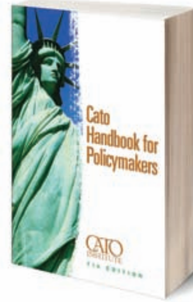
NAT HENTOFF
First Amendment defender joins Cato
PAGE 3

SUSETTE KELO
Government stole my home
PAGE 5



CATO HANDBOOK FOR POLICYMAKERS
A 688-page guide to smaller government
PAGE 17

Cato Policy Report

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Vol. XXXI No. 2

How to Turn a Recession into a Depression

BY WILLIAM A. NISKANEN

Four federal economic policies transformed the Hoover recession into the Great Depression: higher tariffs, stronger unions, higher marginal tax rates, and a lower money supply. President Obama, unfortunately, has endorsed some variant of the first three of these policies, and he will face a critical choice on monetary policy in a year or so.

TRADE

The Smoot-Hawley Tariff Act was passed by the House in May 1929, before the stock market collapse in October, and was enacted in June 1930 despite the opposition of many economists and several leading businessmen. Tariffs were increased 60 percent on 3,200 imported products, although most imports remained duty free. Moreover, most of the tariffs were in dollars per unit, so the real cost of the tariffs increased with the subsequent deflation. This act provoked 60 other governments to enact retaliatory tariffs. The higher tariffs and the general recession reduced total world trade by about two-thirds by 1933, and the U.S. unemployment rate increased from 7.8 percent when the Smoot-Hawley Act was enacted to 25.1 percent in 1933.

Senator Obama had been a cosponsor of the Fair Currency Act of 2007, which would have authorized a countervailing duty on imported products from a nonmarket economy with an undervalued exchange rate. Although directed primarily against China, it was also broadened to include Canada and Mexico. Approval of this act would surely provoke some form of retaliation; the United States is especially vulnerable to retaliation by China, because we are dependent on China to finance our current account deficit. A statement by Treasury secretary-designate Timothy Geithner during his confirmation hearing increases the prospect that the Obama administration will rule that China has manipulated its currency. During his campaign for the presidency, Obama also proposed opening up NAFTA to renegotiate the labor and environmental standards, and he opposed the several outstanding bilateral trade agreements that had been negotiated but not yet approved. During the congressional deliberations on the 2009 fiscal stimulus bill, however, President Obama expressed caution about any Buy America provision that might provoke trade retaliation.

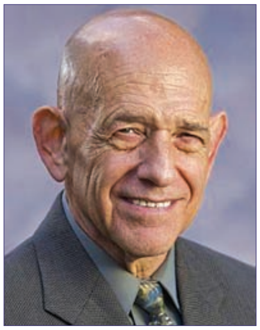
LABOR

The Davis-Bacon Act of 1931 required that labor employed on a federally financed

Continued on page 6

WILLIAM A. NISKANEN is chairman emeritus and distinguished senior economist of the Cato Institute. He is the author of *Bureaucracy and Representative Government* and *Reflections of a Political Economist,* among other books.

More than 300 economists, including 3 Nobel Laureates, signed the Cato Institute's full-page ad opposing the misguided stimulus spending bill, which appeared in the *New York Times,* the *Washington Post,* the *Wall Street Journal,* and other newspapers nationwide. Here Sen. Roger Wicker (R-MS) cites the ad in explaining Republican opposition to the bill, at a news conference with Sens. John Ensign (R-NV), Jim Bunning (R-KY), and Robert Bennett (R-UT). PAGE 8.



BY ROBERT A. LEVY

"The Preamble tells us that government gets its powers from "We the People," not vice versa."

Chairman's Message

Constitutional Basics for President Obama

With 12 years under his belt as lecturer and senior lecturer at the estimable University of Chicago Law School, President Barack Obama is no stranger to the Constitution. Nonetheless, he accepts the fashionable yet flawed notion of a malleable, "living" document, which has sufficient structural flexibility to accommodate rapidly changing social, economic, and technological conditions. Obama's invocation of that theory will be to appoint judges who "stand up for social and economic justice" and have "empathy . . . to understand what it's like to be poor, or African-American, or gay, or disabled, or old."

Of course, no rational person is anti-empathy or opposed to social and economic justice. The question, instead, is whether a judge's application of those values should dictate how he interprets the Constitution. An alternative view, embraced by "textualists," is that constitutional interpretation must be anchored in the words of the document itself, not the subjective policy preferences of judges, however empathetic. When "structural flexibility" is required, the Framers crafted an amendment process by which the Constitution can be updated.

Meanwhile, the written text is bedrock; and from it, our new president should extract two lessons in particular. First, and most important, the Framers gave us a limited federal government with strictly enumerated powers. The Preamble tells us that government gets its powers from "We the People," not vice versa. The body of the Constitution identifies those powers with specificity. Then the Tenth Amendment reminds us, "The powers not delegated to the United States by the Constitution . . . are reserved to the States . . . or to the people." That's our principal defense against an abusive national government—but not our only defense.

A second textually explicit safeguard is the separation of powers among the three branches—legislative, executive, and judicial. As Obama presides over America's largest-ever injection of public funds into the used-to-be-private economy, he would do well to reexamine the very first sentence of Article I: "All legislative Powers herein granted shall be vested in a Congress." Only the legislature, not the executive branch, is authorized to make laws. Yet the Treasury Department has obviously been immersed in the lawmaking business—initially to purchase troubled assets; then to acquire part ownership of insolvent companies; and, finally, to reverse itself and start over again. With each day's newspaper came reports that the rules of the game had changed—without congressional input.

Earlier, the national government had encouraged debt and leverage by double-taxing dividends while making interest deductible. The Federal Reserve had maintained artificially low rates—another incentive to borrow. Fannie Mae and Freddie Mac, with implicit taxpayer-backed guarantees, had purchased and securitized risky mortgages to fund "affordable" housing. Then, to unravel the mess, Congress endorsed the socialization of a key economic sector by giving an executive official virtual carte blanche over our financial institutions. The predictable outcomes: redistribution of wealth from taxpayers to individuals and businesses who took excessive risks; substitution of politicians for shareholders as corporate decisionmakers; and a handcuffed version of capitalism, frustrated in the performance of its periodic restorative function—purging transactors who are inefficient or incompetent.

Congress provided no coherent guidance to the executive branch when it enacted the Troubled Asset Relief Program, which essentially authorized the Treasury Department to experiment with hundreds of billions of tax dollars—unconstrained power, unaccountable to the taxpayers, and unconstitutional. To be sure, that horse has already left the barn. Nobody seriously expects the president to admit that he and his predecessor exercised unconstitutionally delegated legislative powers. Still, Obama might acknowledge that the bailout raised crucial constitutional questions. At least that would buttress the case for dumping the program as soon as the perceived emergency has ended. And it would caution Congress against abdicating responsibility for laws that have effectively nationalized large segments of the financial community.

President Obama is a remarkable man who has come to office at a decisive moment in history. As he grapples with our nation's problems, he must reaffirm that government is bound "down from mischief by the chains of the Constitution."

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A concluding, unrelated note: This is the first of my *Policy Report* messages as chairman of the Cato Institute. I am privileged to head the board, and especially honored to succeed Bill Niskanen, who served splendidly for 23 years and continues as director and chairman emeritus. Like Bill, I am committed to the principles of limited government, individual liberty, free markets, and peace. The implementation of those principles will require a prodigious effort and significant resources. Fortunately, no organization has officers, administrators, and policy professionals who are more dedicated to promoting liberty. As chairman, I promise our supporters that the Cato Institute will remain vigilant in pursuit of that goal.

Robert A. Levy

New Regulation

Do Patents Work?

A fierce debate rages among free market supporters over the value of patents. Do they encourage economic growth and innovation as traditional property rights do, or are they simply another unnecessary government-granted monopoly? In the Winter 2008–2009 edition of *Regulation,* James Bessen and Michael J. Meurer of Boston University argue that historical evidence, cross-country evidence, economic experiments, and estimates of net benefits all indicate that general property-rights institutions have a substantial direct effect

on economic growth. But, empirical evidence indicates that intellectual property rights have at best only a weak and indirect effect on growth. Further,it appears that for public firms in most industries today, patents may actually discourage investment, as these firms fear winding up on the losing side of a patent fight.

