

## 10 Myths about Social Security

by Michael Tanner

The debate over Social Security reform is heating up. As it does, we can expect the air to be filled with competing claims and counterclaims. Organizations from the AFL-CIO to the National Organization for Women have announced plans to mount a campaign against proposals to transform the 63-year-old retirement program to a system of individually owned, privately invested accounts. Therefore, it seems like a good idea to dispel some of the myths that you may be hearing over the next few months.

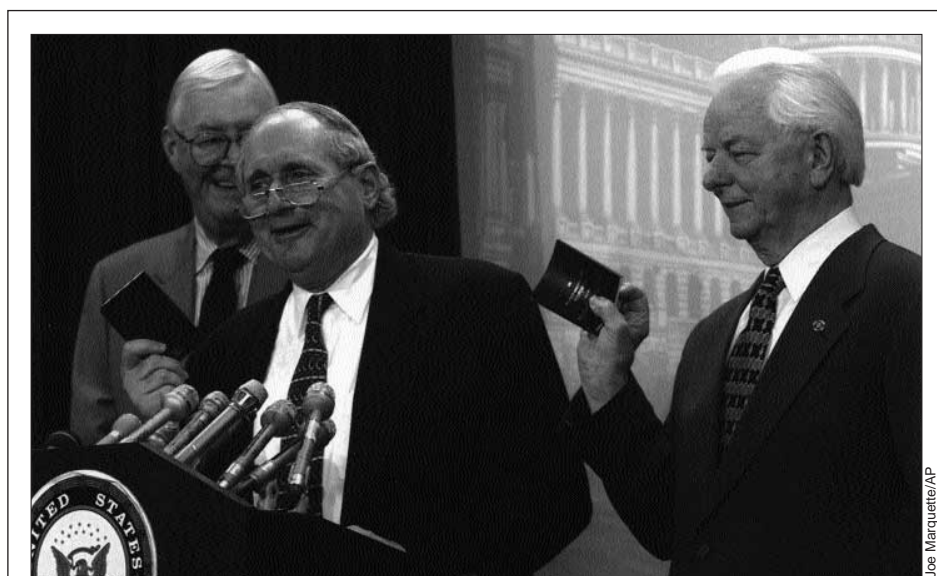
### Myth 1: There's No Need to Rush; Social Security Is Safe for the Next 35 Years

That rush of hot air you heard a couple of months ago was the collective sigh of relief when the Social Security trustees reported that the system's technical insolvency date had been extended to 2032. But that date does not provide the full story of Social Security's looming crisis. The important date is 2012. Social Security taxes currently bring in more revenue than the system pays out in benefits. The surplus theoretically accumulates in the Social Security Trust Fund. However, in 2013, just 15 years from now, the situation will reverse. Social Security will begin paying out more in benefits than it collects in revenues. To continue to meet its obligations, it will have to begin drawing on the surplus in the trust fund. Which brings us to

### Myth 2: The Trust Fund Is Real

The trust fund is really little more than a polite fiction. For years the federal government has used the trust fund to disguise the

*Michael Tanner is director of the Cato Institute's Social Security Privatization Project and coauthor with Peter Ferrara of A New Deal for Social Security and Common Cents, Common Dreams: A Layman's Guide to Social Security Privatization.*



At a Capitol Hill press conference celebrating the Supreme Court's rejection of the line-item veto law, Sens. Carl Levin (D-Mich.) and Robert Byrd (D-W.Va.) read from their Cato-supplied pocket Constitutions. Sen. Daniel Patrick Moynihan (D-N.Y.) looks on. Copies of the booklet containing the Constitution, the Declaration of Independence, and an introduction by Roger Pilon are available in any quantity for \$1.00.

actual size of the federal budget deficit, borrowing money from the trust fund to pay current operating expenses and replacing the money with government bonds—essentially IOUs. Half the trust fund consists of those bonds. The other half is simply an accounting entry attributing interest to the bonds.

The Social Security Administration insists that there is no need to worry. Those bonds are backed by the full faith and credit of the U.S. government. But that is irrelevant. Pretend for a moment that there were no trust fund. What would happen in 2013? The government would have to raise taxes to continue paying promised benefits. Now, consider what will happen with the trust fund. The government will have to raise taxes to make good on the bonds to continue paying promised benefits.

Either way, young workers can expect to get hit with a big tax increase.

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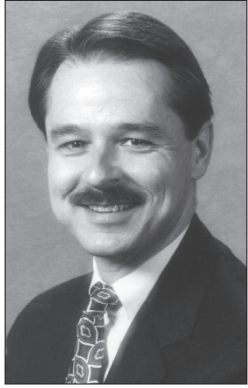
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# Are Libertarians Anti-Government?



For the past several years, especially since the Oklahoma City bombing, the national media have focused a lot of attention on “anti-government” extremists. Libertarians, who are critical of a great deal that government does, have unfortunately but perhaps understandably been tossed into the “anti-government” camp by many journalists.

There are two problems with this identification. The first and most obvious is that many of the so-called anti-government groups are racist or violent or both,

and being identified with them verges on libel.

The second and ultimately more important problem is that libertarians are not, in any serious sense, “anti-government.” It’s understandable that journalists might refer to people who often criticize both incumbent officeholders and government programs as “anti-government,” but the term is misleading.

A government is a set of institutions through which we adjudicate our disputes, defend our rights, and provide for certain common needs. It derives its authority, at some level and in some way, from the consent of the governed.

Libertarians want people to be able to live peacefully together in civil society. Cooperation is better than coercion. Peaceful coexistence and voluntary cooperation require an institution to protect us from outside threats, deter or punish criminals, and settle the disputes that will inevitably arise among neighbors—

a government, in short. Thus, to criticize a wide range of the activities undertaken by federal and state governments—from Social Security to drug prohibition to out-of-control taxation—is not to be “anti-government.” It is simply to insist that what we want is a limited government that attends to its necessary and proper functions.

But if libertarians are not “anti-government,” then how do we describe the kind of government that libertarians support? One formulation found in the media is that “libertarians support weak government.” That has a certain appeal. But consider a prominent case of “weak government.” Numerous reports have told us recently about the weakness of the Russian government. Not only does it have trouble raising taxes and paying its still numerous employees, it has trouble deterring or punishing criminals. It is in fact too weak to carry out its legitimate functions. The Russian government is a failure on two counts: it is massive, clumsy, overextended, and virtually unconstrained in scope, yet too weak to perform its essential job. (Residents of many American cities may find that description a bit too close for comfort.)

Not “weak government,” then. How about “small government”?

Lots of people, including many libertarians, like that phrase to describe libertarian views. And it has a certain plausibility. We rail against “big government,” so we must prefer small government, or “less government.” Of course, we wouldn’t want a government too small to deter military threats or apprehend criminals. And *Washington Post* columnist E. J. Dionne, Jr., offers us this comparison: “a dictatorship in which the government provides no social security, health, welfare or pension programs of any kind” and “levies relatively low taxes that go almost entirely toward the support of large military and secret police forces that regularly kill or jail people for their political or religious views” or “a democracy with open elections and full freedom of speech and religion [which] levies higher taxes than the dictatorship to support an extensive welfare state.”

“The first country might technically have a ‘smaller government,’” Dionne writes, “but it undoubtedly is *not* a free society. The second country would have a ‘bigger government,’ but it *is* indeed a free society.”

Now there are several problems with this comparison, not least Dionne’s apparent view that high taxes don’t limit the freedom

of those forced to pay them. But our concern here is the term “smaller government.” Measured as a percentage of GDP or by the number of employees, the second government may well be larger than the first. Measured by its power and control over individuals and society, however, the first government is doubtless larger. Thus, as long as the term is properly understood, it’s reasonable for libertarians to endorse “smaller government.” But Dionne’s criticism should remind us that the term may not be well understood.

So if we’re not anti-government, and not really for weak or small government,

how should we describe the libertarian position? To answer that question, we need to go back to the Declaration of Independence and the Constitution. Libertarians generally support a government formed by the consent of the governed and designed to achieve certain limited purposes. Both the form of government and the limits on its powers should be specified in a constitution, and the challenge in any society is to keep government constrained and limited so that individuals can prosper and solve problems in a free and civil society.

Thus libertarians are not “anti-government.” Libertarians support limited, constitutional government—limited not just in size but, of far greater importance, in the scope of its powers.

**“The challenge is to keep government constrained and limited so that individuals can prosper and solve problems in a free and civil society.”**

—David Boaz

Two new books present the latest arguments

## Social Security Privatization: The Time Is Now

Today the problems faced by Social Security are more apparent than ever," write Peter Ferrara and Michael Tanner in the preface to *A New Deal for Social Security*. "The system's finances are unsustainable. Without major tax hikes it will soon be unable to pay promised benefits. But Social Security taxes are already so high that many young workers will receive a negative rate of return on their taxes. This book provides an alternative. It lays out the political and economic case for transforming Social Security. It provides the details for a new system of retirement—a system based on individual liberty and private capital."

