Cato Policy Report

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Seven Reforms to Balance the Budget

by Stephen Moore

Over the past 50 years Congress has lost all control over federal spending. As Table 1 shows, even after adjusting for inflation, the federal government spends almost four times more today than it did 40 years ago. Entitlement spending has seen the largest growth. My overall conclusion from the data is that government today is America's number-one growth industry.

A top priority for this Congress should be passage of a new budget act. The 1974 Budget Reform and Impoundment Control Act has been a monumental failure. One of the purposes of that act was to eliminate deficit spending, but this is the actual legacy of that legislation: In the 20 years before the act, the federal deficit averaged just 1 percent of gross domestic product, or $30 billion 1994 dollars. In the 20 years since the 1974 act, the *average* budget deficit has been $170 billion per year, or 3.5 percent of GDP. We have accumulated more than $4 trillion in debt since 1976. By any objective standard, the budget process has not worked better under the 1974 act—it has worked much worse.

Figure 1 shows how the budget deficit has grown since Harry S Truman was president. Despite recent progress in reducing the deficit, the long-term prognosis remains grim. In fact, the Congressional Budget Office predicts that if we stick with the Clinton budget plan, the deficit will begin rising after 1996 and reach a record high of $350 billion within 10 years.

The 1974 Budget Act cannot be fixed. Tinkering won't do the trick. Congress ought to repeal the act before it does more damage to our national economy.

The centerpiece of any budget reform quite clearly should be an amendment to the Constitution outlawing deficit spending. Most members of this committee are keenly aware of the need for a balanced-budget requirement, so I will not dwell on it.

Deficit spending is an unconscionable form of fiscal child abuse. There are hundreds of groups in Washington that pretend to speak for the interests of children. But who in Washington, among the thousands of powerful special-interest lobbyists and self-proclaimed do-gooders, speaks for the children who are going to have to pay off our irresponsible debts? The single most pro-child policy that any of us can pursue in Washington today is to reduce the crushing burden of debt our government is now preparing to place on the next generation's backs.

I sincerely wish that we did not need a

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Stephen Moore is director of fiscal policy studies at the Cato Institute and author of Government: America's #1 Growth Industry *(1995). This article is based on testimony he delivered before the House Committee on Government Reform and Oversight on March 27, 1996.*

Mark Fondersmith

At Cato's 14th Annual Monetary Conference, Scott Cook, cofounder and chairman of Intuit, predicts great consumer benefits from the emerging age of electronic commerce, p. 11.

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Susan Eisenhower on Russia's political future, p. 4.

Editorial

The Hubris of Politics

Sen. Richard Lugar (R-Ind.), reflecting on his presidential campaign, writes in the *Washington Post,* "I argued for a ban on assault weapons, for which I see no legitimate social purpose."

Leave aside the substance of the specific issue and consider the sweeping audacity of "for which *I* see no legitimate social purpose." One might well ask, Who appointed Senator Lugar the arbiter of what can be sold in the United States? And how many of the millions of products for sale could be determined to have a "legitimate social purpose"? Cigarettes? Electric toothbrushes? Jolt Cola? Copies of *It Takes a Village?* Most products have a private, not a social, purpose. The food and clothes that I buy serve *my* needs, not society's.

Senator Lugar's statement is a perfect example of the mentality people develop after too many years in public office. They seem to think that every opinion of theirs should be made law and enforced by the police.

"What kind of philosophy looks at America and sees 'nothing' except what the government does?"

Lugar is hardly unique. The day after his article ran in the *Post,* the Senate Banking Committee held hearings on a bill, sponsored by Chairman Alfonse D'Amato (R-N.Y.), that would prohibit banks from charging fees to noncustomers who use their automatic teller machines. Senator D'Amato says, "Congress should not *condone* ATM surcharging" (his emphasis). He seems to believe that Congress must roam across America, looking for immoral activities that cannot be condoned—like providing people a useful service for a price—because Congress has some sort of moral responsibility for every activity in our society.

Again, consider the presumptuousness of such a bill and the relative contributions of banks and senators to our lives. Civil society, hampered at every turn by petty political rules, takes thousands of years to develop the technology, the complex market mechanisms, and the levels of trust necessary for individuals to be able to get cash, at midnight, in an airport or a 7-Eleven thousands of miles from home, from a bank that they do no other business with—and members of Congress decide that the bank shouldn't be able to charge a dollar for that service. Imagine what kind of banking services we'd have if we had to wait for Congress to develop the necessary institutions, and then imagine what we might have if Congress got entirely out of the business of controlling, hamstringing, and bullying banks.

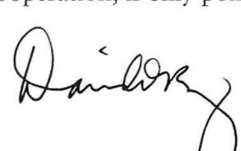
Too many people in Washington think nothing happens—or should happen—in America except at their behest. In their own minds, political society has entirely replaced civil society. Sen. Edward M. Kennedy (D-Mass.) said in 1992, "The ballot box is the place where all change begins in America"—conveniently forgetting the market process that has brought us such changes as the train, the skyscraper, the automobile, the personal computer, and charitable or self-help endeavors from settlement houses to Alcoholics Anonymous to Comic Relief.

This disease has infected too many people in our society. The "Mini Page," a Sunday supplement for children distributed in many newspapers, urged children recently, "Look through your paper for problems the country is facing. Which Cabinet members do you think might help solve them?" It might have done better to ask, "Which Cabinet members do you think caused the problems?" But the real mistake here is thinking that all problems have a political solution. In fact, most of the social problems that people have faced throughout history have been ameliorated or solved through the voluntary workings of civil society and the market process. We didn't relieve ourselves of the burden of backbreaking labor, or bring the world closer together through a series of transportation revolutions, by passing laws; we worked, saved, invested, and created economic progress.

Critics of the welfare state are often charged with wanting "to tear down government programs and put nothing in their place." But what kind of political philosophy looks at the vibrancy of America and sees "nothing" except what the government does?

Hillary Clinton's philosophy, apparently. The First Lady said recently, "This is an ominous time for those of us who care for the arts in America. A misguided, misinformed effort to eliminate public support for the arts not only threatens irrevocable damage to our cultural institutions but also to our sense of ourselves and what we stand for as a people." A similar argument was made in the conservative *Weekly Standard* in a cover article by Joseph Epstein titled "Why, Despite Everything, Republicans Should Not Abandon the Arts." But whatever Mrs. Clinton and Mr. Epstein may think, no one is proposing to "abandon" the arts. Some Republicans are proposing that of the $37 billion spent on the arts in the United States (according to the American Arts Alliance), the $167 million that is coercively extracted from taxpayers should be eliminated. Who could view such a cut as "threatening irrevocable damage"—except someone who looks at the bounty of civil society and sees a barren wasteland enlightened only by the activities of the federal government?

Every morning's newspaper—at least if your morning newspaper is the *Washington Post*—is filled with the pronouncements of politicians and policy wonks on what people should be forced to do to make this a better world. The denizens of political society should develop a little humility and a little appreciation of what people achieve through voluntary cooperation, if only politicians will let them.



—David Boaz

14th Annual Monetary Conference

Will Cyberspace Change Monetary Policy?

Will the information revolution lead to monetary institutions that protect freedom and privacy and limit the growth of government? That and other questions were the focus of the Cato Institute's 14th Annual Monetary Conference, "The Future of Money in the Information Age," held at the F. A. Hayek Auditorium on May 23.

This year's conference, organized by Cato's vice president for academic affairs James A. Dorn and supported by Corporate One, E*Trade Securities, Inc., and *Forbes ASAP,* was unique in a number of ways. For the first time, the Institute set up nine televideo sites across the United States—including New York City, Chicago, San Francisco, and Silicon Valley—featuring live video and audio interaction with the speakers. Furthermore, proving the Institute's commitment to expanding its presence on the Internet, the luncheon speech by Scott Cook, chairman of Intuit, was broadcast live on the Internet. In all, the conference attracted more than 400 participants and was covered by, among others, *The Economist*, *Forbes ASAP*, *Dow Jones TV*, the *Financial Times*, *Investor's Business Daily*, and *Business Week*.

In his opening address, Rep. Michael Castle (R-Del.), chairman of the House Subcommittee on Domestic and International Monetary Policy, stated that "the emerging electronic technologies and new business opportunities . . . will drive a worldwide commercial revolution projected to rival the Industrial Revolution." However, if that projection is to become a reality, Castle warned, the private sector will have to prevent government from acting on "the natural bureaucratic imperative to regulate" the marketplace.

Fortunately, the emerging electronic technologies are already working on the side of private enterprise. According to Cato adjunct scholar and University of Georgia economist Lawrence White, the information revolution, by dramatically lowering transactions costs, will allow millions of U.S. citizens to have interest-bearing accounts with offshore banks, thereby creating pressure to remove inefficient regulations in the U.S. banking system. "Such a development, combined with anonymity, would enhance the prospects for the public's turning away from government-issued notes and currency," said White.

