



JEFFREY MIRON

Conference on financial crisis

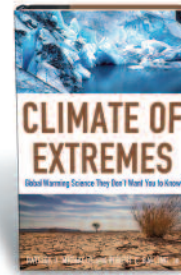
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The Return Of Big Government?

BY DAVID BOAZ

It's been a long time since a U.S. election generated feelings of actual joy beyond the ranks of partisan activists. If Barack Obama hasn't yet ushered in a new "era of good feelings," all Americans can take pride in the demise of yet another glass ceiling in a nation conceived in liberty and dedicated to the proposition that all of us are created equal, entitled to the inalienable rights of life, liberty, and the pursuit of happiness.

Indeed, we can take some satisfaction in observing that something normal happened: A party that had given Americans a long war and an economic crisis, led by a strikingly unpopular president, was defeated. Republican government requires that failed parties be turned out of office. The American Founders believed firmly in the principle of rotation in office. They thought that even successful officeholders should go back home to live under the laws after a short period in office. No doubt more members of the 110th Congress would have been given that privilege were it not for the vast

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DAVID BOAZ is executive vice president of the Cato Institute, author of *Libertarianism: A Primer* and *The Politics of Freedom*, and editor of the new *Cato Handbook for Policymakers*, from which this article is drawn.



Charles Murray tapes a podcast on his new book, *Real Education: Four Simple Truths for Bringing America's Schools Back to Reality*, before his October 8 Cato Policy Forum. Murray challenged the conventional wisdom that "everyone should go to college." His remarks at the forum can be found in audio or video at www.cato.org/events (click Event Archives), and daily podcasts can be found in the upper right corner of the Cato Institute homepage.



BY DAVID BOAZ

“Libertarians care about more than economics, and there are issues where Obama could appeal to us.”

Editorial Hoping for Freedom

After the 1968 election, the *Washington Post* cartoonist Herblock, who had always depicted Richard Nixon with a heavy five o'clock shadow, climbing out of a sewer, showed him in a barber's chair with a sign reading "THIS SHOP GIVES EVERY NEW PRESIDENT OF THE UNITED STATES A FREE SHAVE." Although we haven't treated the new, young president the way Herblock had treated Nixon, I'm adopting the same policy. I'm going to hope for the best from President Obama.

In that spirit I note that Barack Obama wants to be a consequential president. And as David Friedman noted to me the other day, one way to achieve that would be to reshape the political landscape in America by pulling fiscally conservative, socially liberal voters into the Democratic party and leaving the Republican party with only its socially conservative base. It's a tall order, and Obama's economic policies seem likely to make it impossible.

But libertarians care about more than economics, and there are issues where Obama could appeal to us.

Iraq. Obama first found favor on the campaign trail for his early and firm opposition to the war in Iraq. I hope he will move promptly to extricate American troops from Iraq and begin a process of military disengagement from the Middle East. If the experience with the Iraq war leads policymakers to a greater skepticism about military force, perhaps his administration will also find a peaceful solution to the growing tensions with Iran.

Cuba. Obama comes to power as the world's longest-serving dictator, Fidel Castro, reaches the end of his reign. Perhaps he could team up with people like Sen. Mike Enzi, Rep. Jeff Flake, and younger Cuban-Americans to end the failed embargo and restore normal trade relations with our neighbor.

Executive power. During his campaign Obama promised to reverse the sweeping claims of executive authority made by the Bush-Cheney administration. He said, for instance, "The President does not have power under the Constitution to unilaterally authorize a military attack in a situation that does not involve stopping an actual or imminent threat to the nation. . . . I reject the Bush Administration's claim that the President has plenary authority under the Constitution to detain U.S. citizens without charges as unlawful enemy combatants." Campaigning in the Mountain West, he declared that libertarians should support him on the basis of concerns about such policies as warrantless wiretaps. With some skepticism that any actual president will give up any of the powers of his office, we look forward to his fulfilling these commitments.

Immigration. Immigrants are a source of economic and social vitality for the United States, as they have been throughout our history. It will take real political

skills to bring about secure borders, legalization of people already living and working here, and a workable system for continued labor flows. However, with the economy slowing, this might be an opportunity to make progress on the issue, and a 2002 Cato study, "Willing Workers," lays out a way forward.

Guantanamo. The Obama administration should repudiate the claim that America is a battlefield and work with Congress to restore habeas corpus, close the Guantanamo prison, and repeal the Military Commissions Act. That would go a long way toward persuading some libertarians that freedom might be safer in Democratic than Republican hands.

A middle-class tax cut. It's not a good idea to raise taxes on the most successful people in America, people who generate innovation, investment, job creation, and economic growth, so libertarians are going to fight the Obama administration if it tries. But candidate Barack Obama insisted every day that he would cut taxes for 95 percent of Americans, and polls showed that he persuaded most of them. If he does retain or reduce the current tax rates for most Americans—without all the social-engineering tax gimmicks that he called "tax cuts" on the campaign trail—then he'll find a lot of support.

Drug policy reform. It is long past time that we recognized the failure of drug prohibition. Voters are ahead of elected officials on this issue. In more than a dozen states, the people have voted to allow the use of marijuana for medical purposes or even to decriminalize marijuana. Marijuana outpolled Obama in both Michigan and Massachusetts this year. Congress and the administration should stop federal interference with state marijuana law initiatives and reform or repeal mandatory minimum sentences. Beyond that, the president-elect is not the only national leader who has acknowledged youthful drug use. Presumably neither he nor his colleagues thought that their lives or their communities would have been improved had they been incarcerated. Could he not lead a thoughtful debate on whether prohibition is working? He could start with a blue-ribbon commission to review the budgetary, social, and health costs and benefits of prohibition.

Barack Obama's election has given hope to a lot of people who would like to see a freer, more open society. With policies like these he could turn that hope into reality. I hardly dare hope that he'd also promote free trade, lower taxes for all, a competitive marketplace, and economy in government—but if the Republicans are going to give us bigger government, couldn't the Democrats pick up the smaller-government banner?

Wedding Bells



The Cato Institute recently celebrated another staff wedding. Justin Logan, associate director of foreign policy studies, has married former Cato employee Jessica Guido. Logan was a research assistant in foreign policy studies when he met Guido, then an accounting clerk, in 2005.

Prompted by Cato Cupid/Constitutional Studies research assistant Madison Kitchens, Guido accepted a dinner invitation from Logan and the pair promptly hit it off. Guido and Logan coasted to the altar in August 2008. Mr. and Mrs. Logan currently make their home in Chicago, where Justin will soon finish an MA degree in International Relations at the University of Chicago.

For earlier wedding photos, see the July/August 2003, March/April 2005, and July/August 2005 issues of *Cato Policy Report*.

Cato News Notes



The Cato Institute is pleased to name **VIRGINIA ANDERSON** chief information officer. Anderson has been with the Cato Institute since 1998, overseeing the growth of www.cato.org and its affiliate websites, from their earliest html incarnations to their current, content-rich form. In her new capacity as CIO she will continue to oversee Cato's web presence, as well as manage Cato's information technology services and web-based outreach efforts.

TAD DEHAVEN has rejoined the Cato Institute as a budget analyst. Formerly a research assistant at Cato, he has since served as deputy director of the Indiana Office of Management and Budget and as a policy analyst at the National Taxpayers Union. DeHaven has also worked as a policy adviser to senators Jeff Sessions (R-AL) and Tom Coburn (R-OK).

DAVID H. RITGERS has joined the Cato Institute as a legal policy analyst concentrating on civil liberties, counterterrorism, and criminal justice. Prior to joining Cato, Rittgers served in the United States Army as an Infantry and Special Forces officer, including three tours in Afghanistan. During his military career, he was awarded an Army Commendation Medal with a "V" Device for valorous action and two Bronze Star Medals. He earned his JD from the University of North Carolina.

SWAMINATHAN S. ANKLESARIA AIYAR, a research fellow at the Cato Institute's Center for Global Liberty and Prosperity and a columnist for the *Times*



of India, was awarded second prize in the International Policy Network's annual Bastiat Prize for Journalism. The prize was developed to encourage and reward writers whose published works promote the institutions of a free society: limited government, rule of law brokered by an independent judiciary, protection of private property, free markets, free speech, and sound science. First place in the 2008 judging went to Bart Hinkle of the *Richmond Times-Dispatch*. Other

finalists included Tyler Cowen of George Mason University and the *New York Times* and Fraser Nelson of the London *Spectator*. Judges included Anne Applebaum of the *Washington Post*, Brian Carney of the *Wall Street Journal*, author Amity Shlaes, and Nigel Lawson, who served as chancellor of the exchequer in Margaret Thatcher's government. Swami Aiyar has been called "India's leading economic journalist" by Stephen Cohen of the Brookings Institution. The columns for which he won the award examined how foreigners have improved Indian living standards, the relationship between financial crisis and greater equality, and how the lack of development planning has led to high growth in India.



