

# Cato Policy Report

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## From Republic to Empire: The Constitution and the Evolution of U.S. Foreign Policy

by Ted Galen Carpenter

The recent congressional hearings investigating the Iran-contra scandal underscore how far the American republic has drifted from the foreign policy moorings established by the Founders. Oliver North, John Poindexter, and other members of the president's staff casually asserted that the executive branch may legitimately circumvent Congress in order to implement foreign policy measures. They justified such conduct on the basis of "the national interest," much as practitioners of amoral Old World realpolitik have done for generations.

Theirs is the language of empire, not a republic based on the principles of limited government and political accountability. Both the foreign policy they advocate and the tactics they employ to execute it are profoundly alien to American traditions.

**Ted Galen Carpenter is director of foreign policy studies at the Cato Institute.**

A prominent feature of the republic during its formative years was the ability of its political leaders to pursue a perceptive and restrained foreign policy. Throughout the Revolutionary War and the decade that followed, a generation of statesmen learned a crucial lesson about international affairs. Although the Founders conceded that temporary alliances with other governments might be necessary when the nation's security was in dire jeopardy, they perceived that such entanglements were generally undesirable.

Alliances, the Founders realized, threatened to involve the new nation in a multitude of complex quarrels, most of which would have little or no bearing on its legitimate security concerns. The United States would dissipate its wealth, incur an unhealthy militarization of its society, and even endanger its hard-won independence through a rash involvement in European-dominated power politics. Histo-

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rian Selig Adler aptly summarized the Founders' policy conclusions as follows: "There seemed to be little sense in jeopardizing the peace of the New World with the ingrained rivalries of the Old. European wars could mean nothing but trouble for America."

There was also a growing conviction during the initial years of independence that America's destiny was to set a powerful example for the rest of the world. Freed from the stifling impediments of a corrupt Old World aristocracy, the United States symbolized an invigorating experiment in limited government and individual liberties. In such an atmosphere Americans could both pursue commercial success and establish ethical standards that oppressed people everywhere would wish to emulate. That unique mission required the United States to remain aloof from foreign, especially European, political and military entanglements. They would not only imperil the nation but compromise its commitment to liberty, thereby undermining the appeal of the American model.

For those reasons, isolationism—or,

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Federal Reserve Board vice chairman Manuel H. Johnson (left) talks with Cato chairman William A. Niskanen at a Cato luncheon for Johnson, held in the Institute's garden.



## The Trade Bill: Making Us All Poorer

### Chairman's Message



In the name of reducing the large U.S. trade deficit, both Congress and the Reagan administration have endorsed measures that would make most of us poorer. Moreover, those measures would have no significant effect on the trade deficit.

The most controversial provision of the House trade bill, sponsored by Democratic presidential candidate Richard Gephardt, is the requirement that sanctions be levied against countries that have a large trade surplus with the United States if the surplus is the result of "unfair" trade practices. The primary problem with that provision is that Congress is unilaterally extending the definition of unfair trade practices beyond the one delineated by the General Agreement on Tariffs and Trade and other trade agreements. Like the Senate version, the House bill designates export targeting and the denial of workers' rights as unfair trade practices.

The corresponding provision of the Senate bill requires that trade sanctions be levied against countries that maintain a consistent pattern of import barriers. The primary problem with that provision is that it would probably provoke retaliatory actions by other countries; the United States has long maintained barriers against the import of textiles and apparel, steel, and certain agricultural products.

Both bills broaden the conditions under which the International Trade Commission may determine that imports have injured a domestic industry, and both restrict the president's authority to reject trade restraints recommended by the ITC. In addition, both bills introduce elements of a national industrial policy; for example, the House bill requires the registration of significant foreign investment in the United States, and the Senate bill requires advance notice of plant closings and substantial layoffs.

Any bill that emerges from the September House-Senate conference would increase the prices of U.S. imports and competing products and reduce the incomes of those who produce goods and services for export. Contrary to a common misconception, the Constitution authorizes the president to negotiate trade agreements; no specific legislation is required. Legislation would be required for the president to get Congress to enact a new trade agreement under the "fast track" procedure, but that authority would not be needed for several years. President Reagan should veto any trade bill that is developed by the conference committee.

During the past two years the administration has implemented trade restraints on semiconductors and lumber with-

out new trade legislation, and it has pressured the Federal Reserve and other central banks to reduce the foreign exchange value of the dollar. Those measures reduce the amount of foreign goods and services that Americans can buy for their dollars, as anyone who has traveled in Europe or Japan recently is well aware.

The trade deficit is the difference between saving by Americans and investment in the United States. It has increased rapidly since 1982, primarily because the budget deficit did not decline as much as it usually does during a recovery. The trade deficit can be significantly reduced only through measures that increase personal and business saving, reduce the budget deficit, or reduce domestic investment. Other trade measures can affect the level of trade, the product composition of trade, and the U.S. balances of trade with specific countries, but they have little effect on the trade deficit. A U.S. monetary stimulus can reduce the exchange value of the dollar without having much effect on the trade deficit because the higher price of imports is offset by a stronger U.S. demand. Conversely, monetary restraint by other governments can reduce the value of the dollar without having much effect on the trade deficit because the lower price of U.S. exports is offset by a weaker foreign demand. We should not be surprised that the 30-40 percent devaluation of the dollar since early 1985 has not had much effect on the trade deficit.

Some reduction in the trade deficit is likely in both 1987 and 1988, primarily because both a weakening of domestic investment due to the Tax Reform Act of 1986 and a reduction in the budget deficit can be anticipated. We should, however, expect to have a large trade deficit until we are prepared to make the hard choice to reduce either private consumption or government spending. That choice will be the central issue in American politics for years to come.

In the meantime our government is engaged in its usual practice of making most of us poorer through various indirect means of redistributing income to favored groups—without addressing the basic conditions that led to the trade deficit. Those conditions are only compounded by the low level of understanding of the issue displayed by some of our elected representatives.

*William A. Niskanen*  
—William A. Niskanen

### "Principled Judicial Activism"

## Defense of Constitutional Rights Drawing Widespread Attention

The Cato Institute's Project on Constitutional Rights has been generating quite a bit of attention. Cato scholars have brought a new school of thought about judicial issues to the forefront of public discussion.

Cato's challenge to the selective judicial activism of the left and the judicial restraint of the right prompted a three-way debate in *Legal Times*. Conservative scholar Gary McDowell criticized "economic libertarians" who favor the use of substantive due process in both economic and civil liberties cases, and former congressman Robert Drinan wrote, "Liberals . . . don't need, don't want, and don't have any alliance with the libertarians."

Cato adjunct scholar Randy Barnett, a professor at the Illinois Institute of Technology, Chicago-Kent College of Law, argued that "the Constitution explicitly establishes a structure of enumerated congressional powers and expansive individual rights. . . . Congressional acts must therefore be substantively evaluated by judges to see whether they are in fact within an enumerated power. Even if they are, they must be further evaluated and stricken if they violate individual rights."

Due to the adoption of the Fourteenth and Fifteenth Amendments, according to Barnett, "Congress and the courts are now expressly authorized to protect from state as well as federal infringement the economic and non-economic rights to 'life, liberty, or property' of all persons."

Barnett, who is now working on an anthology about the Ninth Amendment for the Cato Institute, was recently named one of five outstanding law pro-



Randy Barnett



Stephen Macedo

fessors under the age of 40 by the *National Law Journal*.

President Reagan's nomination of Judge Robert Bork to the Supreme Court brought further attention to Stephen Macedo's *The New Right v. the Constitution*, a revised and expanded edition of which has just been published. Macedo added a chapter on the Supreme Court's treatment of economic and personal liberties in several of its cases as well as his 1986 debate with McDowell. Macedo's book is sharply critical of Bork's "majoritarian" jurisprudence.

The Cato Institute's latest book on constitutional rights, *Economic Liberties and the Judiciary*, edited by James A. Dorn and Henry G. Manne, has created much controversy among judicial scholars and commentators. Such publications as the *Wall Street Journal*, the *Washington Times*, and *Policy Review* have joined the discussion of just which economic liberties are guaranteed by the Constitution.

