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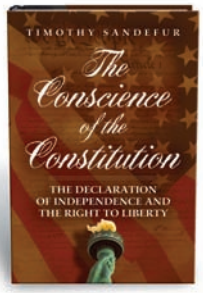


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# Cato Policy Report

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# Tax Revolt! It's Time to Learn from Past Success

**BY BRIAN DOMITROVIC**

For about 15 years now, the federal government, in all its myriad activities, has been in major expansion mode. The Federal Reserve, the regulatory apparatus, the tax code, the police and surveillance machinery of the state—all of these extensions of the government have broadened their reach, power, and ambition in significant fashion since the late 1990s.

The basic metric that reflects all this is the level of federal spending. In 2013 the government of the United States spent 55 percent more money—in real, inflation-adjusted terms—than it did in 1999. Economic growth in that 14-year span has been 30 percent. Where government at all levels soaked up 32 percent of national economic output in 1999, it took in 37 percent in 2013—an increase of nearly a sixth, in less than a decade and a half. By way of comparison, for the first 125 years of this nation's existence under the Constitution, through 1914, government spending was largely parked between 3 percent and 6 percent of national output.

The gorging on the part of government in our recent past has been so unrelenting that aside from flashes from the likes of the Tea Party, the public is meeting the development with quiescence. At $6.4 trillion per year, total government spending is now so immense that any yearning for something smaller and more reasonable from our minders in the state runs the risk of appearing as quaint and otherworldly.

Government that is huge and ever-expanding is a matter of concern in its own right. But perhaps less understood is an additional problem: the developments of the current millennium are inuring a rising generation of Americans to the immovable fact of big government. We now not only have Leviathan, but also a crucial intellectual component of its perpetuation: government's enormous growth ensures that memory of something different is harbored by fewer and fewer persons, getting older every year.

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**BRIAN DOMITROVIC**, who received his PhD in history at Harvard University, is chairman of the history department at Sam Houston State University and the author of *Econoclasts: The Rebels Who Sparked the Supply-Side Revolution and Restored American Prosperity*.

After giving the opening keynote address at a Cato Institute Conference on NSA surveillance in October, Sen. Ron Wyden (D-OR) fielded questions from reporters outside the F. A. Hayek Auditorium. "This conference could not be more timely," Wyden said in his remarks.

BY DAVID BOAZ

EDITORIAL

# The Longing for Utopia

> "The real ideological divide in our world is between free-market liberalism and cronyism of one sort or another."

Back in the early 1980s I was walking through Boston Common and paused to watch an anti-war rally. An activist on the fringe handed me a flyer extolling the benefits of socialism. "Like in China and the Soviet Union?" I asked her. "We're more interested in the experiments taking place in Nicaragua and Zimbabwe," she replied. Well, at the time, I didn't know much about those experiments, so I didn't have an effective response. Now, of course, we know that the socialist experiments in Nicaragua and Zimbabwe didn't turn out well.

Still, it seems there's always some new socialist dream on the horizon, while virtually any economic system other than communism is called "capitalism," no matter how far from a free market it actually is. One of the difficulties that libertarians face is this constant intellectual competition between actually existing institutions and some dreamy vision of a caring, sharing society of equality and community.

Two men who dominated the news in late 2013 remind me of this challenge. Pope Francis issued his "apostolic exhortation" decrying the "new tyranny" of "trickle-down" capitalism. Obituaries for Nelson Mandela explored his early alliance with the Communist Party and the much more pragmatic policies he pursued as South Africa's president. Many conservatives and libertarians deplored both men's opposition to capitalism.

But a few observers recognized how each man's history might have led him to oppose something he thought of as "capitalism." Michael Novak wrote at *National Review Online* that one should read the exhortation "through the eyes of a professor-bishop-pope who grew up in Argentina." More than 200 years ago, he pointed out, "Adam Smith . . . noted that in Latin America [unlike North America] there were still many institutions of feudal Europe—large landholders, plantations, plantation workers." The world of Jorge Mario Bergoglio was "a largely static society, with little opportunity for the poor to rise out of poverty." Inflation eroded savings. The grandsons of great landowners dominated big companies. "Instability in the rule of law undermined economic creativity."

Argentina was hardly a capitalist society. Indeed, Novak notes, beginning in the pope's early years, "a destructive form of political economy, just then spreading like a disease from Europe—a populist fascism with tight government control over the economy—dramatically slowed Argentina's economic and political progress." But intellectuals and journalists tend to call any economy with private ownership "capitalism." And it's no wonder that they and their readers react against such systems.

As for Mandela, my South African–born colleague Louise Bennetts wrote in *Forbes*:

> Of all the inaccuracies and myths that surround South Africa's former Apartheid government, the most persistent falsehood is that the Apartheid government was a purveyor of modern western capitalism. . . .
>
> It would be a very curious capitalist country that encouraged the development of national monopolies. . . Limited economic activity by geographical, ethnic, and other arbitrary measures. And imposed heavy taxes on a small taxpayer base to prop up a system that was as inefficient as it was unfair. Far from being capitalist, at heart the Apartheid system was fascist with all the traits of the "social democratic" systems of 1930s Germany and Italy. . . .
>
> It was this version of "capitalism" that shut down [Mandela's] law firm because it was located in a "whites only" area. . . . No wonder he mistrusted capitalism, because the capitalism he knew was a bastardized version of a market that was anything but free.

Fortunately, Mandela spent his 27 years in jail and his first 4 years as a free man reading and learning. When he became president, he had dropped his starry-eyed view of nationalization. Unfortunately, he hadn't read enough; he mostly continued South Africa's cronyist system, just making sure that some black cronies got to share in the spoils. Still, that has given South Africa a far more productive economy than the failed socialist experiments in Ghana, Tanzania, Zimbabwe, and too many other countries.

You could argue that the real ideological divide in our world is between free-market liberalism and cronyism of one sort or another. If cronyism is a system in which government hands out favors to established businesses or to associates of those in power, then that seems to include every kind of interventionism. If decisions aren't made in free markets, then they are necessarily made by politburos, dictators, politicians, or bureaucrats. And such people, being at best fallible humans, will tend to favor their friends.

That's the issue we must put to popes, political leaders, and voters: that the choice for each society is free markets regulated by the rule of law, or cronyism and favoritism. And in that task, we might remember the advice of F. A. Hayek:

> We must make the building of a free society once more an intellectual adventure, a deed of courage. What we lack is a liberal Utopia, a programme which seems neither a mere defence of things as they are nor a diluted kind of socialism, but a truly liberal radicalism which does not spare the susceptibilities of the mighty.

*A comprehensive new research tool from Cato*

# The Launch of HumanProgress.org

A growing body of evidence points to dramatic improvements in human well-being. In recent decades these improvements have been especially striking in the developing world, but unfortunately there is often a wide gap between reality and public perception. A realistic look at the state of humanity must, in addition to recognizing persistent problems, acknowledge positive long-term developments.

With the launch of HumanProgress.org, the Cato Institute hopes to correct those misperceptions by stimulating an intelligent debate on the drivers of this global advancement. HumanProgress.org offers over 500 datasets of human development indicators from a variety of sources, allowing visitors to compare indicators with one another, create and share graphics, and calculate differences in human well-being between different countries over time. The website is a project of the Cato Institute, with major support from the John Templeton Foundation, the Searle Freedom Trust, and the Brinson Foundation.


The goal, then, is not to paint a rosy picture of the state of humanity, but an accurate one. "A realistic account of the world should focus on long-term trends, comparing living standards between two or more generations," editor Marian Tupy says. "Crucially, it should compare the imperfect present with a much more imperfect past, rather than with an imagined utopia in the future."

The website pr ides the tools necessary to inform users about the many ways in which the world has become a better place. All of its wide-ranging data comes from third parties, including the World Bank, the OECD, the Eurostat, and the United Nations. By putting together this comprehensive data in an accessible way, the website provides a useful resource for scholars, journalists, students, and the general public.

In the end, the hope is that HumanProgress.org will lead to a greater appreciation of the improving state of the world. While Cato's scholars argue that policies and institutions compatible with freedom and openness are important factors in promoting human progress, this website lets the evidence speak for itself.

**PLEASE VISIT HUMANPROGRESS.ORG TODAY AND SUBSCRIBE TO THE YOUTUBE CHANNEL TO RECEIVE UPDATES ABOUT VIDEOS RELATED TO THE IMPROVING STATE OF THE WORLD.**

# CATO NEWS NOTES

## FREEDOM IN DECLINE

Economic freedom in the United States has continued to fall even as it has increased modestly at a global level. That's according to the *Economic Freedom of the World: 2013 Annual Report*, copublished by the Cato Institute, the Fraser Institute, and more than 70 think tanks around the world.