Cato president Ed Crane welcomed an overflow crowd to the Wintergarden for cocktails on election night. Vice President Gene Healy, author of *The Cult of the Presidency*, offered some remarks on why we expect too much from presidents and why we're always disappointed, with special reference to the burgeoning Cult of Obama.

Cato Institute foreign policy analyst MALOU INNOCENT traveled for three weeks with Cato intern and Pakistani native BASIM KAMAL through the Islamic Republic of Pakistan as part of her research for a study and a book in progress. She interviewed more than two dozen politicians, generals, journalists, and intelligence agents. Here she interviews ISHRAT UL EBAD KHAN, the governor of Sindh province (left).



WILLIAM A. NISKANEN (right), Cato's chairman emeritus and distinguished senior economist, signed copies of his new book, *Reflections of a Political Economist*, at a reception held at Cato in conjunction with the nearby meeting of the Southern Economic Association. The book includes essays on taxation, health care, terrorism and military preparedness, and corporate governance and critiques of other notable economists, including Paul Krugman, Mancur Olson, James M. Buchanan, and Alan Greenspan.



TONY LEON, a leader of the parliamentary opposition to the Nationalist apartheid government and then the ANC government in South Africa, was a Cato visiting fellow in the fall. Here he speaks at a Cato Policy Forum, “The State of Freedom in Africa.” Also speaking at that forum was the courageous Ugandan journalist ANDREW MWENDA, shown here recording a podcast interview with multimedia producer CALEB BROWN, the voice of *CatoAudio* and Cato’s daily podcast.



JAMES GWARTNEY, coauthor of *The Economic Freedom of the World*, discusses the findings of the 2008 report at a November 24 Policy Forum. One striking finding: Economic freedom around the world remains on the rise, but it has declined notably in the United States since the year 2000.



At an October 10 Policy Forum, ROBERT B. LAUGHLIN, Nobel Laureate in Physics and author of *The Crime of Reason and the Closing of the Scientific Mind*, argues that intellectual property laws and government security demands are increasingly restricting access to the most useful information.

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incumbent protection complex of laws and regulations and subsidies.

George W. Bush and the Republicans promised choice, freedom, reform, and a restrained federal government. As far back as the Contract with America in 1994, congressional Republicans pledged “the end of government that is too big, too intrusive, and too easy with the public’s money.” But over the past eight years they delivered massive overspending, the biggest expansion of entitlements in 40 years, centralization of education, a war that has lasted longer than World War II, an imperial presidency, civil liberties abuses, the intrusion of the federal government into social issues and personal freedoms, and finally a \$700 billion bailout of Wall Street that just kept on growing in the last month of the campaign. Voters who believe in limited government had every reason to reject that record.

At the Cato Institute we stand firmly on the principles of the Declaration of Independence and the Constitution, and on the bedrock American values of individual liberty, limited government, free markets, and peace. And throughout our 32 years we have been willing to criticize officials of both parties when they sought to take the country in another direction. We published papers critical of President Clinton’s abuse of executive authority, his administration’s misguided antitrust policies, his nation-building experiments, and his unwillingness to take on corporate welfare. Our analysts were among the first to point out the Bush administration’s profligate spending, as well as the administration’s policies on executive power, habeas corpus, privacy, expansion of entitlements, the federal marriage amendment, and the misbegotten war in Iraq.

But we have also been pleased to work with administrations of both parties when they seek to expand freedom or limit government—with the Clinton administration on free trade, welfare reform, and a few tentative steps toward Social Security reform; with the Bush administration on tax cuts, the initial response to the 9/11

“At this point it is important that the recent emergency measures be recognized as just that: emergency—if not panic—measures and not long-term policy.”

attacks, health savings accounts, immigration reform, and Social Security accounts. We look forward to opportunities to work with the Obama administration when it moves to reverse the worst mistakes of the Bush years or otherwise to advance policies that would enhance peace, freedom, and prosperity.

The Current Crisis

In the current economic crisis, our first task is to understand it and its causes. This was a crisis caused by regulation, subsidization, and intervention, and it won’t be cured by more of the same. Christopher Hitchens had a point when he wrote, “There are many causes of the subprime and derivative horror show that has destroyed our trust in the idea of credit, but one way of defining it would be to say that everybody was promised everything, and almost everybody fell for the populist bait.”

The backdrop is central banking and implicit federal guarantees for risky behavior. The Federal Reserve Board creates money and adjusts interest rates, so any notion that our financial system was an example of *laissez-faire* fails at the start. Meanwhile, Congress and regulators pushed Fannie Mae and Freddie Mac to become a vast duopoly in the mortgage finance industry. Their debt was implicitly backed by the U.S. Treasury, and they were able to expand their debt and engage in risky transactions. As Lawrence Summers wrote, “Little wonder with gains privatized and losses socialized that the enterprises have gambled their way into financial catastrophe.”

There was substantial agreement in Washington that homeownership was a good thing and that more homeownership would be even better. Thus Congress and

regulators encouraged Fannie, Freddie, and mortgage lenders to extend credit to underqualified borrowers. To generate more mortgage lending to low- and moderate-income people, the federal government loosened down-payment standards, pressured lenders to increase their percentages of “affordable” loans, and implicitly guaranteed Fannie and Freddie’s dramatic expansion. All that hard work paid off: The share of mortgages classified as non-prime soared, and the quality of those loans declined. And Federal Reserve credit expansion helped to make all of this lending possible, as Lawrence H. White wrote in his Cato Briefing Paper, “How Did We Get into This Financial Mess?”

“Everybody was promised everything”—cheap money, easy lending, and rising home prices. All that money and all those buyers pushed housing prices up sharply. But all good things—at least all good things based on unsustainable policies—must come to an end. When housing prices started to fall, many borrowers ran into trouble. Financial companies threatened to fall like dominos, and an ever-expanding series of bailouts began issuing from the Treasury department. And instead of the usual response to businesses that make bad decisions—let them go into bankruptcy or reorganization and let their workers and assets go to more effective companies—the federal government stepped in to keep every existing enterprise operating.

At this point it is important that the recent emergency measures be recognized as just that: emergency—if not panic—measures and not long-term policy. Congress should turn its attention to extricating the government from financial firms and basing long-term policies on a clear diagnosis of what went wrong. Congress should repeal the Community Reinvestment Act and stop pressuring lenders to make loans to underqualified borrowers. The Treasury should use its authority as conservator to liquidate Fannie Mae and Freddie Mac. The federal government should refrain from using its

equity investments in companies to exercise power over their operations and should move with all deliberate speed to withdraw from corporate ownership.

One lesson of the credit crisis is that politicians prefer to “promise everybody everything”—low interest rates, affordable mortgages, higher housing prices, lower gas prices, a chicken in every pot. That’s why it’s important to keep politics out of such matters.

The End of Libertarianism—or a New Beginning?

Various pundits and public figures have claimed that the credit crisis means “the end of libertarianism” or even more dramatically “the end of American capitalism.” As noted above, the crisis can hardly be considered a failure of laissez-faire, deregulation, libertarianism, or capitalism, since it was caused by multiple misguided government interventions into the workings of the financial system. It was and is precisely a failure of interventionism.

But could capitalism or libertarianism come to an end despite the facts? After all, the Great Depression was primarily caused by poor Federal Reserve policy and high tariffs. But a false impression that it was somehow caused by laissez-faire led to New Deal policies (pursued first by Herbert Hoover and then by Franklin D. Roosevelt) that turned a contraction into the Great Depression. What policies? Restrictive banking regulations, increases in top marginal tax rates, interventions to keep wages and prices from adjusting, and government rhetoric and activism that created (in the words of historian Robert Higgs) “pervasive uncertainty among investors about the security of their property rights in their capital and its prospective returns.” That set of policies lengthened the Great Depression by eight years or more and is uncomfortably similar to recent and proposed policy responses to the 2008 credit crisis.

