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Extending the Reagan Revolution

by Malcolm S. Forbes, Jr.

Given the realities of the world and the frailties of human beings, the Reagan administration's economic policy to date has to be judged an enormous success. The chief achievement of the Reagan presidency is the massive reductions in individual income-tax rates. The benefits that have resulted from those tax reductions outweigh all of the shortcomings and missed opportunities in other areas of the administration's economic policy.

Taxes are not simply a means of raising revenue; they are also a price. The taxes on our income, capital gains, and corporate profits are the price we pay for the privilege of working, the price we pay for being productive, and the price we pay for being innovative and successful. If the price of those things is too high, we get less of them. If the price is lowered, we'll get more of them.

The Kemp-Roth bill of 1981 and the tax reform bill of 1986 reduced individual income-tax rates to levels we hadn't seen in 60 or 70 years. Too many of our policymakers ignore the simple fact that *people* make an economy run—*people* manage companies, not investment tax credits or accelerated depreciation schedules.

To see evidence of that, all we have to do is look at Japan and Britain. Japan's corporate income taxes are about twice as high as ours. By contrast, for almost 30 years Britain had some of the most liberal business depreciation investment incentives and laws in the Western world. Which country has invested more in the past 30 years, Japan or Britain? Which country has had more economic growth? To ask those questions is to answer them. If people have an incentive to get ahead—if they're able to keep enough of what they earn through their labor and innovation—then the economy as a whole benefits, even if some of the traditional business incentives aren't in force.

The tax reforms of 1981 and 1986 are forcing states to reduce their marginal rates, and they're going to force other industrialized countries to reduce their onerous rates as well. We live in an age of mobility. Brains and money are mobile; they go where the opportunities are. Today the opportunities are more likely to be found in the United States than in most other industrialized nations. Why do we have a capital inflow? It's not because we are big spenders. Nor is it because we have high interest rates—if that were the reason, money would have been going to the Philippines or Zaire. Capital has been coming to this country because there are more opportunities here.

Our tax rate reductions will force other industrialized countries to lower their tax rates not because of anything we might say but because of the sheer pressure of events. In fact, several countries have already begun to compete with each other to do so. The Canadians have made a halting start; the British have said that they will be reducing their rates; the other Europeans are taking small steps; the Japanese are stumbling in that direction. So it's not just the United States that will benefit from our recent rate reductions; other nations will benefit from them as well—

(Cont. on p. 10)

Malcolm S. Forbes, Jr., is deputy editor-in-chief of *Forbes* magazine.

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Cato Institute chairman William A. Niskanen looks on as federal budget director James C. Miller III shakes hands with Moe Biller, head of the American Postal Workers Union, who picketed Miller's talk at Cato conference "Privatization and the Postal Monopoly."

Liberating the Black Underclass

President's Message

Our nation is moving toward two societies, one black, one white—separate and unequal." That was the conclusion of the acclaimed Kerner Commission report, issued two decades ago this year. Tragically, despite the torrents of rhetoric, hundreds of task forces and studies, and billions of dollars directed at solving the problems of the black inner-city underclass, those words ring as true today as they did 20 years earlier.

With such an enormous and intractable problem destroying lives and threatening to tear our society apart, it is time for men and women of good will to devise radical alternatives to the policies that have failed. To continue to pursue those policies would be both foolhardy and insensitive to the plight of those they purport to help.

First, we must end the government's monopoly over education. The vast majority of Americans cannot afford to send their children to private schools and thus must resort to the nation's public schools, which, as *A Nation at Risk* made abundantly clear, have done a disgraceful job. That applies with a vengeance to inner-city schools, which are often little more than day-care prisons, breeding crime and turning out millions of functional illiterates.

Our friend Joan Davis Ratteray heads Washington's Institute for Independent Education, a network of 250 inner-city (and mostly black) alternative schools. She relates heart-rending stories about parents who can barely afford to pay the rent desperately taking children out of public schools and placing them in very small private schools (garages are not atypical locations). Interestingly, when children who were often considered malcontents and low achievers suddenly started getting and doing homework, their test scores started going up.