The United States has seen more than a decade of decline, having been ranked 3rd on the index in 2000 and 17th in the current report. The authors note that the country has fallen in all areas that the report measures: size of government, the legal system and security of property rights, sound money, freedom to trade, and regulation.

## A NEW LOOK FOR LIBERTARIANISM

Libertarianism.org, the Cato Institute's website dedicated to the theory and history of the libertarian tradition, has been redesigned, offering a more user-friendly interface. The website features a collection of resources—including a blog, new and classic videos, essays on great classical liberals, and a new podcast show (hosted by editor Aaron Ross Powell and research fellow Trevor Burrus) about libertarianism and the ideas that influence it. Newly posted videos include talks from the 1970s and 1980s by Murray Rothbard, Karl Hess, Ed Crane, and David Friedman.

By examining the philosophy of freedom at a deeper level, Libertarianism.org seeks to shed light on the animating principles of an open and civil society.

## LINDZEN JOINS CATO

The Institute is pleased to welcome Richard S. Lindzen, emeritus professor of meteorology at Massachusetts Institute of Technology, as a distinguished senior fellow at Cato's Center for the Study of Science.

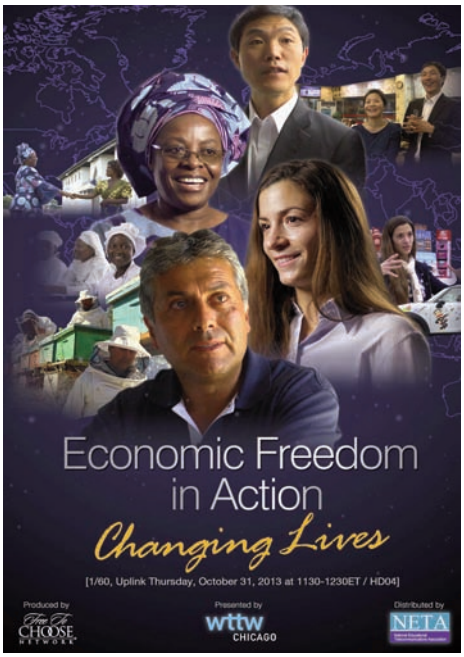
Lindzen's pioneering research in atmospheric dynamics has led to multiple analyses of the sensitivity of surface temperatures to atmospheric carbon dioxide increases, all of which support the hypothesis that the sensitivity is considerably below that necessary to generate disastrous climate change.

As a distinguished senior fellow, Lindzen will focus his work on the interaction between climate science and policymakers and the biases that are introduced into science when it becomes a government-funded enterprise.

Cato's Hayek Auditorium hosted 83 Policy Forums and 11 conferences in its first full year of operation. Besides its 210 plush seats, its state-of-the-art communications technology allows thousands of people to watch Cato events on the internet live or afterward.


Mike Moore (left), New Zealand's ambassador to the United States and former director general of the World Trade Organization (WTO), and Jennifer Hillman, former WTO Appellate Body jurist, former U.S. trade negotiator, and former commissioner at the U.S. International Trade Commission, spoke about the failure of the WTO's multilateral negotiations to achieve broader and deeper reductions in global trade barriers, despite the fact that bilateral and regional agreements have flourished.

At a Cato forum for the newly expanded edition of his book, *Kindly Inquisitors: The New Attacks on Free Thought*, Jonathan Rauch, senior fellow at the Brookings Institution, argued that suppressing hateful speech does minorities more harm than good.




In a new PBS documentary, *Economic Freedom in Action: Changing Lives*, Cato senior fellow JOHAN NORBERG profiles inspiring entrepreneurs around the world and shows how increased opportunity has allowed them to build better futures for themselves and their communities.


The sluggish recovery from the Great Recession raises a troubling question: is this the new normal? TYLER COWEN (at podium), professor at George Mason University, argued that the "low-hanging fruit" of growth has already been picked. Moderated by *New York Times* reporter ANNIE LOWREY (left), the event included Cato vice president for research BRINK LINDSEY, who agreed that slow growth will be hard to avoid in the coming years.


At a Cato/Institute for Humane Studies invitation-only student seminar, JASON BRENNAN, assistant professor of philosophy at Georgetown University, gave a talk on "How to Present Libertarianism to the Left." Contrary to its caricature, libertarianism is a political philosophy with a rich system of thought, Brennan said, and challenging the misconceptions surrounding it requires explaining its nuances.

*Continued from page 1*

**RECLAIMING A TRADITION**

The moment is apt, then, to reclaim a tradition of our recent history, a tradition that the big-government 21st century is striving to suppress. This is the great successful effort to slow Leviathan of a generation and a half ago—the effort that gave us the Ronald Reagan revolution of the 1980s.

For despite the still large displacement of the economy, the market, and private life that the government brought about in the 1980s and 1990s, even in the wake of President Reagan's major reforms, the scope of government in that era pales in contrast to what prevails today. From the early 1980s to the late 1990s, the Fed largely stuck to keeping the dollar sound against gold. Regulatory expansions planned in the 1970s did not come to pass thereafter. And the major spending initiatives tended to involve cuts, such as in welfare and defense.

Again, the outlay picture tells a tale. The federal government grew by 33 percent in real terms from 1983 to 1999, while the economy grew by 78 percent. Before the current millennium, we had a government that got bigger all right, but comfortably less than the economy did. Now, we have a government that leaves the economy in the dust when it comes to growth.

> "The achievements of the 1980s and 1990s stemmed from one source above all: the centerpiece of Ronald Reagan's economics, the great tax cut of 1981."

The achievements of the 1980s and 1990s stemmed from one source above all: the centerpiece of Ronald Reagan's economics, the bill that Congress passed in the summer of 1981. This was the great tax cut that had been originally sponsored in Congress in the 1970s by Rep. Jack Kemp of New York and Sen. William V. Roth of Delaware, "Kemp-Roth."

The tax cut of 1981—which took all rates of the income tax down by an average of 23 percent, lowered the capital gains rate by 29 percent, and reduced business taxes—was the point of origin of the renaissance of the 1980s and 1990s whereby the economy expanded well in excess of the government.

The tax cut made everything else easy. First of all, it took the heat off the Fed. The Fed did not have to worry about stimulating the economy, because growth flowed from the tax cut. Furthermore, lower tax rates made loopholes less important as a source of profit, so business focused more on real entrepreneurship. Competition, efficiency, and product development reached soaring new heights in the 18 years after 1981. And government spending at last decelerated. Forty million new jobs reduced the welfare rolls, while the collapse of Soviet communism made a portion of the defense establishment redundant.

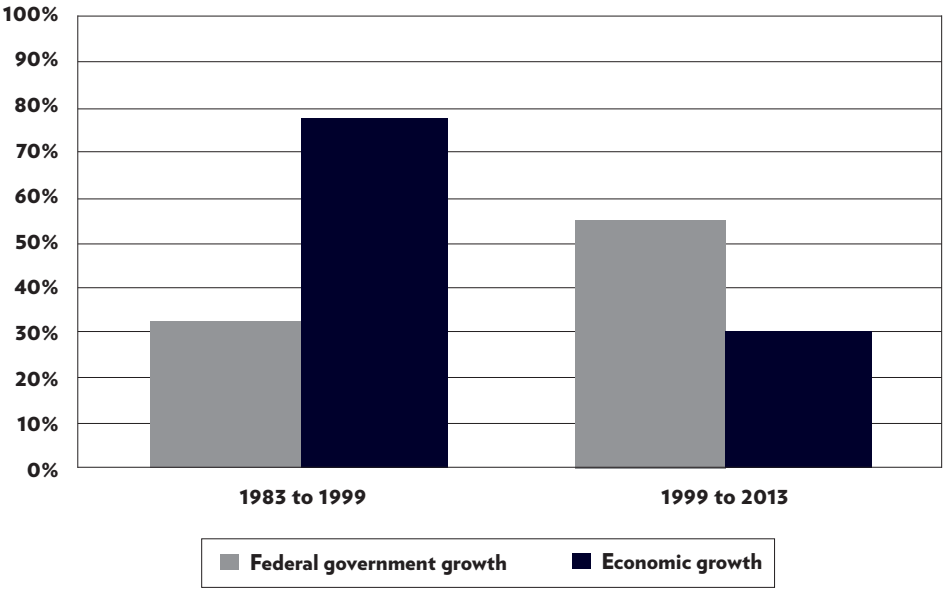
The example of 1981 proves that efforts to constrain government to the benefit of the real economy can succeed. It remains the greatest resource that our recent history provides as we seek motivation and precedent to expand prosperity and freedom by shrinking government.