In *Newsweek*, Jacob Weisberg declared that the financial crisis is “the end of libertarianism.” But it was in fact “progressive”

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interventionism that caused the crisis—just the economic philosophy that Weisberg supports. So if one big failure can kill an ideology, then let’s hear it for “the end of interventionism.”

If this crisis leads us to question the “American-style capitalism” in which a central monetary authority manipulates money and credit, the central government taxes and redistributes \$3 trillion a year, huge government-sponsored enterprises create a taxpayer-backed duopoly in the mortgage business, tax laws encourage excessive use of debt financing, and government pressures banks to make bad loans—well, it might be a good thing to reconsider that “American-style capitalism.” Or indeed, as a *Washington Post* editorial put it in October, “Government-sponsored, upside-only capitalism is the kind that’s in crisis today, and we say: Good riddance.”

Libertarianism calls for freedom and responsibility, free markets and civil liberties, a minimal government that stays out of both boardrooms and bedrooms. Obviously libertarianism wasn’t in the driver’s seat in either the Clinton or the Bush administration.

Even if there are misperceptions about the causes of the crisis, both the system of capitalism and the idea of libertarianism are going to have more staying power than pundits such as Weisberg would like. There was a time when half the world rejected capitalism, and leading intellectuals in the “free world” worried that the centrally planned economies would obviously out-compete the capitalist countries and that “convergence” on some sort of half-capitalist, half-socialist model was the wave of the future. But after the world got a look at the results of the two systems in East and West

Germany, North and South Korea, Hong Kong and Taiwan and China, the United States and the Soviet Union, it became clear that socialism is a clumsy, backward-looking prescription for stagnation at best and tyranny at worst.

Meanwhile, the half-planned economies of the West—Great Britain, New Zealand, the United States, and more—developed a milder version of economic sclerosis. Starting in the 1970s many of those countries began eliminating price controls, removing restrictions on market competition, opening up the economy, cutting tax rates, and reducing trade barriers. It came to be widely recognized—eventually on both sides of the Iron Curtain—that private property and markets are indispensable in organizing a modern economy. A nearly simultaneous cultural revolution opened up society. Women, racial minorities, and gays and lesbians entered the mainstream of society throughout the Western world. Art, literature, and lifestyles became more diverse and more individualized. The Sixties and the Eighties both led us to what Brink Lindsey in *The Age of Abundance* called “the implicit libertarian synthesis” of the United States today.

Some people see a future of ever more powerful government. Others see a future of greater freedom. *Reason* editors Nick Gillespie and Matt Welch write: “We are in fact living at the cusp of what should be called the Libertarian Moment, the dawning of . . . a time of increasingly hyper-individualized, hyper-expanded choice over every aspect of our lives. . . . This is now a world where it’s more possible than ever to live your life on your own terms; it’s an early rough draft version of the libertarian philosopher Robert Nozick’s ‘utopia of utopias.’ . . . This new century of the individual, which makes the Me Decade look positively communitarian in comparison, will have far-reaching implications wherever individuals swarm together in commerce, culture, or politics.”

Is it possible that Congress will choose to pursue policies—tax increases, yet higher spending, continued subsidies for risky

“If one big failure can kill an ideology, then let’s hear it for the ‘the end of interventionism.’”

decisions, intrusion into corporate decisionmaking—that would slow down U.S. economic growth, perhaps make us more like France, with its supposedly kinder, gentler capitalism and its GDP per capita of about 75 percent of ours? Yes, it’s possible, and clearly there are proposals for such policies. But if we want economic growth—which means better health care, scientific advance, better pharmaceuticals, more leisure opportunities, a cleaner environment, better technology; in short, more wellbeing for more people—there is no alternative to market capitalism. And if we want more growth, for more people, with wider scope for personal choice and decisionmaking, libertarian policy prescriptions are the roadmap.

A Libertarian Agenda

Beyond the immediate financial crisis, there are many more issues confronting us. Fiscal reform, for instance. Federal spending increased by more than a trillion dollars during the Bush years, or more than 70 percent (even before the budget-busting bailout and stimulus packages). The national debt rose even more sharply, from \$5.727 trillion to more than \$10.6 trillion, or an increase of more than 85 percent. The 2009 budget deficit may exceed \$1 trillion. Trends like this are unsustainable, yet elected officials continue to promise more spending on everything from new weaponry to college tuitions. Congress and the administration must find a way to rein in this profligacy.

The current rates of spending don’t yet reflect the acceleration of entitlement

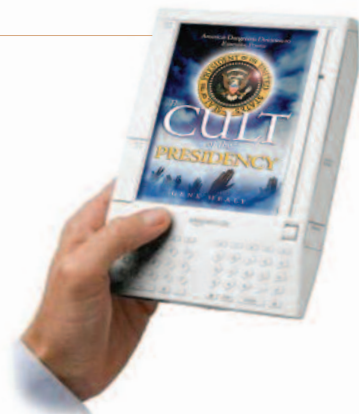
spending as the baby boomers start retiring. Entitlements are already about 40 percent of the federal budget. In 20 years they may double as a share of national income. The unfunded liability of Social Security and Medicare is now over \$100 trillion, an unfathomably large number. Within barely a decade, the two programs will require more than 25 percent of income tax revenues, in addition to the payroll taxes that currently fund them. Congress needs to think seriously about this problem. Are members prepared to impose the tax burden necessary to fund such levels of transfer payments? Do we want that many Americans dependent on a check from the federal government? Eventually, the projected level of entitlements will not be feasible. It would be best to start now to make changes rationally rather than in a panic a few years from now.

Private property, free markets, and fiscal restraint are important foundations for liberty, and the party that claims to uphold those values has done a poor job of it lately. But there are restrictions on liberty beyond the realm of taxes and regulations. We hope that elected officials of both parties will recognize the dangers of censorship, drug prohibition, entanglement of church and state, warrantless wiretapping,

indefinite detention, government interference with lifestyle and end-of-life choices, and other such policies. Americans declared in 1776 that life, liberty, and the pursuit of happiness are inalienable rights, and in 1787 they wrote a Constitution that empowers a limited government to protect those rights.

Fidelity to those founding principles of respect for civil liberties and limited government may be easy when times are easy. The true test of our faith in those principles comes when we are beset by diabolical assaults from without and economic turmoil within, when public anxiety may temporarily make it seem expedient to put those principles aside. The importance of paying scrupulous deference to the Constitution’s limits on federal power, of respecting its careful system of checks and balances, is greatest precisely when the temptation to flout them is strongest.

For those who go into government to improve the lives of their fellow citizens, the hardest lesson to accept may be that Congress should often do nothing about a problem—such as education, crime, or the cost of prescription drugs. Critics will object, “Do you want the government to just stand there and do nothing while this problem continues?” Sometimes that is exactly what Congress should do. Remember the ancient wisdom imparted to physicians: First, do no harm. And have confidence that free people, left to their own devices, will address issues of concern to them more effectively outside a political environment. ■



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Lessons from the Subprime Crisis

On the front page and atop every policymaker's agenda is the ongoing financial crisis. Is the United States heading for a recession? If so, how bad will it be? What should policymakers do about it? What shouldn't they do? Economists wrestled with those questions at the 26th Annual Monetary Conference, an all-day event held on November 19 at Cato's F. A. Hayek Auditorium in Washington, DC. Panelists offering varied perspectives and prescriptions ranged from Austrian economists to the vice chairman of the Federal Reserve Bank.

GERALD P. O'DRISCOLL JR., Cato Institute:

We remain in an economic crisis and financial crisis, one that Gary Gorton has named "The Panic of 2007." Monetary policy has played a pivotal role. Under Greenspan and now Ben Bernanke, the Fed has conducted monetary policy so as to foster moral hazard among investors, notably in housing. Not money alone, for the crisis is the product of a "perfect storm" of misguided policy. Policies to encourage affordable housing fostered the growth of subprime lending and complex financial products to finance that lending. Regardless of the desirability of the social goal, the financial superstructure depended on housing prices never falling. Housing prices do fall sometimes, and did so decisively beginning in 2007.

It is a myth that unregulated financial capitalism failed and new regulation is needed. Aside from health care, financial services is the most heavily regulated industry in the economy. No part of it completely escaped regulation and most parts were heavily regulated, typically with multiple government agencies overseeing the activities of financial services firms.

