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Defender of Constitution, Cato's new chair
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Mayor and drug-raid victim
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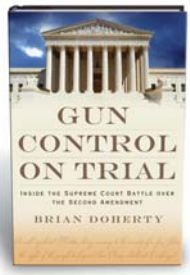

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Cato Policy Report

November/December 2008 Vol. XXX No. 6

Are We Ailing From Too Much Deregulation?

BY DAVID R. HENDERSON

"Americans May be Losing Faith in Free Markets" reads the title of a July 16 "news analysis" by *Los Angeles Times* reporter Peter G. Gosselin. "Wave Goodbye to the Invisible Hand" is the title of an August 1 article by Pulitzer Prize–winning *Washington Post* columnist Steven Pearlstein.

This recent trend in economic reporting actually began with an April 13 article by *New York Times* economics reporter Peter S. Goodman titled "A Fresh Look at the Apostle of Free Markets." Goodman's article, which I examined at length on the Cato@Liberty blog, was full of misinformation, not just about his subject, Milton Friedman, but also about economic thought and about the state of the U.S. economy. The newer articles continue the trend. And they're all wrong.

Many journalists claim that the U.S. economy since the late 1970s has been very free, with little regulation; that this absence of regulation has caused markets to fail; that there was a consensus in

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DAVID R. HENDERSON is a research fellow with the Hoover Institution and an associate professor of economics at the Naval Postgraduate School in Monterey, California. He was previously the senior economist for energy policy and health policy with President Reagan's Council of Economic Advisers. He is the editor of *The Concise Encyclopedia of Economics*.

Gov. Mark Sanford (R-SC) was one of a number of distinguished speakers at the annual Cato Club 200 retreat, held in September at Kiawah Island, South Carolina. Sanford, one of the most small-government elected officials in the country, spoke on the continuing tension between the "Ted Stevens branch" and the "Tom Coburn branch" of the Republican party, and he urged the assembled Sponsors to continue to support candidates in favor of lower spending and greater personal choice.

BY EDWARD H. CRANE

> "The logic behind the superiority of capitalism hasn't disappeared because of the recent economic unpleasantries."

Message from the President

Taking Ideas Seriously

"Fannie Mae Corporation is easing the credit requirements on loans that it will purchase from banks and other lenders. . . The nation's biggest underwriter of home mortgages has been under increasing pressure from the Clinton Administration to expand mortgage loans among low and moderate income people."
—New York Times, *September 30, 1999*

The utter foolishness of the commentaries about the collapse of laissez-faire capitalism and the end of libertarianism in light of the financial fiasco we face is laid bare by the above quote. In that *Times* article cheering the enlightened policies of the Clinton altruists, the one free-market person quoted was Peter Wallison of the American Enterprise Institute. Wallison said, "This is another thrift industry growing up around us. If they fail, the government will have to step up and bail them out the way it stepped up and bailed out the thrift industry."

Let's try to think clearly about all this. The federal government has been regulating banks and monetary policy *intensely* since the 1913 creation of the Federal Reserve and well into the 19th century in the case of banks. Laissez-faire capitalism this ain't. It is not even clear it's capitalism. This is a crisis born and bred in halls of the United States federal government. It is the furthest thing from a market failure. It is a pure example of government failure.

Jacob Weisberg, editor of *Slate,* begs to differ. In an article entitled "The End of Libertarianism," he cites as "a source of mild entertainment" the efforts of libertarians to point out this government failure. Our efforts, Weisberg says, "fall wildly short of providing any convincing explanation for what went wrong." Hmmm.

Let's go back to the $800 billion bailout of the savings and loan industry in the mid-eighties. Big government friends of Mr. Weisberg had clamored for more and more federally insured deposits (not per person, but per deposit) which had the effect of wealthy people spreading $100,000 deposits around the country, oblivious to the financial conditions of the thrifts. In 1982, at a time when the federal government and other big government apologists were saying the thrift industry was sound, with a solid positive net worth, Cato published a Policy Analysis by Joe Stilwell that read in part, *"The financial health of the savings and loan industry has drastically deteriorated. The industry has a negative net worth in excess of $70 billion and it is experiencing significant liquidity problems."*

So much for libertarians not understanding how markets work. As for the subprime crisis, it was not just Peter Wallison sounding the alarm. In 1997 Cato published a Policy Analysis by Vern McKinley entitled "The Mounting Case for Privatizing Fannie Mae and Freddie Mac." Vern wrote: *"Because of their quasi-government status, there is a market perception that Fannie Mae and Freddie Mac mortgage-backed securities and debt carry and implicit federal guarantee against default. Hence, the GSEs expose the federal taxpayer to an ever-increasing potential contingent liability that could ultimately cost tens of billions of dollars to rectify."*

In the meantime, the sophisticated big government types so admired by Jacob Weisberg were demanding more mortgages for people who should have been renting rather than buying. Rep. Barney Frank was typical when he said in 2003, "I do not see any possibility of serious financial losses to the treasury" because of Fannie or Freddie. He urged the agencies the "roll the dice" by making even shakier loans. To see the likes of Frank, Sen. Christopher Dodd, Rep. Maxine Waters, and others who demanded the Community Reinvestment Act and more sick loans from Fannie and Freddie preening in front of cameras celebrating the "end of capitalism" is, well, appalling.

The latest affront to common sense is the demand from House Speaker Nancy Pelosi and Senate Majority Leader Harry Reid that the clueless secretary of the Treasury, Henry Paulson, use some of the unconstitutionally acquired $700 billion bailout dough to bail out the auto companies. Never mind that those companies are in trouble for caving in to the very unions whose uncompetitive wages and benefits are the main source of the problem. Pelosi and Reid, both of whom support the "card check" proposal that will end up physically intimidating millions of workers into joining unions, are longtime union advocates in Congress. As with the subprime crisis, the creators of the auto industry disaster are demanding that you and I pony up to cover up their mistakes.

The logic behind the superiority of capitalism hasn't disappeared because of the recent economic unpleasantries. Indeed, capitalism's resilience in overcoming the spending and regulatory burdens from the New Deal to George W. Bush is a testament to the strength of the market. Bureaucrats and politicians make things worse. Always have, always will. Get rid of corporate welfare, to be sure, but free America's entrepreneurs to do what they and only they do best: create wealth.

Niskanen honored for 23 years of service

Cato Names Robert Levy Chairman

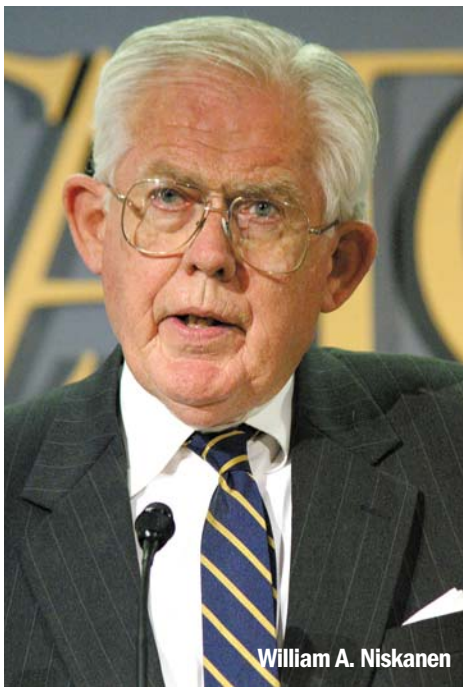
Robert A. Levy, former senior fellow at Cato's Center for Constitutional Studies and a board member since 2007, has been elected as chairman of the Cato Institute. He succeeds William A. Niskanen, who was elected chairman emeritus after 23 years of valued service. The change was precipitated by evolving corporate governance standards favoring nonemployees as board chairmen.


Robert A. Levy

After receiving his PhD in business from American University, Robert Levy founded CDA Investment Technologies, a major provider of financial information and software, where he served as CEO until 1991. He then received a JD degree from George Mason University School of Law and subsequently clerked for Judge Royce Lamberth on the U.S. District Court in Washington and for Judge Douglas H. Ginsburg on the U.S. Court of Appeals for the D.C. Circuit. Levy joined the Cato Institute in 1997 as a senior fellow in constitutional studies, covering such issues as tobacco regulation, Microsoft and monopolies, José Padilla, and the future of federalism. Levy originated, organized, and funded the recent challenge to the District of Columbia's draconian gun laws that resulted in the *Heller* Supreme Court decision upholding an individual's right to keep and bear arms under the Second Amendment. He is the coauthor, with Institute for Justice president William H. Mellor, of the widely acclaimed *The Dirty Dozen: How Twelve Supreme Court Cases Radically Expanded Government and Eroded Freedom*.

Before joining Cato, William A. Niskanen served as acting chairman of President Reagan's Council of Economic Advisers. He also served as chief economist at Ford Motor Company, and filled top-level positions at the Office of Management and Budget and the Defense Department. Niskanen was professor of economics at both the University of California, Los Angeles, and the University of California, Berkeley. He has written books, studies, and op-eds on a remarkable range of subjects, including national defense, budget policy, regulation, Social Security, taxes, trade, and more, including the classic public choice text *Bureaucracy and Representative Government*. Much of his writing found its way into his recently released collection of essays *Reflections of a Political Economist*.

Cato Institute president Ed Crane said, "I salute Bill for his more than two decades of service to the Institute and look forward to working with him as a colleague in the years ahead. We are very pleased to be able to have another distinguished American, Bob Levy, take over the chairmanship."