The scholarly discipline of history has not been helpful in terms of relating to us the achievements of the 1980s and 1990s, in particular the victory of the great tax cut of 1981. Professors write books with titles such as "Zombie Economics" and "Peddling Prosperity" when it comes to retelling the profound revolution that brought Kemp-Roth to the fore. I strove to correct this condition myself by authoring *Econoclasts* (2009), a narrative history of supply-side economics, the movement that seeded Kemp-Roth and the Reagan Revolution. Also, Larry Lindsey's classic, countercultural study of the first benefits of the 1981 tax cut, *The Growth Experiment*, has now thankfully been re-released in a new and updated edition.

We have to cut through the academic and political obfuscation about "the last 30 years" (a progressive epithet today) and reexamine the policy clarity and impetus to reform that coalesced in the late 1970s and early 1980s and left in its wake an economy zooming ahead of government.

In particular, we should reflect upon the four major aspects of the movement that brought about the tax cut of 1981: its intellectual origins, its institutional period of development (which occurred in journalism as opposed to government), its capacity to incur

**FEDERAL GOVERNMENT GROWTH vs. ECONOMIC GROWTH**



political traction, and its relevance to an economy beset with the kind of big government that took hold in the United States in modern times.

> "The example of 1981 proves that efforts to constrain government to the benefit of the real economy can succeed."

### FROM THE 1960S THROUGH THE '70S TO THE '80S: A USABLE PAST

The supply-side economics that culminated in the tax cut of 1981 first arose (avant la lettre: the term was coined in 1976) in the mainstream of academic economics, in the early 1960s work of the economist Robert A. Mundell. Mundell was working for the International Monetary Fund during the first, recession-prone years of the John F. Kennedy administration. Beginning in 1961 he published a series of papers showing that the best way for the United States to slough off bad times was to strengthen the dollar while cutting taxes.

One of these papers from 1963 was a model of insight—in 1999, when Mundell won the Nobel Prize in economics, the prize announcement cited this paper. Its purpose was to show that loose money and high taxes conduce to stagnation. Namely, if profits are to come in a depreciating currency, and be subject to increasing government levies, investors will prove reluctant to take risks to gain them. The result of loose money and high taxes is no-growth and unemployment. In contrast, a dollar solid in value (particularly against its classical metric, gold) and supported by tax cuts will call forth a business and jobs boom.

Somehow Mundell's advice was actually taken, if only by default, in the Kennedy years. The great tax cuts of 1962 and 1964—along with a new Federal Reserve vigilance about the dollar—yielded eight years of growth at 5 percent per year. But then the consensus unraveled. In 1968 and 1969, there were tax increases. From 1971 to 1973 the Fed and Treasury conspired with President Richard M. Nixon to untie the dollar from gold as well as from fixed exchange rates with other currencies.

The era of "stagflation" came upon the nation. After a double-dip recession in 1969–70, there was another more severe double-dip episode from 1973–75, and yet another still more severe from 1980–82. From 1969 to 1982, all told, growth was mediocre at 2.4 percent per annum, the price level nearly tripled, and stocks lost half their real value. It was the worst extended performance of the American economy since the Great Depression of the 1930s—and it remains debatable whether our own era of the Great Recession actually exceeds the magnitudes of the economic crisis of the long 1970s.

In the midst of these difficulties, an intellectual transition occurred. Mundell's ideas, passed over and forgotten in the academy (not to mention policy) in the 1970s, began to resonate in journalism, particularly on the editorial page of the *Wall Street Journal*. The economist Arthur B. Laffer, a colleague of Mundell's at the University of Chicago, caught the ear of Jude Wanniski of that page. The two began having extended discussions about how to overcome stagflation via dollar stability and tax cuts. Wanniski's editor, Robert L. Bartley, took the initiative to convene monthly meetings at a Manhattan steakhouse where the group, including Mundell, now resident in New York at Columbia University, could talk things through.

By the latter part of the nasty 1973–75 stagflation-recession, when unemployment hit 9 percent in the context of double-digit inflation and a stock collapse of 45 percent, the *Journal* was publishing the insights of Mundell and Laffer on a regular basis. An end-run around the academy had been effected. If the economic establishment was not going to promote low-tax, stable-money ideas adequately, then the major business media would.

As the *Journal* plugged away, certain quarters of Congress, including the Joint Economic Committee, developed new thinking about economic policy along similar lines. Kemp, representing a Buffalo, New York, experiencing de-industrialization in the face of stagflation, began crafting a bill to put things into practice. In 1977 Roth lent his name as a co-sponsor, and Kemp-Roth began life. The bill called for three successive yearly cuts in the income tax of 10 percent. The model was the tax cut of 1964, which had taken all rates of the income tax down by 30 percent and occasioned the great economic recovery of that era.

Taxes were particularly onerous in the 1970s because of the way they mixed with inflation. The tax code was not indexed for inflation, meaning when the regular 7 percent increase in prices came every year, a taxpayer was thrown into a higher tax bracket if earnings kept up with prices. If one got only a "cost-of-living" increase, real income was reduced—and the government kept the difference.

The situation was worse with respect to property and capital gains taxes. In the 1970s houses soared in value as hedges against inflation, and so did tax assessments on those houses. Stocks (and real estate) that went up with inflation were subject to a capital gains tax (that reached 49 percent) on the unreal gain.

Thus, by 1978 the inevitable happened: a national tax revolt. In California, where house prices had leapt some five-fold as people bid up land to hedge the dollar, property taxes increased proportionately. A movement organized by Los Angeles businessman Howard Jarvis brought a ballot measure requiring a permanent reduction in California property taxes. Proposition 13 won big in June 1978.

In Congress that same year, a little-known representative from Wisconsin, William A. Steiger (who would die that December at age 40) proposed a capital gains rate cut of 21 points. It became so popular that President Jimmy Carter signed it into law, though on the condition that Kemp-Roth be tabled.

These first electoral and legislative moves in the direction of tax cuts gave way to four of

the strangest years ever in the American economy. From 1979 to 1981 inflation was above 10 percent each year, even though a recession occurred and growth totaled only 1.2 percent per annum. In 1982 inflation moderated to the still excessive level of 6 percent, but growth crashed to -1.9 percent. It was stagflation with a vengeance: a motionless—indeed, shrinking—economy in the context of intolerable increases in prices.

In the latter portion of this quite terrible period, with the *Journal* hammering away at the tax-cut, stable-money solution, Reagan pushed Kemp-Roth into law seven months into his presidency, in August 1981. However, the first year's tax cut was reduced by half, to 5 percent. When the full 10 percent tax-cut installment arrived in the middle of 1982, the economy turned, and big, for the long term.

Stocks bottomed in August 1982, went up 30 percent the rest of the year, and over the next 18 years soared another eleven-fold. Inflation, intractable for a dozen years at an 8 percent average, plummeted to 3 percent immediately and stayed there to date. Unemployment tumbled from 11 percent to 5 percent, then to 4 percent, as the labor force expanded magnificently by 40 million. The amount of time spent in recession in the 18 years following 1982 was one-fifth that lost to recessions in the 13 years of stagflation.

> "The scholarly discipline of history has not been helpful in terms of relating to us the achievements of the 1980s and 1990s, in particular the victory of the great tax cut of 1981."

## MAKING USE OF THE LEGACY

The great Reagan tax cut of 1981 stands as one of the most successful policy initiatives of modern American history. It was borne into existence by the determination of a cadre of intellectuals, political organizers, unsung members of Congress, and a president who had had enough—as well as a proud and ambitious nation yearning once again to breathe free after a long decade of harsh experience. Indeed its scope was broadened to an extent in 1986, when further legislation also sponsored by Kemp brought the top rate of the income tax all the way down to 28 percent, one of the lowest ceilings in the entire hundred-year history of the income tax.

There were compromises along the way. In terms of money, 3 percent inflation, while a vast improvement over what had come before, still ate away at the dollar's value, to the tune of a 40 percent devaluation each generation. In terms of taxes, Presidents George H. W. Bush and Bill Clinton both raised the marginal income tax rate. However, Clinton, at the behest of the Republican-led Congress, cut the capital gains rate. The result was that the paltry eight months' worth of recession over the 18-year run from 1982 to 2000 was part of Bush's record, not Clinton's.

In all, there was consensus in these years that the tax code was supposed to get out of the way of an American economy brimming with potential. That potential had gone un-tapped and unrealized in the previous era of stagflation, when so much useful capital had to hide out in inflation and tax hedges on account of overweening government.