Cato Distinguished Senior Fellow James M. Buchanan and Cato adjunct scholars Richard Epstein, Mario J. Rizzo, and Manne will be speaking at a Federalist Society conference on economic liberties in Washington, D.C., October 16-17.

## AU Student Wins Foreign Policy Essay Contest

David Isenberg, a student at the American University School of International Service, won first prize in the Cato Institute's second annual foreign policy essay contest. In his essay, "The Reagan Doctrine: Why a Good Offense Is Not the Best Defense," Isenberg analyzed the U.S. policy of aiding diverse anti-Marxist insurgent movements throughout the Third World. He argued that "aid to guerrilla movements ties the United States to their fortunes. If a movement should face defeat . . . , U.S. policymakers would confront the difficult choice of allowing it to fail, which would not be an easy decision once American sympathies and prestige had been committed, or expanding U.S. involvement in the conflict."

The contest is designed to encourage young scholars to consider the relevance of the noninterventionist view-

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David Isenberg

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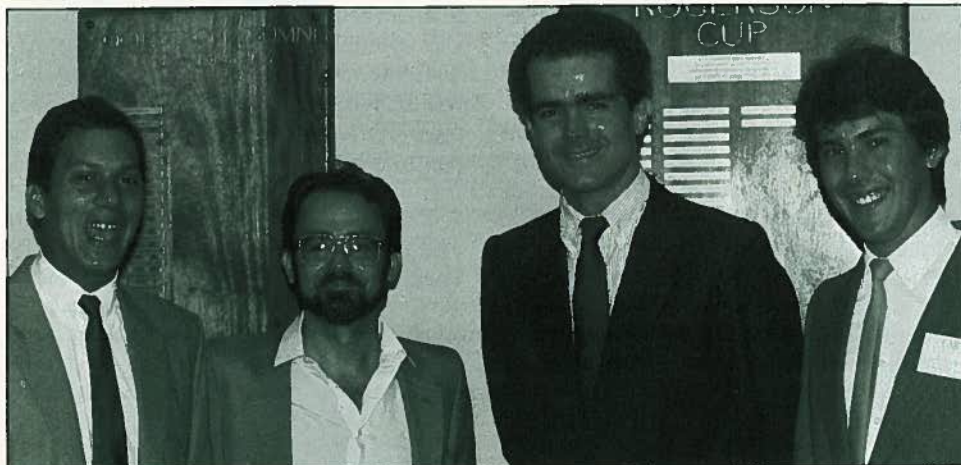
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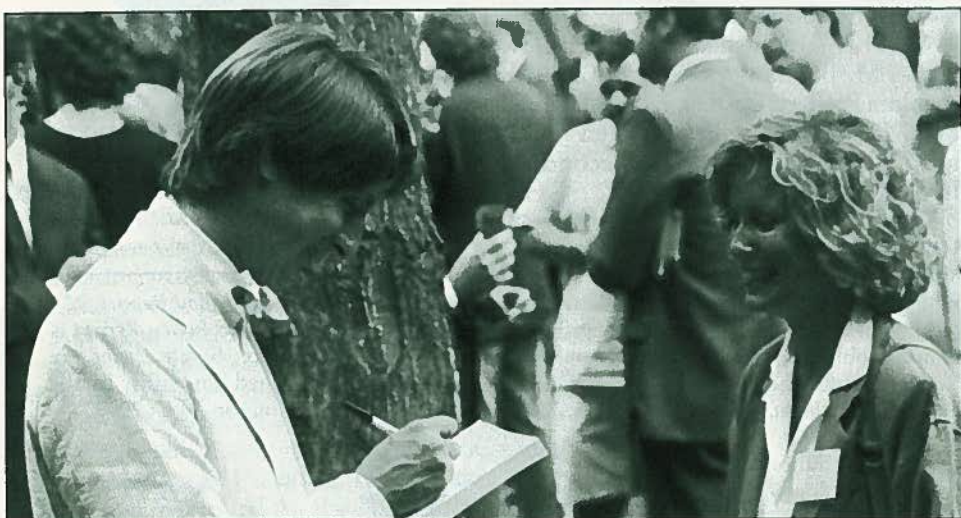




Ted Galen Carpenter, Cato's director of foreign policy studies, speaks on capitalism, Marxism, and the Third World at Cato's annual Summer Seminar in Political Economy.



Among the international participants in this year's summer seminar, held at Williams College, were Jaime Alvarez from the Dominican Republic, Roberto Dubuc and Carlos Blohm from Venezuela, and Carlos Villanueva from Mexico.



P. J. O'Rourke, humorist and author of *Republican Party Reptile*, autographs a copy of his book at a Cato reception in his honor.

## Superfund Is a Pork Barrel, Not Effective

**S**uperfund has failed to safeguard the nation's environment. After close to seven years, fewer than 20 hazardous waste sites have been fully cleaned up, and many of those are reportedly still leaking," says a new study from the Cato Institute.

Policy analyst James Bovard writes, "Federal environmental policies are based on the traditional command-and-control approach to economic problems. Yet federal policies will always be driven by pork-barrel interests, partisan squabbles, and little or no information. We should not trust our environment to slow-moving bureaucrats and vote-buying politicians. As long as we continue to rely on the government to protect the environment, we will continue spending billions of dollars and having little or nothing to show for it."

Bovard points out that the original Superfund law ordered the Environmental Protection Agency to find "at least 400" sites to be cleaned up—remarkably close to the number of congressional districts. The bill also specified that there must be at least one site in every state.

Bovard argues that reliance on private property rights and tort law would be a more effective means of responding to real environmental problems than Superfund is. He also charges EPA with overstepping its authority, particularly by invoking joint and several liability without congressional authorization.

Bovard cites a number of research studies that have found fault with Superfund and its execution. One such study concluded, "There is little scientific evidence that chemical disposal sites have had serious effects on [the] health of populations living near them." An analyst for the Office of Technology Assessment noted that "the [hazard] ranking system is only very loosely related to the actual severity of the problems at the sites."

Bovard's study, "The Real Superfund Scandal," is no. 89 in the Cato Institute's Policy Analysis series and is available from the Institute for \$2.00. ■

### New Cato Book

## The Financial Services Revolution: Is Banking Regulation Stuck in the 1930s?

**P**apers from the Cato Institute's fifth annual monetary conference, held in February 1987, will appear in *The Financial Services Revolution: Policy Directions for the Future*, to be copublished by Cato and Kluwer Academic Press in October.

The book, edited by Cato senior policy analyst Catherine England and Citibank vice president Thomas Huertas, is divided into three sections: the history of banking and bank regulation, shortcomings in the current regulatory structure, and options for reform. In the first section, George Kaufman examines bank failures and runs during the late 19th and early 20th centuries, and Bert Ely recounts the banking history of the 1920s and 1930s. Their papers demonstrate that the industry showed considerable stability before 1920 and that many of the problems of the 1920s and the early 1930s were a result of improper regulatory and monetary system responses to changing conditions.

William Shughart analyzes the passage of the Banking Act of 1933 from a public choice perspective, arguing that Congress did not act solely in the public interest but rather responded to special interests. Michael Bordo and Angela Redish point out that Canada's 1935 decision to establish a central bank was based not on a perception that the Canadian banking system was unstable but on arguments of a more political nature. James Barth and Martin Regalia end the section by tracing the evolution of thrift industry regulation.

Three papers in the second section of the book examine federal deposit insurance's role in creating the banking and thrift industries' current problems. In the first two papers, Gerald O'Driscoll, first alone and then with Roger Garrison and Eugenie Short, describes the impact of deposit insurance on the risk-taking decisions of banks. Regulators' largely unsuccessful attempts to limit such risks in the face of rapidly changing market circumstances are also discussed. Next Gillian Garcia outlines the problems faced by the savings and loan industry and its insurer in light of

the large number of insolvent thrifts allowed to exist alongside healthier institutions. To round out the section, Mark Toma examines the implications of the Federal Reserve Board's monopoly power over reserve requirements, and England argues the broader case for restructuring the regulatory regime under which banks labor.