*A New Deal for Social Security* has already drawn much praise. Dorcas R. Hardy, former social security commissioner, calls it "an excellent analysis of how we slid into the looming crisis of bankruptcy facing our Social Security system. One quickly realizes that redesign of the system is imperative, and inclusion of private and personal savings accounts is the only avenue to achieve security in our retirement years. This book is a must read for all baby boomers." And Rep. Mark Sanford (R-S.C.) says, "Michael Tanner and Peter Ferrara clearly explain how Social Security reform can bring all Americans greater retirement security. I have learned a great deal from them, and I strongly recommend this book."

Ferrara, associate policy analyst at the Cato Institute, and Tanner, director of Cato's

Project on Social Security Privatization, provide a short history of Social Security; describe the financial problems the current system faces; show why Social Security is a bad deal for the poor, minorities, women, and families; discuss how privatization would have positive macroeconomic effects; recount the experiences of numerous countries that have successfully privatized their state pension systems; and present a model privatization plan.

The authors' plan, which closely resembles the system Chile implemented in 1981, is based on the following elements. First, current workers would be free to choose either the private option or Social Security. For those who chose the private plan, workers and employees would each pay 5 percent of wages, instead of the current Social Security payroll tax of 6.2 percent for each, into private investment accounts. In addition to supporting retirement benefits, the accounts would finance private life and disability insurance. Second, workers who opted out of the current Social Security system would receive recognition bonds from the federal government that would pay them a proportion of future Social Security benefits equal to the proportion of lifetime taxes they had already paid. Third, benefits promised to current retirees would be paid in full.

Ferrara and Tanner conclude, "We can have a Social Security system that will allow today's young workers to retire with the same dignity that their parents and grandparents



did.

We can have a Social Security system that is financially solvent, without piling more and more taxes on future generations. We can have a Social Security system that will allow the poor to accumulate real wealth and that will increase economic growth. The next step is up to the American people."

*A New Deal for Social Security* can be purchased for \$19.95 (cloth) or \$10.95 (paper) by calling 1-800-767-1241. ■

In *Common Cents, Common Dreams: A Layman's Guide to Social Security Privatization*, Peter Ferrara and Michael Tanner offer a short, readable introduction to the opportunity for Social Security privatization. The book is timed to coincide with the national debate on Social Security reform that President Clinton launched in January.

In this slender book, Ferrara and Tanner lay out the problems with the current system, the successful reforms in Chile and elsewhere, and a realistic plan to transform Social Security into a system of individually capitalized, privately managed retirement accounts. The book makes clear that the Social Security "crisis" will not come in 2030, when the so-called trust fund runs out of money, or even 2012, when the trust fund first begins dipping into general revenues. It is here and now, when 100 mil-

lion Americans are forced to put 12.4 percent of their wages into a retirement plan in which money is not saved or invested and does not belong to them.

The initial print run for *Common Cents, Common Dreams* is 50,000, and copies are being made available at steep quantity discounts to individuals and groups around the country working for full privatization of Social Security. Individual copies are \$4.95.



*Levy and Glassman v. Nader and Love on Microsoft*

# Trade, Free Speech, Economic Liberty

◆**April 2:** The legal doctrine of pervasiveness justifies censorship of certain media, such as television and radio, on grounds that they invade our homes and private lives. But is such a justification for censorship reasonable? And if it is, should it apply to the Internet as well? Four panelists considered those questions at a Policy Forum, “**The Internet Invasion? A Debate about the Pervasiveness of Internet Speech.**” Jonathan D. Wallace, coauthor of *Sex, Laws, and Cyberspace* and author of a recent Cato study on the pervasiveness doctrine, said that individuals invite the media into their homes. Tom W. Bell of the Cato Institute maintained that, like welfare programs, the pervasiveness doctrine encourages individuals to depend on the federal government to handle their responsibilities, parental and otherwise. Bruce Watson of Enough Is Enough and Karen Jo Gounaud of Family Friendly Libraries argued that parents cannot adequately monitor what their children watch and hear.

◆**April 3:** With Belgrade’s recent crackdown on ethnic Albanians in the Serbian province of Kosovo, NATO is considering taking over the UN border operation in neighboring Macedonia and deploying a “protective” force in northern Albania. At a Policy Forum on “**Kosovo: The Next Balkan Intervention?**” George Kenney, a former U.S. Department of State official in the European Bureau, argued that Western powers should

allow Kosovo to emerge as an independent state or merge with Albania, as it naturally would without intervention. Alex Dragnich of Vanderbilt University spelled out the history of the Kosovo conflict. Jonathan Landy of the *Christian Science Monitor* urged the United States to take a more interventionist approach.

◆**April 6:** The Cato Institute and the Keidanren sponsored “**Deregulation in the Global Marketplace: Challenges for Japan and the United States in the 21st Century,**” a day-long conference on how Japan and the United States can introduce liberal political and economic policies. Among the speakers were Murray Weidenbaum, former chairman of the Council of Economic Advisers; Kazuo Kukazawa, senior managing director of the Keidanren; George Melloan of the *Wall Street Journal*; Kensuke Koga, chairman of Nisshin Steel Co., Ltd.; Jesper Koll of J. P. Morgan Securities Asia; and Cato’s William A. Niskanen, Brink Lindsey, and José Piñera. The following day, Cato, the Japan Center for Economic Research, and *The Economist* hosted a luncheon event on the demographic problems that the Japanese and American public pension systems face.

◆**April 13:** The Cato Institute hosted “**Revisiting Slaughterhouse—To Put the Fourteenth Amendment Back on Course,**” a Policy Forum to discuss whether the

infamous *Slaughterhouse* cases had been decided correctly 125 years ago. Roger Pilon, director of the Cato Institute’s Center for Constitutional Studies, and William H. Mellor, president and general counsel of the Institute for Justice, said that the Supreme Court reached the wrong decision in *Slaughterhouse*. They maintained that the Privileges or Immunities Clause of the Fourteenth Amendment needs to be reinvigorated to protect citizens from oppressive legislation by local governments. Mark Tushnet of the Georgetown University Law Center agreed that *Slaughterhouse* was probably wrongly decided but was wary of judicial action that would strike down local laws approved by a majority of the populace. Gregory E. Maggs of the George Washington University School of Law said that it is unclear whether the Court reached the right conclusion in *Slaughterhouse* and thus contended that the decision should not be overturned.

◆**April 14:** Charles Adams, an adjunct scholar of the Cato Institute, discussed his book *Those Dirty, Rotten Taxes: The Tax Revolts That Built America* at a Book Forum. Adams recounted the intellectual and tactical reasons why Americans were able to mount several successful tax revolts in the 18th and 19th centuries and considered the prospects for current anti-tax movements. Commenting on the book was Shelley L. Davis, former

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**Ian Vásquez welcomes House Majority Leader Dick Arney and economist Charles Calomiris to a Cato Policy Forum on proposals to expand the IMF's resources by \$18 billion.**



**The Reverend Robert A. Sirico of the Acton Institute on Religion and Liberty criticizes those Christian activists who call for trade sanctions on countries that violate human rights.**



**Washington Post columnist James Glassman asks Ralph Nader why Microsoft should be prevented from selling its products to willing buyers.**

historian of the Internal Revenue Service and author of *Unbridled Power: Inside the Secret Culture of the IRS*.

◆**April 16:** At a Capitol Hill Policy Forum titled “Road to Hell: Problems with the Highway Bill,” Edward Hudgins of the Cato Institute, Liz Tobias of Citizens for a Sound Economy, Ronald Utt of the Heritage Foundation, John Berthoud of the National Taxpayers Union, Fred Smith of the Competitive Enterprise Institute, Thomas Schatz of Citizens Against Government Waste, and James Lucier Jr. of Americans for Tax Reform said that the bill would waste

billions of dollars on pork-barrel projects, bust the budget, keep taxes high, and actually create more traffic jams.

◆**April 20:** At “Antitrust Goes High Tech: The War against Microsoft,” a Cato Institute Policy Forum, Robert A. Levy, senior fellow in constitutional studies at the Institute, and James K. Glassman, columnist for the *Washington Post*, argued that Microsoft is serving its customers well—offering new and improved products at falling prices—and that federal intervention would be bad for American business and would damage our liberty. Ralph Nader and James P. Love of

the Consumer Project on Technology maintained that Microsoft wields such tremendous market power that aggressive prosecution under existing antitrust statutes is necessary to keep the computer industry competitive.

◆**April 21:** At a Policy Forum on “The Vulnerable Homeland: Catastrophic Terrorism and U.S. Foreign Policy,” Richard K. Betts, director of national security studies at the Council on Foreign Relations, said that terrorism is the most pressing national security problem that the United States faces. He maintained that biological weapons are the major threat; that U.S. intervention abroad is the principal cause of international terrorism directed at the United States; and that American intelligence agencies should be given more power and resources, even if such a move would infringe upon civil liberties. Ivan Eland, director of defense policy studies at the Cato Institute, agreed that America’s attempts to police the world will likely provoke international terrorism. However, he was wary of anti-terrorist measures that would compromise domestic liberty.