William A. Niskanen

NEWS NOTES

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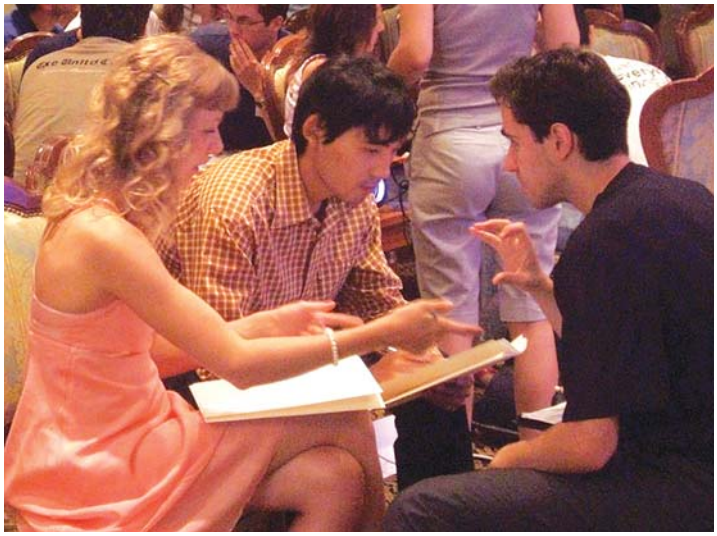
Seminars on Freedom around the World

Between mid-June and mid-September the Cato Institute and its Center for Promotion of Human Rights held week-long seminars on individual freedom, property rights, and free markets in Ghana, the Republic of Georgia, California, Morocco, Germany, Belgium, Malaysia, China, Ukraine, and Slovenia—and even on Capitol Hill in Washington.

Tom G. Palmer, vice president for international programs at the Cato Institute and director of the Center for Promotion of Human Rights, lectures on the long history of liberty at the Freedom Academy in Selangor, Malaysia. Palmer taught in Ghana, Germany, Hong Kong, China, the United States, Belgium, Ukraine, and Malaysia during the summer.



Alushta, a town on the Black Sea in Crimea, Ukraine, was the site of an intensive Cato.ru seminar on "Property and Freedom." Here students prepare their arguments for a class on defending the market economy.

Prof. Boudewijn Bouckaert of the University of Ghent explains the relationship between a prosperous market economy and the rule of law at a Cato seminar in Bakuriani, Georgia. Most of the students were from Eastern Europe and Central Asia.

Cato director of health policy studies Michael Cannon explains the complexities of health care economics—and the dangers of ever more state control over health decisions—at Cato University in San Diego.

June Arunga explains the virtues of sound thinking about rights, law, and public policy, and the benefits of freedom of thought and enterprise, to students from West African nations at the seminar in Accra, Ghana.

U.S. Circuit Judge Stephen F. Williams in Yalta, at the Livadia Palace where the fate of Eastern Europe was decided by Churchill, Roosevelt, and Stalin. The visit was during a historical field trip from the Cato.ru Summer Seminar in nearby Alushta, where Williams lectured on the history of property rights in pre-Bolshevik Russia.

Professor Liu Junning explains the principles of constitutionalism, rights, and the spontaneous emergence of order at the summer seminar in Huangzhou, China.

Faculty and students at the conclusion of the Akademi Merdeka ("Freedom Academy") in Malaysia, which marked the launch of the WauBebas.org ("Kite of Freedom") program cosponsored by the Cato Institute and the Malaysia Think Tank.

Continued from page 1

favor of little regulation; and that, now, this consensus is fading. On all these counts, the reports are false. Specifically, the U.S. economy has not been free since before the New Deal of the 1930s. Even before the 1930s, the U.S. economy was "mixed"—that is, a combination of economic freedom and government regulation—and Franklin Roosevelt's New Deal altered the "mix" substantially toward regulation and away from freedom. The deregulation of the late 1970s and 1980s reversed some of the regulations that came with the New Deal and some that preceded it, but the net amount of regulation has been much higher in the alleged era of deregulation than it was during the post–National Recovery Admnistration New Deal. Moreover, most of the apparent "market failures" that these articles refer to fall into one of two categories: Either they are not market failures at all, but market successes, or they are failures that are due to government regulation. Also, the consensus has not shifted from deregulation to regulation: there never was a consensus in favor of deregulation. There was a consensus in favor of deregulation among economists and a minority of politicians in the late 1970s and early 1980s, but never among the majority of politicians. Finally, most of the problems that have happened in the U.S. economy in the last few years strengthen the case for economic freedom and against government control.

Consider some specifics. Pearlstein writes:

> For the past 25 years, the United States has put its faith in open, unregulated and lightly taxed markets, and there's little doubt that, over time, that model has expanded economic output and improved economic efficiency. But what Americans have also come to realize is that the same model is less adept at providing other things that we value highly—things like safety, fairness, economic security and environmental sustainability.

There are two main problems with that two-sentence paragraph: the first sentence and the second sentence.

> "The U.S. economy has not been free since before the New Deal of the 1930s."

An Era of Deregulation?

Take the first sentence. "Unregulated markets" for the past 25 years? The Federal Register, which lists new regulations, averaged 72,844 pages annually during the Carter years from 1977 to 1980. These were presumably, by Pearlstein's 25-year standard, the last time before now that Americans didn't have "faith" in open, unregulated markets. Then the average fell to 54,335 during the Reagan years, rose to 59, 527 during the Bush I years, to 71,590 during the Clinton years, and, finally, to a record 75,526 during the administration of that great believer in laissez-faire, George W. Bush. It's true that when governments deregulate, they must announce those changes in the Federal Register, too, and so some of the pages represent genuine deregulation. But most of the pages were new regulations, no matter what president was in power at the time. So, far from moving away from regulation, the U.S. economy became even more regulated during Pearlstein's alleged 25-year era of light regulation.

Of course, the number of pages in the Federal Register is a crude measure of regulation. But it's not the only measure we need rely on. Veronique de Rugy and Melinda Warren, in "Regulatory Agency Spending Reaches New Height," an August 2008 report by the Mercatus Center and the Weidenbaum Center, found that between 1980 and 2007, roughly the years that Pearlstein labels "unregulated," the number of full-time employees of U.S. government regulatory agencies increased 63 percent, from 146,139 to 238,351. During that same time, the U.S. population rose from 226.5 million to about 301 million, an increase of only 33 percent. Moreover, according to de Rugy and Warren, U.S. government spending on regulation alone (not including compliance costs, a much bigger number) tripled, from $13.5 billion to $40.8 billion (all in 2000-year dollars.) As a percent of GDP, spending on regulation rose from 0.26 percent to 0.35 percent, a 35-percent increase. Some deregulation.

One could argue that we need to distinguish here between different kinds of regulation. Often people refer to "economic regulation" when they mean restrictions on whether new firms can enter businesses or that require firms to get government permission before setting their prices. If this is what they mean, then there is a case to be made that, in substantial sectors of the economy, there is less government regulation now than before the late 1970s. There has been substantial deregulation at the federal level of airlines, trucking, railroads, oil, and natural gas, to name five large sectors. And indeed, as we shall see later, this deregulation has had, on net, good effects.

What was the nature of this new regulation? The biggest growth came in so-called "homeland security," where spending more than quintupled, from $2.9 billion in 1980 to $16.6 billion in 2007 (all in real 2000 dollars). The second-largest growth rate was in regulation of finance and banking, where spending almost tripled, rising from $725 million to $2.07 billion. Together, regulation of homeland security and of finance and banking now account for over half of federal regulatory spending.

Markets vs. Government

Also incorrect is Pearlstein's second sentence. Free markets have done much better than governments at providing safety, fairness, economic security, and environmental sustainability. The reason, for three out of the four, is simple. Economic freedom tends to lead to economic growth, as Pearlstein himself admits in the above quote, and economic growth leads to more safety, more economic security, and more demand for environmental quality. Safety and environmental quality are what economists call "normal goods." As our real incomes rise, we want more of them. Over the 20th century, as our real incomes rose, we workers demanded more safety. And we got it. As economist W. Kip Viscusi

> "Free markets have done much better than governments at providing safety, fairness, economic security, and environmental sustainability."

notes in "Job Safety," published in *The Concise Encyclopedia of Economics,* as U.S. per capita disposable income per year rose from $1,085 in 1933 to $3,376 in 1970 (all in 1970 prices), death rates on the job fell from 37 per 100,000 workers to 18 per 100,000. Note that all of this preceded the Occupational Safety and Health Administration, which began in 1970. This shouldn't be surprising. As workers, we show our demand for safety by the wage premium we insist on to take a given risk. As real incomes rose, this wage premium rose. Employers found it cheaper to avoid some of the risk premium by reducing risk—that is, by increasing safety. In short, there is and has been a "market for safety."

The case with environmental quality is similar. Past some income level, environmental quality is almost certainly a normal good, that is, a good that people demand more of as their income increases. But demand does not guarantee supply. Why not? One major factor is that so much of the environment is a "commons," a resource that everyone can use but no one owns. As Garrett Hardin pointed out in his classic 1968 article "The Tragedy of the Commons," when no one owns a resource, it will be overused because no one has much incentive not to overuse it. One obvious solution is to transform, to the extent possible, the commons into private property. This has been done with rivers, lakes, and land, but is hard to do with air and oceans. But certainly we could go much further toward private ownership than we have until now, turning rivers, for example, into private property, as is done in Scotland. Scotland, not coincidentally, has pristine rivers. So note the irony. Contra Pearlstein, one reason that we haven't had the environmental quality we have demanded is that overregulation has prevented private ownership.