Bessen and Meurer noted one important exception to their findings on patents: pharmaceuticals, where patents appear to encourage a statistically significant level of innovation. But Henry I. Miller argues that the gradual move toward limited approvals of new drugs by the Food and Drug Administration, combined with the imposition of new safety and efficacy requirements has damaged one of the nation's most innovative and critical industries and delivered a devastating double-whammy to patients.

Meanwhile, Dwight Jaffee tackles Fannie and Freddie reform, and Craig Pirrong seeks a cure for systemic financial risk.

Visit www.cato.org/regulation to secure your one-year subscription to *Regulation* magazine for only $20.00.

Cato News Notes

The Cato Institute has been recognized by *Foreign Policy* magazine as the world's most innovative think tank. The Brookings Institution and the Carnegie Endowment for International Peace came in second and third, respectively. James G. McGann of the University of Pennsylvania performed the study as part of *Foreign Policy* magazine's "Think Tank Index." *FP* also noted Cato's unique position as a voice of reason in a partisan city: "Cato has antagonized liberals with its push to privatize Social Security, as well as conservatives with its vigorous opposition to the Iraq war."

DOUG BANDOW has rejoined the Cato Institute as a senior fellow. He will focus on issues of foreign policy, defense, and civil liberties, although his interests and past writings range widely from religion to conscription to regulation. After graduating from Stanford Law School, he worked as a special assistant to President Ronald Reagan. He then edited *Inquiry* magazine before working as a Cato senior fellow from 1985 to 2005. His books include *Foreign Follies: America's New Global Empire; Leviathan Unchained: Washington's Bipartisan Big Government Consensus; Tripwire: Korea and U.S. Foreign Policy in a Changed World; Perpetuating Poverty: The World Bank, the IMF, and the Developing World; The Politics of Envy;* and *Beyond Good Intentions: A Biblical View of Politics.*

Celebrated writer and civil libertarian NAT HENTOFF has joined the Cato Institute as a senior fellow. Hentoff is considered a leading authority on the First Amendment and the Bill of Rights. The author of some three dozen books and countless newspaper and magazine articles, Hentoff was a columnist and staff writer with *The Village Voice* for 51 years, from 1957 until 2008.

In addition to his weekly column, Hentoff also writes for *Free Inquiry* and the *Washington Times*. A jazz expert, Hentoff writes on music for the *Wall Street Journal* and *Jazz Times*. Hentoff serves on the board of advisers of the Foundation for Individual Rights in Education and is on the steering committee of the Reporters' Committee for the Freedom of the Press.

Hentoff has been repeatedly recognized for his contributions over the course of his career. In 1980, he was awarded an American Bar Association Silver Gavel Award for his coverage of the law and criminal justice in his columns. In 1983, the American Library Association awarded him the Imroth Award for Intellectual Freedom.

Justin Yifu Lin, chief economist and senior vice president at the World Bank, meets with Cato vice president for academic affairs James A. Dorn and chairman emeritus William A. Niskanen, before a luncheon with Cato analysts. Lin is a longtime contributor to *Cato Journal*, edited by Dorn, beginning with a 1989 article on institutional change.

Afghan ambassador Said T. Jawad speaks at a December Cato Policy Forum, "Afghanistan Seven Years Later." Jawad, who was instrumental in the drafting of Afghanistan's constitution, said the security situation in Afghanistan is rapidly deteriorating and called for an American surge of troops and spending there. Ted Galen Carpenter, Cato's vice president for defense and foreign policy studies, countered that the United States has neither the funds nor the expertise in nation-building to make such a plan work.

Shortly after resigning as prime minister of Georgia in November 2008, Lado Gurgenidze came to Cato to discuss past victories and new challenges facing the nation. Gurgenidze praised Georgia's adoption of a flat tax in 2005, and highlighted Georgia's 10 percent per year economic growth rate thereafter. But he argued that maintaining that growth rate would be difficult in the face of a global economic recession and ongoing tensions with Russia.

"Whither the Amazon?" For the past several decades, a fierce tug-of-war over the Amazonian rainforest has played out between environmentalists and developers. At a Cato Policy Forum, Blairo Maggi (left), governor of the state of Mato Grosso in Brazil, argued that an optimal balance between conservation and development can be achieved if only both sides would stop talking past one another. Cato senior fellow Jerry Taylor moderated the event.

The Government Stole My Home

No U.S. Supreme Court decision in the modern era has been so quickly and widely reviled as the infamous *Kelo v. City of New London* decision, in which the Court ruled that Susette Kelo's small home in New London, Connecticut, and the homes of her neighbors could be taken by the government and given over to a private developer based on the mere prospect that the new use for the property might generate more taxes or jobs. Three years after the decision, on the eve of the release of a new book about her story, *Little Pink House: A True Story of Defiance and Courage,* Susette Kelo came to Cato to give a first-person account of the struggle to save her home.

When this eminent domain situation first began about 10 years ago, I had no experience in public speaking. When I was first asked to speak, I said, "Oh no, I can't possibly do that."

Friends and supporters said I could. All I had to do was stand up, speak from the heart and tell the truth. So here goes:

My name is Susette Kelo and the government stole my home.

First, the municipal government of my hometown, New London, Connecticut, stole it. The state of Connecticut said it was legal for them to take it. Finally, the federal government said it was constitutional to steal not only my home but the homes of all my neighbors and, in fact, anyone's home for the purpose of economic development.

And even though over 40 states have passed legislation offering some protection to home and business owners, don't think your property is safe, because it is not.

Over 10 years ago, I was lucky enough to find a great deal on a house with a terrific view of the Thames River, the Long Island Sound, and the Atlantic Ocean, in New London, Connecticut. I spent every spare moment fixing it up and making itthe kind of home I had always dreamed of. I'm sure you've heard the expression "location, location, location." Well, this was the wrong location, even if I didn't know it yet.

One morning in 1998, I picked up the paper to discover that Pfizer pharmaceutical company was coming to town. And one of the things that Pfizer did not want, according to the Pfizer executive who just

happened to be the husband of the president of the New London Development Corporation, Claire Gaudiani, was to see tenement buildings through their glass windows. Maybe we did not live in the grand manors that the Pfizer executives lived in, but our homes were well cared for, we paid our taxes, and we lived in a neighborhood that was comfortable for us. But we weren't going to be comfortable for long.

For 10 long years, we fought to keep our homes. We fought in the media. We fought in the city council and in the legislative offices. We fought in the courts. We won the support of the public, but the politicians made our lives hell.

Eviction notices were posted on our doors Thanksgiving eve. Our neighbors' homes were demolished around us. Our streets were shut down. Some of us became ill. Some of us even died.

Even the air was difficult to breathe from the demolitions and the blasting around us. But we never gave up because we believed this land was our land. That is, until the U.S. Supreme Court told us—and the world—differently.

What the Supreme Court basically said was our land was only our land until someone else could make better use of it and pay more taxes. Even though we, the plaintiffs in the *Kelo v. New London* case, lost our personal battle, the war is still being fought. As a result of the Supreme Court's unbelievable ruling, a majority of the states have passed legislation offering more protection to American property owners. Probably everyone who has ever given a speech hopes that something he or she said will be worth remembering, and in my case, I hope you remember this:

If it's true that it takes an entire village to raise a child, then we, and our children, are in serious trouble. Although 42 states have passed laws providing more protection against the abuse of eminent domain, there are still many places where neighborhoods are destroyed to make way for malls, hotels, and spas.

Chief Joseph of the Nez Perce Indian tribe once said: "The White Man made us many promises, but he kept only one. He said he'd take our land and he did." This practice still continues. Let this generation be the one to bring this terrible abuse to an end.

Continued from page 1

construction project be paid no less than the local rates on a similar project. The Norris-LaGuardia Act of 1932 made "yellow dog" contracts, which made an agreement not to join a union a condition for employment, unenforceable in federal courts, and it banned any federal injunctions in nonviolent labor disputes. This was followed by the 1935 Wagner Act—which guaranteed workers' rights to organize unions, collective bargaining, and strikes—and the 1938 Fair Labor Standards Act, which established a federal minimum wage and banned child labor. These acts increased the real price of labor services, especially in the industrial sector, and were an important contributor to the substantial increase in the unemployment rate during the Great Depression.