There was no financial deregulation during the boom of 2002–2007. The last legislative deregulation occurred in 1999 during the Clinton administration. The most significant change it wrought was to permit commercial and investment banks to combine into universal banks. (In reality, the statute legalized and regularized activities

already in place.) All such entities, such as Citigroup and JP Morgan Chase, have survived the debacle. Stand-alone investment banks, the legacy of the Glass-Steagall Act, have fared much worse. Of the five major investment banks operating at the beginning of 2008, Merrill Lynch merged with a commercial bank, Bank of America; the Fed financed and arranged for the shotgun marriage of Bear Stearns with JP Morgan Chase; Lehman failed; and Goldman Sachs and Morgan Stanley each sought protection by transforming themselves into bank holding companies. Born in one crisis, Glass-Steagall's 75-year-old separation of commercial and investment banking was undone by another.

Regulation certainly failed, but not for lack of quantity. Financial services regulation pretty much functioned as public choice economists would have predicted: agencies were largely captured by the industries they regulate. It is unclear how adding more regulation would change that outcome.

ANNA J. SCHWARTZ, National Bureau of Economic Research:

The disruption of credit flows can be traced to the asset price bubble in housing. It has become a cliché to refer to an asset boom as a mania. The cliché, however, obscures why ordinary folk become avid buyers of whatever object has become the target of desire. An asset boom is propagated by an expansionary monetary policy that lowers interest rates and induces

borrowing beyond prudent bounds to acquire the asset.

The Fed was accommodative too long from 2001 on and was slow to tighten monetary policy, delaying tightening until June 2004 and then ending the monthly 25-basis-points increase in August 2006. The rate cuts that began on August 10, 2007, and escalated in an unprecedented 75-basis-points reduction on January 22, 2008, were announced at an unscheduled video conference meeting a week before a scheduled FOMC meeting. The rate increases in 2007 were too little and ended too soon. This was the monetary policy setting for the housing price boom.

The federal government encouraged the housing boom by stimulating demand for houses. Congress was more than a bit player in this campaign. Beginning in 1992 Congress pushed Fannie Mae and Freddie Mac to increase their purchases of mortgages going to low- and moderate-income borrowers. In 1996, the department of Housing and Urban Development, gave Fannie and Freddie an explicit target: 12 percent of their mortgage financing had to go to borrowers with incomes less than 60 percent of their area's median income. That number was increased to 20 percent in 2000 and 22 percent in 2005. The 2008 goal was to be 28 percent. Between 2000 and 2005, Freddie and Fannie met those goals every year. They funded hundreds of billions of dollars worth of loans, many of them subprime and adjustable-rate loans made to borrowers who bought houses with less than 10 percent down. Fannie and Freddie also purchased hundreds of billions of subprime securities for their own portfolios to make money and help satisfy HUD affordable-housing goals. Fannie and Freddie were important contributors to the demand for subprime securities. Congress designed Fannie and Freddie to serve both their investors and the political class. Demanding that Fannie and Freddie do more to increase home ownership allowed Congress and the White House to subsidize low-

income housing outside of the budget, at least in the short run.

Unfortunately, that strategy remains at the heart of the political process, and of proposed solutions to this crisis.

DONALD L. KOHN, Federal Reserve Board:

The identification of bubbles in real time is tricky because not all of the fundamental factors driving asset prices are directly observable; thus, any judgment by a central bank that an asset is overpriced is by nature uncertain. My views on this aspect of the identification problem have been reinforced by my experience during the inflation of the housing bubble. Over the first half of the decade we saw a sustained, rapid rise in both home values and mortgage debt. As this process continued, concern about its sustainability grew and many observers started speculating that a bubble was in place. During this period, staff throughout the Federal Reserve System examined whether house prices were overvalued and arrived at a wide range of answers. For example, one set of models that linked rental rates and house prices indicated as early as the start of 2004 that the market was significantly overvalued, while another set of models suggested, even as late as December 2005, that house prices could be justified by fundamentals. Thus, controversy over the existence of a bubble persisted almost right up to the actual peak in the housing market.

BERT ELY, Ely & Company:

The greatest single factor contributing to overleveraging by individuals is the tax deductibility of home mortgage interest and, for corporations, the combination of the tax deductibility of interest paid on debt and the double-taxation of dividends—once at the corporate level and again at the individual level. Given this tax-code favoritism toward debt, it is hardly surprising that individuals will borrow a much higher percentage of a home purchase price than would be the case if mortgage interest was not tax-deductible.

There may not be a direct cause-and-effect, but one cannot help but notice that the net international investment position

of the United States declined from a positive \$67 billion at the end of 1985 to a negative \$2.44 trillion at the end of 2007. One can reasonably wonder about the relationship between the 1986 Tax Act, the tremendous \$5.6 trillion growth of home mortgage debt since then, the decline in the U.S. savings rate from almost 10 percent of disposable personal income in 1985–87 to slightly negative in the 2005–07 period, and the United States’ emergence as the world’s



Gerald P. O'Driscoll Jr.

“Financial services regulation pretty much functioned as public choice economists would have predicted: agencies were largely captured by the industries they regulate.”

largest debtor nation. Two other pieces of housing data also show the possible impact of the increased tax-deductible, mortgage-debt utilization by households—the 9.6 percent increase in the size of owner-occupied homes, from 1,712 square feet in 1985 to 1,876 square feet in 2007, driven by a 49.2 percent increase in the average size of a new home, from 1,544 square feet in 1985 to 2,304 square feet in 2007.

WILLIAM POOLE, Cato Institute:

Those who want more regulation should keep two facts in mind. First, regu-

lation will inevitably be bent to serve political purposes. Of course, that is exactly what some pro-regulation observers want. Before the financial crisis, many members of Congress cheered subprime mortgages because they served affordable housing goals. Second, the financial economy is inherently competitive. With access by Internet, many financial firms could relocate abroad, thus escaping federal jurisdiction.

Actions this year are creating moral hazard to an unprecedented degree; unwinding this situation will be costly. We are clearly seeing the effects already. Lehman, I believe, delayed raising capital expecting that it would receive the same sort of support Bear Stearns did. Lehman was instead permitted to fail. Investment banks have become bank holding companies so that they would qualify for Federal Reserve resources. There are reports that GMAC is trying to convert to a bank charter to become eligible for Fed support and for the Treasury’s capital infusion program for banks. Auto companies are asking for access to the \$700 billion TARP fund.

The Federal Reserve and federal government need to move quickly to limit which firms have access to government resources. The Federal Reserve should put a moratorium on all conversions of corporate charters to commercial bank charters. Congress should refuse to bail out any more firms; weak firms should be required to seek protection under the bankruptcy law. The clear fact is that the greater the number of firms bailed out in coming quarters, the greater will be the number of applicants for bailouts. I see no way to decide which firms are “deserving” of a bailout and which are not.

It appears that the federal government will operate Fannie Mae and Freddie Mac for the indefinite future. Fannie and Freddie have increased their market share over the past 20 years and this trend is likely to continue until the entire mortgage market is effectively federalized. Fannie and Freddie rules on what mortgages can be securitized will control the structure of mortgages. These rules will

stifle innovation and prevent emergence of strong private competitors. The only way around this prospect is to phase out Fannie and Freddie over time.

LAWRENCE H. WHITE, University of Missouri-St. Louis:

The Federal Reserve's new interventions into financial markets over the past year have proceeded at its own initiative, without precedent, and without congressional oversight. None of the new lending facilities have anything to do with acting as a lender of last resort in the traditional sense. Through all the recent turmoil there has been no threat of a shrinking money stock, and only one run on a commercial bank, Indy Mac. Investment banks do not issue checking deposits, are therefore not subject to depositor runs, and are not part of the payment system. Neither are securities dealers. The Fed's expansions of its own activities therefore had nothing to do with protecting the payment system or stabilizing the money supply.

The Fed's new activities instead seem to aim at protecting banks and nonbanks from the consequences of holding portfolios overweighted with mortgage-backed securities, or derivatives based on such securities, while keeping levels of capital inadequate for such portfolios. Attempting such a bailout is a worrisome role for the Fed to take on, especially at its own initiative, without oversight. That the Fed's bailout is "self-financed" does not mean that it provides a free lunch. It is ultimately financed by the Fed's power to levy an implicit tax on dollar-holders, putting us all at risk of inflationary depreciation of the dollar. Thus far, because it did not require an appropriation from Congress, the Fed's bailout efforts seem to be enjoying the complete freedom from oversight that Secretary Paulson unsuccessfully sought for the Treasury's bailout. That should change. The threat of a financial meltdown should not be the occasion for a constitutional meltdown. It is time for a public debate on the wisdom of the Fed's remarkable departure from its traditional roles.