On the issue of economic security, the wealthier we are, the more secure we are. And because, as Pearlstein himself admits, economic freedom creates wealth, it necessarily creates security. Virtually no one in America ever needs to worry any more about starving. That is in part due to the welfare state but is mainly due to the riches created by relatively free markets. Of course, if, by "economic security," Pearlstein means confidence that one's income will never fall, then he's right that markets don't lead to that. Nor does government regulation. Government regulation of the economy's money supply, high tariffs, high taxes, and regulations that kept wage rates high all caused the Great Depression or contributed to its length.

Freedom and Fairness

Pearlstein objects that economic freedom does not lead to fairness, but it does. One of the fairest things in life is that people reap what they sow, getting the benefits when they make good decisions and bearing the costs when they make bad ones. Markets create that fairness every day. And what makes Pearlstein's argument ironic is that elsewhere in his article he writes that "government has had to step in to rescue the markets from their excesses and prevent a meltdown of the financial system." If he really believes that these are excesses and if he really wants fairness, why does he think that the government should bail people out from their mistakes? Some of the people whom the government is bailing out are very wealthy people who will retain more of that wealth because of the bailouts. Many of the people paying taxes for the bailouts are middle-income people who acted responsibly. Just what is Pearlstein's view of fairness, anyway?

In his article, Gosselin details three factors that are "pushing people to favor more regulation"—the high price of gasoline, the fall in house prices, and the dismal performance of the stock market for most of the current decade. If Gosselin were simply stating that these factors have made people more favorable to regulation, he might have a point. But that's not all he does. He seems to take the side of those who see these three factors as market failures. On gasoline prices, although he points out that most economists think these prices are due to "booming global demand meeting limited global supply," he dismisses this reasoning, arguing that "the price run-ups seem out of whack with demand, which has increased only about 1% worldwide." But Gosselin is confusing demand and consumption. It's consumption of oil that has increased a little. Demand has increased much more than consumption. That's why the price rose. A standard exercise in introductory economics classes is to show students that when supply is fairly inelastic and demand increases a lot, the price will rise a lot, and the actual amount produced and consumed will rise just a little. That's what has happened in the world oil market. Moreover, why has global oil supply been so limited? There are three main factors, all of which are entirely due to regulation. The first factor is OPEC, an organization of governments that regulates the supply of oil. OPEC was formed, incidentally, in response to President Eisenhower's regulations on oil imports, which discriminated against imports from the countries that formed OPEC. The second factor is that almost all oil-producing countries in the world have government-run oil industries. The third factor is the U.S. government's restrictions on offshore drilling for oil and on oil development in the Arctic National Wildlife Refuge. Whether one favors or opposes these restrictions on drilling, the point is that they do constrain the supply of oil and do, therefore, cause the price of oil to be higher than otherwise.

Interestingly, Gosselin leaves out the major price declines that have occurred in some of the most unregulated or newly deregulated parts of the economy: computing power (there is little regulation of the computer industry) and clothing (there has been a major shift toward free trade in clothing.)

> "The three overriding facts are: (1) we have not had a period of light regulation, (2) deregulation didn't fail, and (3) regulation makes things worse."

Fannie, Freddie, and the Housing Crunch

On housing prices, Gosselin claims that "the rise in house prices and the recent plunge grew out of an almost unregulated corner of the mortgage market—the one for riskier loans." But in fact much of this problem arose from regulation. Jeffrey Hummel and I detailed how in *Investors' Business Daily* ("Blame the Feds, Not the Fed, For Subprime Mortgages," March 23, 2008). Federal government regulation contributed in three ways. First, the federal government helped cause the boom in housing prices by helping cause moral hazard: people taking risks because they know that if things turn out badly, someone else will bear some of the cost. The federal government's semiautonomous mortgage agencies—Fannie Mae, Freddie Mac, and Ginnie Mae—all buy and resell mortgages. Of the more than $15 trillion in mortgages in existence in early 2008, about one third were owned by, or were securitized by, Fannie Mae, Freddie Mac, Ginnie Mae, the Federal Housing and Veterans Administration and other government agencies that subsidize mortgages.

Although Fannie Mae and Freddie Mac were no longer government agencies during the time period at issue, they were government-sponsored enterprises. Many buyers of their repackaged loans, therefore, assumed an implicit federal-government guarantee. That assumption, as we now know, was all too true. This implicit guarantee caused less scrutiny by lenders than otherwise, which helped drive up housing prices.

The federal government's second contribution to the increase in housing prices was the Community Reinvestment Act. This act, first passed in 1977 and beefed up in 1995, requires banks to lend in high-risk areas that they otherwise would avoid. Banks that fail to comply pay fines and have more difficulty getting approval for mergers and branch expansions. As Stan Liebowitz, a University of Texas economist, has pointed out, a Fannie Mae Foundation report enthusiastically singled out one mortgage lender that followed "the most flexible underwriting criteria permitted." That lender's loans to low-income people had grown to $600 billion by 2003. Its name? Countrywide, the largest U.S. mortgage lender and one of the lenders in the most trouble for its lax lending practices.

Finally, a little-noted change in regulations by the comptroller of the currency in December 2005 acted as the trigger. The comptroller made it mandatory for banks to require minimum payments on credit card balances, causing increases of at least 50 percent for most cards and as much as 100 percent on others. Many people who hold subprime mortgages are people for whom a higher monthly payment on a credit card would be a problem. Whereas before this regulation, many people's priorities would have been mortgage first, credit card second, the new regulation caused many borrowers to reverse the order. Thus the comptroller's seemingly small increase in regulation had the unintended effect of causing some mortgage borrowers to default.

This is not to say, of course, that private businesses never do anything stupid unless it is caused by bad government policy. Certainly, many actors in the private sector put their and other people's money at risk in absurd way. It is safe to say, though, that in the case of the subprime mess, regulation and government subsidies deserve much of the blame.

Why Regulation Fails

Moreover, notably absent from all four earlier-mentioned articles is an argument for why regulation would work or how deregulation fails. I have already provided evidence of how badly regulation has worked in oil and in the housing market. But there's more to say. There are two main reasons that regulation generally works out badly. One is that the regulators have little incentive to get things right. Indeed, when their regulations fail, they often use this fact to argue for more power and more regulation. Astonishingly, the argument often works. The second reason is that regulatory agencies are often captured by the politically powerful and used to stomp out competition. The recent regulations on housing finance, for example, require mortgage brokers to be licensed. That will reduce competition in mortgage brokering and enhance the incomes of existing mortgage brokers.

And we have powerful evidence of the beneficial effects of deregulation. Air fares, for example, according to Brookings Institution economists Clifford Winston and Steven Morrison, are 22-percent lower than they would have been had regulation continued. Brookings economist Robert Crandall and Mercatus economist Jerry Ellig estimated in the late 1990s that when the lower air fares are adjusted for the decline in quality and amenities, passengers saved a cool $19 billion a year. In other words, the majority of us prefer lower fares to higher fares, more meals, and emptier airplanes. According to Hoover Institution economist Thomas G. Moore, between 1977, the year before deregulation of trucking began, and 1982, inflation-adjusted rates for truckload-size shipments fell by 25 percent and service quality improved. And, of course, because of decontrol of oil and gasoline prices under presidents Carter and Reagan, increases in world oil prices have been passed on to consumers rather than suppressed, so that the time-killing line-ups for gasoline in the 1970s have not been repeated.

It's possible that I'm being uncharitable in interpreting Gosselin. Perhaps his tone simply reflects the tone of Americans whom he sees as souring on economic freedom. But shouldn't economic journalists, whatever else they do, get the facts right? And the three overriding facts are: (1) we have not had a period of light regulation, (2) deregulation didn't fail, and (3) regulation makes things worse. ■

Should No-Knock Police Raids Be Rare or Routine?

The police department of Prince George's County, Maryland, is under fire for a recent drug raid on the home of Berwyn Heights mayor Cheye Calvo. Unbeknownst to Calvo, a box containing marijuana was delivered to his home. Shortly thereafter, police officers kicked in the front door and shot both of Calvo's pet Labrador retrievers. The police subsequently cleared Calvo of any wrongdoing but are unapologetic about their raid tactics. Are no-knock, paramilitary raids an appropriate tactic for drug investigations? Or do sudden, unannounced entries bring unnecessary violence to police investigations? Weighing in at a September 11 Cato Policy Forum were Cheye Calvo, mayor and victim of a botched no-knock raid, Radley Balko, senior editor at *Reason* magazine and author of the Cato White Paper *Overkill: The Rise of Paramilitary Police Raids*, and Peter Christ, co-founder of Law Enforcement Against Prohibition.

CHEYE CALVO: My wife and I are still in our 30s and don't have kids of our own. But we do have—or we *did* have—two black labs.

The story of their deaths begins on July 29, 2008, a regular summer day. I was hosting a community meeting that evening, but before that I returned home from my day job to walk my dogs. Before I left on my walk, my mother-in-law, who was cooking, told me a package had been delivered and was on the front step. On the walk, I noticed that a few black SUVs in the neighborhood, but thought little of it other than to wave to the drivers.