Senator Obama had been an original cosponsor of the Employee Free Choice Act of 2007, the primary effect of which would be to outlaw secret ballots on the decision to certify a union. Another provision of this proposed law would authorize the government to write the labor contract in newly unionized firms if management and the union have not agreed to an initial labor contract within a specified time. Obama has also been a consistent supporter of higher minimum wages, which increases the unemployment rate of young unskilled workers.

TAXES

A year before the bottom of the Great Depression, the Revenue Act of 1932 increased the top marginal federal tax rate on personal income from 25 percent to 63 percent, increased the corporate tax rate from 12 percent to 13.75 percent, and doubled the estate tax rate. The Revenue Act of 1936 further increased the top marginal tax rate on personal income to 79 percent and the rate on undistributed corporate profits to 42 percent. These two revenue acts increased federal tax rates more than in any other peacetime period and extended the length of the Great Depression by substantially weakening the incentive to work, save, invest, and increase productivity.

During his presidential campaign, Senator Obama proposed a combination of tax credits for low- and middle-income households, a substantial increase in marginal tax rates for those with an annual household income over $250,000, and several selective changes in business taxation. The top marginal rate on income would be increased from 35 percent to 39.6 percent, the marginal payroll tax would be increased from 1.45 percent to 5.45 percent (plus an equal increase to the employer), and the rate on capital gains and dividends would be increased from 15 percent to 20 percent. A phase-out of the personal exemption and specific deductions would add about 4.5 percentage points to the marginal tax rate (an estimate by the Tax Foundation).

> "Obama has not proposed a reduction in the corporate tax rate, although this rate is now the second highest among the industrial nations."

The total marginal tax rate, thus, would be increased from 36.45 percent to 49.55 percent, reducing the after-tax return to additional earnings by about one-fifth; a lot of small business owners and professional couples would be subject to these higher marginal tax rates. Obama has not proposed a reduction in the corporate tax rate, although this rate is now the second highest among the industrial nations. His proposed changes in business taxation are designed to change the *composition* of U.S. business activity, increasing taxes on oil and gas companies and on U.S. multinationals that defer repatriation of foreign profits in favor of companies that produce renewable energy and increase domestic employment.

Obama's proposed federal tax rates do not look unusual compared to federal taxes before the Reagan-era rate reductions, but they would be a significant increase relative to recent years at a time when many other governments are reducing their personal and business tax rates.

MONETARY POLICY

In retrospect, the origin of the Great Depression seems surprisingly similar to recent conditions—with one huge exception. The Federal Reserve had increased the money supply from 1921 through 1927 by around 60 percent, contributing to the rapid increase in stock prices. In early 1928, however, the Federal Reserve began a policy of monetary restraint that continued through May 1929, increasing the discount rate from 3.5 percent to 5 percent in three stages. This triggered the stock market collapse in October.

The fall in stock prices and the subsequent general deflation led to a large increase in the demand for money. Following the collapse of the Bank of the United States in December 1930, however, the Federal Reserve increased interest rates again in early 1931. From 1929 to 1933, the money supply declined by around one-third, constrained by the rules of the gold standard, although the Federal Reserve Bank of New York had consistently urged a policy of monetary expansion. During this period, the number of U.S. banks also declined by around one-third due to either failure or merger.

This combination of a large increase in the demand for money and a substantial reduction in the supply of money was the primary cause of the first phase of the Great Depression. This period of monetary contraction ended only in 1933 when President Roosevelt raised the price of gold by 75 percent, permitting a renewed expansion of the money supply. In 1936 and 1937, however, the Federal Reserve doubled bank reserve requirements, leading to the short sharp recession of 1937–38 within the longer period of the Great Depression.

The monetary policy that led to the current recession was similar to the policy that led to the first phase of the Great Depression. The Federal Reserve maintained an expansionary monetary policy from 2001 into 2004, with a federal funds rate lower than the general inflation rate, contributing to both the housing boom and the increase in stock prices. Then from mid-2004 through mid-2007, the federal funds rate was increased by 4.25 percentage points, leading to a decline in residential investment beginning in the spring of 2006 and a decline in the stock market and national output beginning in the fall of 2007.

As in the 1930s, the decline in stock prices and the subsequent deflation greatly increased the demand for money and other financial instruments such as Treasury bills. The major difference from the earlier period is that the Federal Reserve has maintained a very aggressive monetary policy since mid-2007, reducing the federal funds rate by 5 percentage points. Moreover, beginning last fall, the Federal Reserve has purchased a wide range of private and public financial instruments, *doubling* the monetary base since last August. This dramatic change in monetary policy is primarily attributable to the lessons from Fed Chairman Ben Bernanke's studies of the monetary policy mistakes during the 1930s.

The very rapid increase in the monetary base since last August was, I believe, the correct response to the huge increase in the demand for money and is likely to be much more effective than any fiscal stimulus plan. But it presents a potentially large future danger. At such time as there is a revival of some general inflation and increased confidence in the security of nonmonetary assets, the demand for money will decline to a more normal level relative to total money income.

At that time, the Federal Reserve and the Obama administration will be faced with a very difficult choice—allow a high rate of inflation or raise interest rates fast enough to avoid that outcome. The first option would be the policy of inaction; the second option would require selling most of the financial assets that the Federal Reserve has accumulated in the past few months. My guess is that the time for this difficult choice is not too far off, probably in the next year or two, a guess based on observing that there has already been some increase in stock prices and commodity prices since November. And that will be a difficult time to make this difficult choice. Bernanke's term as Fed Chairman expires in January 2010 and, of course, there will also be a congressional election that fall, reducing the incentives and support for a rapid increase in interest rates. The second option would also present the potential for a W-shaped recession and recovery, extending the period of weak economic growth to avoid a high rate of inflation. In either case, the only way to avoid being faced with such a difficult choice in the more distant future is to correct the conditions that led this recession to be a financial crisis. This would require restructuring the mortgage market such that mortgages and mortgage-backed securities are more liquid and their risks are more transparent.

> "Four federal economic policies transformed the Hoover recession into the Great Depression. President Obama, unfortunately, has endorsed some variant of three of these policies."

OTHER RELATED POLICIES

The trade and labor policies of the 1930s were designed to maintain the prices of products and labor services, usually at the expense of the amounts supplied. Other policies had the same objectives and effects. The 1933 National Industrial Recovery Act authorized cartels to maintain prices; until this act was declared unconstitutional in 1935, for example, members of these cartels were subject to fines for discounting. The most egregious of such policies was the Agricultural Adjustment Act of 1933; until this act was declared unconstitutional in 1936, this act authorized payments to farmers to reduce their acreage under cultivation. In effect, these policies established a floor under prices that prevented many product and labor markets from clearing, given the decline in nominal demand. These policies were an important reason why total output did not recover to the 1929 level until 1939, and the unemployment rate at the end of this decade was 17.2 percent.

Several current agricultural programs also have much the same objective and effects. The price of milk is maintained by a government-authorized cartel, the price of sugar by a quota on imports, and the price of corn has been increased by a regulation that requires a substantial production of corn-based ethanol as a motor fuel. I do not know Obama's position on the dairy cartel. During his campaign for the presidency, however, Senator Obama was a strong supporter of both the sugar quota and the ethanol program.

One other policy of both the Hoover and Roosevelt administrations was a substantial increase in federal expenditures for public infrastructure, especially hydroelectric facilities. These programs did not reduce total output but they were clearly not effective, given the combination of other policies, in reducing the depth or duration of the Great Depression. The government of Japan enacted a substantially larger public infrastructure program in the 1990s, also with no effect on ending what turned out to be a decade of very low economic growth. A major provision of President Obama's fiscal stimulus proposal, of course, is a substantial increase in federal expenditures for public infrastructure. Fed Chairman Bernanke was correct to observe recently that "Fiscal actions are unlikely to promote a lasting recovery unless they are accompanied by strong measures to further stabilize and strengthen the financial system."

CONCLUSION

The most important lesson of this paper is to avoid repeating the policies that increased the depth and duration of the Great Depression, particularly in combination. Unfortunately, some of these policies still have broad political appeal—limiting international trade, strengthening unions, other measures to support the prices of some products and labor services, and higher taxes on the wealthy and the income from capital. One important lesson that we seem to have learned from the 1930s is to avoid reducing the supply of money in response to an increased demand for money. Another important lesson that we have not yet learned is that some government spending for infrastructure may be both popular and valuable but is not very effective in countering a recession.