Mark Fondersmith

Rep. Michael Castle warns against overregulation of the emerging cybereconomy at Cato's Annual Monetary Conference.

Privacy was also one of the main topics of discussion. Bill Frezza, president of Wireless Computing Associates, argued that "electronic privacy will be an absolute algorithmic certainty," thanks to cryptology. Frezza dismissed government efforts to forestall the emergence of private-sector encryption as futile and concluded that "governments of the world will have to live with the fact that they will be impotent to pry into many private economic affairs."

One of the leading cryptographers in the world, David Chaum, chairman of DigiCash, explained how cryptography can make E-money and E-commerce anonymous and thereby stimulate economic growth and protect freedom and privacy.

In the opinion of William Melton, CEO of CyberCash, as we move toward that system, the trust that makes liquidity possible will be based more or actuarial experience and less on a hierarchy of guarantees. The new system will be rules based and global, thus eliminating the moral hazard problem that hierarchical systems present. Melton concluded that the need for reliable tracking and statistical feedback in actuarial systems will not cause any loss of personal privacy because those systems are "inter-

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Russia, Korea, and global drug war examined

Is Universal Service a New Entitlement?

◆**May 1:** In the name of "universal service," the Telecommunications Act of 1996 empowers the Federal Communications Commission to create public entitlements to advanced telecommunications services. At a Policy Forum on **"Universal Service: Socializing the Telecommunications Infrastructure,"** Milton Mueller, professor of communications at Rutgers University; Wayne Leighton, senior economist at Citizens for a Sound Economy; and Lawrence Gasman, director of telecommunications and technology studies at the Cato Institute, addressed the question: Can mandated and subsidized telecommunications serve consumers better than competition?

Robert J. Barro, Robert C. Waggoner Professor of Economics at Harvard University, discussed his new book *Getting It Right: Markets and Choices in a Free Society* at a Book Forum. Pictured are Cato Benefactor Robert C. Waggoner, Cato chairman William A. Niskanen, Barro, and Cato vice president for academic affairs James A. Dorn.

◆**May 8:** Auctions are heralded as the most beneficial means of allocating the airwaves that have been set aside for advanced television services (ATV), including high-definition television. But if federal regulators insist that broadcasters be subject to public-interest controls, must they offer broadcasters free ATV spectrum as a quid pro quo? That question was the focus of **"Beyond Budgetary Concerns: A Free-Market Perspective on ATV Spectrum Auctions,"** a Policy Forum featuring Tom Hazlett, visiting scholar at the American Enterprise Institute; James Gattuso, vice president for policy research at Citizens for a Sound Economy; and B. Robert Okun, vice president of NBC.

◆**May 14:** Cato hosted a delegation from the Hungarian Embassy at a **Roundtable Luncheon.** The discussion with Cato staff and policy analysts centered on the Hungarian perspective on European security issues, expanding NATO, and U.S. troops in Hungary.

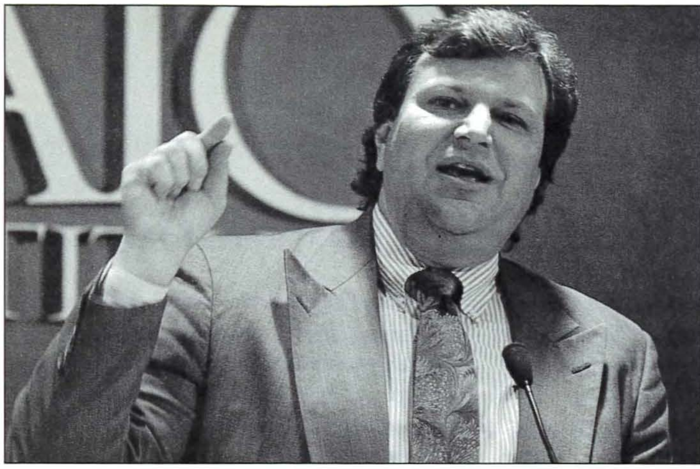
◆**May 15:** During a Policy Forum titled **"Red Resurgence or Revitalized Reform? Russia's Political Future,"** Susan Eisenhower, chairman of the Center for Post-Soviet Studies; Dmitry F. Mikheyev, senior fellow at the Hudson Institute; and Ariel Cohen, senior policy analyst at the Heritage Foundation, discussed the prospects and implications of a possible communist victory in Russia's June election.

◆**May 16:** Although natural gas deregulation is generally considered an economic success pregnant with valuable lessons for other industries, a web of regulatory oversight still surrounds the industry. Jerry Ellig of the Center for Market Processes and Joseph Kalt of Harvard University appeared at a Cato Book Forum to discuss their new book, ***New Horizons in Natural Gas Deregulation,*** a collection of papers originally presented at a 1995 Cato conference. Ellig and Kalt reviewed the past failure of natural gas regulation, the lessons of regulatory reform, and how further deregulation should proceed in the 1990s.

◆**May 22:** As chairman of the U.S. House of Representatives' Task Force on Privatization, Rep. Scott Klug (R-Wis.) is a leading proponent of privatization in the 104th Congress. At a Policy Forum titled **"Privatization: New Zealand's Success Story,"** Klug discussed his fact-finding mission to New Zealand and the success of that country's privatization program. In meetings with railroad executives and sheep and dairy farmers living without subsidies, Klug learned lessons that Americans should heed.

◆**May 23:** The Cato Institute held its 14th Annual Monetary Conference, **"The Future of Money in the Information Age."** The full-day conference addressed the technological viability and economic implications of digital currency, or "E-money." Speakers included Scott Cook, chairman of Intuit, manufacturer of the popular business software Quicken; Rep. Michael Castle (R-Del.), chairman of the House Subcommittee on Domestic and International Monetary Policy; and Jerry L. Jordan, president and CEO of the Federal Reserve Bank of Cleveland. For the first time, a Cato event was carried live via interactive televideo to nine sites around the country as well as broadcast on the Internet. Over 175 people attended the event in Washington, D.C., while others participated in New York, San Francisco, Chicago, Silicon Valley, and other places.

◆**May 29:** This year's decertification of Colombia and the confirmation of Gen. Barry McCaffrey as "Drug Czar" suggest a stepped-up effort in the war on drugs. With that in mind, Cato asked, **"Does the**

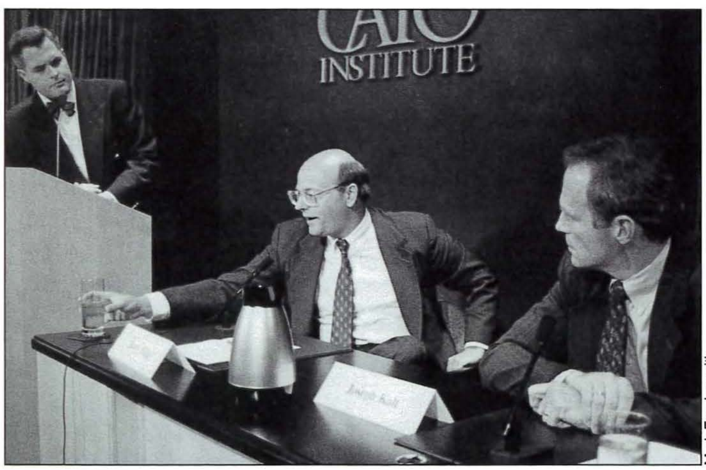


Mark Fondersmith

At a May 8 Policy Forum, Tom Hazlett of the American Enterprise Institute warns broadcasters not to trade their First Amendment rights for free spectrum space.

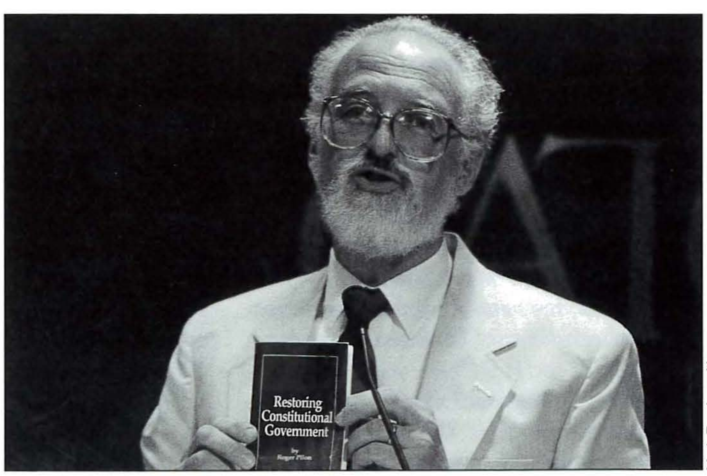
Mark Fondersmith

Rep. Scott Klug discusses New Zealand's successful privatization policy with former U.S. ambassador to New Zealand Paul Cleveland, president of the U.S.-New Zealand Council, after Klug's May 22 Policy Forum.