In the book's final section, Robert Litan asks whether commercial and investment banking should be reunited. Although technological changes have been pushing more and more credit-granting business into the organized capital markets, certain regulations prevent banks from competing effectively with the securities firms that have invaded their traditional turf. Huertas maintains that there is no justification for prohibiting banking organizations from engaging in any business they choose—or for prohibiting any other kind of firm from operating a bank. In the book's last chapter, England explains that in the absence of federal

guarantees and oversight, depositors would protect themselves by using third-party monitors and more-extensive information systems to discourage undue risk taking within the banking industry.

Four themes unite the papers in the volume. First, the current regulatory system is not in the long-term interest of the financial services industry or the country. Second, banking historians err when they maintain that the industry is inherently unstable. Third, although the authors offer many different policy recommendations, all suggest a greater reliance on market discipline and more freedom for all types of financial firms. Finally, the rapid changes in the financial services environment make misguided and interest-group-driven policies a luxury the country can no longer afford.

*The Financial Services Revolution* is available in paperback from the Cato Institute for \$17.95 and in cloth from Kluwer for \$42.00. ■

## Unnecessary Danger in Persian Gulf

**T**he United States is drifting toward an unnecessary and undesirable military confrontation in the Persian Gulf, according to a new Cato Institute study. Sheldon L. Richman of the Institute for Humane Studies at George Mason University writes, "The Reagan administration's decision to reflag 11 Kuwaiti oil tankers and deploy a major force of warships in the Persian Gulf is merely the latest in a series of bizarre and blundering steps toward making the United States a full-fledged belligerent in the seven-year-old Iraq-Iran war."

The Iraqi attack on USS *Stark*, in which 37 sailors died, is likely to be "only the beginning of the direct danger to Americans in the region if the United States fails to reverse this foolish policy," Richman writes.

Although the U.S. naval buildup is ostensibly designed to protect all neutral shipping, its principal effect is to assist Kuwait, one of Iraq's most significant allies. The policy thus suggests

a clear U.S. tilt toward Iraq in its war against Iran.

The importance of the Persian Gulf oil routes is overrated, Richman argues. The percentage of the noncommunist world's oil using the Strait of Hormuz has declined from 41 percent in the mid-1970s to less than 15 percent today. In any case, the market will be capable of adjusting to even major supply interruptions if Washington avoids price and allocation controls and other counterproductive policies of the 1970s. "The best thing the U.S. government could do to ease any disruption would be to create, in advance of a crisis, an atmosphere of entrepreneurial confidence" instead of attempting to penalize speculators.

A major military move against the Persian Gulf nations by the Soviet Union is unlikely, given its difficulties in Afghanistan, whereas U.S. intervention in the gulf region is likely to encourage Islamic fundamentalism and

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## Policy Forum

On May 22 the Cato Institute held its second annual Public Policy Day in conjunction with the celebration of its 10th anniversary. In this issue of Cato Policy Report we present excerpts from three of the talks given at Public Policy Day. The speakers are Charles Murray, senior fellow at the Manhattan Institute and author of *Losing Ground* and the forthcoming *In Pursuit*; Peter J. Ferrara, a Washington attorney and author of three Cato books on Social Security; and Morgan Reynolds, professor of economics at Texas A&M University and author of Cato's recent *Making America Poorer: The Cost of Labor Law*.

**Charles Murray:** I'm going to outline an apocalyptic vision of the future. The trouble with being apocalyptic, of course, is that usually you're wrong; things don't turn out quite as badly as you thought they would. But the danger is great enough to be worth talking about. Let me try to put together the pieces of the puzzle that spell catastrophe.

The first is the current rage for welfare reform. There is a consensus among both liberals and conservatives that certain reforms are the answer to our welfare problems. What especially distresses me is that many of them credit me with pushing the debate to that conclusion, because to me it epitomizes the bankruptcy in our thinking. The linchpin of most of the proposals is workfare—helping or requiring people to get either private-sector or public-service jobs. The common element is that by making those lazy welfare loafers work or else lose their money, you will reduce the underclass and give people real opportunities.

The problem is that we would not be going into those efforts in a vacuum. We've had programs like them before: CETA, WIN, and so on. And you know what happens to such programs, not by chance but because of the dynamics involved. A program starts out with very stiff requirements wherein able-

## Apocalypse Soon

bodied people have to either participate or get taken off the rolls. So if they want to claim a medical disability in the first few months of the program, they'll probably need to get notarized statements from several doctors saying that they're virtually paraplegic. But a couple of years down the road all they'll need to do is say that they have a bad back and they'll get excused.

It's hard to keep enforcing those kinds of rules. The bureaucracy, which often considers it unjust to require people to work, is asked to go to a lot of trouble for no return. It is hard to check up on people to see whether they really have been looking for a job. It is hard to supervise a public-service job



Charles Murray: "What bothers me are the increasing manifestations of a latent racism, which have been systematically fostered by public policy."

site—it's hard to treat those as real jobs, because you don't really need the workers. What ultimately happens is what happened in CETA: through workfare programs, you socialize people to think of their job as a scam. Thus, you do not teach welfare recipients the dignity of work; you teach them that they can con the system by doing as little as possible and still maintain their benefits. So I don't expect much good to result from the proposed workfare programs, and I say that because I spent 12 years evaluating such programs.

Similarly, in principle I'm in favor of proposals to tighten child-support requirements. Anyone who fathers or mothers a child has voluntarily incurred a long-term obligation to sup-

port the child, and I have no problem with using the mechanisms of the state to enforce that obligation. But if a young father doesn't have a job, you can't force him to pay child support, and you certainly can't throw him into jail, right? So in the final analysis you have affected the behavior of relatively few people.

My prediction, then, is that in four or five years we are going to be looking at a welfare population that is roughly the same size as today's, and the kinds of programs about which some of us were so optimistic will once again have disappointed our hopes. That's one element of the potential catastrophe.

Another element is the increasing frequency with which the underclass is identified as being black. And people seem to be happy thinking of the underclass as being black; they are not interested in hearing evidence that illegitimacy is a socioeconomic phenomenon or that a white underclass exists as well but is not as visible because it's more dispersed. What bothers me are the increasing manifestations, not among rednecks but among the white educated elite, of a latent racism, which I believe have been systematically fostered by public policy. Policies that lead to such attitudes have sometimes been imposed in the form of laws, sometimes undertaken voluntarily by our elite institutions, especially our educational institutions.

Suppose, for example, that my child has obscure symptoms that will probably require a subtle, difficult diagnosis and that I have to choose between two doctors, one black and one white. Now, if the only information I have is that both doctors are over 50 years old and that both went to a good medical school, I'll probably choose the black doctor, because any black who got into a good medical school in the 1950s is probably really hot stuff. But I know that the average MCAT score of blacks who were recently accepted at medical schools is lower than the average MCAT score of whites who were rejected. So if I have to choose between two 35-year-old doctors from the same medical school, one white, one black,

I'll choose the white doctor.

Likewise, I know that only 18 percent of the blacks who recently entered the nation's law schools would have been admitted under a colorblind procedure. So if I have a tough legal problem and I have to choose between two 35-year-old lawyers, one white, one black, I'll choose the white lawyer. If I have a less difficult problem, I'll choose the black lawyer, to prove that I'm not a racist.

What I'm saying is that our public policy has systematically encouraged people to adopt behavior that is indistinguishable from the old racism, but their behavior is grounded not in racism but in trying to make the best decision they can with the information available to them. I ask you to empathize with a black doctor or lawyer who is first-rate—how the hell does he prove it in the face of the assumptions people make? Although the same thing has been going on in academia and other fields, I've used medicine and law as instances of an increasingly widespread phenomenon that nobody seems

to want to talk about: behavior among educated whites that expresses condescension, contempt even, toward blacks.

The final piece of the puzzle that spells catastrophe has to do with AIDS. In the next few years the nation's AIDS epidemic, particularly among heterosexuals, is going to be concentrated in the lower-class black community. There are two reasons. One is risk factors; intravenous drug use, a major heterosexual mode of AIDS transmission, is much more prevalent in the black lower class than in the white upper classes. The other reason is that historically the upper middle classes of all races have responded much more rapidly when drastic behavioral changes were called for. Look at smoking. At college faculty meetings with 40 or 50 people in the room and ashtrays on the tables, nobody smokes. At conferences of senior executives, nobody smokes. But in blue-collar neighborhoods, smoking has hardly declined at all. Similarly, there will be a slower response to AIDS among the lower class than among the upper classes.