We have yet to learn the lessons about what caused the current recession and the general financial crisis. The United States had experienced 11 prior recessions since World War II without a general financial crisis, so something new must have happened that caused the current financial crisis. My judgment is that the government policies and private practices that changed the way mortgages are financed are that dangerous new development, but that is a story for another occasion. In this respect, I agree with Chairman Bernanke's recent conclusion that "we should revisit capital regulations, accounting rules, and other aspects of the regulatory regime to ensure that they do not induce excessive procyclicality in the financial system and the economy." ■

Newspaper ads energize critics

Cato Leads Opposition to Bloated Spending Package

Economic historian Robert Higgs called it the "ratchet effect": during times of crisis, government "ratchets up," growing far larger than it had been previously, only to conveniently fail to return to its previous size after the crisis has subsided. That "ratchet effect" is rampant today, with America facing a deep recession and plans afoot for a trillion-dollar "stimulus" package to "save" it—this coming on top of a string of unprecedented bailouts and interventions. In the midst of all of this, the Cato Institute has emerged as a clear leader in facing down calls for greater government spending and deficits, which Cato scholars contend won't help the economy, but will leave us with permanently bigger government.

THE WALL STREET JOURNAL.

October 17, 2008

How's Obama Going to Raise $4.3 Trillion?

To Cut Gov't Purse Strings, Just Say 'No'

NEW YORK POST

September 09, 2008

FANNIE/FREDDIE BAILOUT BALONEY

The Examiner. BALTIMORE

October 09, 2008

Get rid of Fannie Mae/Freddie

The Washington Post

Bailout Raises Libertarians' Market Value

The New York Times

March 1, 2009

Stop the Bailouts

The Problem With 'Nationalization'

Even before Barack Obama took office, advocates of a massive stimulus package had already taken to the newspapers and airwaves. But at every step, Cato scholars were there to counter the flawed reasoning behind those proposals. In a January 14, 2009, *Marketplace* commentary, Cato research fellow Will Wilkinson argued that public works spending, which represents the majority of outlays in the proposed package, would take years to come online, and thus even by its proponents' own terms did not represent a "stimulus" at all. During a December 21, 2008, C-SPAN appearance, Chris Edwards, Cato's director of tax policy studies, pointed out the sheer magnitude of the package, and what it meant for the future. Even without a stimulus package, the government had already incurred an unprecedented trillion dollar-deficit for the year, and certainly couldn't afford spending another trillion, he argued. With entitlement spending for Social Security and Medicare ramping up due to demographics, Edwards warned that if a stimulus package is passed, America "may never have another balanced budget again." In the month of January alone, Cato scholars published articles or were quoted in 22 major newspapers opposing the stimulus, 31 national television programs, and 49 radio programs. The writings of Cato scholars were also featured on several prominent blogs, including those of Harvard economist Greg Mankiw and news pundit Michelle Malkin.

The efforts to oppose the spending bill came to a head with a full-page ad featuring 200 economists who oppose the stimulus, placed by the Cato Institute with generous special funding from Cato Sponsors. The ad begins with a quote from President Barack Obama claiming that all economists agree on the need for a stimulus package to revive the economy, a talking point repeatedly echoed in the media. Declaring "With all due respect / Mr. President, that is not true," it is signed by 200 economists, including Nobel Laureates Edward Prescott, Vernon Smith, and James Buchanan. The ad was published in the *New York Times* on January 28, 2009, and soon also in the *Washington Post*, the *Los Angeles Times*, the *Chicago Tribune, Philadelphia Inquirer,* the *Washington Times,* the *National Review*, the *New Republic*, and more. The *Wall Street Journal* also featured an op-ed by Cato senior fellow Alan Reynolds pointing out that the stimulus represented a massive, long-term transfer of resources from the private to the public sector.

Also on January 28, the Cato Institute launched Fiscal Reality Central on www.cato.org. The page features "must read" commentary such as Cato Briefing Papers on "The Troubling Return of Keynesianism," instructional YouTube videos on how the economy really works, and video featuring some of the highlights of Cato's television appearances. These videos regularly have thousands of viewers, with one anti-stimulus video earning a #1 "most watched" ranking among Youtube nonprofits on February 10. The webpage for Fiscal Reality Central is available for viewing at www.cato.org/fiscalreality. Cato's Youtube channel is at www.youtube.com/catoinstitutevideo.

Consider the ad and the media outreach efforts so far but the opening salvo in the efforts of Cato scholars to counter the return to big-government, Keynesian policies. Going forward, Cato scholars will continue to work to expose the flawed reasoning behind misguided policies that transfer unprecedented sums of power to the federal government at the expense of taxpayers.

“There is no disagreement that we need action by our government, a recovery plan that will help to jumpstart the economy.”

—PRESIDENT-ELECT BARACK OBAMA, JANUARY 9, 2009

With all due respect Mr. President, that is not true.

Notwithstanding reports that all economists are now Keynesians and that we all support a big increase in the burden of government, we the undersigned do not believe that more government spending is a way to improve economic performance. More government spending by Hoover and Roosevelt did not pull the United States economy out of the Great Depression in the 1930s. More government spending did not solve Japan’s “lost decade” in the 1990s. As such, it is a triumph of hope over experience to believe that more government spending will help the U.S. today. To improve the economy, policymakers should focus on reforms that remove impediments to work, saving, investment and production. Lower tax rates and a reduction in the burden of government are the best ways of using fiscal policy to boost growth.

Burton Abrams, *Univ. of Delaware*
Douglas Adie, *Ohio University*
Ryan Amacher, *Univ. of Texas at Arlington*
J.J. Arias, *Georgia College & State University*
Howard Baetjer, Jr., *Towson University*
Stacie Beck, *Univ. of Delaware*
Don Bellante, *Univ. of South Florida*
James Bennett, *George Mason University*
Bruce Benson, *Florida State University*
Sanjai Bhagat, *Univ. of Colorado at Boulder*
Mark Bils, *Univ. of Rochester*
Alberto Bisin, *New York University*
Walter Block, *Loyola University New Orleans*
Cecil Bohanon, *Ball State University*
Michele Boldrin, *Washington University in St. Louis*
Donald Booth, *Chapman University*
Michael Bordo, *Rutgers University*
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George Brower, *Moravian College*
James Buchanan, *Nobel laureate*
Richard Burdekin, *Claremont McKenna College*
Henry Butler, *Northwestern University*
William Butos, *Trinity College*
Peter Calcagno, *College of Charleston*
Bryan Caplan, *George Mason University*
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Focus on real risks, don't overreact

Conference Looks at New Terrorism Policies

1. **A standing-room-only crowd of 380 took in the event.** **2.** **The ACLU's Michael German formerly infiltrated terrorist groups for the FBI.** **3.** **Panel II addressed why people join terrorist organizations.** **4.** **Political scientist John Mueller argued that the threat of terrorism is exaggerated.** **5.** **Jim Harper said overreaction to terrorism plays into the terrorists' hands.** **6.** **The Mercatus Center's Veronique de Rugy asks a question from the audience. Also pictured are (left to right) Paddy Hillyard of Queen's University, security guru Bruce Schneier, and William Burns of Decision Research.**

With a new administration in the White House, January 2009 marks the beginning of a new approach to counterterrorism. On January 12–13, the Cato Institute held a special two-day conference "Shaping the Obama Administration's Counterterrorism Strategy," focusing on how to talk about terrorism, how to evaluate the risk of terrorism, and how to craft sensible public policy with that knowledge in mind. A standing-room-only crowd of 380 took in the event, including journalists from major media outlets. The event was broadcast on C-SPAN and Cato's website, where it is available for viewing at www.cato.org/counterterrorism.