Mark Fondersmith

Jerry Taylor, Cato's director of natural resource studies, moderates a May 16 Book Forum with Jerry Ellig and Joseph P. Kalt, coeditors of ***New Horizons in Natural Gas Deregulation.***



Mark Fondersmith

Judge Douglas H. Ginsburg holds a copy of ***Restoring Constitutional Government*** by Roger Pilon, director of Cato's Center for Constitutional Studies, to illustrate why the general welfare clause in the Constitution didn't empower Congress to erect a vast panoply of transfer programs, at a June 27 Book Forum.

International Drug War Make Sense?" at a Policy Forum featuring Robert Gelbard, assistant secretary of state for international narcotics and law enforcement affairs, and Kevin Jack Riley, author of *Snow Job? The War against International Cocaine Trafficking*. Gelbard reviewed the logic of Washington's international narcotics control strategies and explained how the United States plans to significantly reduce the flow of drugs across its borders. Riley questioned the supply-side campaign, examined its impact on drug-source countries, and assessed its prospects for success.

◆**June 6:** Cato held its midyear **Board of Directors Meeting.** Board members set the Institute's course and were brought up to date on Cato's policy activities, progress in fundraising, and fiscal standing.

◆**June 17:** In Seattle Cato hosted a City Seminar, **"Leviathan and the New Millennium: An Agenda for Real Reform,"** that featured a keynote address by Lawrence Kudlow, economic counsel at Laffer Advisors, Inc., and a panelist on CNBC's *Strictly Business*. Other speakers included José Piñera, co-chairman of Cato's Project on Social Security Privatization, Edward H. Crane, president of the Cato Institute, Stephen Moore, Cato's director of fiscal policy studies, and Michael Tanner, Cato's director of health and welfare studies.

◆**June 18:** America's security commitments abroad remain largely unchanged despite the end of the Cold War. Nowhere is that more evident than on the Korean peninsula, where a commitment of nearly 40,000 U.S. troops, costing billions of dollars a year, threatens to draw the United States into any conflict that might erupt in Northeast Asia. Cato senior fellow Doug Bandow appeared at a Book Forum to discuss his new Cato book, ***Tripwire: Korea and U.S. Foreign Policy in a Changed World.*** Bandow argued that it is time to phase out the American military commitment to South Korea, which has twice the population of North Korea and an economy 18 times as large as that of the North. That step would free the United States of an obsolete obligation and give South Korea responsibility for its own security.

◆**June 19:** Cato hosted a City Seminar in San Francisco on **"Leviathan and the New Millennium: An Agenda for Real Reform."**

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MONEY *Continued from page 3*

ested in the epidemiological behavior of the actuarial group as a whole, rather than individual behavior."

In his luncheon speech, Scott Cook, who called the conference audience "one of the most financially sophisticated audiences on the planet," referred to money and payments systems as social conventions, subject to a great deal of inertia. Thus, instead of new payments systems that emerge overnight, we may well see existing payment systems evolve to deliver the benefits the Information Age makes possible.

In his concluding remarks, Dorn contrasted the current monetary universe, based on market-socialist principles, which is discretionary and highly politicized, with an alternative monetary universe, based on market-liberal principles, where rules "will have to be transparent, equally applied, and consistent with individual freedom if people are to have trust and confidence in the cybereconomy." That new universe, which will appear in the marketplace and not as a result of a government decree, will reduce institutional uncertainty, Dorn added.

The role of the Federal Reserve and monetary policy in the Information Age was also discussed. George Selgin, a Cato adjunct scholar at the University of Georgia, suggested that the emergence of E-money would make it easier for the monetary authorities to adopt a rules-based monetary regime. "E-money," Selgin said, "amounts to a technological end run, circumventing long-standing restrictions on private bank notes." If that is the case and the stock of money is fully privatized, Selgin argued, the Federal Reserve could adopt a rule of maintaining the banking system reserve ratio constant.

The prospect that central bank notes and coin will not be in much demand in the 21st century was also raised by Jerry L. Jordan, president and CEO of the Federal Reserve Bank of Cleveland. Jordan said that "just as fiat money replaced specie-backed paper currencies, electronically initiated debits and credits will become the dominant payment modes, creating the potential for private money to compete with government-issued currencies."

Other speakers included Rosalind Fisher of Visa U.S.A., R. Alton Gilbert of the Federal Reserve Bank of St. Louis, Richard Rahn of Novecon, Bert Ely of Ely & Company, Sholom Rosen of Citibank, Catherine England of George Mason University, David Cronin of the Central Bank of Ireland, and Cato's chairman William Niskanen.

The papers delivered at this conference will be published in a Cato book. ■

EVENTS *Continued from page 5*

The keynote address was given by Ward Connerly, a member of the Board of Regents of the University of California and chairman of the California Civil Rights Initiative, which would outlaw racial quotas in state policy. Other speakers included José Piñera, co-chairman of Cato's Project on Social Security Privatization and Edward H. Crane, Stephen Moore, and Michael Tanner of the Cato Institute.

◆**June 21:** In the postcommunist era Russia and Eastern Europe have implemented systems of parental choice in education similar to the U.S. voucher concept. At a Book Forum for ***Educational Freedom in Eastern Europe,*** author Charles L. Glenn, professor of education at Boston University, discussed his survey of educational reforms in 10 East European countries and the lessons that America might learn. Denis P. Doyle of the Heritage Foundation commented.

◆**June 26:** Living standards and rates of growth differ dramatically around the world. Robert J. Barro, Robert C. Waggoner Professor of Economics at Harvard University and author of ***Getting It Right: Markets and Choices in a Free Society,*** spoke at a Book Forum on what accounts for those disparities. He discussed the relationships among material progress and democracy, domestic institutions, and government policies and concluded that the rule of law has enormous explanatory power as a factor in economic growth and that governments should provide markets with a stable framework of rules and then get out of the way.

◆**June 27:** Sixty years ago the New Deal Supreme Court began unraveling the Constitution of limited government by reinterpreting first the general welfare clause and then the commerce clause. Recently, scholars and the Court have begun to reexamine the commerce clause jurisprudence that gave us the modern regulatory state, but little has been done with the jurisprudence of the general welfare clause that gave us the modern redistributive state. At a Book Forum, Leonard R. Sorenson, professor of history at Assumption College, discussed ***Madison on the "General Welfare" of America,*** his new book that provides a detailed refutation of scholars on whom members of today's Court were schooled. Comments were provided by Judge Douglas H. Ginsburg of the U.S. Court of Appeals for the District of Columbia Circuit. ■

Cato Calendar

Toward an American Renaissance
New York • Waldorf Astoria • September 19, 1996
Speakers include Robert Novak, Jerry L. Jordan, and Edward H. Crane.

Regulation or Private Ordering? The Future of the Internet
Washington • Cato Institute • September 20, 1996
Speakers include Robert Crandall, David Post, Danny Weitzner, Charles Platt, and Lori Fena.

Rate Regulation in the New Video Marketplace: Lessons from the 1992 Cable Act
Washington • Cato Institute • October 3, 1996
Speakers include Thomas Hazlett, Zianpeng Leng, Robert Crandall, Harold Furchtgott-Roth, and George Ford.

Leviathan and the New Millennium
Chicago • Inter-Continental • October 9, 1996

Savings and Social Security Privatization in Mexico
Cosponsored with El Economista and CISLE
Mexico City • October 17, 1996
Speakers include José Piñera.

Leviathan and the New Millennium
Phoenix • October 21, 1996
Speakers include José Piñera and Edward H. Crane.

The United Nations and Global Intervention
Washington • Cato Institute • October 22, 1996
Speakers include Rep. Joe Scarborough, John Bolton, Michael Stopford, Jessica Matthews, and Robert Oakley.

Corporate welfare survives in Congress

Feminist Jurisprudence Undermines Rights

In *Vinson v. Meritor Savings Bank*—a case involving sexual harassment—the Supreme Court rejected the traditional, person-to-person, common law remedies for tort and contract disputes that had been used in similar cases before 1986. Instead, the Court ruled that a "hostile work environment," rather than quid pro quo sexual extortion, was sufficient to warrant legal recourse. *Vinson* thus replaced an objective legal standard with a subjective one according to which the victim's perception, rather than a specific law, defines the offense. In a new Cato study, "Feminist Jurisprudence: Equal Rights or Neo-Paternalism?" (Policy Analysis no. 256), Cathy Young, columnist with the *Detroit News* and author of the forthcoming book *Gender Wars*, and Michael Weiss, adjunct professor at the University of Houston Law Center, argue that if traffic laws were based on the *Vinson* model, there would be no traffic lights or speed limits; you would simply be fined for failing to stop when another motorist expected you to yield, or for driving at a speed that made another driver uncomfortable.

