AMT. It represents progress.

The problem started long before Bush

A Critical Look at the Growing Power of the President

A 1999 survey conducted by C-SPAN found that by a wide margin academic historians consider Abraham Lincoln, George Washington, and Franklin Delano Roosevelt to be the greatest three American presidents. Gene Healy, senior editor at the Cato Institute, begs to differ.

George Washington, of course, has much to credit him. Even when he favored some decidedly un-Founding-Father-like things—a federally funded agricultural research initiative, for one—he at least was modest about it. "I know not whether I can with propriety do any thing more at present than what I have already done," he wrote a European friend. "I have brought the subject in my speech . . . It rests with [the legislature] to decide what measures ought afterwards to be adopted."

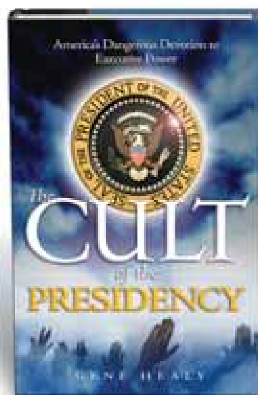
Abraham Lincoln deserves perhaps even more credit—he ended the peculiarly repugnant institution of slavery. But he was no saint, and here Healy chronicles in detail how he used war to trample on civil and economic liberties. With Congress out of session in April 1861 he responded to the Deep South's secession by blockading

> "The splendid book provides the best account yet of how the imperial presidency, abetted by Democrats and Republicans alike, came to pose a clear and present danger to our republic."
>
> —**ANDREW J. BACEVICH,** author of *The New American Militarism: How Americans Are Seduced by War*

Southern ports and suspending habeas corpus. He imprisoned 14,000 purported confederate sympathizers without trial and ordered the shutdown of more 300 newspapers.

You may have heard of some of the things FDR did as president.

The problem with historians, writes Healy, is that they like a good story; they thus favor "heroic presidents," those who go above and beyond the call of duty—and, oftentimes, their constitutional authority. Sometimes that means an executive who helps found a new nation born in liberty with equal rights for all. More often it means a president who tramples on individual freedoms, massively expands the size and scope of government, and often, in so doing, permanently extends the powers of his own office to do more of the same.



This problem isn't limited to historians, though.

The Cult of the Presidency: America's Dangerous Devotion to Executive Power chronicles the rise of the imperial presidency in America, and asks how and why we got here. Academics share some of the blame for our modern day, massively aggrandized presidency, as do the American people who demanded it, the fawning media who sanctioned it, legal scholars who excused it, and the senators and congressmen who did nothing to stop it.

One example highlights how powerful the cult of the presidency has become: Hurricane Katrina. Remarkably, President Bush was blamed for not doing enough about the disaster, which was a state and local issue if there ever was one. Or, as the *National Post's* Colby Cosh put it (quoted in the book), "Americans who have been complaining for five years about George W. Bush being a dictator are now vexed to the point of utter incoherence because for the last fortnight he has failed to do a sufficiently convincing impression of a dictator." So what does the president do? He asks to use federal troops to restore the

> "Gene Healy provides an important public service by puncturing the inflated hopes and dreams of an all-wise, informed, and well-intentioned President. This fundamentally flawed conception of executive power makes us less safe, less free, and less constitutional."
>
> —**LOUIS FISHER,** author of *Presidential War Power*

peace in disaster areas, a violation of the Posse Comitatus' prohibition on using the U.S. military as a police force. More amazingly, Congress granted that power to Bush, crafting what Healy characterizes as a "gaping" new exception to a long-established check on civilian policing. And here Bush couldn't even call upon the war on terror as a basis for his actions.

Still, Healy urges critics, especially on the left, to think twice before they engage in another round of Bush-bashing; they are just as much at fault. After all, they believe that a president that can and should "grow" the economy, educate our children, promote democracy abroad, insure the uninsured, move America away from an oil-based economy, and even heal great emotional divides in the nation. Ultimately, both Left and Right believe in a boundless scope of presidential powers; none see the presidential office as the Founders saw it: an executive acting within the limits placed on him by the Constitution, tasked with enforcing the law, checking Congress when it violates the Constitution, defending the country when attacked—and little more.

The Cult of the Presidency **is available at catostore.org for $22.95.**

Can NATO Survive Afghanistan and Kosovo?