Research on risk response shows that most of us are very bad at knowing what to make of highly improbable but possibly disastrous future events. Risk perception is far from uniform: Some types of risk we tend to grossly underestimate, while other types we systematically overestimate. These biases have been the subject of a great deal of scrutiny following the events of September 11, 2001. William Burns, a research scientist at Decision Research, said that fear serves a critical function when it causes us to flee from danger, but excessive fear serves no purpose and indeed has negative consequences for our lives. According to Burns, excessive media attention devoted to the threat of terrorism makes us no safer but a lot more scared than we ought to be. John Mueller, professor of political science at Ohio State University, backed him up with some numbers: Americans have a 1 in 75,000 chance of being killed by terrorism in a typical 80-year lifespan. When compared to a 1 in 80 chance of dying in an automobile accident, the level of attention Americans give to terrorism is unwarranted.

Unwarranted fear on the part of the public is especially problematic because it results in bad policy, or as Jeremy Shapiro of the Brookings Institution put it, "overreaction." He said that many of our defenses against terrorism are excessive and often counterproductive. Bruce Schneier, a leading expert on security technology, singled out airport security. He said prohibitions on liquid bottles and procedures involving taking off one's shoes are purely for show. He said the truth is that the U.S. government can't keep weapons out of prisons, let alone airplanes, and that such policies only affect innocent civilians.

Meanwhile, Robert Hutchings, the former head of the National Intelligence Council, said the Iraq war had increased the chance that the United States would come under attack again, inspiring a new generation of Islamic radicals. Robert Pape of the University of Chicago agreed. He said that the one unifying strain among terrorists is not poverty—for many terrorists are in fact middle or upper class—nor adherence to fundamentalist Islam—consider the Basques—but instead the desire to evict foreign occupiers from their homeland. Accordingly, America's presence in Iraq, Afghanistan, and its broader intervention in the Middle East are not decreasing the chances it will be attacked but increasing them.

Another issue touched on was where to go from here. Steve Coll, president of the New America Foundation, cautioned that the Obama administration would not be able to begin to address the issue of Iraq until it dealt with the ongoing economic crisis.

Cato Unbound, Cato's online journal of big ideas, featured a special edition in January to coincide with the conference, "Keep Calm and Carry On: How to Talk about Terrorism." You can read that debate at www.cato-unbound.org.

Shaping the Obama Administration's Counterterrorism Strategy

The United States' counterterrorism policy has one thing going for it: seven years after the fact, we have yet to experience another September 11. What policies or programs deserve credit is unclear, though, and by every other measure, our counterterrorism strategy has been sorely lacking. From the never-ending war in Iraq to the never-ending wait to get through airport security, change is needed in our approach. On the eve of a new administration, change was the topic of discussion at a special two-day conference "Shaping the Obama Administration's Counterterrorism Strategy" on January 12 and 13.

JIM HARPER, Cato Institute:

Terrorism represents a dual threat. The obvious threat is that it puts the victim state at risk of direct attacks. The other, more subtle, threat is that it puts the victim state at risk of overreaction in response.

Overreaction multiplies the cost of terrorist acts, and that increases the effectiveness of terrorism and thus its attractiveness as a tool.

Not too long ago, a reporter cited to me the costs of the September 11 attacks as being in the hundreds of billions of dollars, and it occurred to me that that reporter had never separated the direct costs of the attacks from the costs we incurred in spending afterwards. We spent hundreds of billions of dollars in reaction to the attacks, while the direct costs of the attacks might be about $10 billion.

That's not to say those hundreds of billions of dollars of expenditures were wrong, but it is to point out that the spending we take on in response to terrorism is within our control—it was then and it is now.

Let's take a look at the motivations of terrorists. To summarize and perhaps oversimplify, some terrorists have geopolitical aims; some have grievances that they want to avenge; and some are just alienated people who want to be a part of something bigger than themselves. We want to behave in ways that don't gratify any of those terrorists.

Overreaction to terrorism rewards terrorists in three ways. The first and most obvious is when we waste our own blood and treasure. This rewards terrorists with geopolitical aims and grievances. We do their work for them when we weaken ourselves and raise the costs of our own policies.

Overreaction also gives terrorist groups sympathy and recruiting gains. The fact is that terrorists live and move in communities. The people in these communities may or may not support them, or they might be sitting on the fence. But, of course, when these communities suffer a stray bomb, when their doors are kicked in, or when they see images of violence or rights violations that, rightly or wrongly, portray the United States as an evildoing country, they're drawn to support of terrorists.

The final product of overreaction is giving terrorists ideological gains. Terrorists regard themselves as being involved in an ideological struggle with incumbent governments and ideologies. Now, their ideologies are ridiculous, and their prescriptions are ridiculous. But these groups are convinced that their plans are desirable and viable, and they are trying to convince others of that. When they do battle against the United States and the West, they don't have much ability to build their own legitimacy or credibility, but what they can do is tear our credibility and legitimacy down. The way they do that is through terror attacks that induce overreaction and misdirection.

When a victim state comes loose from its ideological moorings of tolerance and freedom and individual rights, when it treats terrorists wrongly according to its own standards, this confirms a terrorist narrative that their ideology is a competitor to the ideologies of Western countries and the United States.

Our actions have sometimes been used to confirm the stories that terrorists tell—that the United States hates Muslims, that the United States is a wicked world power that abuses people, that the United States wants to occupy Muslim lands. None of those things are true, and they don't even seem plausible to most of us. But the question is whether they might look true to terrorists, to people who are physically and ideologically close to terrorists, and, of course, to potential terrorist recruits. Overreaction and misdirection can make the United States look like an evil power, and that hands ideological gains to terrorists.

To recap, terrorism puts the victim state on the horns of a dilemma. It's at risk of direct attacks, but it's also at risk of overreaction in response. Overreaction tends to waste our blood and treasure, it draws sympathy gains to terrorists, and when we come loose from our ideological moorings and abuse rights, we confirm the ideological narrative that motivates terrorists.

JOHN MUELLER, Ohio State University:

The probability of being harmed by a terrorist is extraordinarily small. At present rates, 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, by contrast, is about 1 in 80. That assumes another September 11 every several years; if there are no terrorist attacks of that magnitude, the chance of death by terror slumps to about 1 in 130,000. You have a similar chance of being struck by an asteroid.

One might also instructively tally up the number of people killed by al-Qaeda and its clones, lookalikes, and wannabes outside war zones since September 11. That comes to perhaps 200 or 300 per year.

Which is 200 to 300 too many, but it hardly suggests that the country is under an existential threat—or even under something that deserves to be called a "threat" at all.

Perhaps pointing out these underwhelming figures won't reduce the public's fear, given some of the heuristics and biases the public uses and has. But given all the yammering about terrorism we've endured for eight years, these figures need to be out there in the public consciousness somewhere. Unfortunately, neither Republicans nor Democrats bring them up, nor do they show up in the press.

That's unfortunate, because the war in Iraq—the three-trillion-dollar war in Iraq that was made politically possible by 9/11—has cost the lives of 100,000 people, and considerably more American lives than September 11.

MILTON LEITENBERG, University of Maryland:

If you look at annual U.S. mortality statistics, cancer kills about 600,000 Americans per year, tobacco about 440,000 Americans, and obesity another 400,000. Approximately 1.7 million Americans develop infections in hospitals each year, and 100,000 of them die each year. If you add those four figures together, you have about 1.5 million people dying from various diseases in the U.S. in a single year. Compare that to bioterrorism. In the 20th century, bioterrorism has killed five people in the United States. In the 21st century, so far, no one.

ROBERT PAPE, University of Chicago:

Today I'm going to talk to you about suicide terrorism, which in many ways is the "lung cancer" of terrorism. It's the most deadly form of the phenomenon, and as I'm going to argue today, also is associated with a specific set of risk factors that's quite important to take into account.

Over the past three decades, suicide terrorism has been rising around the world,


Robert Pape

"This presumed connection between suicide terrorism and Islamic fundamentalism is misleading, and is encouraging foreign and domestic policies that are likely to worsen our situation."

but there is great confusion about why. Since many of the attacks, including September 11, have been perpetrated by Muslim suicide terrorists, many have presumed that Islamic fundamentalism must be the cause. However, this presumed connection between suicide terrorism and Islamic fundamentalism is misleading, and is encouraging foreign and domestic policies that are likely to worsen our situation.