◆Some Lessons from the Communist Resurgence

The communist specter is making a reappearance in Central and Eastern Europe. In some cases, as in Belarus, the old communist establishment never left power. In other Soviet bloc nations, such as Lithuania, Hungary, Bulgaria, Slovakia, and Poland, the communists have returned to power. In a new Cato study, "Red Phoenix Rising? Dealing with the Communist Resurgence in Eastern Europe" (Policy Analysis no. 255), former National Security Council staff officer Roger W. Fontaine maintains that there are three important lessons to be learned from the communist resurgence: First, the nations that have pursued the most rapid and radical economic reform programs—such as the Czech Republic and Estonia—have been the least vulnerable to a neo-communist backlash. Second, most of the resurgent "communist" parties have little desire or ability to restore dictatorships or seek a confrontation with the West. Third, although America cannot dictate political and economic outcomes in Central and Eastern Europe, it ought to encourage reform and discourage retrograde trends by refusing to bail out anti-reform regimes with foreign aid.


Mark Fondersmith

Ted Galen Carpenter, Cato's vice president for defense and foreign policy studies, discusses the the Clinton-Hashimoto summit with Ambassador Hisahiko Okazaki during an April 25 policy luncheon.

◆Clinton-Hashimoto Summit Overrated

Media accounts that described the April summit meeting between President Clinton and Japanese prime minister Ryutaro Hashimoto as marking a historic change in the U.S.-Japanese alliance were erroneous, according to a new paper, "Smoke and Mirrors: The Clinton-Hashimoto Summit" (Foreign Policy Briefing no. 41). In it, Cato's vice president for defense and foreign policy studies Ted Galen Carpenter points out that although the United States agreed to consolidate its military bases on Okinawa, overall U.S. troop levels in Japan will remain the same. Furthermore, the Japanese gave no indication that they intend to fight alongside American forces unless Japan itself is attacked. Despite the official and media hype, concludes Carpenter, the summit agreements do not alter Japan's status as a U.S. military dependent.

◆Corporate Welfare Lives On

The federal government currently spends $75 billion a year on direct subsidies to business. Last year both Congress and the Clinton administration pledged to attack pervasive corporate welfare. In a new Cato study, "How Corporate Welfare Won: Clinton and Congress Retreat from Cutting Business Subsidies" (Policy Analysis no. 254), Cato's fiscal policy studies director Stephen Moore and policy analyst Dean Stansel find that those promises have been largely unfulfilled. In fact, for the 35 corporate welfare programs examined, the Clinton administration's 1996 budget actually requested an *increase* in spending. Moreover, of the $19.5 billion budgeted for the programs, Congress ultimately cut just $2.8 billion. In other words, 85 percent of corporate welfare spending survived the budget process.

◆Critique of Cato Study Is Misguided

Benefits available to a typical welfare household substantially exceed the amount a recipient could earn in an entry-level job in virtually every state, according to a new paper by Institute scholars Michael Tanner and Naomi Lopez. The paper was released in response to a critique written by Sharon Parrott of the Center on Budget and Policy Priorities asserting that actual welfare benefits are lower than Tanner, Stephen Moore, and David Hartman stated in a September 1995 Cato study (Policy Analysis no. 240).

But as "The Value of Welfare: Cato vs. CBPP" (Briefing Paper no. 27) demonstrates, the CBPP critique used only 2 of 77 federal welfare programs in its calculations—Aid to Families with Dependent Children and food stamps—while the initial Cato study used 7. The CBPP attack is not supported by the data and seriously underestimates the actual value of the available welfare benefits package. The annual pretax wage equivalent of welfare ranges from a high of more than $36,000 in Hawaii to a low of $11,500 in Mississippi. In eight jurisdictions—Hawaii, Alaska, Massachusetts, Connecticut, Washington, D.C., New York, New Jersey, and Rhode Island—welfare pays at least the equivalent of a $25,000-per-year job. ■

The Future of Money in the Information Age

The Cato Institute's 14th Annual Monetary Conference, "The Future of Money in the Information Age," was held on May 23. Economists, bankers, entrepreneurs, and Federal Reserve Board officers discussed how electronic cash and other new technologies may change monetary activities and policy. Speakers included Lawrence H. White, professor of economics at the University of Georgia; Richard Rahn, president and CEO of Novecon Ltd.; Rosalind L. Fisher, executive vice president of VisaNet Services for Visa U.S.A.; William Melton, founder and CEO of CyberCash; David Chaum, founder and managing director of DigiCash; Bill A. Frezza, president of Wireless Computing Associates; and Scott Cook, cofounder and chairman of Intuit. Excerpts follow.

Lawrence H. White: Suppose that analog currency (coins and paper money) does disappear from common circulation. Will that usher in a world without money, as some writers have suggested? No. Rather, it will "merely" undo the current government monopoly of currency. It will return us to a world where the commonly seen money is privately issued, as it was in sophisticated economies 150 years ago where gold coin was seldom seen outside bank vaults despite being the ultimate money of redemption for deposits and bank notes.

What real difference will digital currency and desktop electronic funds transfer (EFT) make? What strikes me as the most exciting potential development to come from the new payment technologies is that, as they lower the cost of wiring money from $20 to 2 cents or less per transaction, they give ordinary small savers affordable access to offshore banking. With direct deposit of paychecks, and with analog currency available at automated teller machines (ATMs) whenever we want it, many of us no longer need to visit our bank in person. Why not keep your account with a reputable bank (perhaps a branch of a major Swiss bank) in the Bahamas or Cayman Islands? Such an account is perfectly legal for U.S. citizens (though the offshore branch of a U.S. bank is prohibited from directly doing business with American citizens or firms). Offshore banks pay higher interest on deposits (and charge lower interest on loans) than do domestic banks because they are free from the taxes on deposit balances that the U.S. government levies in the form of reserve requirements, deposit insurance "premiums," and taxes on bank earnings. Big-money players have enjoyed the advantages of offshore banking for years. Small firms and individuals do not find it worth accessing the offshore banking market today because the current expense of wiring money back and forth more than consumes the extra interest earned on small sums of money. Cheap desktop EFT will make offshore banking a smart move for small savers. If an offshore bank were linked into an onshore clearinghouse (and an onshore ATM network for providing analog currency, as long as analog currency survived), it could also attract transaction account customers. Individuals concerned about privacy might find an offshore foreign bank attractive for its lesser propensity to surrender its records to domestic authorities.


Mark Fondersmith

Lawrence White, *University of Georgia.*

When commercial online networks and Internet sites begin offering offshore banking services, with zero or very small fees for transferring funds, there will be an exodus of retail banking business from the regulated onshore sector to the untaxed and unregulated offshore sector. The depositors left behind will be those traditionalists who like to do their banking business in person (many households are not yet online, and some people still refuse to use ATMs) and those who think that the Federal Deposit Insurance Corporation is worth its price—despite the fact that uninsured offshore bank deposits have proven safe throughout the postwar era.

Richard Rahn: The electronic age, with virtually instantaneous international financial transactions and with encrypted confidential smart cards substituting for money, will make the taxation of capital transactions, interest, and dividends increasingly problematic. In an age in which most people can transfer money and pay bills with an ordinary telephone, enforcing taxation of those types of transactions will become virtually impossible. The cost of trying to tax them may well exceed the revenue collected and certainly will exact a price in terms of lost economic efficiency and lost privacy rights that exceeds the benefits of their continued taxation.

Government authorities cannot stop that worldwide revolution, because too many knowledgeable people are part of it. Censorship and regulation will not work, because progress in developing the means of evasion will always be far ahead of those who are trying to restrict it. In the same way that most totalitarian governments have largely given up trying to control the flow of information, because technology has made it an impossible task, governments will need to realize that the old central bank monopolies on the issuance of money will also go the way of the buggy whip.

Government officials have two choices: to redesign their tax and monetary systems to reflect technological reality or to try to create a system in which every investment and every expenditure every person makes throughout his life are known. In the new world of monetary freedom there is no middle ground. Either the government will know everything, or the government will only know what is voluntarily revealed. An all-knowing government is doomed to fail, practically and politically, and attempts to impose a "Big Brother" government could impoverish the nation and trample our liberties.

Most Americans are not aware of the broad powers that the government already has to pry into and control their monetary affairs. Many regulations have been enacted as part of the war on drugs and a general attempt to control "money laundering."

“In the age of the cyberpayment we cannot both keep the present income tax system and keep our liberty and privacy.”

—Richard Rahn

The Treasury and other government departments have been holding meetings to determine the nature and form of regulation that they will attempt to impose on what they refer to as “cyberpayments.” On September 23, 1994, President Clinton signed the Money Laundering Suppression Act of 1994. That act increases the federal government's oversight of money-transmitting businesses that engage in check cashing, currency exchange, money order and traveler's check sales, and money transmitting and remittance services.