As for problems during this era of American renaissance, they showed themselves to be perfectly manageable, if not ephemeral. The wealth tossed off by the country over the long boom overwhelmed the "Reagan deficits" of the 1980s. The growth in "inequality" coincided with historic increases in living standards among lower earners.

And totally underappreciated today, the consensus on low and unobtrusive taxes took the pressure off the Federal Reserve. It was only when tax cuts did not come in the face of the huge 1999 and 2000 federal budget surpluses that the Fed began its contemporary activism, an activism which grew to an unimaginable extent in the aftermath of the Great Recession. This is not to mention the unholy tide of regulation and spending, from Dodd-Frank to Obamacare, which has washed upon us since 2008. Given the resurgence of big government in the 21st century, private enterprise in this country has proven reluctant to explore the full extent of its legendary ambition.

Instead of conceding long-term mediocrity under Leviathan, we should take inspiration from our past, indeed our recent past. The last time we were stuck with 2 percent growth for the long term, the 1970s and the early 1980s, we mustered a means of narrowing government. The real results were so stellar that to recite them is to take us back to a world we have lost—but only 15 years ago. Tax cuts, stable money, and the rendering of spending and regulation as superfluous are the formula of the supply-side revolution—the Reagan Revolution. They stand sentinel right there, not long ago in our history, as the way to advance through our sluggishness and purposelessness today. ■

# A Century of Central Banking: Was the Fed a Good Idea?

**The Great Depression left a black mark on the nation's central bank, and the Great Recession has vastly expanded the bank's powers. In 1913 the dollar was defined in terms of gold. Today we have a pure fiat money, and the Federal Reserve is the largest buyer of U.S. public debt, enabling the government to live beyond its means. Would we have been better off adhering to the rules of a gold standard? At the 31st Annual Monetary Conference, experts considered the record of the Federal Reserve since its establishment in December 1913. Speakers included Charles I. Plosser, president of the Federal Reserve Bank of Philadelphia; Leszek Balcerowicz, former chairman of the National Bank of Poland; Lewis E. Lehrman, chairman of the Lehrman Institute; and John A. Allison, president and CEO of the Cato Institute.**

**CHARLES I. PLOSSER:** As the Fed approaches its 100th anniversary, it is entirely appropriate to reflect on its history and its future. Today, I plan to discuss what I believe is the Federal Reserve's essential role and consider how it might be improved as an institution to better fulfill that role.

Central banks have been around for a long time, but they have clearly evolved as economies and governments have changed. They are usually given the responsibility to protect and preserve the value or purchasing power of the currency. In the United States, the Fed does so by buying or selling assets in order to manage the growth of money and credit. The ability to buy and sell assets gives the Fed considerable power to intervene in financial markets, not only through the quantity of its transactions but also through the types of assets it can buy and sell. Thus, it is entirely appropriate that governments establish their central banks with constraints.

Yet, in recent years, we have seen many of these limits stretched. The Fed and many other central banks have taken extraordinary steps to address a global financial crisis and the ensuing recession. These steps have challenged the accepted boundaries of central banking and have been both applauded and denounced. As we contemplate what the Fed of the future should look like, I will discuss those constraints that might help limit the range of objectives it could use to justify its actions.

Many discussions about the Fed's mandate seem to forget the emphasis on the long run. The public, and perhaps even some within the Fed, have come to accept as an axiom that monetary policy can and should attempt to manage fluctuations in employment. I have concluded that it would be appropriate to redefine the Fed's monetary policy goals to focus solely, or at least primarily, on price stability. I base this on two facts: Monetary policy has very limited ability to influence real variables, such as employment. And, in a regime with fiat currency, only the central bank can ensure price stability. Indeed, it is the one goal that the central bank can achieve over the longer run.

The Fed has also ventured into the realm of fiscal policy by its purchase programs of assets that target specific industries and individual firms. One way to circumscribe the range of activities a central bank can undertake is to limit the assets it can buy and hold. My preference would be to limit Fed purchases to Treasury securities and return the Fed's balance sheet to an all-Treasury portfolio. This would limit the ability of the Fed to engage in credit policies that target specific industries.

A third way to constrain central bank actions is to direct the monetary authority to conduct policy in a systematic, rule-like manner. It is often difficult for policymakers to choose a systematic rule-like approach that would tie their hands. Yet, research has discussed the benefits of rule-like behavior for some time. Rules are transparent and therefore allow for simpler and more effective communication of policy decisions. While choosing an appropriate rule is important, research shows that in a wide variety of models simple, robust monetary policy rules can produce outcomes close to those delivered by each model's optimal policy rule.

Finally, the Fed plays an important role as the lender of last resort, offering liquidity to solvent firms in times of extreme financial stress to forestall contagion and mitigate systemic risk. This is not intended to prop up insolvent institutions. However, in some cases during the crisis, the Fed played a role in the resolution of particular insolvent firms that were deemed systemically important financial firms. Nonetheless, by taking these actions, the Fed has created expectations—perhaps unrealistic ones—about what the Fed can and should do to combat financial instability.

The central bank should therefore set boundaries and guidelines for its lending policy that it can credibly commit to following. If the Fed is asked by the fiscal authorities to intervene by allocating credit to particular firms or sectors of the economy, then the Treasury should take these assets off of the Fed's balance sheet in exchange for Treasury securities. In 2009 I advocated that we establish a new accord between the Treasury and the Federal Reserve that protects the Fed in just such a way.

**LESZEK BALCEROWICZ:** My focus will be on the problems currently playing out in Europe, but I will of course touch on monetary issues. The Eurozone is, after all, a monetary arrangement. But let me start with some facts.

There has been much talk recently about Europe as a whole, which unfortunately masks the enormous amount of variation you see within the continent. The problem with aggregates is that you often lose information. If you look, for instance, at gross data for the European Union from 2008 to 2013, you see huge differences in economic growth.

Nine countries have been growing faster, in per capita terms, than the United States. These countries include those with a flexible rate of exchange—like Poland and Sweden—but it also includes countries with hard pegs—like Germany, a member of the Eurozone. A very interesting group of countries—which I call BELL for Bulgaria, Estonia, Lithuania, and Latvia—have Euro-based currency boards, which means they cannot engage in outright devaluation. They suffered a huge currency boom and, as a result, a bust. But then they recovered, and the accumulated growth in these countries has been faster than in the United States.

On the other hand, you have a group of countries that have been lagging behind U.S. growth in 2013. You have boom and bust economies like Greece, Portugal, Ireland—although, again, there are divergences there. Ireland, for example, has been doing much better than Greece. But there are also countries that have entered the crisis period with very distorted economies—like France and Italy—and, as a result, they have very slow growth.

I think it's crucial to acknowledge this huge amount of variation. It's important not to just speak about the European Union or the Eurozone as a whole, but to look at differences in the data. When trying to explain those differences, one should mention that the problem countries—including Greece, Portugal, Ireland, and Spain—have developed two kinds of credit booms. I find it useful to distinguish between those problems that begin as fiscal crises and culminate in the financial or banking sector, and those that progress in the opposite direction. In both cases, however, the proximate cause is an excessive growth of credit.


LESZEK BALCEROWICZ

> "In short, financial crises do not occur with the same frequency across countries."

Of the two, the easier problem to examine and diagnose is the fiscal-to-financial crisis. In Greece, for instance, there was cheap financing, which in turn led to excessive spending and public debt. During this process, financial institutions were buying government debt. But eventually the music stopped, and the fiscal crisis erupted and spilled over into the country's financial institutions. Now, I think it's fairly easy to explain the source of this problem. The root cause, of course, was bad politics. It is therefore up to the citizens to try to advocate better policies and make political competition less destructive. Fiscal constraints, I think, would help.

Now, with financial-to-fiscal crises—as in Spain or Ireland—you've got an excessive growth of credit which can usually be detected. It's not always difficult to figure out when it's expanding too fast. The basic question is what is behind the excessive growth of private credit—and the popular cliché is market failure. It is very fashionable to blame the markets, which are distorted. But if you look at more careful, empirical analyses, you see a lot of policies—from mortgage subsidies to tax regulations to politicized banking in general—which have contributed to the excessive growth of credit. While not the only factor, the monetary policy of the Fed has certainly been a contributor.

Central banks, however, are usually presented as saviors, which means people tend to ask: "What can the central bank do to constrain credit busts?" But the right question is: "What can we do to constrain the central banks?" In short, financial crises do not occur with the same frequency across countries. There are huge differences across time and space. These differences are largely due to differences in politics and, in turn, policies.