From 1980 to 2003, there were 315 completed suicide terrorist attacks around the world. The world leader is a group that many of you probably haven't heard too much about—because they're not attacking us or our allies. They're the Tamil Tigers of Sri Lanka, which is not an Islamic fundamentalist organization but a Marxist, secular, Hindu one. The Tamil Tigers have performed more suicide attacks than Hamas or Islamic Jihad. Further, in this period, at least 30 percent of all "Muslim" suicide attacks were by purely secular groups such as the PKK in Turkey, which is another Marxist—and indeed, anti-religious—suicide terrorist group. Overall, at least 50 percent of all suicide attacks around the world in this period were not associated with Islamic fundamentalism.

Instead of religion, what nearly 95 percent of all suicide attacks around the world have in common is a specific secular and strategic goal: to compel a democratic state to withdraw combat forces from threatening territory the terrorists continue to view as their homeland or prize greatly. From Lebanon to Sri Lanka to the West Bank to Iraq, what all of the nine disputes that account for 95 percent of all suicide terrorism around the world have in common is that the terrorists are fighting for self-determination for territory that the terrorists prize. That is the terrorists' central goal.

Of course, the pattern has changed in the last five years. From 1980 to 2003, about 7.5 percent of those suicide attacks in that 24-year period could be considered anti-American attacks. But now, in the past five years, fully 89 percent of all the suicide terrorism that is occurring around the world is inspired by anti-Americanism and is directly linked to the new presence of American combat forces on territory that the terrorists prize. This is an extremely dangerous pattern, and it is something that is extremely important for the new administration to work to change.

MARC SAGEMAN, Sageman Consulting:

I want to talk to you about terrorism in Europe. Now, Muslims in Europe are a recent phenomenon. They have grown from about half a million before World War II to about 20 million today. Forgive me, but you might call Muslims in Europe "our Mexicans." Europe recruited Muslims for labor jobs, such as in manufacturing and construction. They were self-consciously recruited from rural areas and were not well-educated. The Muslim population of Europe today represents second and third generations of unskilled labor. By contrast, in the United States, first-generation Muslims were well educated and upper-middle class. The average income of a Muslim family in the United States today is about $70,000, or 40 percent higher than the average American family's income of $48,000.

In Europe, the Muslim unemployed rate is three times the rate of the native population. In order to sustain those rates of unemployment, you really need to have a strong welfare state, which Europe certainly has. The money for Muslim terrorist Jihadis in Europe does not come from donations, as it sometimes does in the Middle East. Rather, it comes from one of two places: credit card fraud and welfare payments. So, in a way, the state sponsor of terrorism in Europe is the welfare state. The state sponsors of terrorism are Germany, France, and Great Britain! Another, related factor behind the rise of Muslim terrorism is boredom: without a day job, supported by the state, the unemployed Muslims have plenty of time to dream of making their mark, sometimes in violent, destructive ways.

MICHAEL GERMAN, ACLU:

I learned about terrorists in a unique way: by pretending to be one as an FBI agent. That experience provided me with a different way of looking at the problem of terrorism. I ultimately left the FBI due to differences with their policies, which I don't think help our cause in the ongoing war against terror.

What U.S. policymakers failed to understand after September 11 is that terrorism is not a military strategy that can be defeated with a military counterstrategy. The terrorist's strategy is actually a political one: it is designed to establish his own legitimacy


Marc Sageman

"The state sponsor of terrorism in Europe is the welfare state."

by bringing the legitimacy of the ruling government down in the minds of the masses. It's an interesting political strategy because it begins from a position of profound weakness. It depends entirely on the victim government reacting to the terrorist provocation in a way that undermines its own support.

By provoking a disproportionate or unjust response that affects innocents along with the guilty, terrorists hope to create legitimate grievances out of their attack. Once the injustice of the opposing government is revealed by way of its unjust counterresponse, the terrorist methods then become justifiable acts of resistance.

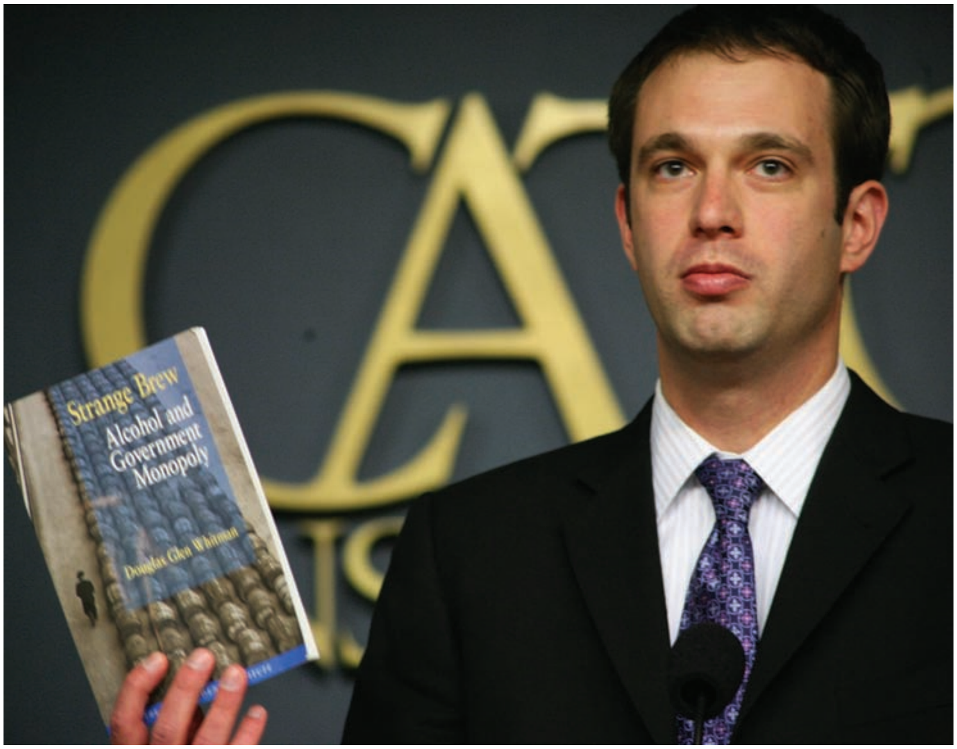
Our policymakers fail to understand what Osama bin Laden is actually trying to accomplish. They all but leapt into the trap he had set by embracing policies that did violence to the universal notions of justice and undermined the rule of law. To be sure, the United States was not the first country to abandon the rule of law in response to terrorism. The French in Algeria and the British in Northern Ireland used virtually the same tactics we have adopted, such as extrajudicial detention and coercive interrogation.

Let's consider the results of these policies. As Irish Republican Army member Tommy Gorman explained: "We were creating this idea that the British state is not your friend, and at every twist in the road they were compounding what we were saying, they were doing what we were saying, fulfilling all our propaganda. The British army and the British government were our best recruiting agents." Today, no doubt, bin Laden would say that water boarding, Guantanamo Bay, and Abu Ghraib are among his best recruiting agents.

Members of Congress listen as MICHAEL CANNON, Cato's director of health policy studies, talks about the perils of universal health care at a Cato breakfast for new members of Congress. (Left to right) REP. GREGG HARPER (R-MS), MICHAEL CANNON, REP. PETE OLSON (R-TX), REP. BILL POSEY (R-FL), and REP. PHIL ROE (R-TN).

President Obama rode to victory on a promise of change. But will he actually change U.S. national security policy? At the Capitol Hill Briefing "Obama's National Security Policy: A New Approach or More of the Same?" CHRIS PREBLE, director of foreign policy studies at the Cato Institute, said Obama was unlikely to rein in defense spending.

DANIEL J. MITCHELL discusses the troubling return of Keynesianism at the Capitol Hill Briefing, "Do Government Spending and Tax Rebates Stimulate Growth?" He pointed out that huge increases in government spending under both Hoover and Roosevelt did not help the economy during the 1930s, and more recent Keynesian initiatives such as President Bush's 2001 and 2008 tax rebates similarly did not yield positive results.



On December 5, 1933, the 21st Amendment to the Constitution was ratified, thus ending our nation's failed experiment with Prohibition. On December 5, 2008, the Cato Institute hosted "Free to Booze: The 75th Anniversary of the Repeal of Prohibition." Among the featured speakers was economist Glen Whitman, the author of *Strange Brew: Alcohol and Government Monopoly,* which Cato's director of government affairs, Brandon Arnold, holds aloft. Blogger/barista/bartender and former Cato media manager Jacob Grier returned to mix exotic cocktails for the reception afterward.