When I returned home, I picked up the box, which was addressed to my wife, and took it inside where I left it unopened on the living room table. I went back upstairs to get into business attire for my meeting.

I was in my boxer shorts when I heard my mother-in-law scream. It was a loud, fearful scream. I ran to the window, where I saw three or four men dressed in black with high-caliber rifles in my yard approaching my house.

I then heard an explosion, which was the sound of my door being blown open, followed by immediate gun fire. There were loud noises, the sounds of boots, and then more gunfire.

I hit the floor and began to yell, "I'm upstairs; please don't shoot!" The men in black had me walk downstairs backwards, in my boxer shorts, with my hands in the air. I still can see two high-caliber rifles pointed at me. At the bottom of the stairs, they bound my hands, pulled me across the living room, and forced me to kneel on the floor in front of my broken door. I thought it was a home invasion. I was fearful that I was about to be executed.

I could see my mother-in-law bound, lying face down on the kitchen floor. Payton, my older dog, was lying dead in a pool of his own blood on the other side of the living room. I soon learned that my younger dog, Chase, was dead in a back room, where he had been shot from behind as he ran away. There were perhaps a dozen men in black, just standing around in my living room. I asked for a warrant. They said that they did not have it with them, but one was en route.

For most of the nearly four-hour ordeal, I was being interrogated, half-dressed in my living room and then in my kitchen. It was surreal.

My wife came home to a SWAT team on our lawn. She figured someone had broken into our house. She asked them about me, about her mother, and then learned that the dogs had been killed. She sobbed.

We offered them anything they wanted and answer their questions as best we could. They left a little after 11:00 p.m. They found nothing to connect us to the box, which they had delivered to our doorstep and said contained 32 pounds of marijuana. Still, they told us we were "parties of interest" and were lucky not to be arrested. I, in particular, was "suspicious" because I had not acted in a typical manner, they said.

Then they left us with an unsecured door, our belongings turned upside down, and two enormous pools of blood, which were tracked and splattered across the floor.

The media circus began the next morning. We had live camera feeds on us when we picked up the paper in the morning. It was particularly rough on my family.

But I'm also a mayor. The raid didn't only affect me: it affected my community. The community rallied behind us. No one in my town ever even asked if we were drug traffickers.

Soon the facts came out. Ten days later, they had arrested the FedEx delivery man and an accomplice in a drug-trafficking scheme. The incident was the subject of international attention, we were exonerated, and the FBI had agreed to open an investigation into county law enforcement agencies for their behavior in ours and other similar cases.

When the raid first happened, I thought

that it was a terrible mistake, but it soon became clear that it was a symptom of deeper problems. Although the box was worthy of police interest, the police failed to do basic investigatory work before deploying a SWAT team. They did not know who I was and had no idea that I was the mayor, which a simple property records check and Google search could have told them. They did not properly survey the house or inform the town police of the operation, which they were required to do under a memorandum of understanding.

However, once made, rather than acknowledge the mistake, they defended the indefensible and then blamed the victims. For the unlawful entry and lack of a "no-knock" warrant, they blamed my mother-in-law's scream for compromising the standard warrant and requiring them to blow down the door, guns blazing. In fact, they continue to deny the existence of "no-knock" warrants in the state of Maryland despite a 2005 law. They even blamed my dogs for "engaging" the officers even though their public statements contradict the physical evidence.

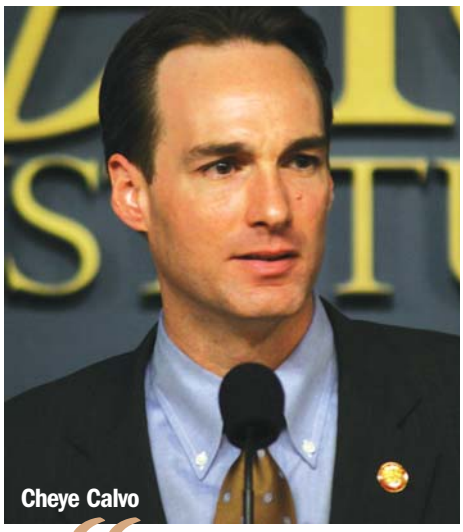
Overreliance on paramilitary police operations has a devastating effect not just on the immediate victims but on whole communities. They undermine relations between the police and underserved areas that need police cooperation the most.

Police activities too often lack adequate oversight, and good people in a bad system will do bad things. Elected officials must exercise leadership and keep these paramilitary units in check.

A SWAT team should be a last, rather than the first, resort. Paramilitary responses are immediate, swift, and painful; the police are supposed to be operating at a more measured pace that follows due process. I'm very concerned about a system of policing that is focused on overwhelming force out of the gate. They are search and destroy, not serve and protect.

RADLEY BALKO: In what types of situation is forced entry appropriate? What happened to Mayor Calvo is awful. But I would argue that even if Mayor Calvo had been guilty, these tactics are wholly inappropriate. No-knock raids are not a proper way to police nonviolent drug crimes. The idea that we have police officers armed, in some cases better than our military is armed in Iraq, breaking down people's doors to serve warrants to prevent people from getting high is absurd. And in many ways, it shows how absurd the drug war has become.

In July 2006, I wrote the Cato White Paper *Overkill: The Rise of Paramilitary Police Raids*, a study of 180 botched raids. Since that paper came out, there have been a couple dozen more botched raids. The raids


Cheye Calvo

> "Overreliance on paramilitary police operations has a devastating effect not just on the immediate victims but on whole communities."

themselves are not rare occurrences. One criminologist says they occur to 40,000 to 50,000 people per year in this country. The vast majority of those are to serve drug warrants, and the vast majority of those are to serve warrants on nonviolent offenders.

After every botched raid, there's a review. It's always the same. It was a tragic, horrible mistake, but it was a *mistake*, policy was generally followed, and no one is to blame.

How did we get here? What series of assumptions piled on top of one another does it take to get to a point where our public officials can look at what happened to Mayor Calvo—and can look at people who have lost their *own* lives to botched raids—and conclude that as tragic as the situation is, no one is to blame and no policies will be changed?

The first assumption is the idea that the government has an obligation to protect us from ourselves. To that extent, the government has the obligation to protect us from what some people in the government have determined to be harmful: taking illicit drugs. That view has widespread public support.

The second assumption is that due to the criminal element involved in drug trafficking and sales, a greater show of force than is typical of a police department must be used. Police departments, then, are expected to be extra tough in policing drug offenders. It should be noted that the criminal element is there because of prohibition. When alcohol was prohibited, the gangs ran that business, too.

The third assumption builds on the second. It is that the criminals are outgunning the police—a false assumption I might add—which I go into further in *Overkill*. To that extent, it is assumed that we need very aggressive tactics. We need to declare war on drugs. Drugs are so powerful and such a detriment to society that only the drastic, emergency actions we permit governments to take in wars are appropriate in prosecuting the War on Drugs.

I think this has profound effects on the psychology of police officers who we ask to go out on the front lines in these cases. When you take a police officer, outfit him in military gear, give him military weapons, military training, and tell him he's fighting a war, it's not difficult to understand how the officer might take it to heart.

The fourth assumption is that—because drugs are so bad, drug dealers so violent, and apprehension of drug dealers so necessary—we must break down doors. If we don't break down doors, these drug dealers will either shoot the police officers trying to apprehend them or they will destroy the evidence.

And we need to immediately incapacitate everyone in the house. We have to use exceptionally violent, exceptionally confrontational tactics. Terror tactics. I've written several articles on how the police always shoot

the dogs in these situations. Sometimes it's just to get the dog out of the way. Sometimes it's because the dogs pose a danger, though that's difficult to believe given the bulletproof gear SWAT teams are wearing. It's worth noting, by the way, that Mayor Calvo's dogs were Labrador retrievers, not the most dangerous breed of dog. Whatever the reason, dogs are often dispatched during these raids.

Pile all these assumptions together and you get an absurd conclusion: that it's perfectly appropriate to break someone's door down, shoot their dogs, handcuff them, and throw them on the floor at gunpoint—over a box of marijuana. And even if a mistake is made, no one should be accountable, because the officers followed the proper procedures.

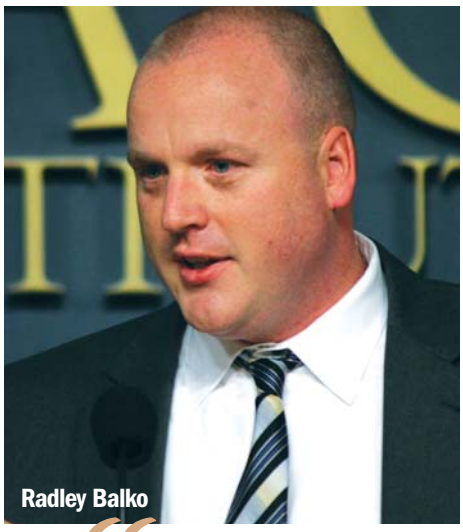
Of course, these procedures are all drawn from the flawed assumptions I've spelled out here.