In **"Cracks in the Foundation: NATO's New Troubles"** (Policy Analysis no. 608), Stanley Kober, research fellow in foreign policy at the Cato Institute, says the longstanding North Atlantic Treaty Organization is beginning to fracture. Its members, sharing the triumphalism that underpinned U.S. foreign policy after the Cold War, took on burdens that have proved more difficult than expected. Increasingly, they are failing to meet the challenges confronting them. The biggest problem is in Afghanistan, where NATO forces are relentlessly under siege by the Taliban, and popular support for staying there is badly flagging. If NATO fails in Afghanistan, the consequences could be as damaging for its survival as the Vietnam War was for the now-defunct Southeast Asia Treaty Organization. There are a number of other problems, too: NATO expansion, which has strained the alliance's capabilities; the proposed deployment of antiballistic missiles in Poland and the Czech Republic; and a potential flashpoint in Kosovo, where the Albanian majority's insistence on independence could divide alliance members. In short, NATO is facing new challenges, while the future of the alliance is unclear. The United States should start to think about what a post-NATO world would like.

Social Security's New Woes

Long-accepted conventional wisdom has held that wage growth alone can improve the financial condition of Social Security—that it is possible to "grow our way out" of the program's looming insolvency. But in **"The Connection between Wage Growth and Social Security's Financial Condition"** (Policy Analysis no. 607), Jagadeesh Gokhale, senior fellow at the Cato Institute, says "not so fast." Wage growth is just as likely to worsen Social Security's financial condition as it is to help it. That's because the way the financial health of the program is currently being measured by the Social Security Administration contains a major short-term bias. These measures consider benefits being paid out as equivalent to current, incoming revenues. However, benefits paid out are based on past, lower wages, while incoming revenue is based on the higher wages of today (and the future). The various measures used by the SSA are not adequately adjusting for the fact that benefits will rise alongside rising wages. Contrary to claims by both sides of the aisle that wage growth will "solve the insolvency," the impact of wage growth on Social Security is theoretically ambiguous at best. And, according to a more realistic model introduced by Gokhale, the effects on solvency are likely to be negative. Gokhale's analysis suggests another reason that Social Security is in need of reform.

Extra Credit for Educational Tax Credits

It is among the most divisive, yet fundamental, questions any democracy faces, and it has been Ground Zero of American politics from time immemorial: How do we educate our children, decide what to teach them, and who should pay for it? Adam B. Schaeffer, policy analyst at Cato's Center for Educational Freedom, says the "us versus them, public versus private, religious versus secular" dichotomy so central to political wrangling over education policy misses the mark. Education should be about the students—preparing them for success in private life and participation in public life. In **"The Public Education Tax Credit"** (Policy Analysis no. 605), he offers a method of delivering that promise:

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. ©2007 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.

CATO POLICY REPORT

David Boaz ... Editor
David Lampo ... Managing Editor
Zachary David Skaggs ... Editorial Assistant
Jon Meyers ... Art Director
Kelly Anne Creazzo ... Photographer

CATO INSTITUTE

Edward H. Crane ... President and CEO
William A. Niskanen ... Chairman
David Boaz ... Executive Vice President
Lesley Albanese ... Vice President
Ted Galen Carpenter ... V.P., Defense & Foreign Policy Studies
James A. Dorn ... V.P., Academic Affairs
William Erickson ... V.P., Finance and Administration
Brink Lindsey ... V.P., Research
Tom G. Palmer ... V.P., International Programs
Roger Pilon ... V.P., Legal Affairs

Virginia Anderson ... Director, Web Services
Brandon Arnold ... Director, Government Affairs
Michael F. Cannon ... Director, Health Policy Studies
Andrew Coulson ... Director, Center for Educational Freedom
Yana Davis ... Director of Sponsor Communications
Jamie Dettmer ... Director, Media Relations
Chris Edwards ... Director, Fiscal Policy Studies
Robert Garber ... Director, Marketing
Jagadeesh Gokhale ... Senior Fellow
Daniel T. Griswold ... Director, Trade Policy Studies
Jim Harper ... Director, Information Policy Studies
Gene Healy ... Senior Editor
Linda Hertzog ... Director, Conferences
Daniel J. Ikenson ... Associate Director, Trade Policy Studies
Andrei Illarionov ... Senior Fellow
Malou Innocent ... Foreign Policy Analyst
Sallie James ... Trade Policy Analyst
David Lampo ... Publications Director
Robert A. Levy ... Senior Fellow, Constitutional Studies
Trisha Line ... Controller
Justin Logan ... Assoc. Director, Foreign Policy Studies
Timothy Lynch ... Director, Criminal Justice
Ashley March ... Director, Foundation Relations
Neal McCluskey ... Assoc. Director, Center for Educational Freedom
Jon Meyers ... Art Director
Daniel J. Mitchell ... Senior Fellow
Johan Norberg ... Senior Fellow
Randal O'Toole ... Senior Fellow
Alan Peterson ... Director of MIS
Christopher Preble ... Director, Foreign Policy Studies
Alan Reynolds ... Senior Fellow
Claudia Ringel ... Copyeditor
John Samples ... Director, Ctr. for Representative Govt.
Adam B. Schaeffer ... Education Policy Analyst
Ilya Shapiro ... Senior Fellow
Michael Tanner ... Director, Health and Welfare Studies
Jerry Taylor ... Senior Fellow
Marian Tupy ... Development Policy Analyst
Peter Van Doren ... Editor, *Regulation*
Ian Vásquez ... Director, Ctr. for Global Liberty and Prosperity
Will Wilkinson ... Policy Analyst