The problem with inner-city public schools is not a lack of money but a lack of choice. The public schools in Chicago (which Education Secretary William Bennett described as being in a "state of meltdown") spend more than $6,000 per pupil annually. Indeed, nationwide spending in real terms has gone up virtually every year for the past three decades—while SAT scores have declined. Monopoly has bred indifference, redundant levels of bureaucracy, and self-serving teachers' unions whose members would rather picket than teach (which, as recent teacher competency tests indicate, may be to the students' advantage).

As economist and Cato adjunct scholar Walter Williams put it, "If the Grand Wizard of the Ku Klux Klan wanted to deny blacks upward mobility, reinforce racial stereotypes of black mental incompetence, and foster racial conflict, he couldn't find a better tool than our public educational system." Education "professionals" argue that parents—particularly in the inner cities—don't have the skills necessary to make decisions about their children's schooling. But those educators are notorious for their lack of understanding of the market process. One need not know how to build an automobile to be able to discover which cars offer the best value in terms of cost, design, engineering, and performance. The market has a way of weeding out the cars that don't measure up.

Does anyone doubt that the inner-city public schools would become the educational equivalent of the Edsel if parents had a choice? Discipline, respect for others, an enthusiasm for learning, and a drug-free environment are some of the things that parents want their children to receive from school. The market process, if allowed to operate through vouchers or education tax credits, would deliver the goods.

Second, we must decriminalize drugs for adults. As such diverse commentators as William F. Buckley, Hodding Carter, and Milton Friedman have pointed out, drug laws have been doing far more damage to our inner cities than drug use. A major portion of the violent crime against persons and property is a direct result of the artificially high cost of drugs under this latter-day Prohibition.

Often overlooked in the debate is the broader impact that drug laws have on young people. Seeing enterprising neighbors making hundreds of dollars a day by dealing drugs all too often causes inner-city youths to turn to a life of crime. Both dealer and user inhabit a criminal subculture that dramatically erodes their respect for society's conventions. Once a young person has entered that ugly subculture, his regard for the law, education, and property rights—not to mention civility—vanishes. Instead of being a law-abiding citizen with a problem (not wholly unlike an alcoholic or a chain smoker), he becomes an enemy of the very social institutions from which he might otherwise seek help.

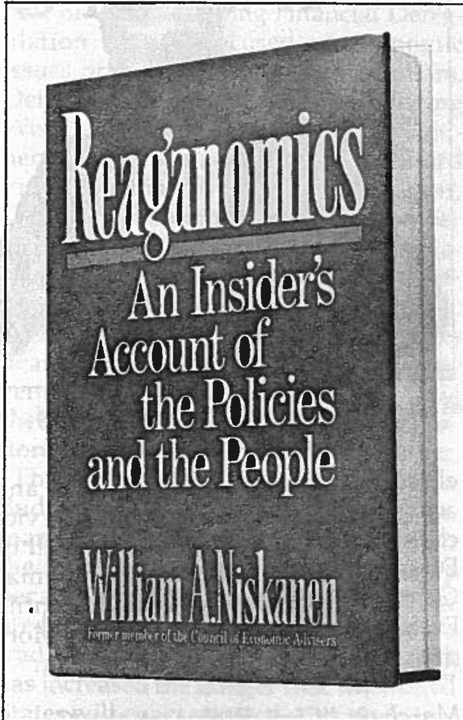
Encouragingly, Baltimore mayor Kurt Schmoke recently called for drug decriminalization. Having noted that inner-city gangs exist primarily to protect drug turf, Schmoke told the U.S. Conference of Mayors, "Let's take the profit out of drug trafficking. . . . What we are doing now as a country not only is not working, but also is hurting our communities."

It is regrettable that the one major candidate for president who exhibits a genuine concern about the plight of inner-city blacks, Jesse Jackson, has endorsed the very policies toward education and drugs that have failed so miserably. The task of liberating the black underclass in America awaits more enlightened leadership.

Ed Crane

—Edward H. Crane

Niskanen Assesses Successes and Failures of Reaganomics in Book



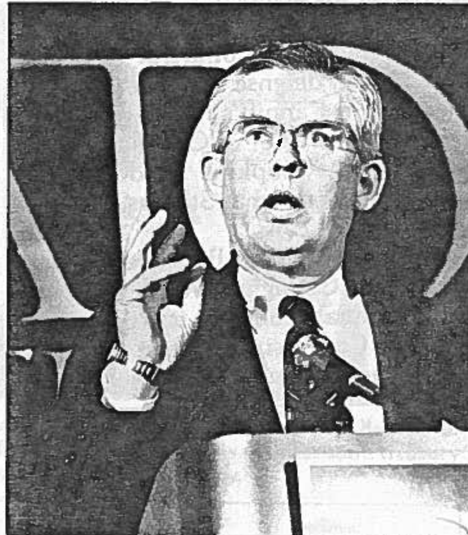
In a new book published by Oxford University Press, Cato Institute chairman William A. Niskanen draws upon his experience as a member of President Reagan's first-term Council of Economic Advisers to provide a wide-ranging analysis of Reaganomics in the making.