DECEMBER 1: *The Price of Everything: A Parable of Possibility and Prosperity*

DECEMBER 2: Whither the Amazon?

DECEMBER 3: Cato Institute Policy Perspectives 2008, Chicago

DECEMBER 5: Does America's Health Care Sector Produce More Health?

DECEMBER 5: Free to Booze: The 75th Anniversary of the Repeal of Prohibition

DECEMBER 10: Just Give Us the Data! Prospects for Putting Government Information to Revolutionary New Uses

DECEMBER 11: Afghanistan Seven Years Later

DECEMBER 17: Obama's National Security Policy: A New Approach or More of the Same?

DECEMBER 18: Do Government Spending and Tax Rebates Stimulate Growth?

JANUARY 12-13: Shaping the Obama Administration's Counterterrorism Strategy

JANUARY 13: The Dangers of Network Neutrality Regulation

JANUARY 14: Does Public Higher Ed Funding Drive Economic Growth?

JANUARY 15: Obama's Fiscal Policies: Ignoring the Global Tax Revolution

JANUARY 22: Avoiding a Health Care Disaster

JANUARY 27: *Little Pink House: A True Story of Defiance and Courage*

JANUARY 28: *Climate of Extremes: The Global Warming Science They Don't Want You to Know*

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

Cato Calendar

CATO INSTITUTE POLICY PERSPECTIVES 2009
New York
Waldorf-Astoria • April 30, 2009

CATO INSTITUTE POLICY PERSPECTIVES 2009
Los Angeles
Century Plaza • May 14, 2009

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.

CONSTITUTION DAY
Washington • Cato Institute
September 17, 2009

CATO CLUB 200 RETREAT
Santa Barbara, California
Four Seasons • October 8-11, 2009

Cato programs entrusted to Atlas Network

Cato Senior Fellow Leads Worldwide Initiative

The Cato Institute's Center for Promotion of Human Rights has become a part of the Atlas Economic Research Foundation. The newly renamed Atlas Global Initiative for Free Trade, Peace, and Prosperity will join forces with market-oriented think tanks around the world as it continues to increase the understanding of ideas and policies based on the inalienable human rights of life, liberty, and the pursuit of happiness.

Since its founding in fall 2005, the Center for Promotion of Human Rights has made great strides in articulating a liberty and limited government alternative to coercive ideologies worldwide. It has issued 56 translations of important works, including Friedrich Hayek's *The Road to Serfdom*, John Stuart Mill's *On Liberty*, Paul Heyne's *Economic Way of Thinking*, and Johan Norberg's *In Defense of Global Capitalism*. Its 18-member, full-time staff oversees the operation of platforms in 13 languages, including InLiberty.ru (Russian), Minbaralhurriyya.org (Arabic), UnMondeLibre.org (French), and Tiandaocn.org (Chinese). The platforms feature online interactive maps of the *Economic Freedom of the World* study, copublished by Cato's Center for Global Liberty and Prosperity, online libraries of liberty, daily media syndication, and more. When at Cato the program hosted 14 major international conferences, most recently "Thirty Years of Reform: China's Path to Harmonious Development," in Beijing, China, in November 2008.

Cato senior fellow Tom G. Palmer, who directs the Atlas Global Initiative, with Dan Grossman, chairman of the Atlas Economic Research Foundation, and Nouh El-Harmouzi, editor of Atlas's Arabic-language website.

Atlas, founded by the late Sir Antony Fisher, works with hundreds of market-oriented think tanks globally. It has started many of them itself, including such well-known groups in the United States as the Manhattan Institute, the National Center for Policy Analysis, and the Pacific Research Institute. Sir Antony founded the first classical liberal think tank in England, London's Institute of Economic Affairs. The chairman of Atlas is Cato Club 200 member Dan Grossman, who was instrumental in arranging the combination.

Tom G. Palmer, director of the Atlas Global Initiative for Free Trade, Peace, and Prosperity, will continue to serve Cato as a senior fellow. More information on the programs is available at www.atlasnetwork.org/global.

From financial crisis to international crises

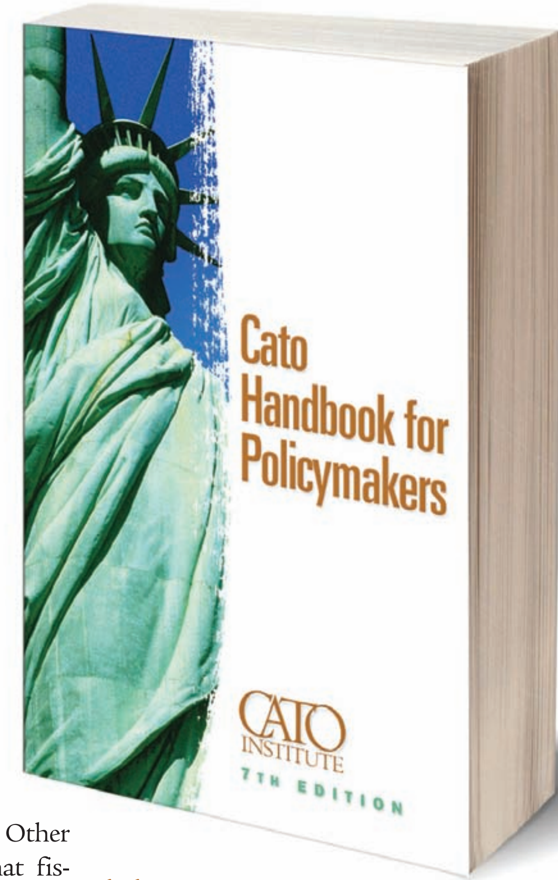
New Policy Handbook

With the election of Barack Obama, "all Americans can take pride in the demise of yet another glass ceiling in a nation born in the idea that all of us are created equal, entitled to the inalienable rights of life, liberty, and the pursuit of happiness." So begins the introduction to the 7th edition of the *Cato Handbook for Policymakers*, which goes on to say that there remains lots of work to be done. With 63 chapters covering everything from the economic crisis to the international drug war, the new administration and the new Congress have plenty to reference in that effort.

The U.S. occupation of Iraq is now well into its sixth year, and the costs of that venture in both treasure and blood have been depressingly high. As of January 2009, the cost of the Iraq war has been estimated at $700 billion, exceeding the price tag of the Vietnam War in inflation-adjusted terms. Meanwhile, more than 4,200 military personnel have lost their lives, and another 30,000 have been wounded. A likely 150,000 Iraqis have died in the conflict. Cato scholars have long supported a prompt, orderly withdrawal from Iraq, and with a new administration in power, now is the time to do it. In Chapter 49, Cato's vice president for defense and foreign policy, Ted Galen Carpenter, argues that the lesson of Iraq is not that we need to do Iraq-style missions better in the future, but that we need to avoid nation-building exercises altogether. In Chapter 27, Tim Lynch argues that we need to close the prison camp at Guantanamo Bay. This is an area where the new administration has already made progress, with President Obama having recently signed an order to close Guantanamo Bay within a year.

In the wake of the financial crisis, it is important that policymakers remember the limits of their ability to control the economy. Jim Dorn, Cato's vice president for academic affairs, argues in Chapter 35 that the Federal Reserve should concern itself exclusively with long-run price stability—that is, avoiding inflation. Unfortunately, Federal Reserve chairman Ben Bernanke appears determined to do just the opposite. So Dorn closes with a reminder, echoed by Cato chairman emeritus William Niskanen in Chapter 36, that the Fed cannot sustainably control output or employment over the long-term. Other chapters deal with the illusion that fiscal policy can "revive" an economy going through a necessary correction.

Spanning practically every issue worked on by U.S. policymakers, the *Handbook* is too rich to possibly detail all of its contents here. But its most important lesson bears repeating: often there is no good reason for policymakers to do anything at all about a problem. As for the other lessons, the *Cato Handbook for Policymakers,* distributed to all members of Congress and to journalists, is available to the public from the Cato store at www.catostore.org or by dialing 800-767-1241. In addition, the complete text of the *Handbook* is available and fully searchable online at http://www.cato.org/handbook.