The danger is very real, but the battle for financial freedom is not yet lost. To win that battle, advocates of liberty will of necessity need to be involved with tax reform. The abolition of the income tax and its replacement with a low-rate noninvasive tax will take away much of the rationale for income and expenditure monitoring by the government.

In the age of the cyberpayment, we cannot both keep the present income tax system and enforce it and keep our liberty and privacy. Let us all work together to get rid of the income tax rather than rid ourselves of liberty.

Rosalind L. Fisher: Visa and its member financial institutions are playing—and must continue to play—a central role in the introduction and use of electronic consumer payment services. I say “central role” for two different but equally compelling reasons.

First, Visa and its member banks have a solid track record of developing an array of payment products and services that meet consumer needs, and we are confident of our ability to continue to do so. Second, the integrity of the payment system, and public confidence in it, could be at risk if so-called electronic money becomes nothing more than zeros and ones—digital signals—without the backing and involvement of regulated financial institutions. The integrity of the payment system and public confidence in it demand that regulated financial institutions be central players. But even as we work to ensure such involvement, we caution that premature government regulation—or the failure to modify existing regulations to accommodate evolving technologies—could chill or halt the delivery of new financial products to consumers.

Some electronic payment services may be offered through entities that are not subject to the same supervision and regulation as Visa's members. Their customers will not have the protection of the bank supervisory system. Furthermore, to the extent that those entities, as a result of not being regulated by bank supervisors, enjoy a competitive advantage over traditional financial institutions, they may worsen the disintermediation of traditional depositories. For that reason and because of the importance to the world economy of developing electronic payment systems and preventing abuse in those systems, it is significant that a recent report by the European Union's Working Group on EU Payment Systems proposed that only banks be allowed to issue stored-value cards.

Mark Fondersmith

Richard Rahn, *president, Novecon.*

Visa also believes that providing new payment products and services through regulated and supervised financial institutions ensures significant safeguards that are not otherwise available. As stored-value cards become an important medium of exchange, policymakers must be cognizant of the potential economic consequences of loss of public confidence in major unregulated, uninsured issuers. Law enforcement officials combating criminal activities such as tax evasion, counterfeiting, and money laundering should consider the problems that could result from the development of stored-value card systems that, unlike Visa's, may not generate a well-defined audit trail and from systems whose record keeping is not subject to periodic supervision and examination. Accordingly, we believe lawmakers should carefully examine the risks that attend participation of those other entities in the payment system.

On the other hand, in view of the highly regulated environment in which our members operate and the numerous safeguards that are already in place with respect to depository institutions, we are concerned that additional regulation in this area will stifle the innovations that are being developed. At the extreme, subjecting new payment products to government regulation could result in their premature death.

William Melton: In the consumer world, all that matters is liquidity—reliable, convenient liquidity. Liquidity (the speed with which a marker is accepted as a valid medium of exchange) has a strong psychological component; indeed, its principal element is trust. Liquidity can only be produced from domains of trust, of which there are two kinds: the domain of actuarial trust and the domain of guaranteed trust.

Life insurance is an example of the former. Because they rely on actuarial tables, life insurance companies can trust that they will have a certain investment horizon for your policy, depending primarily on your age. Another example is a major grocery chain that is willing to accept checks from strangers because actuarial experience has shown that less than one-half of 1 percent of those checks will go bad.

We are more familiar with the domain of guaranteed trust. The government, the bank, or some other strong guarantor says, “Trust me, I guarantee it!” Behind any guarantor there may be another guarantor—behind your bank stands the FDIC, and behind the FDIC is the perceived strength of the government. Thus guaranteed trust domains quickly become very hierarchical.

As a national and, in fact, an international economy we are moving and must move toward actuarial trust. Indeed, modern financial markets spring from the sharing of risk and are actuarial by nature. Even the largest guarantors (governments) are subject to the statistical evaluations of those actuarial domains. Whereas the guaranteed domain of trust is compatible with hierarchical environments, the actuarial domain of trust is

Continued on page 10

“We can develop a payment system that offers the best of both anonymous and fully traceable systems.”

—David Chaum

MONETARY CONFERENCE *Continued from page 9*

frequently found in a market economy.

Relying on an actuarial domain of trust, aggressive banks now routinely issue liquidity to customers whom they have never seen, on a nationwide basis. With the help of massive databases, sophisticated scoring techniques, and carefully delineated actuarial domains, banks issue billions of dollars of liquidity based solely on actuarial trust.

But a funny thing has happened on the way to this great outpouring of liquidity. The cost of distribution (that is, the cost of getting the liquidity to the consumer) is greater than that of evaluating and granting the credit (or liquidity). By today's economics, it might cost $50 to $70 (including advertising and mailings) to acquire a new bank liquidity customer. At the same time, using advanced actuarial techniques it might cost less than $10 to evaluate and complete the granting of the credit.

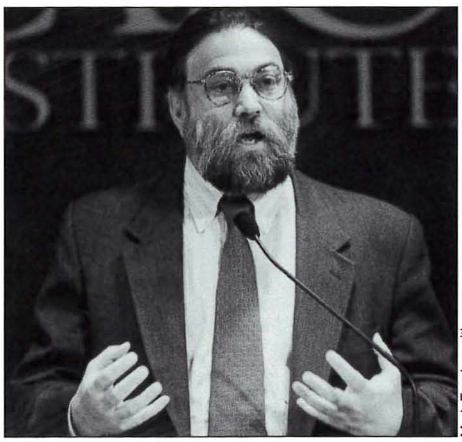
To solve the problem of high distribution costs, aggressive players have begun to rely on existing natural groupings (e.g., your United Airlines Visa card). Those groupings already support distribution infrastructures for their own purposes. In the banking world those are known as “affinity” or “co-branding” efforts.

If chains of trust are the primary ingredient of liquidity, then the technology of digital signatures and digital certificates is indeed a breakthrough that allows maintenance of ever more subtle, more complex, and yet still reliable chains and domains of trust. The economic impact is to provide greater liquidity. Yet that additional liquidity is provided under the tight feedback loops of the market and thus is, on the whole, noninflationary.

The challenge of the marketplace and the newer forms of electronic liquidity is to continually lower transactions costs, continually increase convenience, and thereby enable new markets heretofore not possible. With strong actuarial feedback it is also the job of the market to match the supply of the new forms of liquidity with an equivalent supply of goods and services from both old and new markets.

I am extremely optimistic about the enabling power of increasing efficiency and convenience in payments systems and in the granting of liquidity. I am doubly optimistic about the power of the marketplace that is being born on the Internet, a marketplace where geography has largely evaporated and time is measured in baud rates. I believe that those combined efficiencies can bring society a new age of plenty and opportunity. We live in exciting times.

David Chaum: There are two different scenarios for electronic cash. One is what we might call a fully traceable world—others might call it Clipper cash or data fascism. Making ordinary consumer payments totally traceable by government would curtail all kinds of activities, peaceful and not so peaceful.


Mark Fondersmith

David Chaum, *chairman, DigiCash.*

One way to do it—familiar from science fiction—would be to require the consumer to identify himself by some kind of biometric, like a fingerprint or retina scan. Once identified, the consumer could access his account and conduct transactions. Of course, there would be central records of all transactions, and a customer could be locked out of the system at any point.

Another way is a little trickier: to create a chip that is in effect a portable bank officer. Like a Clipper Chip, it would be a little black box that everyone would have to carry with him in order to access his financial accounts and records. The consumer would have no way of knowing just what was on the chip; it might be sending out encrypted messages revealing his transactions to all kinds of parties. It might even be programmed to discriminate against certain people or to enforce arbitrary rules. The consumer's lingering doubt about what's on that chip would have a chilling effect on society. I hope neither of those systems is implemented in the United States.

Another scenario would involve anonymous transactions. Of course, we already have anonymous transactions—using paper bank notes. Many people like paper dollars, but those dollars are very expensive. Perhaps 2 to 3 percent of the gross national product is tied up in maintaining the bank note payment system. Also, the paper dollar system makes possible counterfeiting, extortion, bribery, tax evasion, money laundering, and other criminal activities.

Some people think we have to strike a balance between the anonymous and fully traceable systems. But I think we can instead develop a system that offers the best of both worlds. We would use the line-signature payment technology that is being launched by Deutsche Bank and other major European banks and that we have on chip cards and in electronic malls. Under such a system, instead of receiving digital money from your bank, you would create randomly on your own computer serial numbers that could be hidden in a layer of encryption that only your own computer could unlock. Then you would submit money forms to your bank to be validated, remove the layer of encryption, and no one would know who you were when you spent that money. You would know whom you were paying, and you could always retroactively reveal the recipient of the funds. Thus extortion, bribery, and black-market trading would be no more likely with electronic cash than they are with checks because the recipient could always be traced by the payer and because the money would have to be deposited into a bank to be verified as valid. Each person's total revenue would be known—and subject to taxation—but not how he spent his money or his total wealth.