◆**April 29:** Trade lawyers and government officials addressed the question “Will the Sun Ever Set on Antidumping Orders?” at a Policy Forum. The antidumping law, which penalizes imports that have “unfairly” low prices, is a major protectionist barrier. The United States is now preparing to conduct sunset reviews of hundreds of existing orders. Discussing the issues surrounding those reviews were Kenneth Pierce of Willkie Farr & Gallagher, Roger Schagrin of Schagrin Associates, David Oliver of the International Trade Commission, and Bernard Carreau of the Department of Commerce.

◆**April 30:** At a policy forum on “Encryption Intrigue on the International Stage,” David Banisar of the Electronic Privacy Information Center described the worldwide trend toward less regulation of strong encryption—and the exceptions, generally countries like Russia and France, known for widespread use of electronic surveillance. Patrick Ball of the American Association for the Advancement of Science described how police access to decryption keys would endanger human rights workers worldwide.

◆**May 6:** Many critics of capitalism, on both the left and the right, deplore the effect of

*Continued on page 6*

markets on art and culture. At a Policy Forum on “**Art, the Market, and the Case for Cultural Optimism**,” economist Tyler Cowen of George Mason University, author of *In Praise of Commercial Culture*, argued that competitive markets and wealth creation support the arts in a variety of ways and also that there are many reasons for optimism about the quality of art and culture now and in the future. David Brooks, senior editor of the *Weekly Standard*, offered a more cautious view of the prospects for culture in commercial society.

◆ **May 7:** John Miller discussed the theme of his book *The Unmaking of Americans* at a Cato Institute Policy Forum. Miller contends that the Americanization process, which has successfully assimilated tens of millions of immigrants in this century, is under assault. Miller believes that government programs such as bilingual education, welfare assistance, racial preferences, and multiculturalism in the schools are undermining the traditional assimilation ethic. He also fears that those institutions are flaming the public’s hostility to immigration in general—which Miller views as a positive force for America. Cecilia Munoz, political director of the National Council of La Raza, maintained that Miller’s concerns are overblown and that most objective measures show that contemporary immigrants are doing well, both socially and economically, in the United States.

◆ **May 8:** At a Policy Forum titled “**Should We Open the Door for High-Skilled Immigrants?**” Stuart Anderson, a former policy director at Cato and now research director for Sen. Spencer Abraham (R-Mich.), spoke in favor of raising the visa quota for foreign-born, high-technology workers. Bruce Josten of the U.S. Chamber of Commerce said that, without an open immigration policy, the U.S. economy will lose its flexibility to create cutting-edge technology. Vin O’Neill of the Institute of Electrical and Electronic Engineers opposed raising the quota, arguing that the emphasis should be on training American workers.

◆ **May 11:** Razeen Sally of the London School of Economics discussed his forthcoming book, *Classical Liberalism and the International Economic Order*, at a Roundtable Luncheon. Sally noted that the international economy, like a domestic free market, is not the creation of grand human

design but a spontaneous order resulting from individuals and nations adapting to changing market conditions.

◆ **May 12:** Four panel members debated the question, “**Should the United States Pursue a Global Investment Treaty?**” at a Policy Forum organized by Cato’s Center for Trade Policy Studies. William Danvers, Washington representative for the Organization for Economic Cooperation and Development, maintained that the Multilateral Agreement on Investment now being negotiated by members of the OECD would protect investors’ rights and stimulate global capital flows. Stephen Canner of the U.S. International Business Council endorsed the treaty in concept, saying it would create a rule of law for international investment that would bolster recent liberalization. Robert Stumberg of the Georgetown University Law Center warned that the treaty would compromise U.S. sovereignty. Attorney Daniel Price, a former U.S. trade negotiator, said the treaty would not conflict with U.S. legal and constitutional principles.

◆ **May 13:** Zev Golan, associate director of the Institute for Advanced Strategic and Political Studies in Jerusalem, spoke at a Policy Forum titled “**A Tour of the Israeli Economy**.” Golan described the lack of freedom that Israelis experience in virtually every area of their country’s economy, which is dominated by the state and by government-sanctioned monopolies. He explained why liberalization and an end to foreign aid—the single greatest obstacle to economic freedom in Israel—would lead to prosperity and growth in the Jewish homeland.

◆ **May 14:** Controversy has erupted over recent proposals to outlaw technologies that could be used to circumvent copyright protection. At “**Cracking the Copyright Lock: A Debate about Implementing the WIPO Treaty**,” the panelists—Jessica Litman of the Washington College of Law at American University, Emery Simon of the Business Software Alliance, Seth Greenstein of the Home Recording Rights Coalition, and Steve Metalitz of the International Intellectual Property Alliance—debated whether such proposals threaten the fair-use doctrine, technological innovation, and property rights.

◆ **May 19:** From 1945 to 1972, the U.S. government administered the island of Okinawa, regarding it as little more than a convenient forward staging area for U.S.

forces in East Asia. Should the United States reconsider its Cold War era security strategy and withdraw its troops from Okinawa? At a Cato Policy Forum on “**America’s Unfinished Business in Japan: Returning Okinawa to the Okinawans**,” Masahide Ota, the governor of Okinawa, discussed that and other questions.

◆ **May 20:** House Majority Leader Dick Armey and economist Charles Calomiris of Columbia University asked, “**Do We Really Need the IMF?**” at a Cato Institute Policy Forum. Armey challenged the International Monetary Fund’s secrecy and lack of accountability and warned that a larger IMF could further weaken the global financial system. Calomiris, author of an article in the latest *Cato Journal*, explained that the fund is not needed as an international lender of last resort and that it is undermining the natural process of reform in Asia as it has done in Mexico since the 1994 collapse of the peso.

◆ **May 22–25:** At the first session of **Cato University**, held in Princeton, N.J., philosopher David Kelley discussed individualism and individual rights and legal scholar Randy Barnett lectured on justice, the rule of law, and the Constitution. Evening talks were given by David Boaz of Cato, author Charles Murray, and Tom G. Palmer, Cato’s director of special projects and organizer of Cato University.

◆ **May 27:** The Reverend Robert A. Sirico of the Acton Institute for the Study of Religion and Liberty attacked “**The Immorality of Trade Sanctions**” at a Policy Forum. Sirico said government subsidies for exports and foreign investment are immoral because they force taxpayers to underwrite commerce with regimes they may find morally objectionable. He criticized business leaders for ignoring the moral implications of their decisions and blamed leaders of the religious right for failing to weigh the economic consequences of sanctions. Cato senior fellow Doug Bandow advocated private consumer boycotts and the use of the bully pulpit by officials as alternatives to sanctions.

◆ **May 28:** At a Policy Forum, “**Russian Politics: Issues and Flashpoints**,” speakers included John Helmer, Moscow bureau chief for the *Journal of Commerce*; Susan Eisenhower, chairman of the Center for Political and Strategic Studies; and Charles William Maynes, president of the Eurasia Foundation. ■

# Deregulating the Japanese Economy

**O**n April 6 the Cato Institute and the Japanese business association Keidanren cosponsored a conference in Tokyo, “Deregulation in the Global Marketplace: Challenges for Japan and the United States in the 21st Century.” Among the speakers were Cato Institute chairman William A. Niskanen; Jesper Koll, vice president of J. P. Morgan Securities Asia; Brink Lindsey, director of Cato’s Center for Trade Policy Studies; and Alan Reynolds, director of economic research at the Hudson Institute. Following are excerpts from their remarks.



**William A. Niskanen: “We now appear to be at the dawn of a third industrial revolution.”**

**William Niskanen:** The four major challenges that Japan and the United States will face in the next century are technology, trade, demographics, and politics. The one common theme is that individuals, firms, and national economies will prosper to the extent that they regard change as an opportunity, rather than as a threat.

New technology is reaching a broad market much more quickly. In the United States, the time from first demonstration of a new technology to its use by a quarter of the population was 55 years for the automobile, 26 years for television, 13 years for the cellular phone, and 7 years for the Internet.

We now appear to be at the dawn of a third industrial revolution, one based on the dramatic reduction in the cost of storing, retrieving, processing, and transmitting information that is made possible by digital technology.

In the workplace, organizations will become flatter. The Internet and organization-specific intranets will reduce the relative number of middle managers and middle staff positions. For a while, maybe for a generation, the relative earnings and influence of computer-literate employees, often younger employees, will increase. More employees will telecommute more of the time. Organizations will also subcontract tasks, often to other countries, the output of which can be transmitted on-line.

One old rule is even more important: Information is power, for individuals acting alone and for those within an organization. As more information is generated and made available to virtually anyone, inefficiencies and failures are more rapidly exposed,

enhancing the role and influence of performance-based management systems. One of the young sages of this new technology has described this development as “the end of the official story.”