"A soup-to-nuts agenda to reduce spending, kill programs, terminate whole agencies and dramatically restrict the power of the federal government."

— *WASHINGTON POST*

Teaching Still Pays

It is widely believed that starting public school teacher salaries are too low, and student loan burdens are too high. If true, we could be facing a situation in which recent college graduates cannot afford to go into teaching because they will be unable to repay their college debts. Public policies are already being formulated on the basis of that conclusion. Unfortunately, the only major analysis of teacher salaries and student debt published to date is based largely on borrowers' subjective feelings about debt manageability. To provide legislators with a more objective basis for policymaking, Neal McCluskey, associate director of Cato's Center for Educational Freedom, assesses first- year teachers' ability to pay back college loans given their actual salaries and expenses. In **"Unbearable Burden? Living and Paying Student Loans as a First-Year Teacher"** (Policy Analysis no. 629), McCluskey reveals that first-year teachers in even the least affordable districts can easily afford to pay back their debts. Indeed, with just some basic economizing, a first-year teacher could not only pay back average debt, but could handle debt levels nearly three times the national average. There is no need for policymakers to intervene in either teacher pay or student aid to ensure that college graduates can afford to become public school teachers.

Free the Forests

The Forest Service, Bureau of Land Management, National Park Service, and Fish and Wildlife Service collectively manage well over a quarter of the land in the United States. Although everyone agrees that the lands and resources managed by these agencies are exceedingly valuable, the lands collectively cost taxpayers around $7 billion per year. Several Cato Institute studies have called for privatization of the public lands, but this idea is strongly resisted by environmentalists, recreationists, and other users of public land. In **"A Matter of Trust: Why Congress Should Turn Federal Lands into Fiduciary Trusts"** (Policy Analysis no. 630), Cato senior fellow Randal O'Toole offers an alternative policy that would both enhance the values sought by environmentalists and improve the fiscal management of the lands: turning those lands into fiduciary trusts. Congress should create two types of trusts. Market trusts would have a mission of maximizing revenue while preserving the productive capacity of the land. To achieve this mission, Congress should allow them to charge fair market value for all resources. Nonmarket trusts would have a mission of maximizing the preservation and, as appropriate, restoration of natural ecosystems and cultural resources on the public lands.

No Energy Policy Needed

Many politicians and pundits are panicked over the existing state of the oil and gasoline markets. Disregarding past experience, they advocate massive intervention in those markets, which would only serve to repeat and extend previous errors. Richard L. Gordon, professor emeritus of mineral economics at Pennsylvania State University, says that these interventionists propose solutions to nonexistent problems. In **"The Case against Government**

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Intervention in Energy Markets" (Policy Analysis no. 628), he argues that the interventionists embrace second- and third-best remedies rather than first-best remedies for the alleged problems. Fear of oil imports is premised on pernicious myths that have long distorted energy policy. The U.S. defense posture probably would not be altered by reducing the extent to which oil is imported from troublesome regions. Fears about a near-term peak in global oil production are unwarranted, and government cannot help markets to respond properly even if the alarm proved to be correct. Market actors will produce the capital necessary for needed investments; no "Marshall Plans" are necessary. Price signals will efficiently order consumer behavior; energy-consumption mandates are therefore both unwise and unnecessary.

Free Trade in Services

Although they are part of a large and growing segment of world trade—and a prominent feature in healthy, vibrant economies—services are often overlooked in trade negotiations in favor of higher-profile trade in agriculture and manufactured goods. Yet countries with more open services markets benefit from higher growth rates and living standards. Because services are an input to most other sectors of the economy, the benefits from open and competitive markets are pervasive. Indeed, the gains from lowering remaining trade barriers in services would eclipse the gains from trade liberalization in agriculture and manufacturing. The recently derailed Doha round of global trade talks seem to have put globally coordinated efforts towards liberalizing services trade on the back burner for the foreseeable future. Fortunately, the United States does not have to wait for a negotiated trade agreement to benefit from more open trade in services. In **"A Service to the Economy: Removing Barriers to 'Invisible Trade'"** (Trade Policy Analysis no. 38), Sallie James, policy analyst with Cato's Center for Trade Policy Studies, argues that the United States should continue to press other nations, including developing countries, to open their markets to American service providers, while removing unwieldy restrictions at home. By autonomously reducing the remaining barriers on maritime services, rail and air transportation services, distribution services, and restrictions on the temporary entry of workers from abroad, many of the benefits to American consumers and industry will be realized regardless of what other nations choose to do.

A Corporate Model for Medicine?

The traditional model of medical delivery, in which the doctor is trained, respected, and compensated as an independent craftsman, is anachronistic. When a patient has multiple ailments, there is no longer a simple doctor-patient or doctor-patient-specialist relationship. Instead, there are multiple specialists who have an impact on the patient, each with a set of interdependencies and difficult coordination issues that increase exponentially with the number of ailments involved. In **"Does the Doctor Need a Boss?"** (Briefing Paper no. 111), Michael Cannon, director of health policy studies at the Cato Institute, and Arnold Kling, a Cato adjunct scholar, propose a market solution to the problem: a corporate model of organization. At least two forces stand in the way of robust competition from corporate health care providers. First is the regime of third-party fee-for-service payment, which is heavily entrenched by Medicare, Medicaid, and the regulatory and tax distortions that tilt private health insurance in the same direction. Consumers should control the money that purchases their health insurance, and should be free to choose their insurer and health care providers. Second, state licensing regulations make it difficult for corporations to design optimal work flows for health care delivery. Under institutional licensing, regulators would evaluate how well a corporation treats its patients instead of the credentials of the corporation's employees. Alternatively, states could recognize clinician licenses issued by other states. That would let corporations operate in multiple states under a single set of rules and put pressure on states to eliminate unnecessarily restrictive regulations.

"To Be Governed..."

A GOVERNMENT THAT NEEDS ANOTHER $825 BILLION

Agriculture Secretary Tom Vilsack . . . learned that his new workplace contains a post office, fitness centers, cafeterias and 6,900 employees. But he remained uncertain about exactly how many employees he supervises nationwide.

"I asked how many employees work at USDA, and nobody really knows," he said.

—*Washington Post,* January 24, 2009

THANK YOU, PRESIDENT BUSH

Barack Obama takes office today with a realistic prospect of joining the ranks of history's most powerful presidents. . . .

Historians, recent White House officials and senior members of the incoming team expressed broad agreement that Obama begins his term in command of an office that is at or near its historic zenith. . . .

The federal government itself is a far more potent instrument, in its breadth and depth of command over national life, than it has ever been before.

—*Washington Post,* January 20, 2009

KEYNES IS BACK AND AMERICA'S GOT HIM

Policy makers are invoking the ideas of British economist John Maynard Keynes (pronounced "canes"), who argued that governments should fight the Great Depression in the 1930s with heavy spending. With consumer and business spending so weak, he argued, governments had to boost demand directly.

Drama was a Keynes tool. During a 1934 dinner in the U.S., after one economist carefully removed a towel from a stack to dry his hands, Mr. Keynes swept the whole pile of towels on the floor and crumpled them up, explaining that his way of using towels did more to stimulate employment among restaurant workers.

—*Wall Street Journal,* January 8, 2009

YOU COULDN'T TELL IT BY THE FEDERAL BUDGET OVER THE PAST EIGHT YEARS

House Minority Leader John Boehner [says,] "I and most Republicans believe that a smaller, less costly government gives us a healthier economy and a healthier society."

—National Public Radio, January 22, 2009

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

CHRISTMAS PRESENT FOR WASHINGTON

The government's bailout of the banking and automobile industries is likely to expand the federal bureaucracy, creating jobs that could fill vacancies in office buildings, according to the report by the Downtown D.C. Business Improvement District.

—*Washington Post,* December 24, 2008

CONVERGENCE AT LAST

The Kremlin seems to be capitalizing on the economic crisis, exploiting the opportunity to establish more control over financially weakened industries that it has long coveted.

—*New York Times,* December 7, 2008

HE'S BETTING OUR MONEY

Obama Bets Big on Big Government

—Headline in the *Washington Post,* January 8, 2009

WASHINGTON'S VIEW OF THE WORLD

Cobb Island [Md.] has always attracted a variety of people, from government workers to politicians.

—*Washington Post,* January 31, 2009

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