

Cato's Letter

*A Quarterly
Message
on Liberty*

*Summer 2009
Volume 7
Number 3*

Freedom in Crisis

DAVID BOAZ

Freedom is under assault, and has been for a while. We went through a lot in the past eight years—the excesses of the Patriot Act; the intrusion of the federal government into local schools; state decisions on marijuana, end-of-life choices, and state marriage law; the biggest expansion of entitlements in 40 years; a law to sharply restrict core political speech; the steady accumulation of power in the executive branch and in the person of the president; the assertion and exercise of the president's power to arrest and incarcerate American citizens without access to a lawyer or a judge; an increase in federal spending of more than a trillion dollars; and a near doubling of the national debt.



*David Boaz is executive vice president of the Cato Institute. He is the author of *Libertarianism: A Primer*, described by the Los Angeles Times as “a well-researched manifesto of libertarian ideas,” and the editor of *The Libertarian Reader*. His most recent book is *The Politics of Freedom*. This edition of *Cato's Letter* is adapted from a speech Boaz made at the Cato Institute's 2009 Benefactor Summit.*

**CATO
INSTITUTE**

Back in September and October, a lot of us were feeling shell-shocked by the blows to free-market capitalism—the federal “takeover” of Fannie Mae and Freddie Mac, the collapse of Lehman Brothers, the bailout of AIG, the all-power-to-Henry-Paulson plan, the collapse of Washington Mutual, congressional passage of the power-to-Paulson-plus-pork plan, the sharp drops in the Dow Jones average, the Federal Reserve Board’s unprecedented decision to lend directly to nonfinancial companies, the government’s partial nationalization of major banks, Paulson’s announcement that he would use his bailout money for something other than what he asked Congress to authorize, the auto bailout in direct defiance of a congressional vote, and so on, and so on.

There was no time to fight these measures. Most of them were announced as done deals—every Mon-

day morning the secretary of the treasury would tell us what he and the Fed chairman had done over the weekend.

With the incumbent president in charge, both presidential candidates going along, and most of Congress afraid to challenge the dire warnings of catastrophe, it was impossible to create any real political debate. De-

fenders of capitalism were reeling. Adding insult to injury, then came the claim that the free market caused these problems, that American capitalism had failed. We faced a crisis caused by the Federal Reserve, the corporate tax system, Fannie Mae and Freddie Mac, and the Community Reinvestment Act. But the response of many people in Washington was to blame it on capitalism. A few even blamed it on libertarianism, as if libertarians had been in charge during the Clinton and Bush administrations.

Big government causes massive problems like this—and then demands more money and power to fix them. Again and again. If it can actually cause big enough problems to be a “crisis,” so much the better.

Robert Higgs, in *Crisis and Leviathan*, told us that the way government grows in the United States is not at a steady pace, a little every year. It grows during crisis periods.

Leviathan happens during wars, economic depressions, and natural disasters—that’s where you get government growth.

A couple of years ago, left-wing author Naomi Klein wrote *The Shock Doctrine*. In an interview, she explained that “the Shock Doctrine is a political strategy that the Republican Right has been perfecting over the past 35 years to use for various different kinds of shocks. They could be wars, natural disasters, economic crises, anything that sends a society into a state of shock to push through what economists call ‘Economic Shock Therapy’—rapid-fire, pro-corporate policies that they couldn’t get

“Leviathan happens during wars, economic depressions, and natural disasters—that’s where you get government growth.”

through if people weren't in a state of fear and panic." She has a point. Panics, crises, and states of shock do lead to political change. We saw that after 9/11, which was certainly a shock to the system. People wanted something to be done. They were afraid. And what happened? The Bush administration gave us the Patriot Act, which included everything law enforcement had wanted for a decade without necessarily being related to 9/11. We got the federalization of airport screeners, the Homeland Security Department, and the war in Iraq. All of that demonstrates the idea of the shock doctrine. But deregulation? Free markets? The fact is, governments take advantage of crises to amass more money and power.

In fall 2008 we had a lot of economic shocks. Did the Republican administration summon up the spirit of Milton Friedman and cut government spending? Did it deregulate and privatize, as Naomi Klein would predict? No. It did what governments actually do in a crisis—it seized new powers over the economy. It dramatically expanded the regulatory powers of the Federal Reserve and injected a trillion dollars of inflationary credit into the banking system. It partially nationalized the biggest banks. It appropriated \$700 billion to intervene in the economy. It made General Motors and Chrysler wards of the state. It wrote a bail-out bill giving the secretary of the treasury extraordinary powers that could not be reviewed by courts or other government agencies.