The primary new effect on the marketplace will be to reduce the relative number of agents: travel agents, real estate agents, securities brokers, auto dealers, other retailers, and so forth. Sellers will find new ways of communicating with potential buyers without someone acting as liaison. Consumers will find new ways of shopping, such as scanning the options on-line and then asking for bids to sell a specific new model car. That will lead to lower and more uniform prices, by reducing both selling costs and inventories. The elimination of any significant distance effect on the costs of communication, of course, will accelerate the globalization of commerce.

The home, in contrast to the firm, will be *less* specialized, serving as the locus of many different activities formerly conducted in different locations. More adults will work at home; more students will study at home, with access to superior on-line instruction and libraries; a wider variety of entertainment will be available in the home. People will also have more choice of *when* they want to participate in such activities.

George Orwell’s vision of the political effects of electronic technology, of course, was most ominous. Orwell feared that the ubiquitous telescreen would greatly increase the power of the state to monitor and control individual behavior. So far, fortunately,

Orwell’s fears have not been realized. The essential feature of government is its monopoly of the legal right of coercion in some defined space. Yet the obvious and dominant political effect of digital technology, because it reduces the economic role of space, is to reduce the monopoly power of government to tax and to regulate.

Politics will present a continuing major challenge for capitalism. The success of any economic system will depend on low marginal tax rates, limited and transparent regulation, a stable monetary framework, and a nondiscriminatory legal framework. Capitalism, however, is especially dependent on an effective agent to protect capital against both internal and external predators, and government is usually the most efficient such agent. The historical challenge has been to ensure that government does not use its power to become the dominant predator.

For most of human history, of course, the government *was* the dominant local predator, using tribute to build pyramids, palaces, and empires. Markets and private property were tolerated only to the extent that they increased the net returns to the government. Many governments in Africa are best described as “kleptocracies” even today.

Over the past several centuries, however, most governments have become increasingly responsive to the consent of the governed—a development, even if subject to occasional abuse or reversal, that we should welcome. A broader franchise has increased the number of people who share the net benefits of government but, by itself, has not much reduced the magnitude of coercive redistribution. The key difference between an exploitive majoritarianism and a just democracy is that in the latter the rules by which the government operates—the constitution—reflect a much broader and more stable consensus.

In the modern world, unfortunately, both capitalism and constitutional government are undermined by using the powers of government to serve special interests. Firms and industries that seek special favors are part of the problem—they encourage other firms to seek similar favors, corrupt the political process, and undermine political support for capitalism.

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## “About one-third of Japan’s financial companies will not exist in their current equity ownership form in three to five years.”

**JAPAN** *Continued from page 7*

In this sense, every firm that seeks a special favor creates a public bad. The larger problem, however, is the welfare state, a consequence less of the avarice of governmental officials than of being overly generous with other people’s money, time, patience, and goodwill. Any one firm is torn between playing the game to gain a special favor and supporting a principle to preserve the system. That is why it is especially important for broad-based business organizations like the Keidanren to maintain their support for the principles that preserve capitalism and constitutional government.



**Jesper Koll:** “For the first time, economics is coming to Japan.”

**Jesper Koll:** The Big Bang—the large-scale financial deregulation that is just getting under way—is part of a tremendous restructuring of Japan’s entire economic system. For the first time, economics is coming to Japan.

What is economics? Economics is the allocation of scarce resources. In Japan until 1990, there were never any real scarcities. Your labor force was growing, your land prices were going up, your economy was growing at 5 to 7 percent on a nominal basis. That has come to an end, and as a result Japan is forced to restructure its entire economic system. First, look at the rate of return on capital in the business sector, that is, the efficiency with which the economic system allocates capital for productive purposes. Japan has fallen behind even the European Community, and of course behind the United States. I think it is the realization that Japan *could* become a second- or third-rate

power in the 21st century that is unleashing a demand for policy change in the business community.

Another element in the rethinking is the pension crisis. Japanese society is aging very fast. The pension crisis is not a problem of the future; it is a problem now. Since 1991 pension fund returns have fallen short of obligations. And as a result of that shortfall, Japanese pension managers have had to sell assets.

One other element is very important. The Japanese government is earning a higher return on financial assets than is the household sector. That is happening because the public sector’s role in the financial system has been getting bigger and bigger. One-third of financial intermediation is being done by the public sector. And as a result, the postal savings system actually generates higher returns than average investors can get. That situation is starting to generate tremendous political pressure.

Another real concern is the fact that Japan’s economy is going to slow down. At J. P. Morgan, we expect that the average growth rate over the next decade is going to be around 1.5 percent, at best. Why is it slowing down? The answer has to do with the factors of production—labor, capital, and land. In Japan the fundamental factor of production, labor, is actually starting to decline. The labor force grew annually by 1 percent on average in the 1980s, but from now on it will contract by half a percent. So there is a natural reduction in the rate of growth. Japan now is the only G-7 country that has net emigration. It’s a brain drain from Japan, and the impact on growth is, of course, negative.

Look at the second factor of production, capital—not money, but the capital stock. How much capital does Japan need to generate one unit of gross domestic product? At the time of the first oil shock, Japan needed one unit of capital to produce one unit of growth. Today Japan needs 1.8 units of capital for one unit of growth. Your country is very capital intensive already. So, as a result, the policymakers are trying to come up with a new paradigm of growth that would foster new investment opportunities through deregulation. Deregulation over the next decade will add between 5 and 7 percent to Japan’s potential GDP. However, at first



**Brink Lindsey:** “When it comes to U.S. demands on Japan, three out of five right is good.”

the impact will be negative: the inefficient producers will have to go, and only then will we see a recovery.

And that is exactly what Big Bang is doing. Big Bang will bring about new producers and a new economic recovery in Japan. The old way of moving savings into investments was directly through straight deposits and loans or indirectly through mutual funds, insurance companies, pension funds. Big Bang opens up all the doors of competition. There is free entry for banking, insurance, and brokerage companies. The destruction of the old cartels in the financial service industry is what Big Bang is all about.

That will create a lot of failures. At J. P. Morgan, we think that about one-third of Japan’s financial companies will not exist in their current equity ownership form in three to five years. There will be mergers, foreign takeovers, and bankruptcies. At the same time, with deregulation a new mode of intermediation and disintermediation is being opened up. New companies that provide specialized financial services are going to spring up, and that will generate employment. Let me use an American example: between 1989 and 1993, one-third of American banks closed down. However, at the same time, the financial system as a whole generated 2 million new jobs. And that is the opportunity that Big Bang is going to provide the Japanese economy.

**Brink Lindsey:** In the 1970s and 1980s, a series of large and prominent U.S. industries found themselves under competitive assault by Japanese companies. Those industries

## “The Japan, Inc., system of political economy was much better suited to playing catch-up than it was to fostering growth at the cutting edge.”

included consumer electronics, automobiles, and semiconductors. At the same time, Japan as a whole was growing and advancing much faster than the United States, and extrapolation suggested that it would soon overtake the United States as the world's leading economic power. Finally, it was clear that Japan's economic system was significantly different from the American model. The differences included the close and informal ties between industry and government, stable cross-shareholding, and heavy reliance on relationship-based bank financing rather than impatient capital markets, *keiretsu* alliances with suppliers and distributors, and lifetime employment arrangements.

Many influential U.S. observers fundamentally misinterpreted the situation. They concluded that the Japanese system of political economy, widely known as “Japan, Inc.,” was superior to the American system; that Japan, Inc. was fundamentally protectionist and predatory; and that a sharp deviation from the normal liberal trading rules was therefore necessary to avoid worldwide economic domination by Japan. In particular, they argued for high tariffs or restrictive quotas on Japanese imports, and for explicit market-share commitments for foreign products in the Japanese market—in other words, managed trade or results-based trade.

If the so-called revisionists were wrong, what then was really happening? First, Japanese companies had developed new and superior manufacturing techniques, including such innovations as continuous improvement and just-in-time inventory. Those innovations were sufficiently important that they distinguished a new system of so-called lean production from traditional mass production. Armed with superior techniques, Japanese companies did indeed pose a formidable competitive challenge in selected industries, although certainly not across the board.

Second, Japan as a whole was experiencing continuing high growth and rapid advancement because it was playing technological catch-up with the West. It is much easier to grow and improve productivity quickly when you are adopting and adapting technologies invented elsewhere than it is when you have to develop those new technologies yourself.

And market forces, not interventionist

trade policies, were ultimately responsible for making the dire predictions of an unstoppable Japanese juggernaut look foolish in retrospect. First, with often-painful restructuring, U.S. companies adopted the new lean production manufacturing techniques and regained their competitiveness. At the same time, Japan's economic performance naturally slowed as the country reached the technological frontier. The limits of industrial policy were revealed, as such fiascos as the Fifth Generation Computer Project and the HDTV initiative showed.

Indeed, it turned out that the Japan, Inc. system of political economy was much better suited to playing catch-up than it was to fostering growth at the cutting edge. In particular, the clubby, relationship-based system of allocating capital now looks dread-



**Alan Reynolds:** “Japan is now more hostile to capital than is the United States.”

fully wasteful and inefficient.