A distinguished economist, Niskanen was at the forefront of the administration's economic program—as its supporter or internal critic and as a participant in or witness to many of the crucial decisions that shaped it. In *Reaganomics: An Insider's Account of the Policies and the People,* he assesses the impact of the president's program on the budget, taxes, regulation, trade, and monetary growth.

Although Niskanen describes the administration's successes in such areas as lowering tax rates and promoting the deregulation of a number of industries, he does not shrink from examining instances in which the Reagan vision of free markets and limited government went awry, such as the Commerce Department's often-mercantilist view of imports and the many politically motivated concessions on spending policy.

Herbert Stein, a former chairman of the Council of Economic Advisers, called Niskanen's book "a lucid analysis of Reagan's economics by that rare creature, an objective insider."

Reaganomics: An Insider's Account of the Policies and the People is available from the Cato Institute for $22.95. ■



Cato Institute chairman William A. Niskanen discusses Reaganomics.

Postal Service Getting Worse

"Mail service in the United States is getting slower, more expensive, and less reliable," but the U.S. Postal Service has little incentive "to treat its customers with the respect they receive elsewhere in a competitive economy." That's the conclusion of a Cato Institute study issued as the Postal Service's latest rate hike took effect.

In calling for an end to the Postal Service's monopoly over first- and third-class mail delivery, Cato associate policy analyst James Bovard cites a number of recent internal reports that indicate how bad its service has become. One team of auditors found properly addressed undelivered mail at 76 percent of the post offices it visited, and another estimated that the typical letter carrier wastes an hour and a half each day, which costs the Postal Service more than $636 million each year.

Bovard also observes that "in the areas where the Postal Service faces competition, it has been unsuccessful." He notes that it now carries less than 10 percent of the parcels shipped by the public and that its share of overnight-delivery mail has plummeted from 20 percent to less than 10 percent in the last three years.

Having noted that nearly 85 percent of the Postal Service's budget — $38 billion a year—goes into direct labor costs, Bovard estimates that ending its monopoly and privatizing letter delivery could save the United States over $10 billion annually.

"The Slow Death of the U.S. Postal Service" is no. 102 in the Cato Institute's Policy Analysis series. It is available from the Institute for $2.00. ■

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David Lampo .... Managing Editor
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Could a New Strategy Rescue the Welfare System?

Cato Events

February 10: **"Will C.U.R.E. Be the Death of the Railroads?"** Robert Hébert, an economist at Auburn University, debated the wisdom of special interests' efforts to reregulate the railroad industry with Mark Cooper, director of research at the Consumer Federation of America. Hébert argued that overturning all or part of the Staggers Act of 1980 would raise costs for millions of shippers and consumers and jeopardize the financial stability of the industry.

February 11: **"Welfare Reform: Forging a Conservative Agenda."** Stuart Butler, director of domestic policy studies at the Heritage Foundation and coauthor, with Anna Kondratas, of *A Conservative Strategy for Welfare Reform*, discussed prospects for decreasing the federal government's role in antipoverty initiatives with Charles Murray, author of *Losing Ground*. Having contended that the "war on poverty" has failed, Butler proposed a welfare system in which a renewed emphasis would be placed on the family and in which the states—instead of Washington—would be responsible for policymaking. Murray countered that any new welfare mechanism, no matter how well it was constructed, would be destined to fail because self-interest always governs bureaucrats' behavior.