**LEWIS E. LEHRMAN:** As a soldier of France, no one knew better than Professor Jacques Rueff, the famous French central banker, that World War I had brought to an end the preeminence of the classical European states system and its monetary regime, the classical gold standard. World War I had decimated the flower of European youth; it had destroyed the European continent's industrial primacy. No less ominously, the historic monetary standard of commercial civilization collapsed into the ruins occasioned by the Great War. The international gold standard—the gyroscope of the Industrial Revolution, the guarantor of more than one hundred years of price stability and unprecedented economic growth, the common currency of the world trading system—all this was brushed aside by the belligerents. Into the breach marched unrestrained central bank credit expansion—the express government

purpose of which was to finance the colossal budget deficits occasioned by war and its aftermath.

With the benefit of hindsight we can see that quantitative easing was actually inaugurated with World War I. We can see also that the potential of discretionary central banking in the United States coincided with the founding of the Federal Reserve System. Because The Federal Reserve Act had been designed to reinforce the international gold standard, such an outcome would become one of the great ironies of American monetary history.

To interpret the financial events associated with the Great War—and their effect on the ensuing hundred years—my colleague John D. Mueller and I have highlighted two crucial events of 1913. First, of course, the establishment of the Federal Reserve system; and second, the publication by the young John Maynard Keynes of his book, *Indian Currency and Finance*. Either event by itself would probably not have forestalled resumption of monetary stability and economic growth under the pre-war classical gold standard. But the inauguration of the Federal Reserve, and the monetary ideas of Keynes, taken together, gave rise to the perfect financial storm.

Rueff was involved in the successful stabilizations of the French franc after two World Wars. As secretary of the French Treasury and deputy governor of the French central bank—his hands-on experience reinforced his path-breaking views on monetary economics. I recommend his theoretical and policy studies not least for the practical reason that his genius inspired two vital restorations of franc convertibility to gold—in 1926 and in 1959, even as Great Britain failed in 1925, and the United States in 1971. Rueff's success, I believe, was in part due to the fact that he was not only a gifted monetary economist. He was also a successful practitioner—whereby he had shorn himself of the illusions of his academic counterparts.

Rueff's fundamental rule by which to guide a central bank in a reasonably free economy is, first, to understand that no central bank, not even the mighty Federal Reserve System, can determine the quantity of money in circulation—the conceits of John Maynard Keynes and his followers to the contrary notwithstanding. You will remember that Keynes declared in the13th chapter of *The General Theory* that "the quantity of money is not determined by the public." Moreover, Keynes presumed that the authorities can "govern the activity of the economic system by varying the quantity of money."


JOHN A. ALLISON

> "I can tell you with absolute certainty that market discipline beats regulatory discipline."

In these academic conceits originates the regime of central bankers as central planners. But the truth of experience and the empirical data show that a central bank may influence indirectly the stock of money and credit; but upon a moment's reflection, it is clear that the central bank cannot determine the quantity of money in circulation. In a non-totalitarian society, only the money users—consumers and producers in the market—determine the cash balances they desire to hold. Sovereign consumers do not consult the authorities when they freely vary their currency and bank deposit holdings. Has any solvent person in this audience been unable on a daily basis to increase or decrease the cash balances he wishes to hold by varying his stock of other assets in exchange for money?

**JOHN A. ALLISON:** I'm going to talk from a different perspective because I am the only person who actually ran a bank that's been speaking today, and from that context I can tell you with absolute certainty that market discipline beats regulatory discipline. In fact, I will argue that regulatory discipline will always fail to reduce volatility and will slow economic growth. These observations are based on my understanding of public choice theory and particularly on 40 years of concrete experience in the banking business.

One observation in my 40-year career at BB&T: I don't know a single time when federal regulators—primarily the FDIC—actually identified a significant bank failure in advance. Regulators are always the last ones to the party after everybody in the market (the other bankers) know something is going on. Thus, in that context, regulators have a 100 percent failure rate. Indeed, in my experience, whenever they get involved with a bank that is struggling, they always make it worse—because they don't know how to run a bank.

An interesting reflection from public choice theory, reinforced consistently throughout my career, is that regulators regulate for the "regulatory good." They like to talk about the "public good," and sometimes the public good and the regulatory good may align. But they don't manage for the public good; they consistently manage for the regulatory good.

In good times, regulators basically don't regulate banks for safety and soundness. If

*Continued on page 17*

*A new book on the primacy of liberty*

# The Conscience of the Constitution

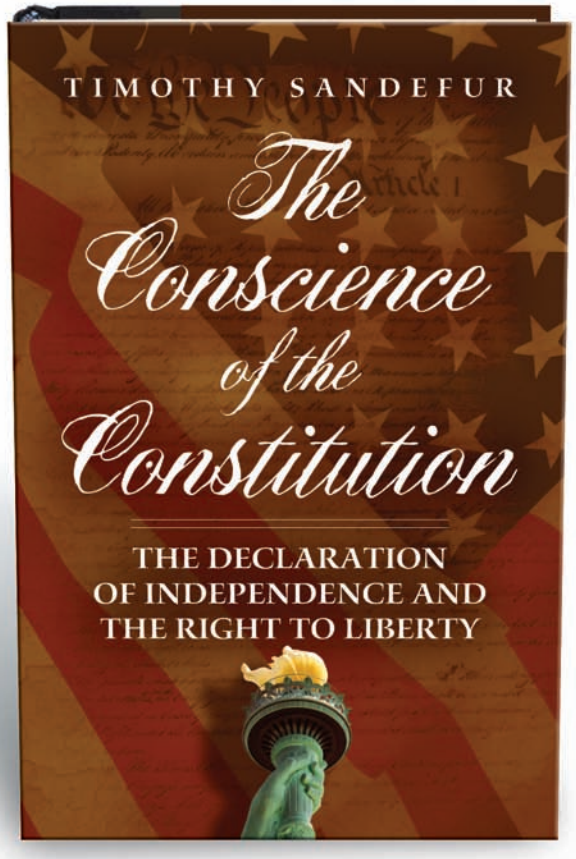
"Freedom is the starting point of politics; government's powers are secondary and derivative, and therefore limited," according to Timothy Sandefur. In *The Conscience of the Constitution: The Declaration of Independence and the Right to Liberty*, Sandefur, a Cato Institute adjunct scholar and principal attorney at the Pacific Legal Foundation, explores this insight, arguing that an overemphasis on democracy by today's legal community devalues the primacy of liberty. That principle, which was most eloquently expressed in the Declaration of Independence, is the light by which we must guide our understanding of the country's political and legal institutions. "Liberty is the goal at which democracy aims," he writes, "not the other way around."

Sandefur begins by looking at the Declaration of Independence and how Progressive intellectuals upended its principles to prioritize democracy over liberty. "In what can only be called a complete reversal of the Founders' perspective, judges, lawyers, political scientists, politicians, and journalists today generally see democracy as the source of liberty, and hold that the most basic principle of our Constitution is not that each person deserves to be free, but that we all have a right, collectively, to govern each other," he writes. According to Sandefur, the growth of government power at the expense of individual rights—demonstrated in everything from the abuse of eminent domain, to the censorship of speech, to intrusions on our rights of personal privacy—all "have their origin in this basic reversal of priorities."

The country grappled with the dilemma between the individual's right to freedom and the majority's power to govern perhaps most directly in the institution of slavery. After the Civil War was fought, the Fourteenth Amendment—which, according to Sandefur, "for the first time defined the terms of American citizenship"—helped recommit the country to the primacy of liberty. Unfortunately, that amendment was crippled by the Supreme Court's decision in the *Slaughter-House Cases*. As Sandefur details in full, the damage done from that 1873 precedent still hampers protections for liberty to this day.

Sandefur next turns his attention to the controversial legal doctrine known as substantive due process, which has played an important role in protecting individual rights against state interference. Although substantive due process has been denounced by both left and right, Sandefur maintains that it serves as a significant protection against government arbitrariness and is a legitimate—even crucial—element of our constitutional law. In effect, the requirement "puts legally enforceable boundaries around the power of government, and those boundaries are built on the foundation of equal liberty articulated in the Declaration and the Constitution.

Finally, Sandefur examines the ongoing debate about "judicial activism"—the charge that our democracy is being sabotaged by judges who ought to be more deferential toward legislatures. "If the left and right agree on nothing else," he writes, "they share a conviction that judges—particularly unelected federal judges—frequently exceed the scope of their office and impose their own political views from the bench." But in fact, a vigorous, independent judiciary is essential for a legal order that is dedicated, as ours is, to securing individual rights.