The stereotype of Japan as a closed market remains, but the stakes have gotten dramatically lower. Gaining access to the Japanese markets continues to be important for particular companies, but there is no longer a widely held perception that we as a nation are threatened by Japan.

Today, criticism of Japan focuses on its failure to stimulate domestic economic growth that would absorb exports from the other ailing economies of the region. Beyond the complaint that “Japan is not bearing the burden of leadership”—as if pulling itself out of stagnation should be seen as a burden—there is the fear that the financial collapse of Japan

could precipitate a global economic downturn.

Those new complaints about Japan, Inc. have implications very different from those of the complaints that dominated the 1980s. Most prominently, the United States is no longer pushing for deviations from free-trade principles: there are no serious calls for import restrictions, the demands for market-share targets have little steam, and there is no significant support for further currency manipulations.

Instead, the main U.S. proposals today are for Japan to cut taxes, boost spending, clean up the banking mess, deregulate the financial sector, and enforce the Antimonopoly Act more vigorously. Of those five reform proposals, only two are bad ideas. Keynesian public works spending has been tried on a massive scale over the past decade, and it has been a total failure. Most of the money has been utterly wasted, and all there is to show for the spending is a ballooning public debt. Increased antimonopoly enforcement is a blind alley. U.S. complaints are aimed at undermining *keiretsu* ties with suppliers and distributors, but government second-guessing of those arrangements is a quagmire where it is much easier to do harm than good.

Still, three of the items on the U.S. wish list—cutting taxes, resolving the bad debt crisis, and liberating the financial sector—are good ideas. When it comes to U.S. demands on Japan, three out of five right is an unusually good score.

**Alan Reynolds:** American economists have been giving policy advice to Japan since the Shoup Tax Reform Commission of 1949. Even then, the advice was not always helpful.

Rather than rely too heavily on economic theory, or on foreign advice, it is often useful for a country to reexamine its own history (and that of its neighbors) to see which policies were followed by prosperity and which were not.

In the late 1940s, the American occupation imposed brutal income tax rates on Japan, as high as 86 percent on income above 5 million yen. That was a central part of a severe austerity program, *not* a plan to

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# “Privitizing Social Security will make every worker an investor.”

**MYTHS** *Continued from page 1*

## **Myth 3: Your Social Security Taxes Are Being Saved for Your Retirement**

Social Security is a pay-as-you-go program. The money that you pay in taxes today is not saved or invested for you in any way; it is immediately paid out in benefits to today's retirees. You have to hope that when you retire there is another generation of workers to pay the taxes that will fund your benefits. Unfortunately, because we are living longer and having fewer children, there are going to be fewer and fewer workers to pay taxes and more and more retirees collecting benefits. In 1950 there were 16 workers paying taxes for every person collecting benefits. Today there are just 3.3; by 2025 there will be only 2.

## **Myth 4: Social Security Is a Good Deal for Today's Workers**

Even if there were no reduction in benefits or increase in taxes—an impossibility given Social Security's looming financing shortfalls—Social Security is an extremely bad investment for most young workers. In fact, according to a study by the nonpartisan Tax Foundation, most young workers will actually receive a negative return on their Social Security taxes—they will get less in benefits than they paid in taxes. Some studies indicate that a 30-year-old two-earner couple with average income will lose as much as \$173,500.

That actual loss does not even consider the opportunity cost, what workers might have earned if they had been able to invest their taxes in real assets that yield a positive return. In fact, a study by financial analyst William Shipman demonstrates that, if a 25-year-old worker were able to privately invest the money he or she currently pays in Social Security taxes, the worker would receive retirement benefits three to six times higher than under Social Security.

That is one more reason why Social Security reform can't be put off. Social Security is not just a bad deal when the program becomes insolvent in 2013. It is a bad deal today. Working Americans are losing money every day that they are forced to continue putting their money into a system that will cost them a substantial portion of their potential retirement income.

## **Myth 5: Well, at Least Social Security Helps the Poor**

The low-income elderly are much more likely than their wealthy counterparts to be dependent on Social Security benefits for most or all of their retirement income. In fact, the poorest 20 percent of the elderly receive more than 81 percent of their retirement income from Social Security. Clearly, raising the rate of return through privatization will help people with no income except Social Security.

In contrast, increasing payroll taxes to keep Social Security solvent would badly hurt the poor. The payroll tax is one of the most regressive of all taxes, a tax on wages. Seventy-one percent of Americans already pay more in payroll taxes than in federal income taxes. They can hardly afford the 50 percent increase in payroll taxes required to keep Social Security afloat.

In addition, the progressivity of Social Security is undermined by differences in life expectancy. Because the wealthy generally live longer than the poor, they receive more total Social Security payments over the course of their lifetimes.

A February 1996 study by the RAND Corporation concluded that, because of differences in life expectancy, Social Security actually transferred wealth from the poor to the rich. The RAND study also concluded that the current benefit structure disadvantages African-Americans, who have lower life expectancies and marriage rates. According to the study, whites consistently earn higher rates of return than blacks. In fact, on a lifetime basis, the income transfer from blacks to whites is as much as \$10,000 per person.

In a privatized system, an individual's benefits would not be dependent on life expectancy. Individuals would have a property right in their savings. Any benefits remaining at their deaths would become part of their estates, inherited by their heirs.

Privatizing Social Security would help the poor in another way, too. Today, after paying for the necessities of life and being forced to contribute 12.4 percent of their income to Social Security, few poor people have the opportunity to invest. But privatizing Social Security will make every worker an investor. The old distinction between capital and labor will come crashing down as every truck driver, waitress, and lathe oper-

ator becomes a capitalist, a stockholder. Sam Beard, a former aide to Sen. Robert Kennedy, calls this process the “democratization of capital” and points out that privatizing Social Security will give every American a real stake in our economic future. Beard also notes that the benefits are psychological as well as tangible. “Personal participation will make savings and economic education part of everyone's day-to-day experience. . . . The benefits of this knowledge for individuals and families will include increased economic capability, a confident sense of the future, and more power to make fundamental choices that effect their lives.”

José Piñera, architect of Chile's successful privatization of its government-run pension system, explains that those types of changes took place in his country:

The new pension system gives Chileans a personal stake in the economy. A typical Chilean worker is not indifferent to the stock market or interest rates. When workers feel that they own a part of the country, not through party bosses or a Politburo, they are much more attached to the free market and a free society.

The same worker empowerment is possible through privatization of Social Security in this country.

## **Myth 6: There Is a Legal Right to Social Security Benefits**

The fact that you paid Social Security taxes all those years doesn't mean that you have any right to Social Security benefits. The Supreme Court has ruled, in the case of *Nestor v. Fleming* (1960), that individuals have no right to Social Security benefits based on the taxes they've paid. Congress and the president can change or reduce Social Security benefits any time they choose. For example, Congress is currently debating whether to adjust the way the consumer price index (CPI) is calculated. If Congress were to adopt the proposal of the Boskin commission to reduce the CPI by 1.1 percent, the average Social Security recipient would lose \$5,000 in lifetime benefits. Other suggested changes to Social Security, such as raising the retirement age or means testing, would also reduce benefits. And we should not forget that many

## “The political risk of staying in Social Security far exceeds the market risk of private investment.”

Social Security benefits are simply taxed away today, a case of the government giving with one hand and taking away with the other. Increasing payroll taxes—as has already been done 38 times since the system’s inception—produces similar results.

### Myth 7: Social Security Can Be Fixed with a Few Minor Reforms

Defenders of the current Social Security system suggest that it can be fixed with only minor tinkering—tax increases or benefit cuts. But Social Security’s unfunded liabilities are truly staggering—more than \$9.5 trillion according to Alan Greenspan. Paying all the promised benefits, under the government’s relatively benign intermediate assumptions, would require nearly a 50 percent increase in Social Security taxes, from 12.4 percent to 18.3 percent. That would be by far the largest tax hike in U.S. history.

### Myth 8: The Market Is Risky; Social Security Is Safe

“Privatizing Social Security is too risky,” warn critics of reforming the retirement program. “You just can’t trust the stock market.” But that seriously misstates both the risks of privatization and those of remaining with the current Social Security system.

Are stocks really risky? In any given year, stocks can go up, but they can also go down. For the last several years the stock market has been riding a wave of expansion. Undoubtedly, there will eventually come a correction. But the year-to-year fluctuations of the market are actually irrelevant. What really counts is the long-term trend of the market over a person’s entire working lifetime, in most cases 45 years. Given that long-term perspective, there is no time at which the average investor would have lost money by investing in the U.S. stock market. In fact, taking just 20 years of stock market returns, the worst period in U.S. history, including even the 1929 crash and the Great Depression, produced a positive real return of more than 3 percent. The average 20-year real rate of return has been 10.5 percent.