Absent ending drug prohibition, how can we help roll back problems associated with paramilitary style drug raids? I have a few suggestions:

At the federal level, for 20 years the Pentagon has been giving away surplus military equipment to local police departments. I think that has helped precipitate the rise of SWAT teams. We also have federal police grants that are tied directly to drug policing. This encourages police departments to use SWAT teams for drug offenses, because every time they arrest someone on a drug offense it adds to their statistics, which helps ensure they get those grants. And I think every raid needs to be videotaped. It would be very easy to affix a small digital camera to each officer's helmet or uniform. This would help clear up conflicting accounts by police and those who have been raided.

PETER CHRIST: We've been doing police work for a long time in this country, since about 1800. And we've been serving warrants for a long time, too. I began in the police force in 1969. In the 1970s and 1980s we used to serve warrants like this: "Hello Mr. Smith, we have a warrant for your arrest. If you'll please come with us now we'll have to take you down to the station." There was usually another officer standing there in case there was a problem.

Then in the late 1980s, SWAT teams started becoming fashionable. You have to understand something about police forces to understand this trend: they're still male-dominated and they're relatively youthful. Being a member of a SWAT team is, in a way, like playing "war," only with real toys. Training's a real kick. And when you actually get out there to do it, it's even more thrilling. And the more of it you can do the better.


Radley Balko

"After every botched raid, there's a review. It's always the same. It was a *mistake*. And no one is to blame."

In 1985, we started a SWAT team in our department, a 110-officer unit that policed a suburb of Buffalo with a population of about 85,000. To be sure, we used it very sparingly before my retirement in 1989. But I've noticed, each time I've gone back, that they are making greater use of SWAT.

I've heard from officers: "We spend all this time and money training for SWAT. If we don't use it, what does that say about us?" You have to justify it some way.

We get upset when we hear about what happened to Mayor Calvo, victims we hear about on the news, or victims that Mr. Balko brings to our attention on his blog. They terrify us because we understand it could be us. As long as it's just scummy drug dealers who are victims of these raids, we're OK with it. We're safe in our homes because we know we don't do that.

But if anyone can be raided, then we're all potential victims. That's what Mayor Calvo's story shows.

Who's to blame for this? Well, it's those cops with their guns and their badges and their cars and—now—tanks. That's right, we now have some police departments that have tanks, tanks with 50-caliber machine guns on them. And you ask yourself: what's the matter with these people?

But we never look in the mirror.

Let me introduce a term for you that hasn't been used today: "Collateral damage." We're in a war! You don't worry about victims in a war! If you take gunfire from a village, you respond. You don't worry about women and children when you're at war.

We don't do drug policy in America. We're waging a war.

Seventy-five percent of the violence that we have today is due to the drug war. That still leaves 25 percent consisting of people who do stupid things while on drugs, but it's not nearly as serious as that *other* problem, that 75 percent.

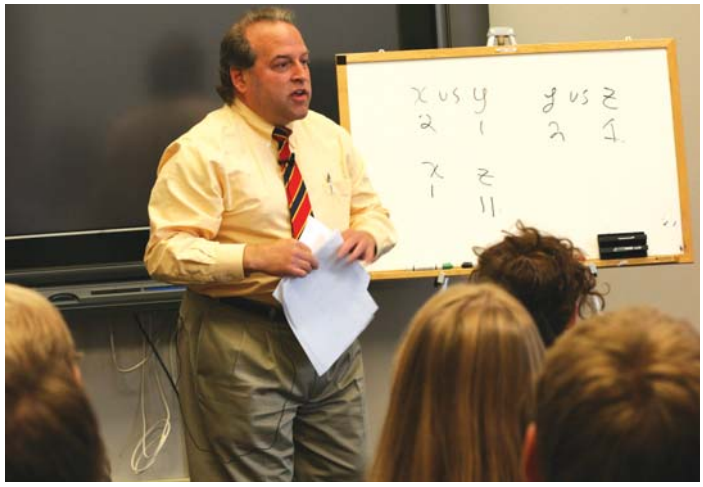
If you're a mayor and you have 10 murders per year, and I come to you with a "solution" for that problem that results in 40 murders per year, are you going to go with that solution? But that's exactly what's happening with the drug war, the ostensible "solution" to the drug problem.

Yet we're not talking about it. There is no active discussion going on in this country about drug *policy*. We're spending all our time dancing around the issue and the ancillary problems associated with it. No one wants to touch it.

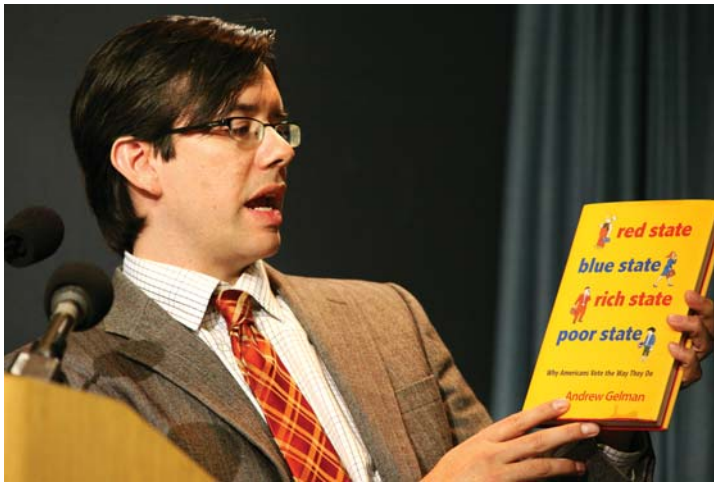
The truth is, at 62 years old, I honestly have no expectation of seeing an end to this drug war in my lifetime. I'm just doing everything possible to help make it end as soon as possible. But we can't make it happen if we don't talk about it. And our failure is to focus on ancillary issues rather than the real issue: drug policy in America—the failure of prohibition. ■

RAZEEN SALLY, senior lecturer at the London School of Economics and the author of the Cato book *New Frontiers in Free Trade: Globalization's Future and Asia's Rising Role,* spoke at a Cato Book Forum in September. Arguing that trade agreements are yielding diminishing returns, he said nations should not wait for reciprocity from their trade partners before bringing down barriers to trade and integration.

Cato friends from far and wide gathered for the annual SalmonFest at the home of Ed and Kristina Crane in September. Pictured: the *Wall Street Journal's* JOHN FUND chats with Cato president ED CRANE.



Some Cato scholars talked about individual rights and markets in places like China and Ghana (see page 4), but Peter Van Doren, editor of *Regulation* magazine, took on the challenge of explaining economics to congressional staffers at Cato University on Capitol Hill during the August recess.



Two months before the election, Cato research fellow Will Wilkinson introduced Andrew Gelman of Columbia University at a Cato Book Forum on his new book, *Red State, Blue State, Rich State, Poor State: Why Americans Vote the Way They Do.* The forum was broadcast by C-SPAN.

AUGUST 12, 14, 19, 21, 26, 28, and SEPTEMBER 2, 4: Cato University on Capitol Hill

SEPTEMBER 11: *Red State, Blue State, Rich State, Poor State: Why Americans Vote the Way They Do*

SEPTEMBER 11: Should No-Knock Raids be Rare or Routine? Featuring Mayor Cheye Calvo

SEPTEMBER 12: Strategic Petroleum Reserve: Reform or Elimination?

SEPTEMBER 14: Salmonfest

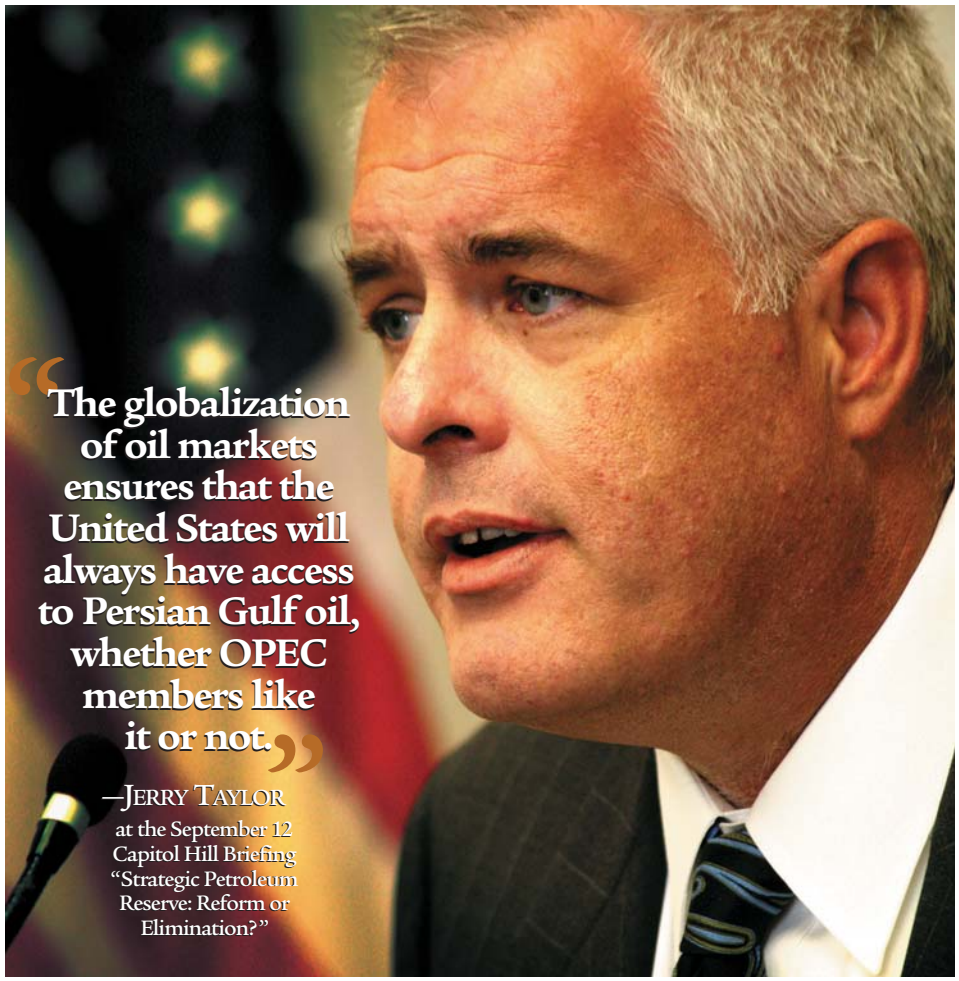
SEPTEMBER 16: *New Frontiers in Free Trade: Globalization's Future and Asia's Rising Role*