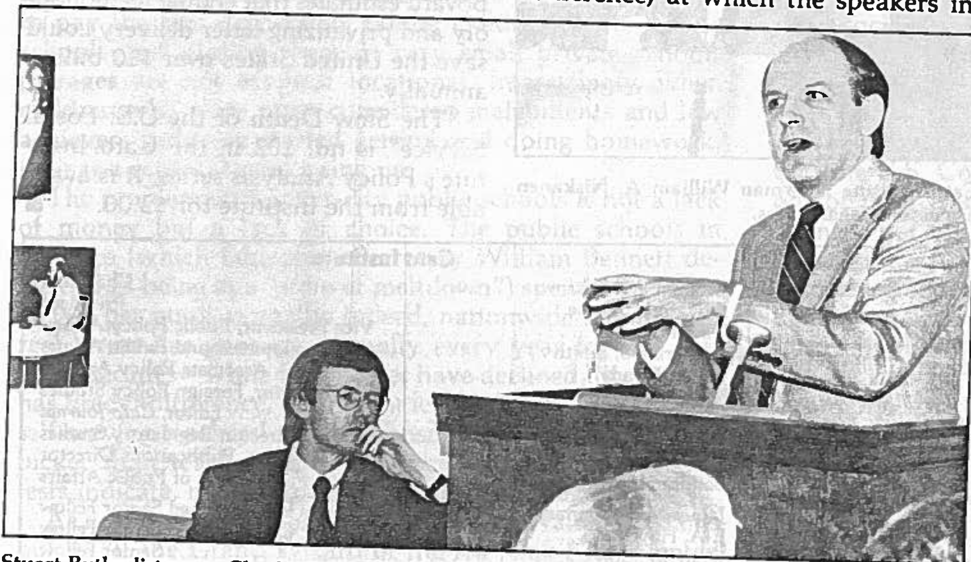
Clint Bolick (left) and Juan Williams (right) discuss whether the civil rights movement needs to change directions.

February 18: **"Free Trade, NATO, and Canada's New Democratic Party."** Paul Canniff, an adviser on U.S.-Canadian affairs for the public relations firm Saunders & Company, traced the growth of the democratic socialist movement in Canada and described the NDP's impact on bilateral free trade and mutual defense agreements. Commenting on Canniff's remarks was Paul Lemco, a professor of Canadian studies at the Johns Hopkins School of Advanced International Studies.

February 25–26: **"Dollars, Deficits, and Trade: The Changing World Economy."** International economic issues were the focus of Cato's sixth annual monetary conference, at which the speakers included such noted policymakers and academics as Federal Reserve Board vice chairman Manuel Johnson, Council of Economic Advisers member Thomas Gale Moore, and Chicago Mercantile Exchange chairman Leo Melamed. More than 250 people attended the event.

March 9: **"Civil Rights at the Crossroads."** Clint Bolick, a senior consultant at the Hudson Institute and a former Justice Department official, discussed the civil rights movement's past and present agendas with Juan Williams, a *Washington Post* reporter and author of the companion volume to the award-winning PBS series "Eyes on the Prize." Bolick argued that in the 1960s the movement abandoned the natural rights principles that had guided it for nearly 200 years. He proposed a policy that would once again stress freedom and equal rights under the law.

March 23: **"The Effects of the Social Security Tax Increases on the Economy."** Economist Aldona Robbins summarized the findings of her recent study (with Gary Robbins) on the 1988 and 1990 payroll tax increases, published by the Institute for Research on the Economics of Taxation. Robbins estimated that the tax increases would cost Americans 500,000 jobs, reduce GNP by $320 billion, and over the next 15 years raise taxes by almost $500 billion. John Mueller, economic counsel to Rep. Jack Kemp, commented on Robbins's remarks. ■



Stuart Butler listens as Charles Murray discusses Butler's proposal for welfare reform.

Annual Monetary Conference

Fix or Float? Trade Deficits and Exchange Rates

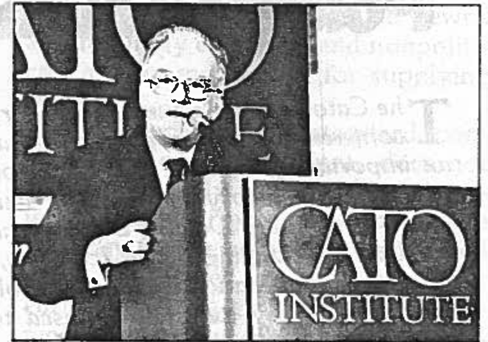
The Cato Institute's sixth annual monetary conference, an important part of Cato's ongoing Financial Deregulation Project, focused on economic issues of global significance. "Dollars, Deficits, and Trade: The Changing World Economy" featured such eminent speakers as Federal Reserve Board vice chairman Manuel H. Johnson, Council of Economic Advisers member Thomas Gale Moore, and Leo Melamed, chairman of the executive committee of the Chicago Mercantile Exchange.