By comparison, relying on the current Social Security system is extremely risky. Because Social Security is at its core a political system, future benefits are dependent on political decisions. A young worker entering

the Social Security system is gambling on what a Congress and president 45 years from now will decide to do. Given the system’s \$9.5 trillion unfunded liability, and the inevitable tax hikes and benefit cuts to come, the political risk of staying in Social Security far exceeds the market risk of private investment.

### Myth 9: The Transition to a Privatized System Would Be Too Expensive

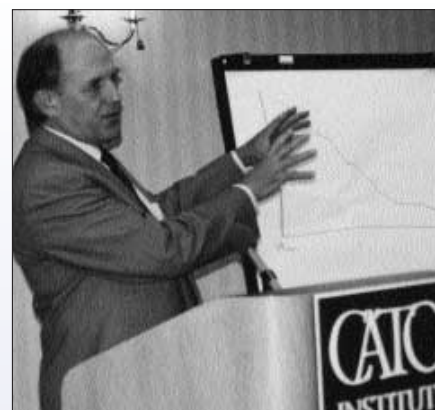
The most difficult issue associated with any proposed privatization of Social Security is the transition. Put quite simply, regardless of what system we choose for the future, we have a moral obligation to continue benefits to today’s recipients. But if current workers divert their payroll taxes to a private system, those taxes will no longer be available to pay benefits. The government will have to find a new source of funds. But that cost must be looked at in light of Social Security’s current unfunded liabilities. Privatizing Social Security will actually reduce the total debt we owe.

Of course, there will be a temporary cash flow problem while we make the transition. We will have to find the revenues to pay benefits to current retirees. While any financing mechanism will be political—involving some combination of debt, transfers from general revenues, asset sales, and the like—the expected budget surplus offers a good place to start. If both parties are willing to forgo new spending programs and junk tax cuts, we can begin the transition to a new, improved Social Security system.

### Myth 10: Social Security Is Politically Untouchable

Former house speaker Tip O’Neill reputedly described Social Security as the “third rail” of American politics—touch it and your political career dies. However, that no longer appears to be true. Polls now show that substantial majorities of the American people support privatization. Indeed, a 1996 poll conducted for the Cato Institute found that two-thirds of voters preferred the opportunity to privately invest their Social Security taxes.

As on so many other issues, the public is out ahead of the politicians. What is needed now are politicians with the courage to demand real Social Security reform. ■



Cato University guest lecturer Charles Murray, author of *What It Means to Be a Libertarian*, challenges the audience to find the point on a trendline at which government intervention occurred; in most cases, he said, government programs accomplish nothing measurable.



About 40 people gathered at the first Cato University seminar, held in Princeton, N.J., over Memorial Day weekend. Philosopher David Kelley (above), author of the forthcoming Cato book *A Life of One's Own: Individual Rights and the Welfare State*, lectured on individualism, natural rights, and welfare rights. Also on the faculty was legal scholar Randy Barnett, author of *The Structure of Liberty*. Barnett and Kelley will lecture again in San Francisco over Columbus Day weekend.

*Silicon Valley renounces corporate welfare*

# Kyoto Treaty ‘Will Have No Discernible Effect’

Last December’s Kyoto agreement, under which the United States would reduce emissions of greenhouse gases by 7 percent below 1990 levels, will “reduce mean planetary warming by a mere 0.19 degree Celsius over the next 50 years,” according to a new study from the Cato Institute. In “The Consequences of Kyoto” (Policy Analysis no. 307), climatologist Patrick J. Michaels finds that “the Kyoto Protocol will have no discernible effect on global climate—in fact, it is doubtful that the current network of surface thermometers could distinguish a change on the order of 0.19 degree from normal year-to-year variations.” Moreover, Michaels, a professor of environmental sciences at the University of Virginia and senior fellow in environmental studies at the Cato Institute, points out, “Since 1986 the mean temperature of the earth has shown no significant warming, despite popular perceptions to the contrary.”

## ◆Overextended Foreign Policy Puts the United States in Danger of Terrorism

“Even the weakest terrorist group can cause massive destruction in the homeland of a superpower,” warns a new study from the Cato Institute. Advances in technology have made it relatively easy for terrorists to acquire or create biological, chemical, and nuclear weaponry. In “Protecting the Homeland: The Best Defense Is to Give No Offense” (Policy Analysis no. 306), Cato’s director of defense policy studies Ivan Eland argues that “the only viable way to reduce the very real threat of such an attack is to reduce U.S. interference in the disputes and conflicts of other nations. Military intervention should be confined to the rare instances in which American vital interests are at stake.”

## ◆Paychecks Conceal Taxes

In “The Hidden Burden of Taxation: How the Government Reduces Take-Home Pay” (Policy Analysis no. 302), Cato fiscal policy analyst Dean Stansel notes that there is a growing “tax wedge” between what employers pay and what their employees receive. Instead of being able to give workers extra compensation, employers are forced to pay the employer share of the payroll tax, unemployment insurance taxes, worker’s

compensation, and the skyrocketing cost of complying with government regulations and “our hopelessly complex tax code.” Nearly half of those costs are hidden so that they are not easily identifiable by the average worker. Stansel reveals that the average manufacturing worker has nearly 30 percent of his or her income taken in taxes and that a worker making \$60,000 per year has 36 percent of his or her income taken.

## ◆Regulation Should Be Handled Privately

“The federal government should consider transferring regulatory functions such as certification, inspection, monitoring, and product testing to independent third parties,” writes Yesim Yilmaz, a doctoral candidate at George Mason University. Often overlooked is the fact that “much regulation in the American economy is private, produced and enforced by independent parties or trade associations.” In “Private Regulation: A Real Alternative for Regulatory Reform” (Policy Analysis no. 303), Yilmaz points to the success of such private regulatory systems as Underwriters Laboratories, Standard & Poor’s, and the kosher food industry. Shifting regulatory roles now assigned to government to independent agencies would “eliminate the existing command-and-control system and replace it with a flexible, responsive, and evolutionary process,” she argues.

## ◆Utilities Privatization Plans Don’t Go Far Enough

“Virtually all industry observers” are convinced “that the business of generating electricity is largely competitive and that major reforms are now necessary,” but the centerpiece of proposed regulatory changes is fundamentally flawed, according to Clyde Wayne Crews Jr., a fellow in regulatory studies at the Competitive Enterprise Institute. In “Electric Avenues: Why ‘Open Access’ Can’t Compete” (Policy Analysis no. 301), Crews says that “the most popular reform idea is to force the utility companies to turn their wires into something akin to public streets. Any power generator would have a right to use the utilities’ wires (known in the trade as the ‘grid’) to deliver electricity to its consumers. Public utilities would, for the most part, be confined to the role of delivering power produced by someone else.

... That idea, variously termed ‘mandatory open access,’ ‘customer choice,’ or ‘retail wheeling,’ has become synonymous with electricity deregulation.” The intentions are good, but the concept is flawed. Mandatory open access violates the property rights of electric utilities, dampens incentives to innovate, promises years of litigation, and imposes a complicated scheme of “managed competition” on an industry that should be freed of regulatory micromanagement, Crews argues. He concludes that “the principles that should guide the restructuring of the electricity industry are the sanctity of the property rights of both producers and consumers and the integrity of the market that emerges from those property rights. Producers should have an unfettered right to sell to anyone, and consumers should have the right to buy from anyone, but neither has the right to use the resources of others without consent.”

## ◆We Owe the UN Nothing

“Claims that the United States owes the United Nations more than \$1 billion are false,” writes Cliff Kincaid. “Even the notion that the United States owes money in the sense of moral obligation is fallacious. It ignores the military and other assistance that the Clinton administration has provided the UN and for which the United States has not been properly credited or reimbursed. Over the past five years, that assistance has amounted to at least \$11 billion, and perhaps as much as \$15 billion.” In “The United Nations Debt: Who Owes Whom?” (Policy Analysis no. 304), author and journalist Kincaid also points out that the United Nations cannot legally compel payments from any nation.

## ◆Medicare: Fundamental Reform Needed

Cato associate policy analyst Peter Ferrara argues that “Medicare’s problems remain deep and intractable. Even after the 1997 reforms, by the time today’s young workers retire, Medicare’s current sources of funding will likely be sufficient to finance only 50 percent or less of the promised benefits.” In “The Next Steps for Medicare Reform” (Policy Analysis no. 305), Ferrara concludes that Medicare cannot survive without fundamental systemic reform. Otherwise,

“U.S. politics over the next two generations will be dominated by battles over draconian tax increases or draconian benefit cuts for Medicare.” Ultimately, he argues, successful Medicare reform must take advantage of “the efficiencies, incentives, competition, and productivity of the private sector.”