The Obama administration is continuing this drive toward central-

“The fact is, governments take advantage of crises to amass more money and power.”

ization and government domination of the economy. Its key players are explicitly referring to their own version of the shock doctrine. Rahm Emanuel, the White House chief of staff, said the economic crisis facing the country is “an opportunity for us.” After all, he said, “*You never want a serious crisis to go to waste.* And this crisis provides the opportunity for us to do things that you could not do before”—such as taking control of the financial, energy, information, and healthcare industries.

For a long time many of us were shell-shocked at the daily barrage of assaults on economic freedom. But that's all over now. Smaller-government folks feel no hesitation about vigorously taking on the Obama-Reid-Pelosi government. Instead of a financial “rescue package”—which one conservative called an attempt to “save the capital markets on which the process of creative destruction depends”—we moved on to debating an old-fashioned, Keynesian, throw-money-at-the-problem spending bill described as “economic stimulus.” Most free-market economists feel no ambivalence about opposing that bill.

The reaction to the so-called stimulus bill may have been the beginning of the renaissance of the free-market movement. Freed from the burden of feeling some connection to a big-government Republican president, Republicans voted overwhelmingly

against the bill in both houses of Congress. Libertarians played leading roles in galvanizing the opposition.

The good news is, the freedom movement is back in gear. The bad news is, it's because the welfare state is on the march.

But we've faced dark days before. Think about the first great fight for American freedom, the Revolution, challenging the power of the mightiest empire on earth. Seventeen-seventy-six was a great year. Americans issued the Declaration of Independence and took up arms. Across the pond, Adam Smith published *The Wealth of Nations*. But by the end of the year, Thomas Paine was writing his famous words, "THESE are the times that try men's souls. The summer soldier and the sunshine patriot will, in this crisis, shrink from the service of their country; but he that stands by it now, deserves the love and thanks of man and woman."

A year later, just before Christmas of 1777, Washington's army took up winter quarters at Valley Forge. They faced a cruel race with time to get huts erected before the soldiers—barefoot and half naked, wrapped in blankets—froze to death. Hundreds of horses starved, and for the army starvation was a mortal danger. Americans persisted and came through the crisis—and established a free country on this continent.

Later, we faced the challenge of

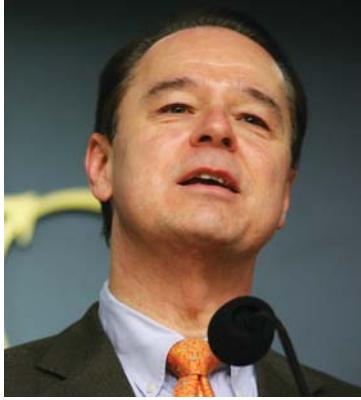
slavery—an institution that had existed from time immemorial, in virtually all parts of the world, until the rise of libertarian ideas in England and America created a movement for abolitionism. We've all read of the horrors of the Middle Passage and the regime of legalized violence that sustained slavery on the plantation. Reports and novels about the reality of slavery helped to change minds. But the fun-

damental principle that motivated the abolitionists was the pure idea of liberty—and the cause of freedom won that fight, too.

Compared to the hardships of Valley Forge and plantation slavery, the New Deal may

seem a minor problem. But it presented a fundamental challenge to economic freedom and constitutional government. There were a lot of similarities then to our own time. People were told the market had failed. There was a crisis atmosphere and a state of shock in the American polity—and pseudo-solutions being passed in panic.

The forerunners and founders of the libertarian movement reacted in horror. Frank Knight told Hayek that the New Deal represented a "general movement of west European civilization away from liberalism to authoritarianism." Henry Simons, another of the early Chicago economists, feared that "the basic values of civilization would be lost" in the coming of the New Deal. Isabel



Paterson wrote that it was not right to say that the New Deal was like fascism. Rather, she said, the New Deal “is fascism.”

As if nine years of the abuse of the market and constitutional government and presidential power wasn’t enough, then came World War II, the greatest, most destructive war in the history of the world. The great Austrian economist, Joseph Schumpeter, said about the New Deal and the likely effects of war, “I cannot help feeling that this will be the end of the American way of life.”