Bill A. Frezza: The Internet will not merely make our existing forms of commerce more efficient; it will also support the emergence of self-organizing, supranational communities whose economic intercourse can be based on the principles of laissez-faire capitalism.

It will never be possible to transport wheat or steel across cyberspace, and real economies will always continue to produce and con-

"Cyberspace differs from our everyday world in that coercive force cannot be projected across a network."

—Bill A. Frezza

sume wheat and steel. But any product of man's mind can be communicated as a stream of digital bits. And it is exactly this sector of our economy—the information industries broadly defined—that is growing the fastest and producing the wealth on which the value of money will someday be based.

The pressing question, then, is, How might a political economy based on exchanging intangibles in cyberspace differ from a political economy based on exchanging wheat or steel in the real world?

First and foremost, privacy in cyberspace will not be an abstract political right based on the vagaries of geography, government policy, or cultural norms. In the future, electronic privacy will be an absolute algorithmic certainty. The day will inevitably come when the amount of effort required to breach the shield of privacy provided by low-cost, widely available encryption will exceed the value of such an attack by so many orders of magnitude that it will not be economically feasible to base public policy on such invasions. The governments of the world will have to live with the fact that they will be impotent to pry into many private economic affairs.

Second, cyberspace differs from our everyday world in that coercive force cannot be projected across a network. That is a discomfiting revelation to most legislators, who like to pretend that their power rests on the consent of the governed rather than the barrel of a gun. Sooner or later, however, any authority that asserts sovereignty over actions that take place entirely within cyberspace must resort to acts of physical coercion or threats thereof.

That, however, requires that the target be identified and located. It will always be possible to identify and locate Fortune 500 companies, whose vast visible assets make them conspicuously vulnerable. But it is going to get very difficult to keep track of the growing number of individuals who are rapidly learning to ply their trades on the Internet.

In practice, that means that ordinary people will be able to create and exchange wealth away from the prying eyes and grasping hands of sovereign powers. Imagine the consequences if a significant fraction of the world's most productive people engaged in unrestrained commerce within an economic system inherently immune from government scrutiny. The wealth produced—that is, the underlying products of their creative output upon which the value of money will be based—may never exist in the physical world. And since that wealth may not have to be exchanged for government fiat currency in order to be useful, there may be scant opportunity to seize it.

That possibility is going to be treated as a grave threat by most national governments. A battle for cyberspace most certainly lies ahead, and you can expect entrenched bureaucrats to do everything they can to demonize the new technology by associating it with pornographers, child molesters, and drug-

Mark Fondersmith

William Melton, *CEO, CyberCash.*

money launderers. Imagine what would happen if the productive efforts of millions were invisible to the Internal Revenue Service, gone from the GNP statistics, blind to the balance of trade, and immune to social or industrial policy mandates.

Cyberspace, which promises to shield individuals from the ravages of coercive force and allow them to conduct their affairs in secure anonymity, will bring forth a burst of creative human genius not seen since the last time a new world was discovered.

Scott Cook: Financial services is perhaps the largest industry whose product is already digital. The largest consumers of mainframe computing power in the world have always been financial institutions. Wealth is not stored physically; it's stored as bits on mainframe disk drives and transferred electronically. What's interesting is that, although the back end of financial institutions is wonderfully automated, the front end—consumer interface—is not.

In the billing cycle in the United States, by far the largest cost is postage: first class stamps, one each way. The gas company and the phone company already have on a computer all the information that appears on your bill. But to bill you they have to translate that digital product into ink on dead trees and then have it hand carried to your home. If you are a Quicken user, the information on your bill gets translated back into digital form and a check gets printed out, put in an envelope, and carried back to the biller and financial institution where the information is rekeyed into the computer; then the check is physically moved around and is ultimately returned to your home.

Clearly, that is ridiculous, but payment systems are first and foremost social conventions. Like languages, they are methods of communication among large groups of people and they have great inertia. Just as language does not change rapidly, neither do other mass-oriented social conventions, including payment systems.

So perhaps for change we should look, not just to new systems, but also to existing systems. If you can take a payment system that is already in use and modify it, tweak it, so that it can deliver the new benefits that are sought, it will probably be the preferred vehicle for new benefits.

I would point to the modifications being made to the credit card system to allow people to secure online credit card transactions as an example of how a system that's already in place and widely accepted can be used. Once the modified system is in place, I think it will become the predominant system for monetary transfer. It won't solve all of the problems, but existing systems are being further modified to handle new things such as microtransactions.

Let me close by saying that I think perhaps the biggest benefits of electronic commerce have yet to be seen. The current system will, of course, improve. People will be able to use their current financial products and services more wisely and more conveniently. More exciting is the probability of the invention of new kinds of financial services that have never been thought of. I wish I knew what they will be. ■

"The single most pro-child policy that any of us can pursue is to reduce the crushing burden of debt our government is placing on the next generation."

BUDGET *Continued from page 1*

constitutional amendment to cure Washington's addiction to red ink. Unfortunately, the destruction of our nation's once firmly held moral rule against deficit spending—what James Buchanan called "the collapse of the constitutional consensus"—requires us to amend our Constitution and command Congress to do what it used to feel honor bound to do—balance the budget.

Tax-and-spend opponents of a balanced-budget amendment argue that a constitutional requirement is just a gimmick. No one really believes that. If the amendment were a gimmick, Congress would have approved it long ago. Defense contractors, corporate lobbyists, federal workers, teachers' unions, the welfare industry, and other powerful special-interest groups ferociously attack the amendment, not because they think it won't work, but because they shudder at the thought that it will. What frightens the predator economy in Washington is that gift-bearing politicians may have the federal credit card taken away from them.

The U.S. House of Representatives last year wisely approved a balanced-budget amendment, but it was defeated in the Senate. The matter is now out of your hands. The real issue is, What can be done in the meantime to make the budget process work better and to end deficit spending?

Last year the House passed a courageous budget, crafted by Budget Committee chairman John Kasich, that promised a balanced budget by 2002. But one thing is a virtual certainty: no matter how sincere your intentions of balancing the budget, the deficit will not be eliminated by 2002 unless new budget enforcement rules are implemented to ensure that this admirable, though minimal, goal is honored.

I would urge that a new budget act contain the following seven provisions, which are discussed in order of priority.

❶ An Enforceable Legislative Balanced-Budget Requirement

Don't wait for a balanced-budget amendment. Act now. The most urgent reform for this Congress to undertake is passage of a balanced-budget law that enforces the deficit targets established in the House budget resolution.

What I have in mind is a new Gramm-Rudman-Hollings formula that establishes iron-clad enforceable deficit targets. One of the great myths in Washington is that Gramm-Rudman was repealed because it wasn't working. Gramm-Rudman was repealed by the pro-spending constituencies in Congress precisely because it was working too well.

Gramm-Rudman was enacted in 1985, when Congress was under intense public pressure to immediately reform the budget and reduce the $200 billion budget deficit. The controversial law required Congress to balance the budget by 1991 by meeting a series of annual deficit reduction targets. If Congress missed those targets, the law would trigger automatic spending cuts—a process called "sequestration"—to reduce the deficit to the mandated level.

Critics charge that the act was a dismal failure because Congress continually veered off the balanced-budget track. It is true that Congress routinely missed the deficit targets. Actual deficits under Gramm-Rudman were, on average, about $30 billion per year above maximum deficit targets.

Still, Gramm-Rudman had a positive effect on the federal budget. The best way to measure its impact is to compare the actual deficits recorded during the five years the act was in effect with what the deficit was projected to be by the Congressional Budget Office without Gramm-Rudman. The 1989 deficit was about $100 billion lower than had been expected in 1985 without Gramm-Rudman. The deficit fell from 6 to 3 percent of GDP under Gramm-Rudman.

Table 1: 40 Years of Government Growth

	Billions of 1995 Dollars 1955	1995	Real Growth 1955-95 (%)
National defense	242.8	271.6	11.9
Health	1.7	272.4	16,374.2
Income security	28.8	223.0	674.0
Social Security	25.2	336.1	1,236.4
Education and social services	2.5	56.1	2,117.4
Veterans' benefits	26.6	38.4	44.5
Community development	0.7	12.6	1,618.8
Interest	27.6	234.2	750.0
International affairs	12.6	18.7	48.2
Science and technology	0.4	17.0	3,937.8
Agriculture	20.0	14.4	-27.9
Justice and general government	5.2	32.1	523.4
Transportation	7.1	39.2	453.1
Energy and natural resources	7.2	26.5	268.4
Offsetting receipts	-19.8	-41.4	108.6
Total outlays	388.9	1,538.9	295.7

Source: *Historical Tables, Budget of the U.S. Government, Fiscal Year 1996.*

The most dramatic effect of Gramm-Rudman was to curb government expenditures. Government spending in the five years before the act grew at a rate of 8.7 percent, but it slowed to only 3.2 percent in the five years Gramm-Rudman was in effect. Even entitlement spending was curtailed under Gramm-Rudman to a 5 percent growth rate, because Congress realized that if it allowed programs like Medicare and Medicaid to rise uncontrollably, that would eat up the rest of the budget and cause painful automatic cuts in discretionary spending.