#### ◆T. J. Rodgers Rejects Corporate Welfare

Corporate welfare programs worth \$65 billion a year “harm U.S. industry in general and Silicon Valley in particular,” according to Cypress Semiconductors CEO T. J. Rodgers in a new Cato Institute study. The appendix to the paper is a “Declaration of Independence” from corporate subsidies, signed by Rodgers and 78 other top executives of Silicon Valley high-tech firms. In “Silicon Valley versus Corporate Welfare” (Cato Briefing Paper no. 37), Rodgers argues that “technology subsidies to corporations are sold using technobabble to camouflage unjustifiable investments, which typically fall into four categories: subsidizing the rich, competing unfairly with private industry, spending that provides no benefit, and spending that hurts the intended beneficiary.” Many people claim that American subsidy programs are necessary because Japan and Europe subsidize their corporations, but Rodgers notes that “Japan’s programs have been consistent losers, [and] Western Europe’s socialized economies are among the least healthy on the planet.”

#### ◆Mining Law Needs to Be Tweaked, Not Overhauled

Critics of the 1872 Mining Law, which governs metal mining on federal lands, contend that it is an environmentally destructive giveaway to corporate mining interests. However, in “Two Cheers for the

1872 Mining Law” (Policy Analysis no. 300), a new study from the Cato Institute, Richard Gordon and Peter VanDoren conclude that the 1872 Mining Law needs minor market-oriented reform but not major alterations. Gordon and VanDoren argue that the \$2.50 per acre price to patent mining claims, set by the 1872 law, is not underpricing that serves as corporate welfare. In fact, the purchase of such lands, when adjusted for risk, creates few if any excess profits, because a vast majority of mines are unprofitable. The purchase of mining claims “is best viewed as a lottery. . . . The ticket price paid by the winner tells us nothing about whether the lottery operator should raise or lower



Cato Institute president Edward H. Crane discusses politics and public policy on NPR’s “Talk of the Nation” on April 28.

ticket prices in general.”

#### ◆U.S. Should Withdraw from South Korea

“Washington should begin withdrawing its forces from South Korea and transfer primary responsibility for North-South relations to Seoul,” Cato Institute senior fellow Doug Bandow recommends in “Free Rider: South Korea’s Dual Dependence on America” (Policy Analysis no. 308). “South Korea has matured as a nation, [and] one characteristic of mature countries is that they defend themselves, rather than remain dependent on others,” Bandow says. He points out that “the Republic of Korea’s continuing defense dependence seems to be

leading, in turn, to economic dependence” on the United States. “The reality is that the ROK has only modest strategic value to the United States, [and] letting manpower-rich South Korea take over its own defense would reduce the likelihood of America’s finding itself at war,” Bandow concludes.

#### ◆U.S. Missile Defense System Is Too Large

“Acquiring all the systems in the current theater missile defense program is unnecessary,” according to a new study from the Cato Institute. “The United States should purchase only those systems that support a national security policy of sending U.S. expeditionary forces to foreign theaters only when vital U.S. national security interests are at stake,” and doing so would reduce the cost of the program from an estimated \$47.3 billion to \$17.4 billion, the study finds. In “Theater Missile Defense: A Limited Capability Is Needed” (Policy Analysis no. 309), defense consultant Charles V. Peña argues that “it is no longer reasonable or rational for the United States to maintain forward-deployed forces

throughout the world and provide protection for friends and allies.”

#### ◆Nuclear Submarine Fleet Should Be Reduced

America’s nuclear attack submarine force remains too large, and the Navy’s plan to push ahead with production of new subs is a waste of taxpayer dollars, according to a new study from the Cato Institute. In “Subtract Unneeded Nuclear Attack Submarines from the Fleet” (Foreign Policy Briefing Paper no. 47), Ivan Eland, Cato’s director of defense policy studies, argues that “although the [Navy’s] planned force of 50 submarines is half the size of the force during

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# “Marginal tax rates on capital and human capital are much too high in Japan, sapping entrepreneurial vitality.”

**JAPAN** *Continued from page 9*

promote economic growth. As Edwin Reischauer pointed out at the time, “Steeply graduated income taxes and inheritance taxes have been adopted to prevent in the future the accumulation of . . . concentrations of wealth.” But taxes designed to punish additions to *income* must also punish additions to *output*—economic growth. So Japan set out to free itself from the oppressive occupation tax regime.

From 1950 to 1974, Japan cut taxes *every year* (except 1960), often by greatly increasing the income thresholds at which the higher tax rates applied or by enlarging deductions and exemptions. The taxable income needed to fall into a 60 percent tax bracket was raised to 3 million yen by 1953, for example, compared with only 300,000 yen in 1949. The Shoup Commission’s net worth tax was also abolished in 1953. The sting of high tax rates was further neutralized by exemptions for interest income and capital gains, deductions from corporate and individual taxes on dividends, a deduction for earnings, and various other holes in the tax base, legitimate and otherwise.

Some deductions were far from neutral, and therefore less desirable than lower tax rates would have been. Yet the continual tax reductions from 1950 to 1974 accomplished two things. First, they greatly reduced effective marginal tax rates. Second, they moved the system a long way toward what is sometimes called a “consumed income tax” or “expenditure tax”—that is, a system that taxes income only once, regardless of whether the income is saved or devoted to immediate consumption.

Before 1975 tax policy greatly reduced marginal tax rates and eased the multiple taxation of saved income. Economic growth in Japan averaged 9.6 percent a year from 1952 to 1973.

From 1975 to 1987, “bracket creep” and higher social security taxes reversed much of the previous progress on marginal tax rates. Economic growth slowed to 4.3 percent from 1975 to 1991.

After 1989 tax policy also *reversed* much of the previous progress toward neutral treatment of savings. Tax rates on new capital investments increased (for individual investors).

Economic growth slowed to 1.2 percent from 1992 to 1997. To continue blaming the change on the “oil shocks” of the 1970s, as many do, is no longer plausible. Oil has been very cheap for more than a dozen years.

Before 1985 Japan had much lower tax rates on capital than the did the United States. Since then, the situation has been reversed—*Japan is now more hostile to capital*. Little wonder that Japan’s domestic investment is weak and capital flows out.

It would be wonderful to see Japan embrace some sort of fundamental tax reform, perhaps borrowing ideas from Hong Kong or Singapore, but that might take more time than the present situation will allow.

The essential point is that marginal tax rates on capital and human capital are much too high in Japan, sapping the entrepreneurial vitality of the economy. The highest tax rates do the most damage to the economy in return for the least revenue.

Economic growth requires more and better capital, including human capital. All taxes, including taxes ostensibly levied on corporations, fall on individual suppliers of labor and capital or on consumption. Even consumption taxes are really production taxes. Taxes on a company’s stockholders, workers, and consumers hurt business; and taxes on business hurt stockholders, workers, and consumers. Excessive tax rates on capital hurt labor by reducing investment and therefore slowing the growth of real output and income per hour of work. Demoralizing tax rates on labor likewise hurt capital by raising reservation wages, shortening lifetime work hours, and reducing the intensity and quality of work.

If Japan continues to embrace the tax and spending policies of Europe and Scandinavia, nobody should be surprised if economic performance becomes as disappointing as it has been in those areas. Without more vigorous economic growth, Japan’s future budget problems could become far more difficult. Philosophers are free to debate “equity” all they like. But the serious question to ask about the structure of tax incentives is the question that was at the top of Japan’s list in the 1950s: *How will this tax proposal help economic growth?* An economy that is taxed into oblivion will not help anyone—not the poor, and not even the politicians. ■

**STUDIES** *Continued from page 13*

the Cold War, even that number is much too high.” To justify keeping more submarines than are really needed, “the Navy began assigning 2 vessels to protect each of the 12 aircraft carrier battle groups,” a mission that is “unnecessary and impractical.” Eland concludes that “a foreign policy that used military force sparingly and only as a last resort would allow the United States to reduce the number of submarines required for fighting wars. A smaller fleet of about 25 submarines . . . would be more than sufficient to fight one major theater war” and to serve as “a hedge against the improbable reconstitution of the Russian submarine fleet.” ■

## Cato Calendar

### Cato University Economics and History Seminar

Chicago • Intercontinental Hotel  
September 4–6, 1998

Speakers include Steven Landsburg, Steven Davies, and Nathaniel Branden.

### Cato University Law and Philosophy Seminar

San Francisco • Radisson Miyako Hotel  
October 9–11, 1998

Speakers include Randy Barnett, David Kelley, and David Friedman.

### Money in the New Millennium: The Global Financial Architecture 16th Annual Monetary Conference

Washington • Cato Institute  
October 22, 1998

Speakers include Lawrence H. Summers, William Poole, Jeffrey Sachs, Robert Mundell, and Steve Hanke.

### Washington, D.C., vs. Silicon Valley 2nd Annual Conference on Technology and Society

Cosponsored with *Forbes ASAP*  
San Jose • Fairmont Hotel  
November 19–21, 1998

Speakers include Milton Friedman, Scott Cook, Eric Schmidt, T. J. Rodgers, and William Melton.