James M. Buchanan ... Distinguished Senior Fellow
José Piñera ... Distinguished Senior Fellow
Earl C. Ravenal ... Distinguished Senior Fellow
Swaminathan Aiyar ... Research Fellow
Randy E. Barnett ... Senior Fellow
Lawrence Gasman ... Senior Fellow in Telecommunications
Ronald Hamowy ... Fellow in Social Thought
Steve H. Hanke ... Senior Fellow
John Hasnas ... Senior Fellow
Penn Jillette ... Mencken Research Fellow
David B. Kopel ... Associate Policy Analyst
Christopher Layne ... Visiting Fellow, Foreign Policy Studies
Patrick J. Michaels ... Senior Fellow in Environmental Studies
P. J. O'Rourke ... Mencken Research Fellow
Gerald P. O'Driscoll Jr. ... Senior Fellow
Jim Powell ... Senior Fellow
Ronald Rotunda ... Senior Fellow, Constitutional Studies
Teller ... Mencken Research Fellow
Cathy Young ... Research Associate

through a system of educational tax credits, which are superior to school vouchers for practical, legal, and political reasons. Schaeffer points to a powerful and determined education lobby, with a vested interest in maintaining the status quo, and argues that in order to defeat it, proponents of school choice must seize the political and rhetorical high ground.

Affordable Housing Requires Affordable Land

Here's a puzzle: Atlanta, Dallas-Ft. Worth, and Houston have been growing by more than 130,000 people per year, yet—bucking the national trend—housing remains quite affordable there. In **"The Planning Tax: The Case against Regional Growth-Management Planning"** (Policy Analysis no. 606) Randal O'Toole, senior fellow at the Cato Institute, says government-imposed growth-management planning is a big reason why. Growth-management planning is a particular form of city planning intended to prevent "urban sprawl." It consists of urban-growth boundaries, adequate-public-facilities ordinances, and growth limits. These strictures make housing unaffordable by limiting the amount of land readily accessible for new home construction. O'Toole has calculated the costs that such policies impose on the aspiring homeowner, and they're enormous—as high as $700,000 for a median home in the San Francisco Bay Area. Artificially inflated prices have significantly contributed to our present day bubble in the housing industry, writes O'Toole. Meanwhile, robust growth doesn't necessarily entail high home prices, as the cases of Atlanta, Dallas, and Houston show. The key to their success is the existence of plenty of private land that is outside the grasp of bureaucrat planners and in the hands of private developers.

CATO UNIVERSITY 2008

Freedom's Campaign in the 21st Century

JULY 20-25, 2008 • SAN DIEGO

Cato University is the Cato Institute's premier educational event of the year. This annual program brings together outstanding faculty and participants from across the globe–business and professional people, retirees, small business owners, students, employees of large and small firms, families (often including children and grandchildren), and others who share a commitment to liberty and learning.

Would you like to meet like-minded people from all over the United States? Or have a spectacular vacation while sharing ideas on how freedom will be advanced, enhanced, and defended? And–would you like to make enduring new friendships? If so, Cato University is definitely for you.

THE SETTING We will be gathering at the magnificent Rancho Bernardo Inn, which is just a few miles north of San Diego. Its world-class facilities, resort amenities, spa, and immediate access to the best of San Diego make this special learning experience a tremendous vacation.

PRICE $925 – covers all meals, lectures, receptions, and books, but not the cost of overnight lodging. Since the 2007 Cato University was a sell-out at the Rancho Bernardo Inn, we recommend you enroll in this year's program as soon as possible.