More than 250 conference attendees heard papers that challenged the conventional wisdom on exchange rate theory, trade deficits, and the international monetary system. In his paper, "The Uneasy Relationship between the Budget and Trade Deficits," Cato chairman William A. Niskanen argued that the latter deficit poses a problem only because it has been erroneously attributed to "unfair" practices by America's trading partners. That misperception has increased the danger that the United States will enact protectionist trade legislation. The country's main economic problem, Niskanen contended, is the budget deficit, which should be reduced through government spending restraint in such increasingly costly areas as defense, medical care, and agriculture.

In another paper, Anna Schwartz of the National Bureau of Economic Research and Michael Bordo of the University of South Carolina described the international monetary disturbances caused by the fixed exchange rate system that was in effect until 1973. They argued that "a stable international order is achievable" by means of a floating rate system that frees countries to pursue stable domestic policies, whereas "policy coordination is neither necessary nor attainable."

In a spirited address that concluded the conference, Melamed recounted the history of the International Monetary Market, the innovative financial futures exchange that he cofounded in the 1970s. Quoting Milton Friedman, Melamed noted that "from the time Bretton Woods became effective, it was inevitable that it would break down." Melamed also cited the extraordinary success of the IMM as an example of the free market's superior ability to adjust to the constant changes in the world economy. He remarked, "The IMM made financial futures an indispensable tool of risk management. . . . We could not have prospered, nor would the world have fared as well, if the IMM had not been a necessary byproduct of the same economics that ushered in the new era of flexible exchange rates."

Papers from the conference will appear in the Fall 1988 issue of the *Cato Journal*. ■



Thomas Gale Moore of the Council of Economic Advisers gives the keynote speech at Cato's annual monetary conference.

Anna J. Schwartz of the National Bureau of Economic Research talks with assistant treasury secretary Michael Darby.

Federal Reserve vice chairman Manuel H. Johnson discusses the use of commodity price targets to guide Fed policy, in a talk that received worldwide press attention.

Leo Melamed of the Chicago Mercantile Exchange warns policymakers not to tamper with the money markets.

Boaz on Byline; England Heads Reg Studies

Cato Institute vice president David Boaz is the newest regular commentator for the Institute's daily public affairs radio program, Byline. Boaz is the editor of *Left, Right, and Babyboom: America's New Politics* and has contributed articles to the *New York Times*, the *Washington Post*, and the *Wall Street Journal*. Other commentators for Byline, heard on some 200 stations nationwide, include columnists Don Lambro and Tom Bethell, First Amendment defender Nat Hentoff, civil rights leader Julian Bond, foreign policy analyst Earl Ravenal, and executive producer Jeff Riggenbach.

Catherine England has been named director of regulatory studies at the Cato Institute. England had been a senior policy analyst at the Institute since 1984. She recently received a Ph.D. in economics from Texas A&M University; her dissertation deals with the banking industry. ■

How Can We Fix the International Monetary System?

Policy Forum

The Cato Institute's annual monetary conference has become recognized as an important forum for the discussion of monetary theory and policy. This year's conference, "Dollars, Deficits, and Trade: The Changing World Economy," focused on international monetary policy. Cato Policy Report *is pleased to present excerpts from some of the papers delivered at that conference. A complete set of conference papers will be published in the Fall 1988 issue of the* Cato Journal.

An International Fiat Money

by Richard N. Cooper

Determination of the basis for a national currency is one of the foremost attributes of national sovereignty. At irregular intervals over the past half-century countries have been urged to link their currencies, through more-or-less rigid formulae, to a variety of commodity baskets, with contents varying from one commodity (gold) to several dozen commodities and even beyond, to an index of prices of goods and services, with varying intermediate combinations. Usually the stated aim is to assure the stability of the real value of money or to reduce uncertainty in the real value of money. Those objectives are typically assumed to be sufficient unto themselves, but sometimes they are justified as reducing uncertainty for business and household decisions that involve the allocation of resources over time and thereby contributing to national well-being.