Today, more Americans are realizing the dangers of expanding the scope of government. "Lawyers, judges, and law professors, adhering to the view that government has a basic right to rule, and that individual rights are only privileges given to people for society's benefit, refuse to defend constitutional guarantees that were written to give life to the principles of the Declaration of Independence," Sandefur writes. The time has come, he concludes, to secure the blessings of liberty not only for ourselves, but for future generations as well. ■

**VISIT WWW.CATO.ORG/STORE OR CALL 800-767-1241 TO GET YOUR COPY OF *THE CONSCIENCE OF THE CONSTITUTION* TODAY; $24.95 HARDBACK.**

*Jurors should know their rights*

# A Historical Look at the Power of Jury Independence

The power of jurors to not enforce the letter of the law and to instead seek justice in deciding their verdict is commonly referred to as jury nullification. Juries have been following this simple doctrine for centuries, serving as a final check on the government's ability to enforce unjust, immoral, or oppressive laws. Yet, there are few principles in the study of criminal law that have inspired more controversy than jury independence.

In *Jury Nullification: The Evolution of a Doctrine*, author Clay S. Conrad, an attorney in private practice in Houston, attempts to reintroduce the concept to a general audience. Recently rereleased by the Cato Institute and Carolina Academic Press, the book concludes that there is nothing "wrong" with jury nullification; nullification is part and parcel of what a jury is all about. Conrad argues that the nullification power has sometimes been abused, as has all power. But these abuses have been exaggerated to discredit the nullification idea itself.


*The Washington Post/Getty Images*

**An advertisement in the Judiciary Square Metro station in Washington, D.C., reminds jurors that they have a right to veto an unjust law. In a book recently rereleased by the Cato Institute, attorney Clay S. Conrad echoes the billboard's sentiment that "good jurors nullify bad laws."**

Central to the history of trial by jury is the right of jurors to vote "not guilty" if the law is unjust or unjustly applied. When jurors acquit a factually guilty defendant, we say that the jury "nullified" the law. The Founding Fathers believed that juries in criminal trials had a role to play as the "conscience of the community" and relied on jury nullification to hold the government to the principles of the Constitution. "It is not only the juror's right, but his duty to find the verdict according to his own best understanding, judgment, and conscience, though in direct opposition to the instruction of the court," John Adams once wrote.

Conrad traces the doctrine of jury nullification from it roots in England to the present day. Although opponents of jury nullification often point to the civil rights era when some all-white juries refused to convict whites accused of brutalizing and killing blacks, Conrad notes that jury nullification was also used to protect people who were prosecuted under the Fugitive Slave Act in the years before the Civil War. Jurors routinely refused to convict people who were helping slaves attain their freedom.

Yet over the last century and a half, the power of jurors has been derided and ignored by American courts, to the point where few jurors are even aware that an important part of their role is, in the words of the Supreme Court, to "prevent oppression by the government." Several state constitutions explicitly say that juries shall have the power to judge the law as well as the facts in criminal cases, but those provisions have been watered down by judicial rulings.

*Jury Nullification* has drawn much praise. Randy Barnett of Georgetown Law School says: "This is the most important book on the independence of juries since Lysander Spooner'sTrial by Jury in 1852. It is meticulously researched and balanced. The enjoyment of reading it stems as much from the beauty of Clay Conrad's writing as from the comprehensiveness of his analysis and the fascinating and important nature of his subject."

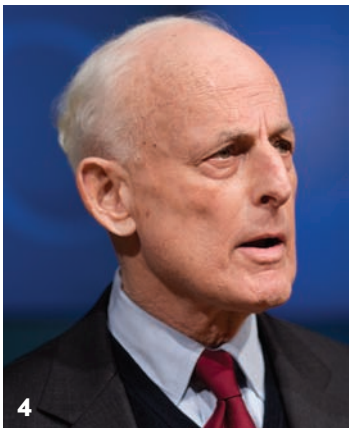
Conrad takes readers through an extensive, eye-opening history of the doctrine of jury independence, the law, and the practical and political implications of nullification. In the end, he writes that the best way for the courts to have their instructions respected is to make them thorough, honest, and even-handed. "Judges should make clear to jurors the gravity and responsibility inherent in a decision to veto the written law," Conrad concludes. "While it is not a responsibility to be exercised lightly, neither is it a responsibility which can be denied or ignored." ■

**VISIT WWW.CATO.ORG/STORE OR CALL 800-767-1241 TO GET YOUR COPY OF *JURY NULLIFICATION* TODAY; $24.95 HARDBACK.**


*The Beautiful Tree* tells the remarkable story of author James Tooley's travels from Africa to China, where he found that the poor are building their own schools and learning to save themselves. In a discussion with Cato's Neal McCluskey (left), Tooley, a professor of education policy at the University of Newcastle, argued that the entrepreneurial spirit can be found in every corner of the globe.

At the inauguration of HumanProgress.org, a new Cato website that allows users to explore human development indicators showing the improving state of the world, former World Bank president Robert Zoellick (left) stressed the importance of such research tools in correcting the public's misperceptions about global progress. He was joined by the site's editor, Cato's Marian Tupy.





At the Cato Institute's 31st Annual Monetary Conference entitled "Was the Fed a Good Idea?," (1) Charles Plosser, president and CEO of the Federal Reserve Bank of Philadelphia; (2) Rep. Jeb Hensarling (R-TX), chairman of the House Financial Services Committee; (3) Rep. Kevin Brady (R-TX), chairman of the Joint Economic Committee, and Judy Shelton, codirector of the Atlas Economic Research Foundation's Sound Money Project; (4) Lewis E. Lehrman, chairman of the Lehrman Institute; and (5) Athanasios Orphanides, professor at the MIT Sloan School of Management, all considered the lessons learned from a century of U.S. central banking.

At a Cato Hill Briefing with Rep. Scott Garrett, KHALIAH BARNES of the Electronic Privacy Information Center (EPIC) highlighted the TSA's problematic practice of deploying Visible Intermodal Prevention and Response squads to perform random sweeps of individuals outside of airports.

# Cato Calendar

**CATO INSTITUTE POLICY PERSPECTIVES 2014**
**NAPLES, FL • RITZ-CARLTON • FEBRUARY 5, 2014**
Speakers include John Stossel.

**26TH ANNUAL BENEFACTOR SUMMIT**
**SARASOTA, FL • RITZ-CARLTON • FEBRUARY 20–23, 2014**
Speakers include John Allison, David Boaz, and "Thomas Jefferson."

**MILTON FRIEDMAN PRIZE PRESENTATION DINNER**
**NEW YORK • WALDORF-ASTORIA • MAY 21, 2014**
Speakers include Garry Kasparov.

**CATO UNIVERSITY**
**SAN DIEGO • RANCHO BERNARDO INN**
**JULY 27–AUGUST 1, 2014**

**CATO CLUB 200 RETREAT**
**MIDDLEBURG, VA • SALAMANDER RESORT AND SPA**
**SEPTEMBER 18–21, 2014**

**27TH ANNUAL BENEFACTOR SUMMIT**
**SARASOTA, FL • RITZ-CARLTON GOLF RESORT**
**FEBRUARY 19-22, 2015**

**OCTOBER 1:** A SAFE Way Out of State and Local Pension Woes?

**OCTOBER 2:** The WTO and the Uncertain Future of Multilateralism

**OCTOBER 2:** Crisis in Syria: Can U.S. Intervention Solve Anything?

**OCTOBER 3:** Common Core: The Great Debate

**OCTOBER 7:** *The Beautiful Tree: A Personal Journey into How the World's Poorest People Are Educating Themselves*

**OCTOBER 8:** Rethinking U.S. Nuclear Weapons Policy

**OCTOBER 9:** NSA Surveillance: What We Know; What to Do About It

**OCTOBER 10:** Buzzfeed for Nonprofits

**OCTOBER 15:** The End of Overkill? Reassessing U.S. Nuclear Weapons Policy

**OCTOBER 15:** Shutdowns, Debt Ceilings, and Downsizing the Government

**OCTOBER 16:** *Kindly Inquisitors: The New Attacks on Free Thought*

**OCTOBER 16:** *Economic Freedom in Action: Changing Lives*

**OCTOBER 25:** Dangerous World? Threat Perception and U.S. National Security

**OCTOBER 29:** Is Slow Growth the New Normal?

**OCTOBER 30:** The Inauguration of HumanProgress.org

**OCTOBER 31:** Cato Institute Policy Perspectives 2013 (New York)

**NOVEMBER 6:** *Democracy and Political Ignorance: Why Smaller Government Is Smarter*

**NOVEMBER 6:** *Money for Nothing: Inside the Federal Reserve*

**NOVEMBER 12:** The Most Important Obamacare Lawsuits You've Never Heard Of

**NOVEMBER 13:** Does History Predict the Future of Climate Science?

**NOVEMBER 13:** Is Science Progressing?

**NOVEMBER 14:** 31st Annual Monetary Conference: Was the Fed a Good Idea?

**NOVEMBER 14:** Mission Creep at the TSA and the Case for Privatization

**NOVEMBER 20:** Cato Institute Policy Perspectives 2013 (Houston, TX)

**NOVEMBER 21:** Cato Institute Policy Perspectives 2013 (Dallas, TX)

**NOVEMBER 25:** Rethinking U.S. Nuclear Weapons Policy

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*A conference on the implications of government spying*

# Leading Journalists and Policymakers Examine NSA Surveillance and Reform

Since June, news reports based on documents leaked by former National Security Agency (NSA) contractor Edward Snowden have uncovered the depth and breadth of NSA surveillance activities. The NSA scandal's many dimensions—from mass domestic surveillance of telephone call information to the alleged access of the Internet's backbone—reveal a scale of government overcollection that might have sounded like science fiction a decade ago.