## The Administration's Catastrophic Policy

**Peter Ferrara:** I'm going to talk about catastrophic health care policy, and the main issue is whether "catastrophic" modifies "health care" or "policy."

Medicare hospital coverage currently runs out after 90 to 150 days of illness, whereupon elderly patients are on their own with whatever private insurance they have. Even before their Medicare coverage runs out, the deductible and coinsurance fees alone can amount to \$20,000. That is what makes the catastrophic health care issue so crucial for the elderly.

Health and Human Services secretary Otis Bowen proposed to expand Medicare to provide catastrophic acute care coverage for an unlimited number of days in a hospital and put a cap of \$2,000 a year on the deductible and coinsurance fees for that coverage. The extra coverage was to be financed through a Medicare premium that would amount to \$5 a month for each elderly beneficiary. But before the ink was dry, the Congressional Budget Office raised the premium to \$6.40 a month—and that was only the first of many increases, because the premium

is indexed to health care cost inflation, which of course Medicare increases. The proposal has since been expanded, as many of us told the administration it would be, and Congress is now debating whether the cap should be \$1,000 a year rather than \$2,000, in which case the premium would be more like \$10 a month.



Peter Ferrara: "Despite Medicare's enormous costs, the elderly now pay the same percentage of their income for health care that they did before Medicare."

So there are three elements that spell catastrophe. One, although we were confident that we knew how to deal with the lower class, lo and behold, our methods didn't work; the poor are still with us. But we are not prepared to make fundamental changes in the structure of our society, and we've run out of solutions that preserve the status quo. Two, because of the phenomena I've discussed, the white elite has become increasingly lax in defending racial equality and justice. And three, there is an increasing perception that the equivalent of a plague is being fostered by black lower-class people. Those are explosive conditions; they have created the potential for a reaction, energized by old-fashioned rednecks, perhaps, but countenanced by the white elite, that could drastically alter race relations in this country.

Much of this picture is speculative, much of it projective. What scares me most is that each of the pieces in the puzzle seems fairly solid, and the way they fit together seems too neat by half.

Although the proposal is widely touted as a great boon to the elderly, it would in fact provide no real benefit to the elderly at all. About 85 to 90 percent of the elderly already receive the coverage proposed and more, through the private sector. Most of them acquired it through one of three vehicles: private insurance that they purchased directly, group health insurance provided by their former employers as a pension benefit, or HMO's that include catastrophic coverage as an add-on. Among the remaining elderly, those who lacked the resources to purchase catastrophic coverage through the private sector are covered by Medicaid if they have significant medical costs.

What really troubles the elderly is not the costs that the proposal would cover but the uncovered costs, which include the cost of long-term nursing home care, doctors' charges that exceed the amounts paid by Medicare, and the cost of prescription drugs, eyeglasses, and hearing aids. Such costs account for 50 percent of the elderly's medical expenses each year. Just remember this simple aphorism: What

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### Health Care (Cont. from p. 7)

the catastrophic health care proposal would cover, the elderly are already covered for; what the elderly are not already covered for, the catastrophic health care proposal would not cover. The proposal would simply put most of the elderly's private coverage into one big public-sector monopoly under Medicare.

As a result, the elderly would lose the freedom to choose a pattern of coverage and an insurance provider; they could no longer opt for a cost-saving vehicle such as an HMO. Instead of having a choice of insurers that are eager to accommodate them because of the competition in the private sector, they would be subject to a government monopoly that would ultimately require them to accommodate it. They would become more vulnerable to rationing and restrictions of access to medical care, which we see in every country that has adopted socialized medicine.

Now, some members of Congress want to finance the proposed Medicare coverage at least partially through a substantial income-tax increase targeted at the elderly. Millions of elderly people would have to bear a tax increase of several hundred dollars a year to pay for the same kind of health insurance coverage that they already have. Where is the AARP when the elderly really need it? The tax increase would also create an antisavings bias. It would

hurt elderly people who had saved in order to have a higher retirement income, so it would discourage people from doing that. Some conservatives in Congress favor the tax increase because they consider it a way of means-testing Medicare. But what would really be means-tested through the tax increase is the private income of the elderly.

The catastrophic health care issue is only part of a larger problem that Congress studiously ignores: the Medicare system is an enormous fiasco. Medicare is going to collapse around the end of the next decade; under the "intermediate assumptions" of the Social Security Board of Trustees, the Medicare payroll tax rate would have to more than double in order to pay for all the benefits promised to the young people entering the workforce today. Under the board's pessimistic assumptions, which are far from being a worst-case scenario, the Medicare payroll tax would have to more than quadruple, to almost as much as the total payroll tax for Social Security and Medicare today.

When you look at Medicare's enormous cost increases, you think, At least the elderly must have benefited. The most amazing statistic I've ever read is that the elderly now pay the same percentage of their income for health care that they did before Medicare was adopted. Their health care costs, whose dramatic increase can be traced back to the mid-1960s and the adoption of Medicaid and Medicare, seem to have

outweighed the benefits of Medicare.

In an attempt to slow down the rapidly increasing costs, the federal government did just what you would imagine. It adopted the diagnostic-related group system and put all the illnesses in the world into 490 categories. Every illness has a category, and every category has a price. If you are diagnosed as having a certain illness, the hospital gets the corresponding amount no matter how much it spends to cure you. So the faster it treats you and releases you, the more money it gets to keep. If you're slow to respond to treatment, the hospital loses money, so you might find yourself being classified as hopeless in a rather perfunctory fashion.

The system not only gives the hospital an enormous incentive to shuffle people in and out as quickly as possible but takes away the consumer's power over the hospital. You can't even volunteer to pay the hospital more to give you better treatment. That's illegal. The AMA had better wake up, because doctors are going to be the scapegoat more and more often. The government has imposed more and more restrictions on their income and their professional freedom, and before long all the doctors are going to be GS-15s.

What should be done about the government's catastrophic policies? The elderly could be allowed to finance the bulk of their Medicare coverage through private tax-exempt savings and insurance that they had accumulated during their working years. The funds could also be used to finance long-term nursing home care. The government would provide back-up catastrophic coverage, but that would be a small piece of the pie. In 1986 there were over 40 cosponsors, including a number of liberal Democrats, for a bill that would eventually shift 80 percent of Medicare to the private sector. It's basically similar to my Super IRA Social Security proposal, and that is another issue on which we should take the offensive. We should seek to have Congress vote on restoring the IRA deduction and expanding the IRA system—along about April of next year. More people would participate in a system that allowed them to own part of the economy and take responsibility for themselves. ■



Frances Kendall (right), coauthor with Leon Louw of *After Apartheid: The Solution for South Africa*, talks about the book's proposal for a decentralized, canton-style government for South Africa, at a Cato Policy Forum.

## Are Labor Unions Equal under the Law?

**Morgan Reynolds:** The labor market may be the most regulated sector of the U.S. economy, although most people fail to think of it as such. In fact, labor matters may be the most important foundation of the welfare state—Social Security, unemployment compensation, and a whole raft of government interventions are fundamentally labor-market issues.

I'd like to elaborate on two contentions that I believe reason and evidence overwhelmingly support. The first is that unions are combinations that amount to government-supported cartels and monopolies. The second is that labor law, which aggrandizes and promotes adversarial and even coercive actions by unionists, impoverishes workers. Indeed, trade unions in the British or American mold are the major obstacle to the enrichment of the working class. When a friend of my son's, a 19-year-old high school student who is not headed for college, discovered that I had written a book about labor unions and collective bargaining, he remarked, "Labor unions, they ain't nothin' but trouble." And I said, "I agree with you, but it usually takes me 300 pages to say that."

How great is the cost of labor law? The figure I cite in my book is \$126 billion a year in terms of what economists call waste, or dead-weight loss. The best estimate would be even larger, but I wanted to be cautious.