JEFFREY M. LACKER, Federal Reserve Bank of Richmond:

The critical policy challenge for our time is to reestablish the boundaries of central bank lending and public support. In doing so, the prime directive should be that the extent of regulatory and supervisory oversight should be commensurate with the extent of access to central bank credit in order to contain moral hazard effectively. The dramatic expansion in Federal Reserve



William Poole

“The clear fact is that the greater the number of firms bailed out in coming quarters, the greater will be the number of applicants for bailouts.”

lending, and government support more broadly, has extended public sector support beyond existing supervisory reach, and thus could destabilize the financial system, absent corrective action. Re-storing consistency between the scope of government support and the scope of government supervision is essential to a healthy and sustainable financial system. One option is simply to adapt our regulatory and supervisory regime to the new wider implied reach of government lending support. This strikes me as an unattractive option, if for no other reason than the cur-

rent uncertainty about the outer bounds of that support. Constraining moral hazard in such a regime would be an immense and daunting task. I take it as given, therefore, that the scope of the financial safety net ultimately must be rolled back.

JEFFREY A. MIRON, Harvard University:

The obvious alternative to a bailout was letting troubled financial institutions declare bankruptcy. That does not mean the institutions would have disappeared; rather, they would have been bought up (at low prices) by other institutions and absorbed. It also does not mean that lending would have frozen up; if one financial institution cannot make productive loans, a profit opportunity exists for someone else. Allowing more failures, or even many failures, might well have contributed to, or at least sped up, the recession, but that would have been a price worth paying. Economies have recessions and failures; capitalism works because it allows failures. And, by letting the process of failure occur, we would reverse, to some degree, the temptation to bank on government largesse in the future. Thus, the right response was for government to do nothing at all.

ANDREW A. SAMWICK, Dartmouth University:

Though their stories seldom make the news, there were borrowers who could have afforded a new home with a subprime mortgage but not a prime mortgage who chose not to buy a home. There were banks that lost market share to mortgage originators because their lending standards precluded them from extending credit in such a risky manner. There were investors that were willing to forgo the additional yield on subprime-backed securities because the opaqueness of their design made them too risky a proposition. There were consumers who lived within their means and tried to save some money for the future, refusing to max out their credit cards or their home equity lines of credit to boost their consumption even further above their income. Those were the participants in financial markets who behaved prudently.

Continued on page 16



After a Cato Book Forum for *Gun Control on Trial: Inside the Supreme Court Battle over the Second Amendment*, author BRIAN DOHERTY (right) poses with ANDREW HANSON; his wife TRACEY AMBEAU HANSON, a plaintiff in the case; and ALAN GURA, lead counsel, who successfully argued the case all the way to the Supreme Court.



RONALD HAMOWY, Cato Fellow in Social Thought, who studied under Mises, Hayek, and Friedman, discusses *The Encyclopedia of Libertarianism* at a Cato Book Forum. The encyclopedia, edited by Hamowy, includes more than 300 succinct, original articles on libertarian ideas, institutions, and thinkers and is available at www.catostore.org.



Two days after the election, still wearing his protest sticker, economist DAVID FRIEDMAN discusses his book *Future Imperfect: Technology and Freedom in an Uncertain World* at a Cato Book Forum. Technological changes already begun, he said, could lead to more or less privacy than we have ever known, effective immortality or the elimination of our species, and radical changes in life, marriage, law, medicine, work, and play.

OCTOBER 2: Global Terror's Central Front: Pakistan and Afghanistan

OCTOBER 8: *Real Education: Four Simple Truths for Bringing America's Schools Back to Reality*

OCTOBER 10: *The Crime of Reason and the Closing of the Scientific Mind*

OCTOBER 14: *The Encyclopedia of Libertarianism*

OCTOBER 21: The State of Freedom in Africa

OCTOBER 30: *Back to Enron: Were the Wrong Lessons Learned for Corporate Governance and Energy Policy?*

NOVEMBER 6: *Future Imperfect: Technology and Freedom in an Uncertain World*

NOVEMBER 10: *Against Intellectual Monopoly*

NOVEMBER 17-18: Thirty Years of Reform: China's Path to Harmonious Development

NOVEMBER 19: 26th Annual Monetary Conference: Lessons from the Subprime Crisis

NOVEMBER 21: Cato Institute Policy Perspectives 2008

NOVEMBER 24: *How Nations Prosper: Economic Freedom and Doing Business around the World*

NOVEMBER 24: *Gun Control on Trial*

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

Cato Calendar

21ST ANNUAL BENEFACTOR SUMMIT

Riviera Maya, Mexico • Fairmont Mayakoba
March 4-8, 2009

Speakers include Charles Murray, Jorge Castañeda, and Tucker Carlson.

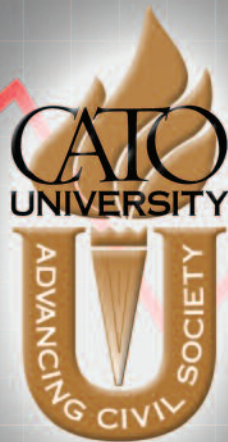
CATO UNIVERSITY

San Diego, California • Rancho Bernardo Inn
July 26-31, 2009

Speakers include David Boaz, Tom G. Palmer, Rob McDonald, Veronique de Rugy, and Robert Higgs.

CATO CLUB 200 RETREAT

Santa Barbara, California
Four Seasons
October 8-11, 2009



Economic Crisis, War, and the Rise of the State

Cato University 2009 • July 26-31, 2009 • Rancho Bernardo Inn • San Diego, CA

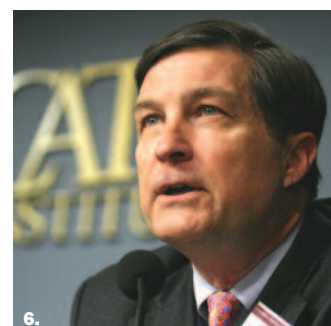
Between economic chaos and wars in Iraq and Afghanistan, the powerful drive to solve problems through government intervention is creating a dangerous new status quo. During a crisis—and now with the multiple challenges of global economic calamity roaring alongside two wars and international terrorism—government grows exponentially. Massive overreaching by government was one of chief causes of these crises, so we are witnessing a disease posing as the cure. And while government may recede after the immediate crisis recedes, it rarely returns to its original size.

But—a crisis also presents opportunities to change the status quo, to reduce the size of government. Cato University 2009 offers a one-of-a-kind opportunity to explore how the state has expanded during times of crises; the threats to liberty, privacy, and independence, as the rush for government-imposed solutions (and, hence, power) increases; and, what can be done to restrain—or reverse—its growth.

For details and registration: www.cato-university.org

Cato's 26th annual monetary conference more timely than ever

Economists Debate Roots of Financial Crisis



1. Lawrence H. White blames cheap money and federal housing regulations. **2.** Mary O'Grady of the *Wall Street Journal* asks a question, flanked by Otmar Issing, Jeffrey Lacker, Charles Calomiris, and Mickey Levy. **3.** Conference organizer James A. Dorn welcomes Clive Crook of the *Financial Times*. **4.** Jeffrey Miron of Harvard argues that failing institutions should be allowed to declare bankruptcy. **5.** Brian Wesbury, John Makin, John L. Chapman, and Lawrence White. **6.** Richmond Fed president Jeffrey Lacker argues that the new financial safety net must be rolled back.

The question of what caused the U.S. financial crisis dominated discussion at the Cato Institute's 26th Annual Monetary Conference, "Lessons from the Subprime Crisis," held on November 19 in the F. A. Hayek Auditorium. That is, if you don't count debate over what ought to be done about it.

The specter of deflation haunted Donald L. Kohn, vice chairman of the Federal Reserve Board. Deflation is a sustained drop in the price level, considered problematic because it discourages consumption and investment as would-be buyers continuously wait for a better bargain. With the federal funds rate sitting at 1 percent, it would be difficult to stimulate new economic activity with further rate cuts, he contended. Still, given the ordeal of Japan in the 1990s, Kohn said the Fed "should be very aggressive with our monetary policy, as aggressive as we can be," should deflation seem to be setting in. Otmar Issing, former member of the European Central Bank's executive board, argued that central banks can help prevent asset bubbles by closely monitoring money and credit growth and

maintaining long-run price stability.