SEPTEMBER 17: 7th Annual Constitution Day

SEPTEMBER 18–21: Cato Club 200 featuring Gov. Mark Sanford

SEPTEMBER 22: *Greatest Emancipations: How the West Abolished Slavery*

WANT MORE? 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/archive.html 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

POLICY PERSPECTIVES 2008
New York • Waldorf-Astoria
November 21, 2008
Speakers include Jeffrey A. Miron and Tucker Carlson.

POLICY PERSPECTIVES 2008
Chicago • The Drake
December 3, 2008
Speakers include Charles Murray, William H. Mellor, and Robert A. Levy.

SHAPING THE NEW ADMINISTRATION'S COUNTERTERRORISM STRATEGY
Cato Institute
January 12-13, 2009
Speakers include Mia Bloom, Steve Coll, Robert Pape, Paul Pillar, and Marc Sageman.

21ST ANNUAL BENEFACTOR SUMMIT
Riviera Maya, Mexico • Fairmont Mayakoba
March 4-8, 2009

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

Shaping the New Administration's Counterterrorism Strategy

A Special Two-Day Conference

January 12–13, 2009 • Cato Institute

With a new administration in the White House, January 2009 will be the starting point for a new approach to U.S. counterterrorism efforts. This new conference, with presentations by more than 35 national and global experts,offers extensive analyses of strategic and proven counterterrorism policies that will provide the most beneficial results for the United States.

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This conference is made possible through the generosity of The Atlantic Philanthropies.

Second Amendment, Guantanamo, securities law, and more

Review Looks at Supreme Court's Recent Cases

Every September 17, on the anniversary of the signing of the Constitution in 1787, the Cato Institute holds its Constitution Day conference. (Left) Delivering the seventh annual B. Kenneth Simon Lecture was Georgetown law professor RANDY E. BARNETT, who asked, "Is the Constitution Libertarian?" (Below) THOMAS C. GOLDSTEIN, who has argued 18 cases before the Supreme Court, and EUGENE SCALIA of Gibson, Dunn & Crutcher discussed the Court's upcoming term. (Lower right) JUDGE DOUGLAS H. GINSBURG, who delivered the first Simon Lecture, with JULIANA PILON of the Institute for World Politics; ROGER PILON, director of Cato's Center for Constitutional Studies; and appellate attorney ERIK JAFFE, who wrote in the new *Cato Supreme Court Review* about political parties and the First Amendment.

In this and earlier editions of *Cato Policy Report* we've chronicled the work of Cato chairman Robert A. Levy, who effectively saved the Second Amendment through orchestrating *D.C. v. Heller*, the landmark decision that saw the District of Columbia's gun ban struck down and the right to bear arms restored for all. He didn't do it alone. In the *Cato Supreme Court Review: 2007–2008*, you'll find an in-depth analysis of that case from Levy's co-counsel Clark Neily, as well as analysis of other key cases from the Court's most recent term.

Neily, senior attorney at the Institute for Justice, revisits the intellectual history interpreting the right "to keep and bear arms." He characterizes the pre-*Heller* Second Amendment as "a sort of constitutional Loch Ness Monster," occasionally sighted, but for the most part not believed to exist—especially by judges. Neily credits a wave of scholarship beginning in the 1970s supporting the individual rights interpretation of the Second Amendment, culminating in the adoption of that view by even prominent liberal academics such as Alan Dershowitz. The time was right for the Supreme Court to revisit the Second Amendment, the only question was when. Neily credits Levy for getting a sympathetic plaintiff in Richard Heller, a security guard by day barred from protecting his family similarly by night, before the Court. And he credits another outpouring of legal scholarship, this time in the form of 68 amicus curiae briefs filed, 48 supporting the individual rights view.

Other cases covered include *Boumediene v. Bush*, which saw habeas corpus rights restored to prisoners at Guantanamo Bay military base in a controversial 5-4 decision. Georgetown law professor David D. Cole supports the decision, arguing that being able to jail people and throw away the key is a power the Framers never would have granted government. University of Chicago law professor Eric Posner dissents, pointing out that never before had the Supreme Court declared unconstitutional the joint action of the president and Congress on a military matter during wartime. Nor had the Court extended the writ of habeas corpus to foreigners, especially foreigners held abroad.

The *Cato Supreme Court Review* also covers cases on contracts, securities, class action suits, and patents. It features a meditation on "the once and future first Amendment" by Judge Janice Rogers Brown of the U.S. Court of Appeals for the D.C. Circuit. The *Review* closes with a look ahead at the next Supreme Court term.

Now in its seventh edition, the *Review*, edited by Ilya Shapiro, senior fellow in constitutional studies, is the first scholarly journal to appear after the term's end and the only one to critique the Court from a Madisonian perspective, grounded in the nation's first principles, liberty and limited government. The *Review* is released each year on September 17, the day that Cato holds its annual Constitution Day conference, honoring the anniversary of the signing of the Constitution in 1787 by the U.S. Constitutional Convention.

Still on the rise around the world, Fraser Institute says

U.S. Falls to 8th in Economic Freedom Annual Report

Economic freedom remains on the rise around the world but has declined notably in the United States since the year 2000. That's the blockbuster finding of the 2008 edition of the *Economic Freedom of the World*, an annual report co-published in the United States by the Fraser Institute and the Cato Institute.

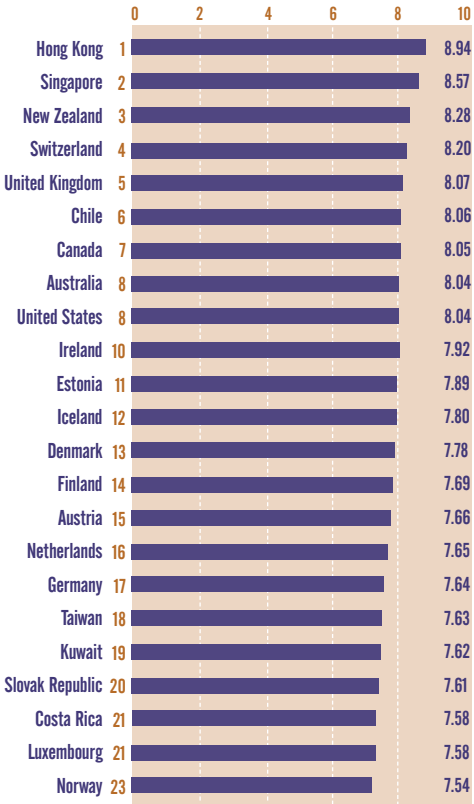
In 2000, the United States was the second-freest economy in the world according to the report, written by economists James Gwartney of Florida State University and Robert Lawson of Auburn University. This year the United States has fallen to eighth place, behind Hong Kong (the perennial first-place finisher), Singapore, New Zealand, Switzerland, the United Kingdom, Chile, and—you heard it here first—Canada.

More significant than the United States' drop in the rankings is its fall in the freedom ratings: on a scale of 0–10, the U.S. fell from 8.55 in 2000 to 8.04. Only five countries have experienced a greater decline over the same time period: Zimbabwe, Argentina, Niger, Venezuela, and Guyana.

The annual peer-reviewed report uses 42 different measures to create an index ranking of 141 countries around the world based on polices that encourage economic freedom. The cornerstones of economic freedom are personal choice, voluntary exchange, freedom to compete, and security of private property. Economic freedom is measured in five different areas: (1) size of government; (2) legal structure and security of property rights; (3) access to sound money; (4) freedom to trade internationally; and (5) regulation of credit, labor, and business.

Research shows that individuals living in countries with high levels of economic freedom enjoy higher levels of prosperity, greater individual freedoms, and even longer life spans.

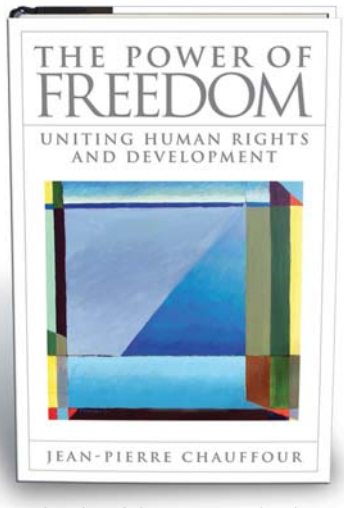
You can order *Economic Freedom of the World: 2008 Annual Report* from the Cato bookstore at www.catostore.org or view it for free online at www.freetheworld.com.