Sen. Phil Gramm (R-Tex.) and House Majority Leader Dick Armey have introduced legislation to restore many of the features of Gramm-Rudman. The most vital reform is a series of deficit reduction targets that, if missed, would trigger automatic across-the-board spending cuts—a sequester. I would urge that any new sequester process include all federal outlays except interest payments and Social Security benefits. That would impose a much-needed dose of discipline on the budget process.

❷ A Supermajority Requirement to Raise Taxes

Americans have been hit with 12 tax hikes in the past 20 years; each one has succeeded in further expanding the size of government rather than reducing the debt. Requiring a three-fifths or two-thirds majority in both the House and the Senate to pass a tax

“The destruction of our nation’s once firmly held moral rule against deficit spending requires us to command Congress to do what it used to feel honor bound to do–balance the budget.”

increase would allow Congress to pass tax hikes in cases of national emergency but would make it very difficult for Uncle Sam to continue the annual ritual of peacetime tax hikes. Several states, including Arizona, California, and Oklahoma, have enacted such measures; they have stopped tax increases dead in their tracks. As one Arizona taxpayer advocate of the supermajority requirement recently told me, “Now the legislature doesn’t even bother to propose new taxes.”

Congress passed the part of the “Contract with America” that promised new rules requiring a 60 percent vote to raise income taxes. That was a good start. But now that hurdle should be made to apply to *all* revenue-raising bills.

❸ A National Referendum on All Tax Increases

Another populist budget reform that is sweeping the states is the requirement that any tax increase be ratified by a popular vote of the people in the next election. That gives the taxpayers veto power over the state legislature’s efforts to raise taxes. Congress, too, should be forced to take its case to the people when it wants to take more dollars out of our paychecks. It is a virtual certainty that George Bush and Bill Clinton’s wildly unpopular record tax increases would have been blocked if such a rule had been in effect.

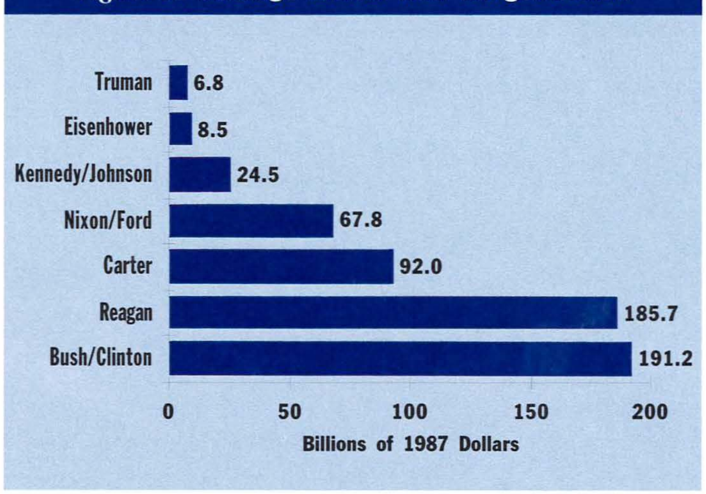
Minority Leader Dick Gephardt deserves hearty congratulations for suggesting this reform as part of his 10 percent tax plan. Perhaps a bipartisan consensus could emerge on the issue.

❹ Dynamic Scoring of Tax Law Changes

The 1986 capital gains tax rate increase has raised roughly $100 billion less revenue than the Joint Tax Committee estimated when the law was passed. Capital gains realizations are less than half the level expected. Why such gigantic forecasting errors? Congress still uses static analysis to score tax rate changes—that is, it assumes little change in behavior in response to tax changes and thus almost no overall economic impact of new tax laws. The assumptions have been shown time and again to be wrong. We know the procedures are wrong, but we still use them.

The capital gains tax cut promised in the “Contract with America” will almost certainly raise revenues for the government—and it might raise substantial new revenues. The rich will actually pay *more* taxes with the rate cut. But the Joint Tax Committee refuses to score those dynamic effects. Scholars at the Cato Institute have long endorsed a zero capital gains tax. But the static revenue estimators say that will reduce revenues by $150 billion over five years. Dynamic estimates indicate that a zero capital gains tax would so energize our economy that total tax revenues might actually increase. But as long as we are slaves to static scoring, pro-growth tax initiatives will be torpedoed by faulty computer models.

***Figure 1:* Average Annual Real Budget Deficit**



Dynamic scoring will yield more accurate tax revenue estimates and thus encourage better policy.

❺ An End to Baseline Budgeting

A 4.5 percent increase in spending on the School Lunch Program is a budget increase, not a budget “cut.” Baseline budgeting is a fraud. Lee Iacocca once stated that if business used baseline budgeting the way Congress does, “they’d throw us in jail.”

It’s time to end the false and misleading advertising in the budget. Congress should be required to use this year’s *actual* spending total as the baseline for the next year’s budget. If Congress spends more next year than it did in the current year, it is increasing the budget; if it spends less, it is cutting the budget.

❻ A Statute of Limitation on All Spending Programs

It has been said that the closest thing to immortality on this earth is a government program. Congress doesn’t know how to end programs—even years and years after their missions have been accomplished. A five-year sunset provision should apply to every spending program in the budget—both entitlements and discretionary programs. That would require the true “reinvention” of programs by forcing the reexamination of every program, including entitlements, every five years.

❼ A Debt Buy-Down Provision

This is Rep. Bob Walker’s idea that would allow taxpayers to dedicate up to 10 percent of their income tax payments to retirement of the national debt. Politicians earmark spending all the time. Taxpayers should have the same right.

Rules Matter

Those budget process reforms are vitally important to the balanced-budget exercise because the rules of the game matter. The rules dictate outcomes. For more than 20 years, forces that favor spending have consistently prevailed over forces that favor fiscal restraint. That pro-spending bias in Washington threatens to cripple our nation’s economic future.

Let me conclude by retelling a story about the late great Washington Redskins football coach George Allen. Allen lived by the motto “the future is now.” He traded all the Redskins’ draft picks for over-the-hill veterans. He spent millions of dollars of owner Edward Bennett Williams’s money to purchase expensive free agents. After several years of that, Williams finally fired Allen. When asked why, Williams responded, “I gave him an unlimited budget and he exceeded it.” That’s the way taxpayers now feel about our politicians in Washington. ■

Campaign finance, Social Security are major issues

Cato Scholars Testify in Congress

Cato Institute scholars have played a key role in several issues facing Congress this year. The Cato Policy Analysis by adjunct scholar Bradley A. Smith, along with several articles by Cato president Edward H. Crane, provided the intellectual grounding for members of Congress and outside groups who opposed restrictive campaign-finance legislation. Smith testified before House and Senate committees, and Crane appeared on two Capitol Hill panels to argue for freedom of speech in election law. At a Cato Forum, Crane and Smith were joined by House Majority Whip Tom DeLay (R-Tex.), Rep. John Doolittle (R-Calif.), and Rep. Bob Ney (R-Ohio), all of whom called for elimination of limits on individual contributions to candidates. Crane also joined former presidential candidates Lamar Alexander and Eugene McCarthy at a seminar sponsored by the Fair Government Foundation.

Institute staff have continued to bring to the attention of Congress the findings of the Project on Social Security Privatization. Among the highlights: Cato senior fellow Tim Penny, director of health and welfare studies Michael Tanner, and vice president for external affairs Leanne J. Abdnor met with several senators during the summer to discuss the coming fiscal crisis of Social Security and the privatization alternative, and Cato director of government affairs Peggy J. Ellis arranged a briefing at which Tanner and pollster William McInturff described the results of Cato's survey on privatization to a group of House members. Several members of Congress, including Sen. Fred Thompson (R-Tenn.) and Reps. David McIntosh (R-Ind.), Sam Brownback (R-Kans.), David Minge (D-Minn.), Bill Brewster (D-Okla.), and John Boehner (R-Ohio), have visited the Cato Institute for Issue Briefings with Cato policy directors.

Cato scholars have also testified before congressional committees more than a dozen times during the second session of the 104th Congress. On March 6 Cato chairman William Niskanen testified before the House Judiciary Subcommittee on a proposed constitutional amendment requiring a 60 percent supermajority vote to increase federal taxes. Niskanen maintained that a supermajority should be required to raise taxes because "any limits on the spending powers of the federal government effectively disappeared during the New Deal."