THE PROGRAM – Freedom's Campaign in the 21st Century Never attended Cato University before? 2008 will be the perfect opportunity to join the Cato University community and become a graduate. There are no prerequisites, and your intellectual passions will be energized and enhanced by the totally new perspectives and sessions we are in the process of creating for our 2008 program. At Cato University you'll spend high-quality time with some of the best speakers (and minds!) in the country, in the company of fellow participants who share your love of freedom.

For details and registration WWW.CATO-UNIVERSITY.ORG

CATO INSTITUTE • WWW.CATO-UNIVERSITY.ORG

PHOTO: Poolside at the Rancho Bernardo Inn

"To Be Governed..."

THE WISDOM OF 13-TERM INCUMBENTS THAT TERM LIMITS WOULD DENY US

Congresswoman Marcy Kaptur came to a House committee hearing on Thursday prepared to ask U.S. Treasury Secretary Henry Paulson tough questions about his involvement in the subprime mortgage crisis.

Unfortunately, she was questioning the chairman of the Federal Reserve.

The Ohio Democrat, at a House of Representatives Budget Committee hearing, said she wanted to know what Wall Street firms were responsible for the securitization of subprime mortgages.

She then asked: "Seeing as how you were the former CEO of Goldman Sachs . . ." But the only person testifying at the hearing interrupted.

"No, no, no, you're confusing me with the Treasury Secretary," said Federal Reserve Chairman Ben Bernanke.

—**Reuters,** Jan. 17, 2008

THE TROTSKYITES PREFER TO BE CALLED NEOCONSERVATIVES, THANK YOU

[Sen. John] McCain said he's hoping for a large turnout and support from independents and Democratic voters who helped him win the Michigan primary eight years ago.

"We're depending on Republicans, Democrats, independents, Libertarians, vegetarians, Trotskyites," said a relaxed McCain.

—***Detroit News,*** Jan. 15, 2008

ALL THOSE WHO'D LIKE TO LIVE IN RWANDA, CUBA, OR VIETNAM, RAISE YOUR HANDS

In the current U.S. Congress, women account for only 16.3% of the members: 16 of 100 in the Senate and 71 of 435 in the House of Representatives. Eighty-four nations have a greater percentage of female legislators than the U.S., including our neighbors Mexico and Canada, as well as Rwanda, Vietnam and Cuba.

—***Parade,*** Dec. 16, 2007

A BULLET WE DODGED

[Rudolph] Giuliani managed a friend's campaign that year, hiring a U-Haul with a loudspeaker to cruise outside the school, but his highest office was hall monitor. He seemed to enjoy wearing a badge and disciplining students for minor infractions, such as talking during a fire drill.

—***Newsweek,*** Dec. 3, 2007

"EXPROPRIATE" MIGHT BE THE MORE ACCURATE VERB

Assembly Speaker Fabian Nuñez (D-Los Angeles) said lawmakers would have to consider raising a host of taxes, including those on Internet purchases and on foreign companies that do business in California.

"We've got to close those tax loopholes," Nuñez told reporters at a news conference. "We can generate billions by doing that."

—***New York Times,*** Nov. 13, 2007

THE SUPREME COURT SHOULDN'T STRIKE DOWN LAWS THE PEOPLE FAVOR, LIKE SEGREGATION, MISCEGENATION, SODOMY, AND INTERNET CENSORSHIP LAWS

Last March, the District of Columbia saw judicial activism replace the will of the people....

More than 30 years ago, the elected representatives on the D.C. City Council decided to enact a system of strict gun laws to help protect public safety. The people in D.C. strongly support these laws....

[The Court of Appeals] imposed their own policy preferences on the people of D.C.

It was a textbook example of judicial activism at its worst....

—**Paul Helmke in the *Atlanta Journal-Constitution,*** Nov. 27, 2007

JIMMY CARTER STILL DOESN'T UNDERSTAND ECONOMICS

I am still a cotton farmer, and I have been in the fields in Mali, where all the work is done by families with small land holdings. Cotton production costs 73 cents per pound in the United States and only 21 cents per pound in West Africa, so American farmers do need protection in the international marketplace.

—**Jimmy Carter in the *Washington Post,*** Dec. 10, 2007

CATO POLICY REPORT
1000 Massachusetts Ave., N.W.
Washington, D.C. 20001

ADDRESS SERVICE REQUESTED