What are the processes through which that cost, largely borne by consumers and nonunion workers, accumulates? Federal laws, most of which were passed in the 1930s, not only distort labor relations for large and small companies alike but hinder in a very perverse way the discovery of superior forms of labor relations. What we see is only the surface manifestation of the harm that labor unions wreak, because we don't see the superior alternatives that otherwise would have evolved in the form of enterprise unions, independent unions, or employee working associations.

The unions that are encouraged by our labor legislation reduce the economic pie in a variety of ways; the one that economists are quickest to recognize is that they divert capital and labor from high-productivity uses. If

unions succeed in raising the price of labor in their sector, they confine the unfortunate to the lower-wage non-union sector. Unions raise unemployment, especially over the business cycle, and thus reduce the price system's ability to put us in the neighborhood of full-employment output.

Unions within firms discourage effort and investment in human capital, partly as a consequence of the compression of the wage structure. Wages aren't as steeply sloped with respect to experience, skill, and the like in a unionized setting. In managing resources, unions resist new technology, insist on the use of unnecessary labor, and foster



Morgan Reynolds: "Unions enjoy many immunities and privileges that aren't available to others."

adversarial attitudes in the workplace. Moreover, unions reduce production and employment opportunities through the use of strikes and, more important, the threat of strikes.

Studies also show that the rate of improvement in productivity over time, otherwise known as technical change, is negatively correlated with the degree of unionization in industries. But the connection between sick firms or industries and unionization is obvious. Highly unionized Great Britain is perhaps the most outstanding example; it went from being the rich man of Northern Europe to being the poor man. Deregulation of the product markets puts unionized firms under severe pressure and widens opportunities for nonunionized firms and employees, an indirect indicator of the harmful effect of unions on productivity and therefore on workers' standard of living.

Unions enjoy many immunities and

privileges that aren't available to others. Ludwig von Mises once said that the economic power of the trade union rests on primitive violence used against the strikebreaker. Our labor laws give unions coercive power—the power to intimidate and threaten. Consider this passage from section 602A of the Landrum-Griffin Act:

It shall be unlawful to carry on picketing on or about the premises of any employer for the purpose of, or as part of any conspiracy, or in furtherance of any plan or purpose for, the personal profit or enrichment of any individual (*except a bona fide increase in wages or other employee benefits*) by taking or obtaining any money or other thing of value from such employer against his will or without his consent [emphasis added].

U.S. labor law is shot through with such discriminatory codes of behavior. Unions are widely thought to warrant special treatment because of labor's great disadvantage under the oppression of 19th-century capitalism. Economists have rarely endorsed such emotional, pseudohistorical rationales, but neither have they dispelled the general ignorance about the consequences of unions by describing them clearly and courageously. At least one early economist, however, didn't share that reluctance. Said David Ricardo in 1820:

Masters are frequently intimidated and are obliged to comply with the unjust demands of their workmen. The true remedy for combinations is perfect liberty on both sides and adequate protection against violence and outrage. Wages should be the result of a free compact, and the contracting parties should look to the law to protect them from force being employed on either side. Competition would not, I think, fail to do all the rest.

Deregulation of the labor market, then, would not mean that there was no role for the state to play. Its legitimate role is to actively enforce property, contract, tort, and criminal law—to protect people and their property from aggressive abuse by trade unions. ■



**Contest** (Cont. from p. 3)

point to foreign policy issues. This year's contest focused on John Quincy Adams's warning that "by once enlisting under other banners than her own," America "would involve herself beyond the power of extrication, in all the wars of interest and intrigue, of individual avarice, envy, and ambition" that "usurp the standard of freedom"; the principles of her policy would change "from liberty to force." Isenberg concluded his critique of the Reagan administration's incursions in the Third World by observing that "if John Quincy Adams could be brought forward in time to be told that the current foreign policy of the United States is to intervene . . . in Africa, Asia, and Latin America in support of anti-Soviet 'democratic revolutions,' he would be aghast."

Ted Galen Carpenter, Cato's director of foreign policy studies, expressed pleasure at the number of excellent essays submitted by graduate students from schools across the United States and in other countries. Carpenter cited Isenberg's study as "an especially perceptive analysis of a controversial and complex foreign policy issue."

For his winning essay, Isenberg received a \$3,000 grant from the Cato Institute. The \$1,500 second prize went to Gary Kline of the University of Texas for his "Essay on Noninterventionism." Jamaican-born Andrea Ewart of the University of Miami won the \$1,000 third prize for "Morality and Realism in Foreign Policy," and Russell Leigh Moses of the University of Pittsburgh was awarded the \$500 fourth prize.

Besides Carpenter, the judges for the contest included Earl C. Ravenal, Distinguished Research Professor of International Affairs at Georgetown University, and Leonard P. Liggio, president of the Institute for Humane Studies at George Mason University.

**Persian Gulf** (Cont. from p. 5)

violence directed at Americans.

Richman's study, "Where Angels Fear to Tread: The United States and the Persian Gulf Conflict," is part of the Cato Institute's Policy Analysis series and is available from the Institute for \$2.00.

**Bovard Joins Cato Institute**

Washington journalist James Bovard has been named an associate policy analyst of the Cato Institute. Bovard will write at least four studies a year for the Institute's Policy Analysis series as well as contributing to a wide variety of outside publications.

Bovard has written several studies for Cato in the past, including "The Last Dinosaur: The U.S. Postal Service," "The Continuing Failure of Foreign Aid," "The Failure of Federal Job Training," and "The Real Superfund Scandal." He is currently researching

papers on U.S. trade law and the World Bank. Bovard's work has been widely published, appearing in such newspapers as the *New York Times*, the *Wall Street Journal*, and the *Detroit News*, for which he writes a weekly column.

Cato president Edward H. Crane said, "We are delighted to be associated with a journalist who has a commitment to individual freedom and the dedication to plow through stacks of official documents to find out what the government is really up to. We look forward to a long relationship with him."

**Cato Institute Policy Conferences****"Assessing the Reagan Years"**

Vista International Hotel  
Washington, D.C. • October 1-2, 1987

Speakers include William A. Niskanen, Murray Weidenbaum, Malcolm S. Forbes, Jr., Clarence Thomas, Paul Craig Roberts, Lawrence Korb, Barry Lynn, and Jerry Jordan.

**"Collective Security or Strategic Independence: Alternative Strategies for the Future"**

Capitol Hill Hyatt Regency Hotel  
Washington, D.C. • December 2-3, 1987

Speakers include Sen. Mark Hatfield, Sen. Eugene J. McCarthy, Earl C. Ravenal, Aaron Wildavsky, Melvyn Krauss, Eugene Rostow, Ted Galen Carpenter, Ronald Steel, Joshua Muravchik, Jonathan Kwitny, and Alan Tonelson.

**"Dollars, Deficits, and Trade: The Changing World Economy"**

Sixth Annual Monetary Conference  
Capital Hilton Hotel  
Washington, D.C. • February 25-26, 1988

Speakers include Federal Reserve Board vice chairman Manuel H. Johnson, Sen. Phil Gramm, Richard Cooper, Robert A. Mundell, Ronald I. McKinnon, William A. Niskanen, Leland B. Yeager, Michael D. Bordo, Anna J. Schwartz, Jacob A. Frenkel, and Gottfried Haberler.

For information on all conferences, contact Sandra H. McCluskey, Director of Public Affairs, Cato Institute, 224 Second St. S.E., Washington, D.C. 20003, (202) 546-0200.

**Foreign Policy** (Cont. from p. 1)

more accurately, noninterventionism—became the foreign policy foundation of the republic. Advocates of noninterventionism eschewed political and military obligations but welcomed extensive commercial connections. Thomas Jefferson invoked that distinction when he asserted that America's policy should be to seek "peace, commerce, and honest friendship with all nations, entangling alliances with none."

The earliest detailed delineation of a noninterventionist foreign policy, though, is contained in George Washington's Farewell Address. Washington cautioned his fellow citizens against "inveterate antipathies" to certain nations and "passionate attachments" to others. The latter were especially insidious, he warned, "facilitating the illusion of an imaginary common interest" and leading to "participation in the quarrels and wars" of the favored nations "without adequate inducement or justification." Although he acknowledged that the republic might employ "temporary alliances for extraordinary emergencies," Washington clearly favored an aloof approach to world affairs: "The great rule of conduct for us in regard to foreign nations is in extending our commercial relations to have with them as little political connection as possible."