But avoid top-down planning and "positive rights"

Freedom Protects Both Human Rights and Development

After 15 years at the International Monetary Fund, Jean-Pierre Chauffor could fill a book with the insights he has gained about worldwide economic development. Luckily for us, he's done just that with *The Power of Freedom: Uniting Human Rights and Development*, published by the Cato Institute. Of course, many of Chauffor's former colleagues at the IMF won't be pleased with what's inside the book. In the tradition of 2002 Milton Friedman Prize recipient Peter Bauer, Chauffor challenges the notion that economic development can be brought about by top-down planning and social engineering. Rather, he points to the centrality of freedom in the success stories of developing countries around the world.

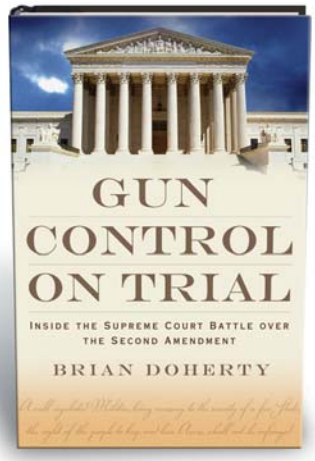


Chauffor criticizes not only the top-down methods of the IMF and others but the central role they assign to "positive rights," such as the right to health care, education, and a clean environment. It is only through the protection of a core group of "negative rights"—rights to property and person—that the various positive rights can be realized. As Chauffor points out, when the United Nations in its Universal Declaration of Human Rights proclaims a "human right" to adequate housing, while paying only scant attention to the negative right to property, it has things backwards. Property rights come first. They allow for the security of one's home. They also allow for the security of one's business and livelihood, certainty in recouping one's investments, and the makings of a productive economy that can deliver adequate housing for the citizenry—not to mention health, wealth, education and a clean environment.

Visit www.catostore.org or dial 800-767-1241 to get your copy today. $22.95 hardcover.

The inside story of a landmark Supreme Court case

How the Second Amendment Was Saved



"A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed." These words, constituting the Second Amendment of the Constitution, form what is perhaps the most hotly contested sentence ever put to parchment. But on June 26, 2008, the day the 5-4 decision in the Supreme Court case *D.C. v. Heller* came down, the debate was decisively resolved: Americans possess a constitutionally protected, individual right to keep and bear arms.

Cato Policy Report readers should have the story down cold by now. As chronicled in past issues, Clark Neily of the Institute for Justice came up with the idea of challenging D.C.'s gun ban; Robert A. Levy, chairman of the Cato Institute, handled strategy, guiding the case's ascent from the lower courts to the nation's highest one; and lead counsel Alan Gura argued the case before the Supreme Court, ultimately resulting in an unambiguous opinion by Justice Antonin Scalia affirming an individual right to keep and bear arms.

But a new book from the Cato Institute, *Gun Control on Trial: Inside the Supreme Court Battle over the Second Amendment*, fleshes that story out considerably. As it turns out, there's much more to be said, and many twists and turns along the way you've never heard about.

Guess which member of the *Heller* team has never owned a gun before and doesn't plan to buy one (but who cares about the Constitution enough to finance a Supreme Court challenge)? If you guessed Robert A. Levy, then you're right.

Here's a harder one. Guess who opposed *D.C. v. Heller* (then called *D.C. v. Parker*) in its early days at the District Court level? If you guessed the mayor of D.C., you're halfway right. But did you know that the National Rifle Association opposed the case, and did much to try to stop it?

The NRA was concerned that the composition of the court might render an unfavorable decision. That could mean the end of gun rights for all Americans. Another reason, according to Doherty, was that they didn't want a couple of Cato and Institute for Justice lawyers moving in on their territory. If a case was going to go forward, quite simply, they wanted their team in charge. So the NRA attempted to take over the case through the legal gambit of "consolidation." The equivalent of a hostile takeover of a legal case, they filed their own copycat lawsuit and attempted to have it merged with the case Levy's team was litigating. The NRA would go on to support the case, and after the decision in *Heller*, they filed lawsuits in Chicago and San Francisco challenging gun regulations there.

All that and more is chronicled in *Gun Control on Trial*. You'll also find extensive analysis of Justice Antonin Scalia's opinion, widely lauded among libertarian legal scholars; the history of Second Amendment jurisprudence leading up to that decision; and behind-the-scenes access from an author, *Reason* senior editor Brian Doherty, uniquely positioned to provide such a look. But ultimately, this book is about more than historical debates, more than even a landmark Supreme Court ruling. It's about a determined team of libertarian lawyers who knew that the right to protect one's family in a dangerous world was enshrined in the Constitution, and the story of their uphill, but ultimately successful, battle to prove it.

Visit www.catostore.org or dial 800-767-1241 to get your copy today. $16.95 hardcover.

Regulation, Fall 2008

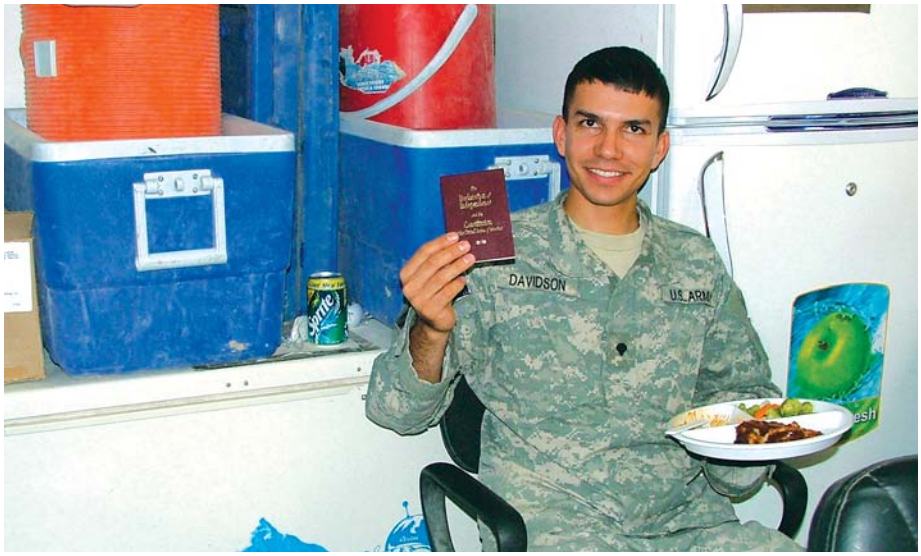
Featuring articles on the law, securities and exchange, corporate law, real estate, and the environment, *Regulation* magazine tackles the policies that are sure to affect you and your business. According to an article by University of Pennsylvania law professor **JASON SCOTT JOHNSTON,** global warming won't be so bad after all. Indeed, a temperature increase of 2 to 3 degrees would likely be positive, resulting in increased agricultural productivity, reduced deaths and disease from cold weather, and increased value from warm weather recreational pursuits. While there would be negative consequences, too, Johnston faults policymakers for totally overlooking any possible benefits. Elsewhere, **PATRICK J. MICHAELS,** senior fellow in environmental studies at the Cato Institute, admits that much of global warming results from human activity, yet not all of that warming is the result of carbon dioxide as Al Gore claims. Indeed, in urban areas, a city's ever-increasing numbers of bricks, buildings, and pavement retain heat, absorb more of the sun's energy, and impede the flow of ventilating winds. After accounting for these factors, Michaels reruns the numbers and determines that overall global warming is overstated by about 15 percent. Other articles deal with legal barriers to innovation, securities and exchange law, corporate law, and the phenomenon of "midnight regulation," where an outgoing president passes a flurry of new regulations in his final months. This issue also features book reviews on *The Lawyer Myth*, a defense of the legal practice, and *Why Popcorn Costs So Much at the Movies*.

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

More than 3.5 million now in print

Pocket Constitution Goes to Iraq

Cato's Pocket Constitution has been around the block. Michigan's senator Carl Levin, West Virginia's senator Robert Byrd, Mississippi's former senator Trent Lott, the late ABC News anchor Peter Jennings, and even Ohio's representative Dennis Kucinich have all been spotted with it. Cato has distributed over 3.5 million copies of the Pocket Constitution, including to all members of Congress, all 50 governors, all state legislators, all federal judges, many student groups, and to countless individuals interested in the foundation of America's republican government. But one place we didn't expect the Pocket Constitution to wind up was Iraq.



That changed in late 2007, when an Army Chaplain named Bonita Davis contacted Cato about securing a shipment of Pocket Constitutions, which contain the texts of both the Declaration of Independence and the Constitution. Davis, now back home in Georgia, was at the time serving just outside Baghdad. According to Davis, she wanted the Pocket Constitutions because although the soldiers had different conceptions of freedom, they could all agree on the U.S. Constitution, the foundational document of America's republican government. She also requested copies of Cato's Arabic-language Pocket Constitution, a bilingual edition that features the Constitution's text in both English and Arabic.