Other panelists disagreed. Harvard University's Jeffrey Miron, echoing panelists ranging from Anna Schwartz to Cato's Gerald O'Driscoll Jr., countered that aggressive Fed rate cuts were what got us into this crisis in the first place. In particular, the Fed's easy money policies following the dot-com bust in 2001, combined with novel federal interventions in the mortgage market, led to overinvestment in that sector. New, underqualified home buyers entered the red hot market using government-encouraged subprime loans, counting on continued growth in home prices to remain in those homes. Investment banks holding mortgage-backed securities and mortgage-holding giants Fannie Mae and Freddie Mac had also banked on the continued growth in home prices, and when the housing bubble burst, all parties went under.

William Poole, senior fellow at the Cato Institute and a past president of the Federal Reserve Bank of St. Louis, said the private sector miscalculated just as badly as did the public sector, but he nonetheless urged cur-

rent policymakers to end the arbitrary and ex post bailing out of failing firms during the current crisis. Such a policy has no intrinsic limit, with new firms lining up for assistance each day, and introduces additional moral hazard when there is plenty to go around already.

Jeffrey M. Lacker, president of the Federal Reserve Bank of Richmond, stressed the need to reestablish boundaries between the public sector safety net provided by the Fed's new lending window and the market. Saying the newly established financial safety net must be "rolled back," he emphasized that in the current situation that would be a daunting task. Lawrence H. White of the University of Missouri, St. Louis, said such action must come soon, and called for a public debate on the wisdom of the Fed's "remarkable departure" from its traditional role.

Full video of the conference is available on Cato's website. Just visit www.cato.org/events/monconf2008/program.html. For *Cato Journal* subscribers, an edited version of the major policy addresses will be included in a future edition of *Cato Journal*.

What You're Missing at Cato's Websites

Each month, *Cato Unbound* presents an essay on a big-picture topic by some of the world's leading thinkers. In the latest issue, *Unbound* tackles the idea that corporations and markets are synonymous, and that what's good for the one is good for the other. Astute economists have noted that far too often, corporations act to restrict the free operation of the market. Corporations that have become successful in a free or quasi-free market don't like to face competition any more than any other entity, and their success gives



them the resources, unfortunately, to stifle would-be competitors. In these cases, corporations and governments can often find themselves in an unholy alliance against consumers, other firms, and liberty itself: corporatism, in other words—a system that seems to value corporations as an end in themselves. What's an advocate of the free market to do? You'll have to read what Roderick Long, Matthew Yglesias, Steven Horwitz, and Dean Baker have to say at www.cato-unbound.org. And don't forget! *Cato Unbound* readers are encouraged to enter into the conversation on their own websites, on their blogs, or in print.

At the recently revamped *Cato@Liberty*, Neal McCluskey, associate director of Cato's Center for Educational Freedom, assesses Barack Obama's selection of the Sidwell Friends School for his daughters' education. The school, based in Washington, DC, is prestigious—it's Chelsea Clinton's old stomping grounds—and, notably, private. McCluskey points out that Obama's opposition to vouchers and tax credits means that only a privileged elite are similarly "free to choose." Meanwhile, director of information policy studies Jim Harper looks at a fascinating new use

of online data. Google has developed a way to predict outbreaks of influenza two weeks before the Centers for Disease Control can—by tracking the search inquiries of its users. At its simplest, when a disproportionate number of people in Delaware query Google to see what they should do about their "coughing," "sniffles," and "sneezes," Google then predicts that there has been an outbreak there. Critics are charging Google with privacy violations, while Google maintains it is offering a useful service and provides no information that can be traced to any affected individual. Stay tuned on whether Google's Flu Trends will be allowed to continue.



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“Corporate power and the free market are actually antithetical; genuine competition is big business's worst nightmare.”

—RODERICK LONG,
Auburn University, at Cato Unbound
(www.cato-unbound.org).

“The chance anyone living outside a war zone will be killed by an international terrorist comes in at about 1 in 75,000—that's not per year, but over an 80 year period. The chance of dying in an automobile accident over the same interval, in distinct contrast, is about 1 in 80.”

—JOHN MUELLER,
Ohio State University, at Cato Unbound

“Neocons, one can't help but conclude, must be politically and logically bipolar, able to swing from 'no more government' to 'hell yes, more government!' in a single op-ed.”

—NEAL MCCLUSKEY,
associate director of the Center for Educational Freedom, at Cato@Liberty

“I don't know much about Arne Duncan, President-elect Obama's choice to be Secretary of Education. But I do note this: In seven years running the Chicago public schools, this longtime friend of Obama was apparently not able to produce a single public school that Obama considered good enough for his own children.”

—DAVID BOAZ,
executive vice president, at Cato@Liberty
(www.cato-at-liberty.org)

“Current per pupil spending, highest poverty city districts: \$9,901.

Current per pupil spending, lowest poverty suburban districts: \$9,455.”

—ANDREW J. COULSON,
director of the Center for Educational Freedom, at Cato@Liberty

“Keynesian economists believe that government budget deficits 'stimulate' the economy during a recession. But we've got \$1.2 trillion this year and \$800 billion next year of deficit 'stimulus' without any special 'stimulus' package. Isn't that enough?”

—CHRIS EDWARDS,
director of tax policy studies, at Cato@Liberty

Dershowitz, Posner, Friedman ponder the expanding criminal law

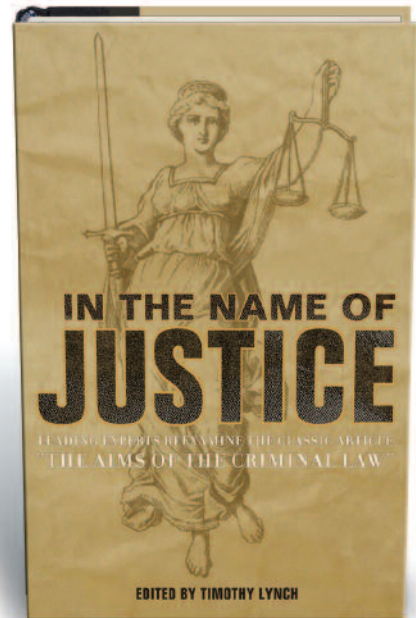
Are We All Criminals Now?

Our criminal codes are so voluminous that they bewilder not only the average citizen, but even the average lawyer. Our courthouses are so busy that there is no longer time for trials. And America now has the highest per capita prison population in the world. Are these trends desirable, satisfactory—or disturbing? *In the Name of Justice*, edited by Timothy Lynch, director of Cato's Project on Criminal Justice, consults America's leading legal experts to answer this question through a critical examination of American criminal law.

In "You're (Probably) a Federal Criminal," Alex Kozinski, chief judge of the U.S. Court of Appeals for the Ninth Circuit, points out the problems with the criminalization of almost everything. Half of Americans have tried illegal drugs, and nearly everyone has transgressed against some arcane law or another. What sanction does the "rule of law" have when almost every American is a criminal of some sort? Richard A. Posner, a judge on the U.S. Court of Appeals for the Seventh Circuit, largely concurs, adding a cost-benefit calculation to the mix: A utility-maximizing

criminal justice system would have few prohibitions but they would be strictly enforced. Such a regime would tend to deter the most heinous, anti-social acts, while allowing a great amount of freedom for the vast majority of citizens.

Alan M. Dershowitz of Harvard Law School asks whether such a regime could handle the "new reality" of suicide terrorism. When would-be terrorists are willing to kill themselves to accomplish their destructive ends, what kind of punishment could deter them? And in their contribution, Milton and Rose Friedman argue that the war on drugs has made a mockery of the criminal justice system. The criminal law is not a moral crusade but a means of deterring socially detrimental acts, yet drug use is plainly a personal matter. Legalize drugs, and street crime would drop dramatically and immediately, they contend.



Meanwhile, respect for and deference to the law would increase.

Other contributors to *In the Name of Justice* include Pepperdine public policy professor James Q. Wilson and Anthony M. Kennedy, associate justice of the U.S. Supreme Court.

Lawfully secure your copy of *In the Name of Justice* by phone at 800-767-1241 (toll-free) or online at www.catostore.org for only \$19.95.

