

Office and Plant:
2800 South 61st Court
Cicero, Illinois 60804-3091

(708) 735-8000
(800) 323-2750



Mailing Address:
P.O. Box 5137
Chicago, Illinois 60680-5137

Facsimile:
(708) 735-8100

July 28, 2009

Reckless Democracy?

During recent years, a good deal of American foreign policy has been directed at fostering democratic institutions in countries around the world. That is certainly a worthy objective, but it is no panacea. Unfortunately, we have witnessed some serious limitations of democratic institutions: Voters in Gaza, in a free and fair election, put Hamas into power. That group soon used force to drive out its opposition and did its best to thwart peace negotiations with Israel. In Lebanon, Hezbollah won a minority in the government, but then forced the majority to give it veto powers over any legislation and prolonged that country's political turmoil. And, the granddaddy of the breakdowns in the democratic process occurred in 1933, when Germany gave the Nazis a plurality of votes and catapulted Hitler into the Chancellorship.

It is easy to say that these failures of democracy took place in countries with severely weakened governments operating under extreme political or economic pressures. But then, how do we explain the breakdown in California?

In the "Golden State" we have not had the election of a rogue party (despite what some Democrats say about Republicans and vice versa). Instead, the demise of rational governance in that state is in good part due to the rise of the ultimate instrument of democracy – the voter initiative. That process allows members of the public, by securing the required number of signatures, to craft legislative proposals for submission to the electorate. If passed, those proposals become law and are not subject to repeal by the legislature under ordinary procedures.

The initiative process was a product of the early 20th Century, when it was widely thought that the state legislature was in the pockets of railroad, oil and other business groups and immune to the interests of the average voters. The initiative was thus a product of reform, a jewel of the democratic process.

And so things went for many decades. Then, in 1978, Proposition 13 appeared on the ballot. That measure limited real property taxes that could be imposed on real estate to 1% of assessed valuation and limited increases in assessments to 2% per year. The provision also required that any proposed increase in state revenues had to be approved by a two-thirds majority in both houses of the legislature. The immediate effect was to reduce

property tax revenues by 57% and, in the intervening 30 years, as land and housing values skyrocketed, inflation adjusted tax revenues from those holdings were actually declining. Warren Buffet pointed out in 2003 that he was paying \$14,401 on his \$500,000 house in Omaha, but only \$2,264 on his \$4 million house in California.

Some might argue that Proposition 13 was a splendid idea, leashing profligate spenders who were throwing away tax revenues on unnecessary frills. But there can be no real argument about one thing: That Proposition opened the floodgates to government by initiative.

Many of those proposals were aimed at social issues, like illegal immigration (Prop 187, passed but declared unconstitutional by the federal courts), medical marijuana (Prop 215), drinking water (Prop 65), curbing affirmative action (Prop 209) banning gays from working for public schools (Prop 6, failed) and same sex marriage (Prop 8). But more and more of them sought to handcuff the legislature on fiscal issues. In addition to limiting the state's taxing powers (a la Proposition 13), initiatives began to *require* that funds be spent on certain activities. Proposition 227, which required that all public school teaching be in English, mandated \$50 million per year be spent on teaching English to individuals who promised to tutor children. Proposition 98 required minimum expenditures on education. As a result, the legislature is hamstrung coming and going and is left with precious little it can work with to get the two-thirds majority required to pass a budget.

One might ask what's wrong with all this? If the voters of California want this democratic institution, why not have it? One answer may be that it is unclear just what the voters want. Many, if not most of the initiatives are now financed by out-of-state interests, seeking to put forward ideas they want to encourage elsewhere. These groups are generally well financed and well prepared for a campaign with thirty second TV spots, mail solicitations and the other trappings of our current political landscape. But is this the way legislation should be considered? Many initiatives are simply poorly drafted, but immune from amendment if enacted. Others delve into highly complicated issues with simplistic solutions.

And finally, there is the test of experience. California has been living on IOUs written to providers of goods and services. The recent compromise on the budget will require cities and counties to loan or give money to the state. The educational system will suffer huge shocks (it used to be one of the best in the country; since Prop 13, it has declined to 48th). Health care will be curbed for children, indigents and most other Californians. Prisoners will be given early releases. And perhaps worst of all, the stage is set for even more of the same next year.

Like most states these days, California has problems caused by the recession. But unlike most other states, it finds itself in a straitjacket in trying to address those problems. And, undoubtedly, an excess of democracy is a major culprit.

It has been said that democracy is the worst form of government – except for all the others. But that is cold comfort to California.

Turning to the cost data for this month:

- Scrap and Pig Iron. Prices for #1 dealer bundles and #1 busheling (Chicago) jumped more than 40% to \$295 and \$305 per mt, respectively. These increases may be showing a firming of the market as well as export demand from Asia. The spot price for Brazilian pig iron (cif New Orleans) was up to \$320 per mt, a 14% increase. These increases would more closely reflect domestic demand.
- Natural Gas. Prices have been steadily melting for a year now. This month the decline was to \$3.26 per mcf, 27 cents below last month. The question now seems to be how low the price can get.
- Ocean Freight. The Baltic Capesize Index declined modestly to 6104, perhaps showing that the pickup of international carriage was not a one month phenomenon.
- Exchange Rates. The dollar has continued its decline, losing three cents to the euro (now at \$1.42), two cents to the pound (at \$1.66) and three cents to the Canadian dollar (92¢).

Like most of you, Corey Steel has become more environmentally aware, and, to that end, we are in the process of changing our mailings of this monthly letter and all other notices to an e-mail format. This month we will test part of the new system by sending a copy of this month's letter to many of you by e-mail. E-mail recipients will also receive a hard copy by mail as will all other individuals on the existing mailing list. We ask all e-mail recipients to advise us of any problems they may encounter.

We will be making this conversion over the next three months. For those who want to continue to receive our monthly letters thereafter, please go to our website www.coreysteel.com and click on "Join Our Mailing List". You will be sent to a contact information form; once you fill it out, we shall automatically add your information to the new e-mail data base. If you do not have an e-mail address or cannot access the contact information form, please call us at (708) 735-8000 and ask the Operator to be directed to a mailing list coordinator.