**Nonintervention in the Constitution**

The nation's commitment to noninterventionism would reach its zenith in the decades following Washington's Farewell Address, but its strength was already evident in several provisions adopted by the Framers when the Constitutional Convention convened in 1787. The structure of the new national government was hardly conducive to the pursuit of imperial ambitions. A critical feature of the Constitution was an emphasis on the dispersal of political power. That attitude was embodied in the principle of federalism, which entailed a division of authority between the states and the central government. A similar principle operated at the national level. Power was divided among three coequal branches, each able to check the excesses of the others.

The power-sharing rationale was also

applied to foreign policy responsibilities. Out of concern about problems that had arisen during the confederation era, the Framers made the presidency the repository of authority over the day-to-day conduct of foreign affairs. Moreover, they invested the president with the responsibility of being commander in chief of the nation's armed forces.

But the Framers also granted a significant foreign policy role to the legislative branch. They accorded the Senate the right to "advise and consent" before treaties were effected. Congress as a whole was empowered to authorize the raising of military forces and allocate funds for their operation. That obstacle to an interventionist foreign policy reflected the Framers' profound distrust of standing armies, typified by James Madison's statement in the *Fed-*

**"The earliest detailed delineation of a noninterventionist foreign policy is contained in George Washington's Farewell Address."**

*eralist*, no. 41, that even a small army "has its inconveniences. On an extensive scale its consequences may be fatal." Most important, the Framers gave Congress, not the president, the power to declare war. And in the parlance of the times, "declare" meant "authorize" or "begin."

The political system most conducive to an interventionist foreign policy is a powerful, unitary national government that is dominated by an unfettered executive and has considerable taxing and regulatory authority plus the ability to raise and sustain a large military force. The Constitution that emerged from the Philadelphia convention created precisely the opposite type of government. Noninterventionism thus not only was the preferred foreign policy doctrine of most Americans, it was em-

bedded in the nation's political structure.

**Forgetting the Framers**

The United States has since deviated markedly from the intent of the Framers in several areas, but nowhere has the departure been more pronounced than in its foreign affairs. Both the substance of contemporary U.S. foreign policy and the manner in which it is conducted violate virtually every noninterventionist precept established by the revolutionary leaders. The vision they articulated has been transformed beyond recognition, with results that are little short of calamitous.

Today the United States is entangled in multilateral or bilateral arrangements to defend more than 40 nations. They include not only well-known formal agreements such as NATO, the Rio Pact, and the Japanese Defense Treaty but a host of more obscure ones. Moreover, the United States is bound by numerous informal promises of assistance. Its "special relationship" with Israel leaves little doubt that U.S. officials would back that nation in any Middle East conflict, even in the absence of treaty provisions.

The United States has also incurred vague but entirely real obligations as a result of presidential proclamations. The Truman Doctrine, promulgated in 1947, pledged the United States to aid friendly nations in resisting either external aggression or internal "armed minorities." That promise had no discernible geographic limitations, and it has in fact served as the basis for Washington's global policy of striving to contain communism. More recently, the so-called Reagan Doctrine pledged the United States to assist anti-Marxist insurgent forces in several left-wing Third World countries, thereby adding an entirely new dimension to America's already extensive foreign entanglements.

**The Costs of Intervention**

Adherence to collective security strategies has had a corrosive impact on American lives, values, and institutions. In human terms alone, the cost has been staggering. Since the abandonment of noninterventionism in the early 1940s, nearly 400,000 young Americans have perished in combat. More than 100,000 of them lost their lives in

(Cont. on p. 12)



### Foreign Policy (Cont. from p. 11)

the Korean and Vietnam wars—conflicts whose relationship to U.S. security was obscure at best.

The financial cost of interventionism has been devastating as well. In the past four and a half decades the United States has spent nearly \$4 trillion on the military. Moreover, the bulk of that vast sum has not been spent on homeland defense. Cato senior fellow Earl C. Ravenal has amassed persuasive evidence that throughout the cold war era more than half of America's "defense" budget has been used to subsidize the security of its allies and client states.

Such burdensome military spending offers a graphic contrast to the noninterventionist foreign policy that prevailed during the nation's first century and a half of independence. As historian Bruce Russett noted, even as late as 1939 U.S. military spending barely exceeded 1 percent of the gross national product. Under the interventionist regime the lowest post-World War II level was 3.9 percent, reached in 1947. Since the Vietnam War the military spending level has fluctuated between 5 and 7 percent; it is currently about 6.5 percent.

The opportunity cost of increased militarization should not be ignored. Wealth spent on soldiers and armaments cannot be used for consumer goods or civilian capital investment. The drain is especially debilitating in a rapidly changing global economy that is increasingly dependent on high technology. More than a decade ago Seymour Melman predicted in his seminal work *The Permanent War Economy* that excessive military spending would sap America's economic vitality. More recently Cato adjunct scholar Lloyd J. Dumas, in *The Overburdened Economy*, validated Melman's warning by presenting sobering evidence that significant deterioration had already occurred. The Founders understood that an excessive military establishment threatened the prosperity as well as the liberty of a free people. That lesson apparently has eluded many of their descendants.

#### The Imperial Presidency

Interventionism has also corroded

America's political structure. The most ominous development is the malignant growth of an imperial presidency. A dramatic expansion of executive power that had grave implications for the system of checks and balances coincided with the advent of a global interventionist foreign policy in the early 1940s. During the months prior to Pearl Harbor, Franklin Roosevelt maneuvered a reluctant nation toward war through a series of unilateral actions. Once the United States officially entered the war, he circumvented Congress to an even greater degree. Major decisions reached with Great Britain and the Soviet Un-

**"Noninterventionism not only was the preferred foreign policy of the Founders, it was embedded in the nation's political structure."**

ion, not only about the conduct of the war but about the postwar settlement, were concluded by executive agreement rather than by treaty; thus, the Senate was excluded from the decision-making process.

Roosevelt's successors duplicated or even exceeded his arrogance. Harry Truman scorned congressional prerogatives by involving the United States in the Korean conflict without even asking for an authorizing resolution, much less a declaration of war. Sen. Robert Taft aptly termed that act "a complete usurpation by the President of authority to use the Armed Forces of this country."

The zenith of the imperial presidency occurred when both Lyndon Johnson and Richard Nixon asserted the right to direct U.S. participation in the Vietnam War without congressional approval. (They even dismissed the Tonkin Gulf resolution as superfluous moral support.) Instead, each president invoked an expansive interpretation of his constitutional authority as com-

mander in chief of the armed forces and spun elaborate theories of "inherent" presidential power.

Congress finally reclaimed some of its foreign policy prerogatives in the early 1970s, thereby restoring at least a semblance of the system of checks and balances that the Founders had envisioned. The War Powers Resolution, restrictions on U.S. foreign aid programs, and provisions for congressional oversight of intelligence agencies curbed the worst abuses of the imperial presidency. That achievement may prove to be transitory, however; the Reagan administration has embarked on a concerted campaign to reinstitute unlimited executive power over foreign affairs. Actions it has taken with respect to Lebanon, Grenada, Libya, Nicaragua, and Iran all suggest a foreign policy formulated in arrogant isolation from Congress and the American people. The constitutional system of checks and balances is still in jeopardy.

It is important to understand that cold warriors do not conceive of an unfettered presidency as an end in itself. Rather, they view it as a powerful, if not indispensable, means to pursue an interventionist foreign policy. The linkage is evident in Secretary of State George Shultz's complaint that post-Vietnam restrictions on "presidential flexibility" have "weakened our country" and caused it to pull back from "global leadership."