Continued from page 11

How have those prudent actors fared in the policy response to the subprime crisis? Banks that first lost market share to reckless lenders are now seeing the government inject capital into the balance sheets of these same reckless lenders. Their net interest spreads are also being narrowed as the Fed lowers interest rates down close to zero to prop up the value of troubled assets across the economy. Households that delayed a home purchase because the prices were too high now see any number of proposals designed to prop up housing prices, keeping them out of reach and in the possession of the speculators and the profligate. Investors that stayed out of subprime-backed pools now see government pro-

grams designed to prop up the value of those pools for those who invested less wisely. Households that delayed a home purchase because the prices were too high now see any number of proposals designed to prop up housing prices, keeping them out of reach and in the possession of the speculators and the profligate. Investors that stayed out of subprime-backed pools now see government programs designed to prop up the value of those pools for those who invested less wisely. Households who didn't treat their housing equity like an ATM and faced higher prices for everyday goods and services in competition with those who did not see programs to forgive the debt being proposed. They also face negative real rates of return on their savings. And every

entity showing positive profits or higher income as a result of their prudence must also shoulder the burden of funding the trillion-dollar bailout proposals.

When the government has intervened, it has done so on behalf of the profligate at the expense of the prudent. The inevitable result is that it breeds more profligacy and less prudence in financial markets in the future. The government always has a choice in how it intervenes. From the standpoint of preventing the next crisis, it is better to let an insolvent institution fail and use the government's funds to assist those solvent institutions damaged by that failure than to use the government's funds to reward the behavior that caused the insolvency in the first place. ■

It's real, but it won't be dramatic

Global Warming: The Facts

“T ick-tick-tick-tick” chants a chorus line of young children in a recent public service ad. “Massive heat waves . . . severe droughts . . . devastating hurricanes,” the ad warns, will be the future our children will inherit if we don’t do something about climate change. We have to do something now, if not for ourselves, then for the children.

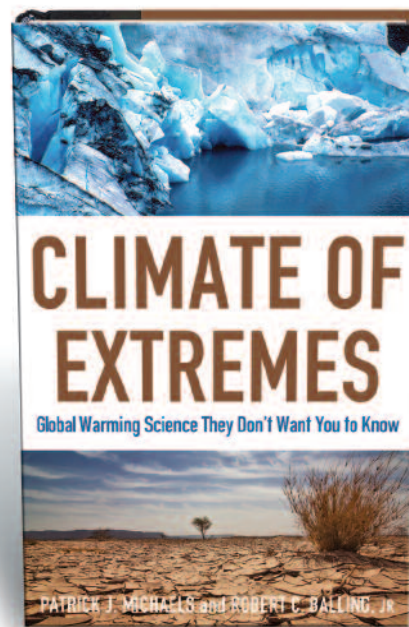
Is climate change happening? If so, how bad will it be going forward? What ought policymakers to do about it? In *Climate of Extremes: Global Warming Science They Don't Want You to Know*, Patrick J. Michaels and Robert C. Balling Jr. offer a detailed analysis of decades of climate data, ultimately concluding that climate change is happening, but its effects won't be dramatic, and the correct approach for policymakers, paradoxically, is to do nothing at all.

Compiling an impressive amount of climate data, statistical analysis, charts, graphs, and secondary material, Michaels and Balling deliver a compelling case against alarmist rhetoric, leaving little of the global warming hype untouched. Panic at “the melting ice caps” succumbs to the facts: the Eurasian arctic was considerably warmer than it is today for several millennia, and at the other pole, while some parts have gotten warmer, fully 98 percent of Antarctica has seen a net cooling over the past 35 years. And “any conclusive connection between global warming and hurricanes,” they write, “will not be made in the near term.” Meanwhile, nonclimate factors

are driving an overestimation of warming over land, ethanol production contributes more carbon dioxide to the atmosphere than gasoline per unit, and the much-touted mathematical models of future atmospheric change aren't worth the PowerPoint slides they're presented on. In short, and much to the chagrin of climate alarmists, the global warming apocalypse is nowhere on the horizon.

Climate of Extremes probably won't change the minds of many die-hard believers' views on the impending apocalypse. But Michaels and Balling make the point that such a response is to be expected. Politics, an incestuous peer review process for scientific research, career-climbing, and other factors combine to produce the dogmatic and wholly unscientific obstinacy that permeates the modern debate about climate change. But to those with an open mind and an eye for detail, *Climate of Extremes* is one of the most all-inclusive sources examining the truths behind trends in climate change and their causes and effects—a one-stop shop for all the answers to those questions that remain unaddressed, or ignored, in the ongoing debate on global warming.

Get your intellectual ammunition by ordering *Climate of Extremes* by phone at 800-767-1241 (toll-free) or online at www.catostore.org for only \$21.95 hardcover.



“A must read for anyone seriously interested in the climate change debate.”

—NIGEL LAWSON
Former UK Secretary of State for Energy

the CATO JOURNAL

Clive Crook of the *Atlantic* says *Cato Journal* is “the most consistently interesting and provocative journal of its kind,” and the Fall 2008 edition is no exception. Here's a taste of what you'll find inside:

- Does size matter? Cato research fellow **Swaminathan S. Anklesaria Aiyar** asks why small states like the Bahamas tend to economically outperform their peers among developing nations.
- U.S. policymakers are wringing their hands at the prospect of deflation, a protracted decrease in the price level. In “Aggregate Supply-Driven Deflation and Its Implications for Macroeconomic Stability,” economist **David Beckworth** addresses how a cash-strapped nation will cope

with the prospect of having to pay less for things.

■ A book review of *Heads in the Sand: How Republicans Screw Up Foreign Policy and Foreign Policy Screws Up the Democrats*, famed liberal blogger **Matt Yglesias's** first bound offering.

■ And *Cato Journal* editor **James A. Dorn** wraps things up with advice on how Chinese policymakers can avoid America's missteps on the path to prosperity in “Creating Financial Harmony: Lessons for China.”

A one-year subscription to *Cato Journal* is only \$22.00 at www.cato.org/pubs/journal.

How Does Your Governor Score?

The ninth biennial “Fiscal Policy Report Card on America’s Governors 2008” (Policy Analysis no. 624), by Chris Edwards, director of tax policy studies at the Cato Institute, examines



the tax-and-spending decisions made by the nation’s governors since 2003. Three governors were awarded an “A” in this report card—Charlie Crist of Florida, Mark Sanford of South Carolina, and

Joe Manchin of West Virginia. Eight governors were awarded an “F”—Martin O’Malley of Maryland, Ted Kulongoski of Oregon, Rod Blagojevich of Illinois, Chet Culver of Iowa, Jon Corzine of New Jersey, Bob Riley of Alabama, C. L. “Butch” Otter of Idaho, and Jodi Rell of Connecticut. Republican governors, on average, received slightly higher grades than Democratic governors. More importantly, there has been a disappointing lack of major spending reforms among governors of both parties in recent years. State tax policies have also been uninspiring. Most tax cuts pursued by the governors have been small and

targeted breaks, not broad-based rate cuts that can foster economic growth.

Popular Vote Plan Unconstitutional

The National Popular Vote plan (NPV), introduced in more than 40 states and adopted by 4, proposes an interstate compact to bring about direct election of the president of the United States. The proposal eliminates states as electoral districts in presidential elections by creating a national electoral district for the presidential election, thereby advancing a national political identity for the United States. According to “A Critique of the National Popular Vote” (Policy Analysis no. 622), by John Samples, director of Cato’s Center for Representative Government, NPV brings about this change without amending the Constitution, thereby undermining the legitimacy of presidential elections. It also weakens federalism by eliminating the role of the states in presidential contests. NPV will encourage presidential campaigns to focus their efforts in dense media markets where costs per vote are lowest; many states now ignored by candidates will continue to be ignored under NPV.

U.S. Foreign Policy after Bush

With Americans regretting the consequences of the Bush administration’s foreign policy, many are looking to the incoming administration for change. President Barack Obama has called for a greater focus on diplomacy, less military action, and an end to the “politics of fear.” But according to Justin Logan, associate director of foreign policy studies at the Cato Institute, Obama is anything but a non-interventionist. In “Two Kinds of Change: Comparing the Candidates on Foreign Policy” (Policy Analysis no. 623), he points out that Obama’s stated positions, record, and selection of foreign policy advisers indicate a leader who may or may not get America out of Iraq, and may further entangle America’s military in Pakistan, Iran, or Georgia. While it is difficult to judge a candidate before he enters office, Barack Obama’s pending presidency is unlikely to change America’s foreign policy for the better.