In October the Cato Institute convened the most in-depth conference any organization has held on NSA spying on U.S. citizens. Entitled "NSA Surveillance: What We Know; What to Do about It," the day-long event featured experts analyzing the reporting challenges, legal issues, technology concerns, and business dimensions of these programs.

Panelists included journalists, lawyers, businessmen, and top academics across several fields—however, the discussion reached its peak during the day's keynote addresses, during which several prominent members of Congress spoke out against government overreach.

This October, the Cato Institute held an all-day conference on NSA surveillance, which included (top) CHARLIE SAVAGE of the *New York Times* and SIOBHAN GORMAN of the *Wall Street Journal* on the implications of these activities from a press perspective; (bottom left) REP. JUSTIN AMASH (R-MI) on what Congress is doing to address the issue; and (bottom right) SEN. RON WYDEN (D-OR) on his work crafting the first comprehensive, bipartisan reform bill since the June disclosures.

Sen. Ron Wyden (D-OR) addressed what constitutes real intelligence reform—those surveillance improvements that "aren't just skin deep." He noted in particular ending the bulk collection of Americans' records, closing the back-door search loophole that allows those communications to be reviewed without a warrant, making the FISA courts operate more like "a court that's worthy of our wonderful country," and expanding the ability of our citizens "to have their grievances heard in federal court."

In his afternoon address, Rep. Justin Amash (R-MI) spoke on the flawed legal reasoning behind the NSA's actions. Section 215 of the Patriot Act, he noted, allows the government to obtain any "tangible thing" that is considered "relevant to an authorized investigation." "But instead of collecting tangible things on people who are actually under suspicion, they were collecting the phone records and, as we learned, the email records of every person in the country—which of course is an astonishing expansion of the word 'relevance.'"

Finally, Rep. F. James Sensenbrenner (R-WI) capped off the day as one of the fiercest critics of how the NSA has used its authority in ways that Congress did not intend. One of the key authors of the Patriot Act, he discussed his plans to champion legislation to ensure that the agency has the tools it needs to pursue threats without endangering civil liberties. "I believed then and now that we can defend our country and our liberty at the same time," Sensenbrenner said.

The Cato Institute has long been at the forefront of issues that emerge from the busy intersection of technology and privacy. "In my view, a good way to measure the credibility of scholars and thinkers in Washington is by watching to see whether they can stay true to their views, regardless of the impact those views have on partisan politics," Wyden said. "That's why Cato scholars like Jim Harper and Julian Sanchez are the go-to leaders—the people we look to—on these issues of security and liberty." ■

*Analyzing the multiplicity of supposed risks from the world*

# Dangerous World? Threat Perception and U.S. National Security

Last year, Chairman of the Joint Chiefs of Staff Gen. Martin Dempsey contended that "we are living in the most dangerous time in my lifetime, right now." This year, he was more assertive, stating that the world is "more dangerous than it has ever been."

Is this accurate? At "Dangerous World? Threat Perception and U.S. National Security," a Cato Institute Conference held in October, experts on international security assessed the supposed dangers to American security, examining the most frequently referenced threats, including wars between nations and civil wars within nations.

"There's a disconnect between perception and reality that is mostly in the direction of overstating threats," PAUL PILLAR (left), a visiting professor at Georgetown University, said at a Cato Institute Conference on the global risks to U.S. national security. JENNIFER KEISTER, a visiting fellow at the Institute, concluded the panel by commenting on the implications of these inflated threats.

Historically, states have posed the greatest threats to international security. The first two panels discussed whether this is still the case, exploring the dangers not only from traditional nation-states but also from sub-state actors. "The U.S. government has overreacted to terrorism relative to its direct physical costs," Max Abrahms, assistant professor at Northeastern University, said. But the policy community has also inflated the risk that terrorism would spread throughout the world. "Just as the direct costs of terrorism have been overstated, so too has the political value."

With a lack of credible state rivals since the end of the Cold War, fears have arisen in response to less traditional dangers, including cyberwar, climate change, and general instability. Mark G. Stewart, director of the Centre for Infrastructure Performance and Reliability at the University of Newcastle, subjected the worst-case scenarios of global warming to cost-benefit analyses. "My answer is that the impact of climate change on national security is manageable," he concluded. "Change is going to be gradual—not abrupt—and there will be plenty of time to adapt."

Given that many of these threats have been inflated, the question remains whether the global order depends on a single power enforcing the rules. In the final panel, scholars considered whether the United States must prevent general lawlessness in order to maintain our relative prosperity. Eugene Gholz, associate professor of political science at the University of Texas at Austin, challenged this thesis by focusing on how costly it is to fight wars. "The claim that the global economy would become unhinged if the United States was not providing primacy and tamping down conflict around the world is just not true," he concluded.

In the end, many of those scholars that disagreed with the Institute's positions nevertheless praised its scholarship—even on issues as divisive as foreign policy. "Cato scholars are very strong and clear advocates of the view that the U.S. should retrench," said Stephen Brooks, associate professor of government at Dartmouth College. "In my view, this comprehensive version of retrenchment . . . is the one which is most interesting and most compelling as an alternative to the current U.S. grand strategy." ■

*Continued from page 11*

things are going smoothly in the economy, bank examiners might see something that bothers them in a bank. But if they start raising red flags, bankers have plenty of political contacts, and the examiners are going to have a career advancement problem. They can't prove their point because they are guessing what's going to happen in more difficult times. Hence, regulators basically do not regulate from a safety and soundness perspective during good times.

In addition, regulators are politically driven. Those at the top of the regulatory organizations are political appointees. You don't get to be head of the FDIC without having some political contacts. You don't get to be head of the Federal Reserve without having political contacts. Hence, you have people who come from a political perspective, and regulations change a lot depending on who is at the top. Regulators are driven by what's happening in the current political environment; there is no rule of law. ■

# The Growth Outlook Is Darkening

For over a century, the trend line for the long-term growth of the U.S. economy has held remarkably steady. Notwithstanding huge changes over time in economic, social, and political conditions, growth in real GDP per capita has fluctuated fairly closely around an average annual rate of approximately 2 percent. According to Brink Lindsey in "Why Growth Is Getting Harder" (Policy Analysis no. 737), however, there are strong reasons for doubting that this historic norm can be maintained. Lindsey, vice president for research at the Cato Institute, considers the four constituent elements of economic growth—labor participation, labor quality, capital deepening, and so-called total factory productivity—that are tracked by conventional growth accounting. "Over the course of the 20th century, these various components fluctuated in their contributions to overall growth," he writes. "The fluctuations, however, tended to offset each other, so that weakness in one element was compensated for by strength in another." However, the simultaneous weakening of all the components of economic growth in the 21st century does not mean that slow growth is inevitable from here on out. Nevertheless, it is difficult to resist the conclusion that the conditions for growth are less favorable than they used to be. In other words, growth is getting harder. "Consequently, policies that are more friendly to long-term growth will be needed if more robust growth is to be revived," Lindsey concludes.

## ELIMINATING EGYPT'S SUBSIDIES

Subsidies to consumer goods, including fuels and food, account for almost one third of Egypt's public spending, or 13 percent of the country's GDP. As Dalibor Rohac, policy analyst at the Cato Institute's Center for Global Liberty and Prosperity, writes in "Solving Egypt's Subsidy Problem" (Policy Analysis no. 741), subsidies are highly ineffective in helping the poor and an increasingly unsustainable drain on the country's public finances and foreign reserves. "Yet reform remains a thorny issue in Egypt's unstable political environment—mostly because subsidies are the main instrument of social assistance used by the government," he writes. Subsidies to consumer goods and fuels have existed in the country since the 1920s. Various approaches are available for scaling them down. Eliminating subsidies and replacing them with cash transfers would produce significant savings and would be politically feasible. But "a successful reform of subsidies will

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will have to be accompanied by a series of complementary reforms, which would reduce food insecurity in the country and improve supply chains," Rohac writes.