The next day Cato's director of fiscal policy studies Stephen Moore testified before the Senate Committee on Governmental Affairs on the elimination of corporate subsidies in the federal budget. Moore identified approximately $75 billion in direct taxpayer subsidies to American businesses and reported that 85 percent of them survived the 1995 budget process. According to Moore, "Congress's first-year performance on the issue of corporate welfare is a mild disappointment. Out of the $75 billion pie, only 15 percent, or about $10 billion to $12 billion, was cut." Moore urged Congress to eliminate corporate welfare immediately by terminating 20 to 25 business subsidy programs, including the Export-Import Bank, the Market Promotion Program, sugar price supports, the peanut program, and the Overseas Private Investment Corporation.

Roger Pilon, director of Cato's Center for Constitutional Studies, testifies before the Senate Judiciary Subcommittee on the Constitution.

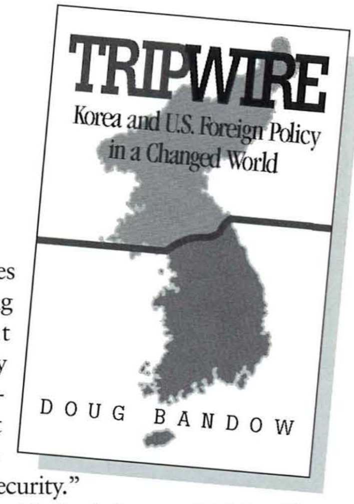
On April 15 Roger Pilon, director of Cato's Center for Constitutional Studies, testified before the Senate Judiciary Subcommittee on the Constitution. Recalling the retroactive tax increase that President Clinton signed into law in 1993, Pilon called on Congress to "erect an impenetrable barrier to retroactive taxation in all of its forms." Pilon also testified on July 11 before the House Judiciary Committee on problems with the proposed victims' rights amendment to the Constitution. While applauding the intent of the legislation, he argued that it would constitute yet another unfunded mandate on the states.

On April 18 Lawrence Gasman, Cato's director of telecommunications and technology studies and author of the Cato book *Telecompetition: The Free Market Road to the Information Highway*, testified before the House Appropriations Subcommittee on the Federal Communications Commission. Gasman told lawmakers that there is no evidence that the FCC can facilitate the advancement of new technology and services for American consumers. "Time is of the essence in today's communications marketplace," he said, "yet there is nothing in the past behavior of the FCC that suggests the commission facilitates timeliness. Indeed, the opposite appears to be the case."

On May 21 Cato senior fellow Doug Bandow testified before the Senate Committee on Labor and Human Resources on discontinuing support for the Corporation for National and Community Service—the federal agency that administers national service programs such as AmeriCorps. According to Bandow, "national service" perverts the American volunteer ethic. "What makes service in America so vital," he emphasized, "is that it is decentralized, privately organized, centered around perceived needs, and an outgrowth of people's sense of duty and compassion. A federal 'service' program, on the other hand, risks teaching that the duty of giving and the job of organizing giving belong to government rather than to average people. Advocates of mandatory service programs thus create a duty to the state rather than the supposed beneficiaries of service." ■

Cato Books

Time to Withdraw from Korea



In his new Cato book, *Tripwire: Korea and U.S. Foreign Policy in a Changed World*, Cato senior fellow and syndicated columnist Doug Bandow presents a comprehensive review of the history of U.S. military involvement in South Korea and argues that it is time to recognize that South Korea is capable of defending itself and bring American troops home.

Bandow contends that military activism abroad may have been justified at one time to contain the hegemonic threat posed by the Soviet Union and its clients. However, with the Cold War behind us, there is no longer any need for U.S. tripwires around the world. Such a tripwire is especially inappropriate on the Korean peninsula.

"In 1953 the ROK was a wreck—impoverished, war ravaged, and ruled by an unloved autocrat whose belligerence had helped plunge his country into a disastrous war. Without an American security guarantee, South Korea would not have long survived. But four-plus decades later the South is prosperous and democratic while its adversary is ruled by an autocrat who lacks both charisma and international friends. North Korea talks of avoiding absorption by Seoul, not of conquest."

Washington's military commitment to South Korea has outlived its usefulness. While South Koreans undoubtedly appreciate the protection, there is no compelling reason for the forward deployment of U.S. troops and the corresponding risk to American lives. South Koreans "will probably still want the United States to be prepared to fight to the last American for them," Bandow writes, "but their wishes should not matter. Washington should risk the lives and wealth of its citizens only when something fundamental is at stake for their own political community. U.S. soldiers' lives are not gambit pawns to be sacrificed in some global chess game."

Bandow builds his case by carefully examining the history of the U.S. involvement in South Korea and its relation to America's changing international role. He notes that the United States "emerged from World War II as the leader of the 'free world' and the only power strong enough to contain a seemingly aggressive and threatening Soviet Union. Between 1950 and 1953 America essentially adopted as its responsibility the defense of the entire globe." South Korea was merely one front in the rivalry between the United States and the Soviet Union.

When the worldwide Soviet threat disintegrated, any need for a strong U.S. presence in South Korea went with it. However, instead of gradually disengaging itself, the United States has pursued a strategy of expanded involvement under the pretext of maintaining regional stability. Bandow examines the various justifications for continued involvement and concludes that the "chimera of stability is likely to lead Washington to risk thousands of lives day in and day out, and to spend tens of billions of dollars year after year, in hopes of preventing events that are not only purely speculative but also tangential to U.S. security."

In the book's final chapter, "A New Foreign Policy for a Changed World," Bandow eloquently makes the case that it is time to return to the American tradition of individual liberty at home and nonintervention abroad. ■

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"To Be Governed..."

◆Right, immigrants aren't that dumb

There is no reason to think public schools are a magnet for Mexicans or Haitians to sneak into the United States.

—*Chicago Tribune* editorial, Apr. 15, 1996

◆Our pork barrel runneth over

When members of the House Appropriations Committee sat down to draft a Pentagon spending bill for 1997 a few weeks ago, they faced a momentary problem: what to do with all the money.

The Budget Committee, with the blessing of the Republican leadership, had allocated so much for defense—more than $10 billion over what President Clinton wanted—that there were funds left over even after billions of dollars had been designated for accelerated procurement of ships, aircraft and weapons.

The solution was to add almost $1 billion to the National Defense Sealift Fund, a little-known account that is emerging as a major source of business for Gulf Coast and southern California shipyards, which, like other Sun Belt industries, have new-found influence in the GOP-controlled Congress.

—*Washington Post,* June 30, 1996

◆Life, liberty, and the pursuit of pepperoni

Pizza deliverers . . . have been threatened, robbed, assaulted and even killed in the line of duty.

Such incidents are why many restaurants and other businesses refuse to deliver to some parts of town. . . .

The Board of Supervisors [in San Francisco] has . . . passed the first ordinance in the country making it illegal for businesses to single out parts of their normal service area for no deliveries. . . .

"When people advertise that they deliver, they should deliver everywhere," said Willie Kennedy, a member of the Board of Supervisors who pushed for the ordinance after her grandson could not have a pizza delivered to his home.

—*New York Times,* July 14, 1996

◆Government helping people

Over a year ago, officers of the White Otter Fish and Game Club in the southern Adirondacks set out to raise $150,000 for a new clubhouse where its dues-paying members could comfortably lounge, drink and swap stories after their duck hunts.

So they turned to an influential ally, a former club president who remains a member. He also happens to be the local State Senator, William R. Sears. . . .

Buried in [New York's] fat spending bills were nearly $1 million in appropriations for his chosen projects, including $150,000 for the private club. Mr. Sears's efforts on behalf of his friends are typical of one of the most secretive and least regulated forms of pork-barrel spending available to the New York State Legislature. It is called the member item. The state money appropriated for Mr. Sears's club was just one of several hundred member items that amounted to at least $150 million last year.

—*New York Times,* July 14, 1996

◆Will Dean Clinton flunk the citizens?

"To me, the community college is the institution in America which most clearly reflects how we ought to be organized, how we ought to work together, and what we ought to be trying to do as we move America into the 21st century," [President Clinton] recently told listeners at an advanced technology center at Central Piedmont Community College in North Carolina. "This country would work better if it worked more like a giant community college."

—*Washington Post,* July 14, 1996

◆What's the penalty for tearing off the French portion of the little tag on your mattress?

Quebec plans to resume strict enforcement of language laws in the province, where French speakers are in the overwhelming majority. . . .

Quebec leaders offered reassurances that the recommissioned police will have fewer powers and staff than in its heyday in the late 1970s and '80s, when random complaints about illegal English-language signs could lead to on-the-spot justice and fines.

"We can apply it with moderation, with a sense of decency about it, without bringing back the ghost of the language police," said David Payne, a Quebec government official.

—*Washington Post,* July 14, 1996

◆How generous

The investors who want to bring a major league baseball team to Northern Virginia offered yesterday to pay about a third of the cost of building a $300 million stadium.

—*Washington Post,* June 5, 1996

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