During the early years of the cold war Senator Taft and other conservatives condemned presidential usurpation of policymaking power and led an unsuccessful fight to reactivate the system of checks and balances. Contemporary conservatives, however, are among the foremost apologists for an imperial presidency. The editors of the *Wall Street Journal* seem especially enamored of executive supremacy; they have devoted numerous editorials to condemning the War Powers Resolution and asserting that the Founders intended to give the president untrammelled authority over foreign affairs. That revisionist assertion resembles something out of George Orwell's *1984*. Such interventionists would have us believe that the Founders—inheritors of the British Whig tradition, with its distrust of executive power—invested the presidency with unilateral foreign

policy authority that not even the British monarchy possessed.

#### Undermining Our Political Values

An interventionist foreign policy has also eroded fundamental American values. Military conscription has been a prominent, largely accepted feature of our society throughout much of the cold war. The emergence of a national security state during and immediately following World War II led inexorably to a demand for conformity, especially on foreign policy issues. Even such conservative critics of globalism as *Chicago Tribune* publisher Robert McCormick and Senators Taft and Kenneth Wherry were confronted with innuendoes about their patriotism. Liberal and radical critics were routinely subjected to allegations of disloyalty. As the cold war deepened, "loyalty" became a political obsession; it culminated in the outrages against civil liberties committed during the McCarthy era.

Although it might be tempting to dismiss McCarthyism as an unfortunate aberration—a collective hysteria created and exploited by a political demagogue—a review of both earlier and later developments casts doubt on that sanguine conclusion. An intolerance of foreign policy dissenters even more intense than that of the McCarthy period emerged during the First World War, a conflict that, not coincidentally, was the first major departure from America's noninterventionist tradition. Pacifists and other critics of America's involvement were intimidated, assaulted, and imprisoned. Likewise, members of America First and other "isolationist" groups attempting to keep the United States out of the Second World War were repeatedly smeared as "profascist" and harassed by the Roosevelt administration.

Nor did the erosion of civil liberties end with the McCarthy era. Throughout the Vietnam conflict antiwar organizations had to contend with governmental surveillance, infiltration, and disruption. Recently the cynical "politics of loyalty" has reappeared; advocates of interventionism are once again accusing their opponents of being "soft on communism." Former White House communications director Patrick Buchanan made use of that rhetorical ploy when he asserted that a vote on U.S.

military aid to the Nicaraguan contras would determine whether members of Congress stood with President Reagan or with "Daniel Ortega and the communists."

Just as interventionism has eroded freedom of expression and other civil liberties at home, it has undermined American values abroad. The credibility of the U.S. commitment to democracy and free enterprise is compromised when Washington endorses and subsidizes "friendly" Third World autocrats. Yet in an effort to line up client states and insulate various regions against Soviet influence, U.S. officials frequently

**"The Founders understood that an excessive military establishment threatened the prosperity as well as the liberty of a free people."**

portray such tyrants as members of the free world and contribute economic and military aid to keep them in power. The strong strain of anti-Americanism in the Third World cannot be understood apart from that betrayal of America's heritage.

John Quincy Adams asserted that a grave corruption of fundamental American values would occur if the United States abandoned its commitment to noninterventionism. America, Adams proclaimed, "goes not abroad in search of monsters to destroy." He then issued this prophetic warning:

She well knows that by once enlisting under other banners than her own . . . she would involve herself beyond the power of extrication, in all the wars of interest and intrigue, of individual avarice, envy, and ambition, which assume the colors and usurp the standard of freedom. The fundamental maxims of her policy would insensibly change from lib-

erty to force . . . She might become the dictatress of the world. She would be no longer the ruler of her own spirit.

One would be hard-pressed to find a more concise description of America's foreign policy since World War II.

#### Intervention in the Nuclear Age

The nation's abandonment of noninterventionism not only has had unpalatable consequences, it has been based on faulty premises. Twentieth-century proponents of globalism typically contend that technological developments have rendered an "isolationist" policy obsolete and that peace-loving nations must unite to thwart an aggressor or fall victim to a divide-and-conquer strategy. Alliances and other collective security measures, they claim, are therefore essential.

But reliance on collective security rather than noninterventionist strategies constitutes a dangerous anachronism. At one time it was plausible to argue that allies might help deter an aggressor and thereby preserve peace. But in the thermonuclear era allies are either superfluous or profoundly dangerous. Washington's ménage of associates and clients would be irrelevant in a U.S.-Soviet clash over an issue central to both superpowers. On the other hand, the United States and the Soviet Union might well become embroiled in a nuclear conflagration sparked by a dispute between reckless clients. There is more than a remote possibility that World War III could evolve from conflicts between Israel and Syria, North and South Korea, or Pakistan and India, even if the underlying issues were of marginal relevance to both superpower patrons. In the nuclear age alliances are, in Earl Ravenal's apt phrase, lethal "transmission belts for war."

The Founders charted a noninterventionist course that served the republic well for 150 years. Since abandoning noninterventionism, the United States has drifted into a series of bloody conflicts, undermined its credibility abroad, and suffered grievous domestic consequences. Worst of all, the country has embraced a strategy that menaces rather than enhances its security. A foreign policy based on noninterventionist principles is even more essential today than it was at the dawn of the republic. ■



## Corruption in the Underground Government

### Policy Report Reviews

**The Machinery of Greed: Public Authority Abuse and What to Do about It**, by Diana Henriques (Lexington, Mass.: Lexington Books, 1986), 161 pp., \$18.95.

**T**he *Machinery of Greed* is an exposé of fraud, corruption, theft, and mismanagement in what James Bennett and I labeled "off-budget governmental enterprises" in our book, *Underground Government* (Cato Institute, 1983). There are tens of thousands of OBEs, or public authorities, at the state and local levels of government. They are typically set up by politicians who wish to avoid constitutional and statutory limitations on governmental borrowing, spending, and taxing. OBEs are almost never audited, are exempt from civil service employment limits, seldom use competitive bidding to award contracts, need not comply with regulations that govern private businesses, have powers of eminent domain, are often statutory monopolies, and, despite the claim of fiscal self-reliance, are heavily subsidized by federal, state, and local governments.

Because of those privileges, OBEs are detached from both marketplace competition and taxpayer scrutiny. As a result, according to Henriques, they are prone to "abuse by . . . politics and by the con artists and crooks such political environments attract." The author, an investigative journalist for the *Philadelphia Inquirer*, provides dozens of documented examples of fraud, corruption, theft, and mismanagement by "public servants" and others involved in the operation of OBEs. Among the forms they take are the outright sale of jobs; the firing of whistle-blowers and cooperative government witnesses; the use of payrolls for the support of political allies, friends, and relatives; and the use of political consulting contracts or politically wired brokers to extort campaign contributions, to foster the welfare of the managers themselves,

and to enhance the values of selected politicians' real estate. "Loans have been used to finance mob-controlled construction projects. . . . Abusers have inflated insurance premiums, received kickbacks, set up lush tax-shelter deals, and sold useless equipment, supplies, or land to public authorities."

Some specific examples: Hearings revealed that an engineering company had been "shaken down for a \$100,000 political contribution to the [Camden County, New Jersey] Democratic party" in exchange for a contract from the local utility authority. The chairman of the Massachusetts Bay Transit Authority in Boston was sentenced to a 7- to 10-year jail term for his role in an extensive kickback operation. In "one of the largest public frauds on record at the time," three Pennsylvania Turnpike Commission officers were convicted of conspiring to steal \$19.5 million in construction funds by transferring them to an engineering firm headed by a commissioner's relatives. Besides the examples in the text, which involve Republicans as well as Democrats, there is an appendix that lists 36 major OBE scandals nationwide. The breadth of Henriques's evidence suggests that such corruption is pervasive.

Henriques's book is also a condemnation of the subdiscipline of political science known as "public administration." For decades scholars in that field used the oxymoron "businesslike government" to describe OBEs. They justified the existence of OBEs by asserting that isolating an OBE from "petty political pressures" would render it, according to one such scholar, "equal to a private corporation." But the proposition that an entity created by a government, controlled by politicians, and given the authority to spend large sums of taxpayers' money without direct accountability or oversight would be immune from politics is incredible nonsense. It is based on the naive view that public administrators would act like mindless robots, faithfully promoting the public interest without regard for their own interests. *The Machinery of Greed* pounds quite a few nails into the coffin of that hoary myth.