## FOOD STAMP FAILURE

The Supplemental Nutrition Assistance Program (SNAP), the program formerly known as food stamps, has become America's fastest growing social welfare program. As recently as 2000, just 17 million Americans participated in the program at a cost of less than $18 billion. Today, roughly 48 million Americans receive SNAP benefits, costing taxpayers more than $78 billion per year. Yet nearly 18 million American households remain "food insecure." According to Michael Tanner, senior fellow at the Cato Institute, in **"SNAP Failure: The Food Stamp Program Needs Reform"** (Policy Analysis no. 738), the evidence suggests that much of the increase was due not to the economy but to deliberate policy choices by both federal and state governments, which loosened eligibility standards and actively sought new participants. "At the same time," he writes, "evidence that the expansion of SNAP has significantly reduced hunger or improved nutrition among low-income Americans is scant at best." As Tanner demonstrates, SNAP has high administrative costs and significant levels of fraud and abuse. The program's work requirements are weak and frequently evaded. The program increasingly breeds greater dependence on government. It has little "bang for the buck." The time has come to reform the food stamp program by reducing its spending and enrollment and, ultimately, by returning responsibility for its operation to the states.

## FINANCIAL SHUFFLE

Since the 2007–08 financial crisis, global regulators have engaged in a lengthy struggle to reshape the international financial system to make it more resilient under stress. In **"The New Autarky? How U.S. and UK Domestic and Foreign Banking Proposals Threaten Global Growth"** (Policy Analysis no. 743), Louise C. Bennetts, associate director of financial regulatory studies at the Cato Institute, and Arthur S. Long, partner at Gibson, Dunn, and Crutcher, evaluate two recent and transformative proposals: the "Foreign Banking Organization" proposal of the U.S. Board of Governors of the Federal Reserve System and the United Kingdom's "ring-fencing" plan. The authors argue that these measures amount to little more than a mandatory, inefficient shuffling of corporate entities and business units that will not help ward off future financial crises. "At the macro level," they write, "both proposals interfere with the ability of global banks to allocate capital and liquidity in the manner they determine to be most efficient." Bennetts and Long underscore the problems with national regulators adopting a parochial, protectionist, or "home country first" approach to regulation. They conclude that regulators should instead focus their attention on creating a credible, coordinated resolution process for globally significant firms.

## DENSE DECREES

In response to state laws and federal incentives, metropolitan areas across the country are engaged in "sustainability planning" aimed at reducing greenhouse gas emissions. In many if not most cases, this planning seeks to increase urban population densities and replace low-density neighborhoods in transit corridors with dense, mixed-use developments. As Randal O'Toole, senior fellow at the Cato Institute, shows in **"Reducing Livability: How Sustainability Planning Threatens the American Dream"** (Policy Analysis no. 740), such planning tramples on property rights and personal preferences. "Surveys show that people of all age groups aspire to live in a single-family home with a yard," O'Toole writes. Yet planners in Portland, San Francisco, and other urban areas seek to reduce the share of households living in single-family homes to well below 50 percent by restricting the construction of single-family homes while subsidizing multifamily housing. To make matters worse, these policies are simply not effective at reducing green house gas emissions. As O'Toole concludes, these plans should be abandoned because they intrude on personal housing preferences and are cost-ineffective at saving energy and reducing emissions.

## TRANSFORMING ANTITRUST

During his presidential campaign, Sen. Barack Obama sharply criticized the lax antitrust law enforcement record of the George W. Bush administration. Subsequently, his first assistant attorney general for antitrust even went so far as to suggest that the Great Recession was, at least in part, caused by federal antitrust policy failures during the previous eight years. In **"Antitrust Enforcement in the Obama Administration's First Term: A Regulatory Approach"** (Policy Analysis no. 739), economists William F. Shughart II and Diana Thomas of the Utah State University School of Business investigate how and in what ways antitrust enforcement has changed since President Obama took office in 2009. Reviewing four recent antitrust cases and the behavioral remedies that were imposed on the defendants in those matters in detail, they find that the Obama administration has been significantly more active in enforcing the antitrust laws with respect to proposed mergers than his two predecessors in the White House. In addition, the Federal Trade Commission, together with the Department of Justice, has "moved antitrust law enforcement away from traditional structural remedies in favor of very intrusive behavioral remedies in an unprecedented fashion," they write. Shughart and Thomas conclude that policy shift has further transformed antitrust law enforcers into regulatory agencies, a mission for which they are not well-suited, resulting in the Department of Justice and Federal Trade Commission being more vulnerable to rent seeking. ■

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# "To Be Governed..."

### TIME TO RETHINK THE PLAN?

Over the past decade, the federal government has had several major challenges: Iraq, Afghanistan, a new homeland security system, Katrina and Obamacare. In almost every case, its performance has been plagued with mismanagement, massive cost overruns and long delays.

—**FAREED ZAKARIA, *WASHINGTON POST*, 11/21/2013**

### DEPENDS ON YOUR VIEW OF LIBERTY, WE SUPPOSE

The preliminary move by the Food and Drug Administration (FDA) to phase out partially hydrogenated oils, the source of most of the trans fat in the food supply, is an insignificant imposition on liberty.

—**EDITORIAL, *WASHINGTON POST*, 11/26/2013**

### CRONYISM IN THE CAPITAL

But scoring a slice of the contracting pie increasingly has become a Washington insider's game. The government's contracting rules have grown so vast and complex—regulations run to thousands of pages—that they are virtually impossible for a layperson to understand....

But, he said, there's something wrong with a government contracting system that is so complicated that it requires the existence of a middleman like Deltek. And he said government auditors are way too cozy with a company they have known for 30 years.

Glaros said that when he started his company in 2006, he was using the cheap and simple accounting software QuickBooks. But he said government auditors urged him to switch to Deltek software, because they told him they were "very comfortable with and trained on Deltek."

"They said, 'Everybody around here is kind of using Deltek,' wink-wink, nod-nod," he said. "The message was clear enough: You really need to be using this more luxurious brand in order for us to ensure we know exactly what you're doing."

Glaros, a former Navy pilot and technology adviser to the defense secretary, said he had "no choice" but to comply with pressure from the government auditors.

—***WASHINGTON POST*, 11/22/2013**

When President Obama highlights the lift the entertainment industry has provided to the sluggish economy on Tuesday, he will single out one production studio, DreamWorks Animation, with a personal visit.

Likely to be left unsaid during his remarks at the company's lush Glendale, Calif., campus will be the boost that chief executive Jeffrey Katzenberg has given to Obama's campaign coffers....

The decision by the White House to put the presidential spotlight on his company underscores how well many top campaign donors have fared in Obama's administration, despite the president's early pledge to temper the influence of wealthy interests on the political system.

Since 2008, Obama has appointed at least three dozen big check writers and fundraisers to coveted ambassadorships in spots such as the United Kingdom, France and Italy. Earlier this year, Obama gave the commerce secretary nod to Chicago hotel heiress Penny Pritzker, who served as national finance chairwoman of his first White House bid and raised more than $500,000 for his reelection....

During a meeting in Los Angeles in February 2012 with then-Vice President Xi Jinping of China, Vice President Biden sealed a deal that lifted that country's quota on foreign films. Katzenberg, who met with Xi during his trip, was among the studio chiefs whom Biden consulted during the negotiations, according to news reports.

"That had nothing to do with me," Katzenberg told the Jewish Journal this summer. "I happened to be standing in a corridor when he was making this deal, and [Biden] asked me, you know, what was my opinion."

—***WASHINGTON POST*, 11/25/2013**

### SWEET DEAL FOR PROTECTED GROWERS

U.S. candy makers are expanding production in other countries as federal price supports and a global glut of the sweet stuff give an ever-greater advantage to foreign rivals...

U.S. prices can't fall much lower because of a federal government program that guarantees sugar processors a minimum price....

Loans, marketing allotments and import restrictions guarantee a minimum price of about 21 cents a pound to domestic sugar processors....

Three candy-making jobs are lost for each sugar-growing and processing job saved by higher sugar prices, according to a Commerce Department report in 2006.

—***WALL STREET JOURNAL*, 10/21/2013**

### WE PRAY THE FEDS WILL GET OUT OF WORKPLACE MICROMANAGEMENT

Employee claims of religious discrimination have climbed as the U.S. and workers' expressions of faith have grown more diverse, creating legal headaches for companies and exposing the complexities of managing religion on the job.

—***WALL STREET JOURNAL*, 10/28/2013**