Yet there were a few people who stood up. In 1943, three remarkable women wrote books that launched the libertarian movement—or re-launched the American movement for freedom. Isabel Paterson wrote *The God of the Machine*. Rose Wilder Lane, the daughter of Laura Ingalls Wilder—than whom you could not get any more American—wrote *The Discovery of Freedom*. And Ayn Rand wrote *The Fountainhead*. These books gathered a readership, the kind of people Albert Jay Nock called “the remnant.” In 1944, Friedrich Hayek published *The Road to Serfdom*. In 1946, with the war over, Leonard Read was ready to start the organized libertarian movement. He founded the Foundation for Economic Education, the first free-market think tank. He launched a movement with these books and these ideas—and a very few people.

Now freedom is under assault again. Statism marches forward, helped along by an atmosphere of crisis and panic. It’s easy to get dis-

“The good news is, the freedom movement is back in gear. The bad news is, it’s because the welfare state is on the march.”

couraged. It’s easy to let the immensity of the challenge stop us. But it didn’t stop Thomas Paine. It didn’t stop Frederick Douglass. It didn’t stop Isabel Paterson, Ayn Rand, or Friedrich Hayek.

And it won’t stop us. Cato scholars have been out there fighting every bit of this nonsense, and getting a lot of attention for it, on television and with our full-page newspaper ads.

Speaking of summer soldiers and sunshine patriot, a few weeks ago I was joking with some free-market economists who declined to sign our ad, and I told one of them, “Some day you’ll be sorry you weren’t on this roll of honor.” And I quoted the St. Crispin’s Day speech from Shakespeare’s *Henry V*:

*We few, we happy few,
we band of brothers;
For he today that sheds
his blood with me
Shall be my brother;
And gentlemen in
England now abed
Shall think themselves
accursed they were not here,
And hold their manhoods
cheap while any speaks
That fought with us upon
Saint Crispin’s day.*

The challenges we face today are not going to stop us.

And I know they won’t stop you.



Cato Scholar Profile: **MARK A. CALABRIA**

MARK A. CALABRIA, PhD, is director of financial regulation studies at the Cato Institute. Before joining Cato in 2009, he spent six years as a member of the senior professional staff of the Senate Committee on Banking, Housing and Urban Affairs. Prior to his service on Capitol Hill, Calabria served as deputy assistant secretary for regulatory affairs at the Department of Housing and Urban Development. He has also been a research associate with the U.S. Census Bureau's Center for Economic Studies. He holds a doctorate in economics from George Mason University.

What was the primary cause of the current financial crisis?

It would be more complete to talk about causes, as what we really had was a confluence of reinforcing policy mistakes and macroeconomic conditions. First, the global savings glut that resulted from the manipulation by Asian governments of their currencies, along with an over-expansionary Federal Reserve monetary policy, kept interest rates too low, for too long, encouraging a borrowing and spending binge across the developed world. Our own policies of subsidizing housing via the tax-code, Fannie Mae/Freddie Mac, and others, coupled with exclusionary zoning practices in many areas, resulted in a housing bubble, the most severe component of financial crisis. Underlying all of this was a belief that whatever our problems, the Federal Reserve could get us out of them, which encouraged excessive risk-taking across the board.

How do you think the crises will play out, based on current policies coming out of Washington?

Current policies will likely drag out the needed adjustment in our financial and housing markets. We have seen implemented and proposed various policies aimed at creating a false floor to the housing market, mostly by stimulating an artificial demand. In addition several proposals have slowed the needed process of resolving the situation of delinquent homeowners. Perhaps most important has been the refusal of both the Administration and Congress to resolve large failed institutions, like AIG, rather than keeping them on indefinite life-support.

As a director at Cato, what do you plan to do to make sure the crisis is resolved properly or to

prevent future crises?

Foremost, educate policymakers and the public (as well as myself) on the causes of our financial crisis. For any set of proposals to prevent future crises to be truly effective, they must be based upon an accurate understanding of the causes of the crisis.

What brought you to Cato?

I felt that most of the debate in Washington over financial regulatory issues was being driven by parties with a direct financial stake in the outcome. As someone involved in policymaking in the Senate, I often found it difficult to identify experts who were not also biased or pushing the agenda of some vested interest. So, feeling the need for objective analysis and advice on financial policy, I decided to come to Cato and fill that void myself.

What did you learn about the policymaking process during your time with the Senate?