Public choice economists take a more

realistic view of political behavior, but they too have misinterpreted the OBE phenomenon. Part of public choice theory holds that the more governmental enterprises in a metropolitan area, the better, for competition among them will hold down costs and improve service quality. But because of OBEs' detachment from taxpayer scrutiny and their propensity for corruption, their proliferation renders local governments more monopolistic and authoritarian, not more competitive.

Henriques offers numerous practical, though admittedly partial, remedies for the public authorities' corruption. Although all are aimed at making the operations of OBEs more open to the public, Henriques places a special emphasis on increased efforts by investigative journalists. Press exposure of political corruption would help, but it cannot be relied upon.

The real remedy for the public authorities' corruption is defined away by Henriques. She writes, "If it is true that public authorities are here to stay—and common sense suggests that it is—then it is all the more important that ways be found to protect them without crippling them." But fraud and mismanagement are inherent features of OBEs and are inevitable whenever a government empowers individuals to spend large sums of other people's money. Privatization is the real remedy for those problems; the private goods and services provided by OBEs could be supplied much more efficiently by private, competitive businesses. More important, taxpayers would not be compelled to finance the theft, kickbacks, and other forms of corruption that epitomize OBEs. Privatization has occurred at the state and local levels of government, so it is not clear that public authorities are necessarily "here to stay," at least on the scale that currently exists. The weakness of her conclusions aside, Henriques has written a valuable study of corruption in the underground government.

—Thomas J. DiLorenzo  
Center for the Study of  
American Business

# The New York Times

NEW YORK, TUESDAY, MAY 19, 1987

### 'Think Tanks'

## Cato Institute Marks 10 Years

By WARREN WEAVER Jr.

Special to The New York Times

WASHINGTON, May 18 — When Edward H. Crane was working on a political campaign in Washington a dozen years ago, he was impressed by public policy research groups like the Brookings Institution and the American Enterprise Institute. They seemed to have a remarkable impact on government, he now recalls thinking, considering how much smaller and poorer they were.

But Mr. Crane, a libertarian, disagreed with much of the national security policy in favor of the conservative A.E.I. and many liberal domestic attitudes at Brookings. So he founded the Cato Institute, a "think tank" that manages to combine dedication to the freest conceivable free market economy, the least possible government, lower military spending, a smaller American military commitment abroad and full civil liberties for all.

On Thursday the Cato Institute celebrates its 10th anniversary with a banquet at the Willard Hotel. A late-comer by Washington standards, this uninhibited upstart of a research group has managed to generate more activity and interest across a wider political spectrum than some of its more sedate competitors with much larger budgets.

In the half-dozen years since Cato moved from San Francisco to an elegant Capitol Hill town house, it has, among other activities, provided impetus for:

• A serious re-examination of the nation's Social Security system that was prompted by a proposal from a Cato adjunct scholar, Peter J. Ferrara, for substitution of a private pension program. This radical idea has won the support of the Heritage Foundation and the National Chamber Foundation of the United States Chamber of Commerce, and it has attracted the interest of at least one Re-

publican Presidential contender, Pierre S. du Pont 4th, former Governor of Delaware.

• A new approach to the longstanding debate over the role of the judiciary that parts company with traditional conservative calls for "strict construction" and "judicial restraint." Cato scholars argue that the Constitution protects economic rights as well as civil rights, and they criti-

### Mixing economic conservatism and liberal social policy.

cize Chief Justice William H. Rehnquist as a preserver rather than an opponent of big government.

• One of the few attacks from an organization with conservative credentials on the level of military spending at the Pentagon, an article of faith with most conservative groups. Cato scholars maintain that United States participation in the North Atlantic Treaty Organization is so expensive that it threatens prosperity at home, and they criticize President Reagan for expanding the military establishment while he argues ineffectively for smaller government.

American voters who have never heard of Cato should not be surprised.

"Our audience is not the voting public," said William A. Niskanen, chairman of the institute and a former member of President Reagan's Council of Economic Advisers. "We don't try to shape popular demand for political change. We hope to shape the

prospective of the policy-making community so that its members are conscious of alternate solutions when the demand for change arises. Our audience is the Washington community."

The Cato Institute remains pretty small potatoes. Its budget for 1985 was less than \$2 million while comparable spending for Brookings was \$14.5 million, the Heritage Foundation \$11.6 million and A.E.I. \$12.5. (The last has since been cut back considerably.) Mr. Crane says his institute is "one of the most cost-effective public policy groups in the nation" in terms of its income and output of books, policy studies, conferences and a scholarly journal.

Although it was not planned this way, the institute soon discovered that its particular blend of economic conservatism and liberal social policy seemed to appeal to younger people of the post-World War II "baby boom" generation. David Boaz, vice president of Cato, attributes this to their disaffection with the Vietnam War, suspicion of government and major political parties, personal economic conservatism and dedication to civil liberties.

Mr. Crane chose the name Cato from the pseudonym of two British essayists who circulated letters on parliamentary issues in the early 1700's in both England and the colonies. The essayists had taken the name from Marcus Porcius Cato, the Elder, the Roman statesman of the second century B.C. who is considered the father of Latin prose.

The Cato founder and president was asked if any of the 1988 Presidential aspirants other than Mr. du Pont interested him. Undoubtedly more influenced by philosophy than his own basketball days at the University of California, Mr. Crane replied: "I'd like to see Bill Bradley get into it."



# "To be governed..."

## What's wrong with this picture?

Let us flee to a favored utopia. For me that would be the late 18th Century but with air conditioning. . . . With both feet firmly planted on the soil of my Virginia domain, and young American flag fluttering above, tobacco in the field, I would relish the freedom.

—R. Emmett Tyrrell, Jr., in *Policy Review*, Summer 1987

## Just say no, Mr. President

Reagan called for "setting a goal of a subsidy-free world" for agricultural commodities by the year 2000 despite the increase of U.S. agricultural subsidies during his presidency.

He also denounced protectionism, comparing it to the "evil of drugs" because "it will end up destroying all those who use it."

—*Washington Post*, June 6, 1987

## And the poor suckers will never catch on

A very important feature of [modified tax-bracket indexing] is that it would raise gradually more and more revenue in each future year and would do so without any explicit increase in taxes.

—Martin Feldstein and Kathleen Feldstein in the *Washington Post*, July 13, 1987

## We work very hard for you; we deserve a proper reward

By a variety of standards, Washington is far and away the most affluent and educated metropolitan area in the United States today. . . .

The average after-tax household income in the Washington area last year was \$47,273—42 percent above the \$33,252 average of all U.S. households. . . .

"We consider 55 percent of the households in the area to be affluent," having, among other things, income greater than \$50,000, said . . . a Merrill Lynch senior vice president. . . . "By comparison, in the United States as a whole, only 16 percent of the households are considered affluent."

—*Washington Post*, July 26, 1987

## Go ahead; you're free to publish

A group of Soviet activists and freed political prisoners today made public the proposed first issue of an independent journal called Glasnost, putting Kremlin leader Mikhail Gorbachev's campaign for public openness to its biggest test yet. . . .

Today's run was limited to 50 copies, as many as the team of about a dozen Soviet activists involved in the project could type out manually. "As you know," [editor Sergei] Grigoryants said, "we don't have a Xerox."

—*Washington Post*, July 4, 1987

## Maybe they should try Chicago graduates

As the circulator of ration cards, regulator of market prices and supplies, manager of a nationwide network of supermarkets and corner food stores and primary purchaser of basic grains from Nicaragua's peasant farmers, Micoín wields enormous economic clout. . . .

"Harvard graduates couldn't solve the problems," according to [Nicaraguan vice president Sergio] Ramirez, because "if you only have 10 eggs and 50 people to feed, you can't make everyone happy."

—*Wall Street Journal*, June 5, 1987

## Better they should license the people who write the exams

Many of the illegal cabdrivers arrested in a citywide D.C. police crackdown Thursday said they were working without a proper license because they were unable to pass the hackers' esoteric examination.

Until recently, the exam included questions such as this:

"All but one of the following words describes a person who displays a low dominance: 1) a follower; 2) agreeable; 3) cooperative; 4) persuasive."

The preferred answer was "persuasive."

—*Washington Post*, July 25, 1987

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