Bullet Trains Misfire

In the face of high energy prices and concerns about global warming, environmentalists and planners offer high-speed rail as

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an environmentally friendly alternative to driving and air travel. California, Florida, the Midwest, and other parts of the country are actively considering specific high-speed rail plans. But as attractive as 110- to 220-mile-per-hour trains might sound, these plans do not live up to the hype. In “High-Speed Rail: The Wrong Road for America” (Policy Analysis no. 625), Randal O’Toole, senior fellow at the Cato Institute, points out that a proposed line in Florida would use more energy and emit more of some pollutants than all of the cars it would take off the road. Meanwhile, California planners forecast that high-speed rail would reduce pollution and greenhouse gas emissions by a mere 0.7 to 1.5 percent there—and only if ridership reached the high end of projected levels. As mega-projects, high-speed rail plans pose serious risks for taxpayers. The California high-speed rail is projected to cost \$33–37 billion. Costs of recent rail projects in Denver and Seattle are running 60 to 100 percent above projections.

Don’t Regulate the Web

An important reason for the Internet’s remarkable growth over the last quarter century is the “end-to-end” principle that networks should confine themselves to transmitting generic packets without worrying about their contents. Not only has this made deployment of internet infrastructure cheap and efficient, it has created fertile ground for entrepreneurship. On a network that respects the end-to-end principle, prior approval from network owners is not needed to launch new applications, services, or content. In recent years, self-styled “network neutrality” activists have pushed for legislation to prevent network owners from undermining the end-to-end principle. Although the concern is understandable, Timothy Lee, an adjunct scholar at the Cato Institute, thinks such legislation would be premature. In “The Durable Internet: Preserving Network Neutrality without Regulation” (Policy Analysis no. 626), he points out that physical ownership of internet infrastructure does not trans-

late into a practical ability to control its use. Regulations are unnecessary because even in the absence of robust broadband competition, network owners are likely to find deviations from the end-to-end principle unprofitable. Meanwhile, new regulations are likely to become a barrier to entry for new broadband firms.

Fossil Fuels for Now

Rising energy prices and climate change have changed both the economics and politics of electricity. In response, over half the states have enacted “renewable portfolio standards” that require utilities to obtain some power from “renewable” generation resources rather than carbon-emitting fossil fuels. Reports of state-level success have brought proposals for a national standard, but according to Robert J. Michaels, professor of economics at California State University, state renewable portfolio standards programs are largely in disarray, and even the apparently successful ones have had little impact. In “A Federal Renewable Electricity Requirement” (Policy Analysis no. 627), he writes that California’s supposedly aggressive program has left it with the same percentage of renewable power as in 1998, and Texas’s seemingly impressive wind turbine investments produce only 2 percent of its electricity. The public may envision solar collectors but wind accounts for almost all of the growth in renewable power, and it largely survives on favorable tax treatment. Wind’s intermittency reduces its efficacy in carbon control because it requires extra conventional generation reserves.

Health Care Nightmare

Barack Obama has proposed an ambitious plan to restructure America’s health care sector. Rather than engage in a detailed critique of Obama’s health care plan, many critics prefer to label it “socialized medicine.” Is that a fair description of the Obama plan and similar plans? Over the past year, prominent media outlets and respectable think tanks have investigated that question and come to a unanimous

answer: no. But according to Michael F. Cannon, director of health policy studies at the Cato Institute, those investigations leave much to be desired. In “Does Barack Obama Support Socialized Medicine?” (Briefing Paper no. 108), he says they are little more than attempts to convince the public that policies generally considered socialist really aren’t. A reasonable definition is that socialized medicine exists to the extent that government controls medical resources and socializes the costs. By that definition, America’s health sector is already more than half socialized, and Obama’s health care plan would socialize medicine even further.

Origins of the Financial Crisis

Former Federal Reserve chairman Alan Greenspan has become everyone’s favorite scapegoat. His policies allegedly caused, or at least contributed to, the current financial crisis. He is attacked from the



left for lax financial regulation, and from the right for loose monetary policy. But according to economists David Henderson and Jeffrey Hummel in “Greenspan’s Monetary Policy in Retrospect” (Briefing Paper no. 109), although Greenspan’s policies weren’t perfect, his monetary policy was in fact tight, and his legacy is one of having overseen low and stable inflation and a striking dampening of the business cycle. Meanwhile, Lawrence H. White offers a different perspective in “How Did We Get into This Financial Mess?” (Briefing Paper no. 110). He argues that after the dot-com bust in 2001, Greenspan held rates extremely low for several years, setting off the mother of all liquidity cycles and a massive demand bubble. While the authors disagree on Greenspan’s contribution, both agree that novel federal government interventions into the economy significantly contributed to the financial crisis.

“To Be Governed...”

BAILOUTS IN ACTION

Surprisingly, the bailout money goes to the largest and, arguably, the strongest bank based in Oregon. Umpqua [Holding Corp.] has been consistently profitable and already was well-capitalized....

Umpqua is already well-capitalized, raising questions about whether the institution needed the federal money. “The bottom line is, we probably don’t,” said Ray Davis, president and CEO of Umpqua Holdings....

Umpqua’s Davis said it made sense to accept the money, which will come in handy if the bank decides to buy out a competitor.

—*Oregonian*, October 29, 2008

A PERFECT INTRODUCTION TO CONGRESS

The U.S. Capitol Visitor Center formally opens to tourists Tuesday, over budget and behind schedule.

At 580,000 square feet, it’s the largest project in the Capitol’s 215-year history. It was originally scheduled to open almost four years ago, and the \$621 million price tag is double the initial estimate.

—*National Public Radio*, December 2, 2008

PAGING NAOMI KLEIN

Obama Chief of Staff Rahm Emanuel, speaking to a *Wall Street Journal* conclave of business leaders Tuesday, said the economic crisis facing the country is “an opportunity to do things you could not do before.”

“You never want a serious crisis to go to waste,” Mr. Emanuel said.

—*Wall Street Journal*, November 29, 2008

LORD, MAKE ME CHASTE, BUT NOT YET

Former Treasury Secretary Robert Rubin, speaking at the same event, also pushed fiscal stimulus while stressing the importance of signaling concerns about the deficit. “The single most important thing we can do right now is a very large fiscal stimulus married with a commitment, once the economy is healthy again, to put in place a multi-year program to get back to a sound fiscal position,” he said.

—*Wall Street Journal*, online edition, November 17, 2008

WHEN YOU LAY OUT A PICNIC, YOU GET ANTS

[There is] an army of accountants, financial advisers, asset managers, lobbyists and others descending on Washington as part of the government’s attempts to rescue the economy and bail out industries.

Big consulting firms like PriceWaterhouseCoopers and Ernst & Young have booked extended-stay apartments and blocks of hotel rooms. Out-of-town financial experts are scouting for office space, expecting to lease it for several months as they help do work for Treasury and others.

Commercial real estate brokerage companies have pulled lawyers and salesmen who usually put together deals on downtown offices to work out loans and foreclose on properties. Some have dubbed themselves the “TARP team” after the Treasury’s Troubled Asset Relief Program created to sort through assets.

“Everything from the policies, the regulations, to the money and the contracts to do the work will be emanating

out of Washington, so people want to be here,” [lawyer Larry] Wolk said. “Wall Street has moved to K Street.”

National crises often provide a stimulus to the Washington economy....

“Firms see this as a potential gold mine,” said Anirban Basu, an economist and chief executive of Sage Policy Group in Baltimore. For Washington, “that has to translate into business sales, high-powered restaurant meals, business suit purchases, and travel and luxury hotel stays. We often talk about D.C. being different economically than the rest of the country and this is perfectly true. I don’t see much evidence of a slowdown here.”

—*Washington Post*, November 8, 2008

HEY, I HAVE THAT TOO!

Gov. [David] Paterson’s chief of staff now says he owed nearly \$300,000 in back taxes, \$100,000 more than was previously known—and his lawyer blamed the problem on “non-filer syndrome.”

—*New York Post*, October 23, 2008

CAN WE LAY THEM OFF IF THEY HAVE LESS WORK? NOT SO FAST

Never before has the U.S. Postal Service laid off workers. Now, it’s a real possibility.

“For the first time in history, that is being considered,” said Gerald McKiernan, a USPS spokesman....

McKiernan says mail volume dropped 11 percent in fiscal 2008, which ended Tuesday.

—*Washington Post*, October 3, 2008

CATO POLICY REPORT

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The logo for Cato Institute, featuring the word "CATO" in a large, bold, serif font with a slight shadow effect.