First, that a basic understanding of markets, much less financial markets, is almost nonexistent. I spent the majority of my time arguing Econ 101 with people, even offices generally thought of as "market-friendly." I also learned that process matters. As much of a failure as the TARP has been, some of that failure is due to the manner in which it was rushed, with little debate, few hearings, and no amendments. Truly not the way laws should be made. Also the willingness of members of Congress to push their responsibilities onto the executive branch was surprising. I am now convinced that much of the shift of power from the legislative branch to the executive branch has been with the consent and at the direction of Congress.

In the Spirit of Commitment



We would like to share the story of how Cato, through the generous support of its Sponsors, was able to stand at the very forefront of the debate on our nation's future. The backdrop of the story is our current crisis—not since the New Deal has the United States experienced such a tidal wave of change. Whole sectors of the economy are being nationalized, deficits are soaring to unimaginable heights, and politicians tout ever more grandiose schemes for big-government intervention.

Although Cato has been steadfast in defending the founders' vision through traditional means—such as books, articles, TV interviews, podcasts and the like—the Institute decided to intensify the debate by running a full page ad in the *New York Times*.

The catalyst for the ad was a statement by then president-elect Obama to the effect that all economists agree on the need for a stimulus package. First appearing on January 9, 2009, the ad's banner declared, "With all due respect Mr. President, that is not true." More than 300 economists were willing to be listed in print as opponents of the stimulus, including Nobel laureates Edward Prescott, Vernon Smith, and James Buchanan.

Given that full page ads are expensive, our initial thinking was that we would be able to run one ad, one time. That's when our generous Sponsors jumped into the fray. Contributions to help defray the ad's cost poured in. Not

only did the contributions pay for the initial *New York Times* ad, they enabled us to place the same ad in the *Washington Post*, *Wall Street Journal*, *Los Angeles Times*, *New York Post*, *Chicago Tribune*, *Philadelphia Enquirer*, *Washington Times*, *National Review*, *New Republic*, and college newspapers across the country.

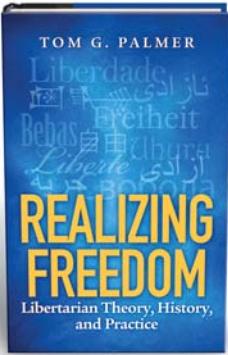
Emboldened by the success of January's stimulus ad, we decided to run yet another full page ad in March. This time the topic was climate change, more specifically President Obama's claim that "the science is beyond dispute and the facts are clear." The ad, signed by more than 100 climatologists, ran with a banner declaring once again, "With all due respect Mr. President, that is not true." And, for a second time, Cato's Sponsors went above and beyond, allowing us to place this second ad in the *New York Times*, *Washington Times*, *Chicago Times*, and *Los Angeles Times*.

We sincerely thank all of you for allowing us to stand in the spotlight as we debate our future as a nation. There is no doubt that we will call on you again as we confront such issues as healthcare, exploding deficits, and contempt for the rule of law. Despite this atmosphere of crisis, be assured that Cato and its scholars are positioned for the future. In fact, we have recently added several scholars, including banking and finance experts, to our roster. So, with your help, Cato will continue to speak out.



Books from the

CATO
INSTITUTE

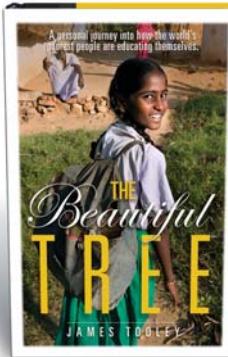


Realizing Freedom: Libertarian Theory, History, and Practice

By Tom G. Palmer

Written from his perspective as scholar, journalist, and activist, Tom Palmer's incisive articles range in subject from the theory of justice, multiculturalism, and democracy, to limited government, globalization, property rights, censorship, individual liberty, and more.

HARDBACK: \$29.95 • E-BOOK: \$14.00



The Beautiful Tree: A Personal Journey into How the World's Poorest People Are Educating Themselves

By James Tooley

An inspiring journey into the lives of families and teachers in the poorest communities of India, Africa, and China who have successfully created their own private schools in response to failed public education.

HARDBACK: \$19.95 • E-BOOK: \$11.00

Available at bookstores nationwide, online at www.cato.org, or by calling toll-free (800) 767-1241.

Cato Institute, 1000 Massachusetts Avenue, N.W., Washington, DC 20001 • www.cato.org

Nonprofit
Organization
U.S. Postage
PAID
Cato Institute

CATO
INSTITUTE

1000 Massachusetts Ave., N.W.
Washington, D.C. 20001
www.cato.org