### Eleventh Annual Benefactor Summit

Cabo San Lucas, Mexico • Melia Los Cabos  
February 17–19, 1999

*Roger Pilon will hold the B. Kenneth Simon Chair*

## Cato Establishes Chair in Constitutional Studies

At the June 5th meeting of Cato's Board of Directors, president Edward H. Crane announced that Cato had established the B. Kenneth Simon Chair in Constitutional Studies and that Roger Pilon, senior fellow and director of Cato's Center for Constitutional Studies, had been named to the chair.

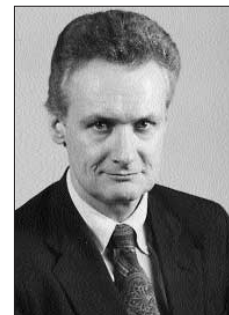
"This is Cato's first endowed chair," Crane said. "It is especially fitting that it should be in constitutional studies since the Constitution, understood as embodying the natural-rights philosophy of the Founders, is the basis and starting point for all of Cato's policy work. And it is fitting, too, that Roger Pilon should be named to the chair since his work has done so much to revive the idea that the Constitution establishes a government of limited powers designed to secure individual liberty, free markets, and the rule of law."

The chair was established with a \$2 million grant from B. Kenneth Simon of Pittsburgh, a retired engineer and entrepreneur who has supported Cato's work for a num-

ber of years. "I am very pleased to see this chair established," Simon said. "I have followed the work of Cato, and of Roger Pilon in particular, for some time. It is important work that needs to reach the broadest possible audience. What could be more important in this country than reviving the idea of limited, constitutional government?"

Since joining Cato nearly a decade ago, Pilon and his colleagues at the center have cut through the sterile constitutional debate between liberals, who urge judges to be active in promoting "social progress," and conservatives, who urge judges to be restrained and to defer to the political branches. In a wide range of writings, speeches, congressional testimony, and media appearances, Pilon has argued that judges should be neither "active" nor "restrained" but responsible to the Constitution they swear to uphold. "To do that," he said, "they must have a better understanding of the philosophy of the Constitution, including its natural-rights foundations, than many of them seem to have. The Constitution does not empower judges to be social

engineers. At the same time, it does not allow them to be handmaidens to the political branches. James Madison, the principal author of the Constitution, got it exactly right when he spoke of the judiciary as being the 'bulwark of our liberties.'"



Roger Pilon

"The B. Kenneth Simon Chair in Constitutional Studies will enable Cato to better advance that vision of the Constitution and the proper role of the judiciary under it," Crane told Cato's board. "We will also initiate the B. Kenneth Simon Distinguished Lecture Series in Constitutional Studies," he added, "which will bring noted constitutional scholars to Washington to address legal issues of the day. We are very proud to establish this chair and very pleased that Ken Simon has enabled us to do it." ■

*Socialsecurity.org attracts growing attention*

## Cato.org Expands, with Spanish-Language Site

The Cato Institute's award-winning Web site, [www.cato.org](http://www.cato.org), continues to expand and garner accolades. The latest addition to the site is a Spanish-language site, [www.elcato.org](http://www.elcato.org), featuring more than 50 of Cato's policy articles translated into Spanish. Many of the articles at [www.elcato.org](http://www.elcato.org) are by Ian Vásquez, director of Cato's Project on Global Economic Liberty, or by Jacobo Rodriguez, assistant director.

[Elcato.org](http://Elcato.org) was developed by Luis Figueroa, an editor and economics writer at the Guatemalan newspaper *Siglo Veintiuno*, who is completing a year-long program at the University of Maryland. The site also includes links to some 15 other Latin American and Spanish-language Web sites. Cato is the first major think tank with a Spanish Web site.

Most Cato events, including forums and conferences, are now broadcast live over the Web site. The broadcasts use RealPlayer soft-

ware, which can be downloaded free.

Meanwhile, the general Web site has received another accolade: it has been picked as a Select Site by "Dow Jones Business Directory." In its review, Dow Jones gave the Cato site a score of 34 out of a possible 40 and said, "The savvy Web site from the Cato Institute proves that the libertarian think tank has its act together. [The site] is always one step ahead of its visitors, providing scores of research and information in a provocative way that keeps the eyes from glazing over." Cato's site has previously received such designations as "Political Site of the Day," "Magellan 4-Star Site," a "Times Pick" of the *Los Angeles Times*, and "Best of the Net."

A different review came from the leftist writer Robert Kuttner in the July–August 1998 issue of the *American Prospect*: "Cato was astute enough to capture the Web site address [socialsecurity.org](http://socialsecurity.org). Go there on the

Internet, and you will find endless libertarian propaganda for full privatization." Actually, says Michael Tanner, director of Cato's Project on Social Security Privatization, "we didn't need to post any propaganda. We just posted a calculator, designed by KPMG Peat Marwick, that allows the visitor to compare his promised returns under Social Security to what he could earn under a private investment plan. That pretty well makes the case."

Cato's site has drawn praise for its size and searchability. The main site, [www.cato.org](http://www.cato.org), contains the full text of more than 1,000 articles and policy studies, fully searchable.

Cato also maintains two other Web sites: [www.freetrade.org](http://www.freetrade.org), which features the work of the Center for Trade Policy Studies, and [www.libertarianism.org](http://www.libertarianism.org), which presently features the books *Libertarianism: A Primer* and *The Libertarian Reader* but is scheduled to expand. ■

## “To Be Governed...”

### ◆What’s a little consistent failure between friends?

House Speaker Newt Gingrich (R-Ga.) sharply criticized the IMF as “consistently wrong” in its decisions but said the House will bring “an appropriate bill to the floor this year in an appropriate way.”

—*Washington Post*, April 24, 1998

### ◆Speak for yourself, Mr. Secretary

“Political theory is really just rationalization of economic interest.”

—Secretary of Agriculture Dan Glickman,  
*Morning Edition*, May 7, 1998

### ◆No human right to trade

The House passed a bill yesterday by an overwhelming margin that would impose sanctions on foreign governments engaged in religious persecution. . . .

Rep. Tom Coburn (R-Okla.) cited the Sudan provision as an example of business interests’ continued influence.

“We’ve got to figure out what we believe in our country. Do we believe in capitalism and money or do we believe in human rights?” he asked.

—*Washington Post*, May 15, 1998

### ◆The recycling police

Attached to the bag was a legalistic warning from the [New York] city Sanitation Department. If the Dechongkit family was caught failing to recycle more than five recyclable items—which now range from cat-food cans to patio furniture in New York—they would face a \$25 fine. . . .

Beginning Monday, 60 members of the Sanitation Department’s “Sanpatrol” or

Sanitation Patrol unit began the unenviable task of picking through the garbage of the 100 Brooklyn households. . . . Recyclable items found in the general trash were placed in a clear plastic bag and left with a warning on sidewalks or near front doors.

—*New York Times*, April 30, 1998

### ◆When I promise to “give something back,” I don’t mean I should pay for it myself

When Rep. J. Dennis Hastert (R-Ill.) was young, he didn’t like school. When Sen. Paul D. Wellstone (D-Minn.) was young, he didn’t like much of anything, including himself. Wrestling was the answer for both kids.

Now both lawmakers want to give something back.

Today the House will debate a measure . . . [to] require colleges to report annually any plans they have for the ensuing four years to cut funding or participation for any athletic team.

—*Washington Post*, April 30, 1998

### ◆Although it’s a bit late for his colleagues

There’s a dinner June 19 at the Excelsior Hotel in Little Rock to celebrate the establishment of the Vincent Foster professorship of legal ethics and professional responsibility at the University of Arkansas law school.

—*Washington Post*, May 1, 1998

### ◆I just think I should personally review every proposed transaction in a \$7 trillion economy and approve or reject it on a gut feeling

“I don’t have this overarching theoretical model I’m trying to lower on the economy, [Assistant Attorney General Joel] Klein says in an interview. “I’m trying to decide each

case on its merits, one at a time, not on theoretical or ideological grounds.”

—*Wall Street Journal*, May 15, 1998

### ◆They should try that system for cocaine

The tobacco industry and its supporters say a similar [to that created in Canada by high cigarette taxes] black market in cigarettes would occur across the United States if legislation drafted by Sen. John McCain (R-Ariz.) is enacted. . . . Deputy Treasury Secretary Lawrence H. Summers and others argue that measures called for in the McCain bill would reduce the potential for a big expansion in the black market. . . .

“With the necessary regulatory provisions in place to deal with potential smugglers, we do not expect a large-scale smuggling problem,” Summers testified.

—*Washington Post*, May 17, 1998

### ◆People with too little to worry about

Walt Disney and its obsessive chairman Michael Eisner are building an authoritarian utopia built upon mindless entertainment and media manipulation, says a scathing new book.

—*New York Post*, May 21, 1998

### ◆Good plan

“If we are all so concerned about unintended consequences, the only thing we ought to do up here is name a courthouse.”

—Rep. Charlie Norwood, reacting to one of the concerns raised by critics of his Patient Access to Responsible Care Act, in *CongressDaily*, May 5, 1998

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1000 Massachusetts Ave., N.W.  
Washington, D.C. 20001

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