Cato's director of marketing Robert Garber was happy to oblige. He responded by sending her a box of free Pocket Constitutions, which were distributed in late November 2007 by Colonel Mark Mueller at Camp Delta in Al Kut, Iraq. One hundred American soldiers from teams Shocker, Nomad, Hidood, and Varsity, who would go on to be stationed at various places on Iraq's border, received English versions of the Constitution, as well as Arabic ones to distribute to Iraqi soldiers who would be serving alongside them at the border positions. According to Davis, the Pocket Constitution's slim profile and portability made it perfect for the soldiers. She reported to us that they helped stimulate discussions among the troops about American civics and individual rights. "It opened up very interesting conversations among some of the soldiers. It served as inspiration to others." She was surprised and pleased to learn that some of the soldiers had memorized the preamble to the Declaration of Independence. Cato would in April 2008 receive a beautiful American flag that had flown over Camp Echo in Ad Diwaniyah in the central-south portion of Iraq, with a signed certificate of appreciation from Davis.

Whether you're in Iraq, the United States, or anywhere around the world, you can pick up your copy of Cato's Pocket Constitution at **www.catostore.org** for $4.95. For bulk pricing options, please call 800-767-1241. The Pocket Constitution is also available in bilingual editions: Spanish and Arabic.

Too Big to Fail—or Survive

The Fannie Mae-Freddie Mac crisis may have been the most avoidable financial crisis in history. Economists have long complained that the risks posed by the government-sponsored enterprises were large relative to any social benefits. We now realize that the overall policy of promoting home ownership was carried to excess. Even taking as a given the goal of expanding home ownership, the public policy case for subsidizing mortgage finance was weak. The case for using the GSEs as a vehicle to subsidize mortgage finance was weaker still, as the GSE structure serves to privatize profits and socialize losses. Allowing the GSEs to assume a dominant role in mortgage finance was also a mistake, as the larger they grew, the more precarious our financial markets became. Arnold Kling, an adjunct scholar with the Cato Institute and a former economist at Freddie Mac, argues in **"Freddie Mac and Fannie Mae: An Exit Strategy for the Taxpayer"** (Briefing Paper no. 106), that regulators should contemplate freezing the mortgage purchase activities of the GSEs while loosening the capital requirements for banks to hold low-risk mortgages. That would result in an industry much less concentrated than the current duopoly, one in which mortgage risk is spread among dozens of institutions, avoiding the sort of catastrophic risk that is represented by the failure of Fannie Mae and Freddie Mac.

Making Healthcare Affordable

One view is that state licensing of medical professionals assures quality health care. Another view, voiced in **"Medical Licensing: An Obstacle to Affordable, Quality Care"** (Policy Analysis no. 621), is that licensure fails to protect consumers from incompetent physicians, while making health care more expensive and less accessible. Shirley Svorny, chair of the economics department at California State University, Northridge, and an adjunct scholar at the Cato Institute, argues that institutional oversight and a sophisticated network of private accrediting and certification organizations, all motivated by the need to protect reputations and avoid legal liability, offer whatever real consumer protections exist today. Consumers would benefit were states to eliminate professional licensing in medicine and leave education, credentialing, and scope-of-practice decisions entirely to the private sector and the courts. If eliminating licensing is politically infeasible, states could increase workforce mobility by recognizing licenses issued by other states.

Counterproductive Accounting

Since the passage of the Sarbanes-Oxley Act in 2002, the Financial Accounting Standards Board has passed rules that it promises will make corporate accounting more transparent. In fact, its revised Generally Accepted Accounting Principles have made it difficult for investors—or even CEOs—to understand a company's financial report, says T. J. Rodgers, CEO of Cypress Semiconductor Corporation. In **"FASB: Making Financial Statements Mysterious"** (Briefing Paper no. 105), Rodgers reports that the first step in the wrong direction came when FASB mandated that companies list "intangibles" such as "goodwill" as corporate assets, artificially inflating balance sheets. Second, FASB meddled with the revenue recognition rules, in some cases not allowing companies to report revenue from cash payments received from a customer for a delivered product. Finally, and worst by far, FASB mandated punitive and nonsensical rules for so-called expensing of stock options.

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School Choice: The Worldwide Evidence

Would large-scale, free-market reforms improve educational outcomes for American children? To understand how genuine market forces affect school performance, Andrew J. Coulson, director of Cato's Center for Educational Freedom, surveys education systems from all over the globe. In **"Markets vs. Monopolies in Education: A Global Review of the Evidence"** (Policy Analysis no. 620), Coulson assesses the results of 25 years of international research comparing market and government provision of education. In more than 100 statistical comparisons covering eight different educational outcomes, the private sector outperforms the public sector in the overwhelming majority of cases. Moreover, that margin of superiority is greatest when the freest and most market-like private schools are compared to the least open and least competitive government systems (i.e., those resembling a typical U.S. public school system).

Cut Executive Pay?

The economic slowdown and the active political season are generating calls for imposing new regulations on executive pay. Not so fast, say Ira T. Kay and Steven Van Putten, consultants with Watson Wyatt and the authors of *Myths and Realities of Executive Pay* (Cambridge University Press, 2007). In **"Executive Pay: Regulation vs. Market Competition"** (Policy Analysis no. 619), they argue that past misunderstandings about executive pay made manifest in legislation have generated unintended consequences that have damaged the economy and hurt the ability of the market for executives to self-regulate. U.S. corporations are subject to more stringent executive pay disclosure requirements than corporations anywhere else in the world. Policymakers bent on additional regulation should examine the rationale for current pay structures and the strong links between executive pay and corporate performance.

What Causes Globalization

In **"Trade, Protectionism, and the U.S. Economy: Examining the Evidence"** (Trade Briefing Paper no. 28), Robert Krol, professor of economics at California State University, Northridge, examines the causes and consequences of increasing global trade and interconnectedness. He finds that income growth accounts for two-thirds of the growth in global trade in recent decades, trade liberalization accounts for one-quarter, and lower transportation costs make up the remainder. He finds that trade expansion has fueled faster growth and raised income in countries that have liberalized. A 1-percentage point gain in trade as a share of the economy raises per capita income by 1 percent. Global elimination of all barriers to trade in goods and services would raise global income by $2 trillion and U.S. income by almost $500 billion. He finds that Americans are $300 billion better off today due to expanded product choices delivered by trade.

"To Be Governed..."

THAT'S THE LAST PLACE THEY EVER LOOK

In the chaotic minutes after the assassination [of John F. Kennedy], [then-U.S. attorney for Dallas Barefoot Sanders] found himself trying to locate federal Judge Sarah T. Hughes to swear in [Lyndon B.] Johnson as the new president aboard Air Force One and frantically searching for a copy of the president's oath of office.

"I was looking for it—I think half the federal attorneys in the country were looking for it," he told the *Dallas Morning News* in 2006. They finally found it in the Constitution.

—***Washington Post,*** Sept. 29, 2008

BUSH'S GUY TO MCCAIN: MOVE LEFT FAST

McCain needs to announce new and unexpected reform proposals. Perhaps he should courageously follow the logic of his health plan and promise health coverage as a universal right guaranteed by subsidies for the purchase of private health insurance. Perhaps he should embrace the goal of getting all American electricity from renewable and non-carbon sources by some ambitious but realistic date. Perhaps he should offer guaranteed funding of higher education in exchange for national service.

—***Washington Post,*** September 4, 2008

LEFTISM STARTS EARLY ON CAMPUS

[In the favorite high school class of Barack Obama's mother] the assigned reading included not only Plato and Aristotle, Kierkegaard and Sartre, but also late-1950s critiques of societal conventions, such as "The Organization Man" by William H. Whyte, "The Lonely Crowd" by David Riesman and "The Hidden Persuaders" by Vance Packard, as well as the political theories of Hegel and Mill and Marx. "The Communist Manifesto" was also on the reading list, and it drew protests from some parents.

—***Washington Post,*** Aug. 22, 2008

SLOW LEARNER

Former House speaker Newt Gingrich (R-Ga.) said in an interview yesterday, "We have now launched big-government Republicanism."

—***Washington Post,*** Sept. 20, 2008

HILLARY CLINTON GOES TO CHINA

Beijing officials have distributed 4.3 million copies of an etiquette book outlining rules on good manners and foreign customs, including rules about what not to wear. The guide is part of an effort by various departments within China's government to clean the city up in preparation for the at least 400,000 foreign visitors who are expected to descend on its capital for the Olympic Games, which start Aug. 8.

Among the no-no's: more than three color shades in an outfit, white socks with black shoes, and pajamas and slippers in public....

The book, published by the Beijing Municipal Government's Capital Ethics Development Office, is part of the department's effort to make Beijing more "civilized," officials said.

Along the same lines, Beijing authorities announced earlier this year that they would step up efforts to fine people who spit in public as much as 50 yuan ($7.33).

Other guidelines range from the obvious to overly specific. Public displays of affection aren't acceptable, for example. In a section about escalators and elevators, the book said people should place their hands on escalator railings to avoid falling.

—***Wall Street Journal,*** Aug. 1, 2008

TED STEVENS: BRIDGE TO THE TAXPAYERS

In Haines alone, Ted has helped fund our public radio station, new library and Native-run health clinic.

—**Heather Lende in the *Washington Post,*** August 3, 2008

POLICYMAKING IN THE WHITE HOUSE

[At the White House meeting on the financial bailout plan] Sen. Richard Shelby, the top Republican on the Senate Banking Committee, presents a five-page list of 192 economists and business school professors who oppose the plan. Bush isn't impressed. "I don't care what somebody on some college campus says," Bush says.

—**ABCNews.com,** September 26, 2008

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