This paper investigates the desirability of basing an international monetary system—encompassing the formal rules and conventional practices governing payments among residents of different nations—on a basket of commodities. It finds that such a move, while technically workable (though difficult), would not have much to recommend it, and it offers an alternative suggestion for improving the international monetary system: a common currency among the industrialized democracies, with a common, jointly agreed-upon monetary policy, which might well be targeted on some measure of price stability.

Richard N. Cooper is the Maurits C. Boas Professor of International Economics at Harvard University.

The exceptional importance of real exchange rate uncertainty suggests that a system should be introduced that can reduce it. Several proposals to accomplish that objective have been made, ranging from target exchange rate zones that would limit exchange rate movements around a calculated equilibrium real exchange rate to close coordination of monetary policy among the free world's three largest economies with a view to both stabilizing their exchange rates and controlling their collective monetary growth.

Richard N. Cooper: "To eliminate exchange rate uncertainty definitively would require a single currency."

But to eliminate exchange rate uncertainty definitively—and sharply reduce real exchange rate uncertainty—would require a single currency. For the international monetary system this could be effectively achieved, with a much greater prospect of negotiability, by introducing the single currency first to the large industrialized democracies of Europe, North America, and Japan, rather than as a global currency. A single money would require a single monetary policy. The new International Central Bank, as we might call it, could be modeled on the Federal Reserve System, with changes appropriate to the circumstance that the participants would be nations rather than regions within a nation. Representatives of national central banks, whether or not under the control of sitting governments, could make up the board of governors, with votes weighted according to the size of their national economies. Or finance ministries could be directly represented, or there could be nationally selected independent appointees, with the number of appointees determined by economic size. Whatever its exact constitution, the key point is that decisions on monetary policy would be collective; no single government could determine the outcome.

The ICB's functions and powers would be similar to those of central banks today, with a discount window for distress lending and open-market operations to influence the monetary base. Governments would share the seigniorage resulting from the issuance of central bank money. But no government could finance budget deficits through the ICB beyond its share of the seigniorage; it would have to go to the financial market for that.

Other democratic countries could formally join the system, and any nonmember could choose to peg its exchange rate to the international krone, which would permit many of the advantages of fixed exchange rates without the formal commitments. (It does not matter what the new currency is called. In view of the widespread use around the world of the U.S. dollar, "dollar" would be a natural designation, but that might be politically offensive to some. So it could be called the "thaler" or the "franc." The *Economist* has suggested the "phoenix.")

What principles should guide the actions of the ICB? It would face many of the same choices that nations face today, although of course it could not fix the exchange rate, because there would be no plausible currency to which to fix it. The various disadvantages of a commodity-based standard are relevant here. Nonetheless, the ICB would need some guidelines. It could be, as Keynes suggested, a tabular stan-

dard based on an index of the wholesale prices of 62 internationally traded commodities; that would imply a secular inflation in consumer prices, which Keynes recognized and welcomed. Or it could be a target based on a weighted average of the consumer price indices in the participating countries, which would imply a secular *decline* in commodity prices. Or it could be a defined price level but modified in response to movements in unemployment away from some target level, as Robert E. Hall has suggested. Or the ICB could even fail to agree on a sharply defined target and muddle through as the Federal Reserve does now. That would not be intellectually satisfying, but we could be much worse off under many alternatives. ■

An International Market Money

by Lawrence H. White

Richard Cooper's paper evokes a certain amount of nostalgia. It is somehow reassuring to find that the ideological outlook at Harvard—a parochial and rather wishful view of the beneficence of government institutions—has not changed appreciably since my days as an undergraduate economics major there.

Monetarists want base money supplied by a national monetary authority—albeit an authority bound by a strict money-growth rule—and cleanly floating exchange rates among the major industrialized nations. Cooper, like at least a few other Keynesians, wants a world central bank, either managed so as to stabilize some price index or empowered to engage in activist countercyclical policy. The important question is not which of those two political monetary systems is better but whether we would be better off with a market-based nonpolitical monetary system.

The idea of a nonpolitical monetary system, unfortunately, nowhere intrudes into Cooper's paper. (In fact, he suggests that any monetary system not consciously designed and collectively installed would be unsatisfactory per se.)

The first sentence of Cooper's paper reminds us of the deep-rootedness of political control over money. It is certainly true that "determination of the basis for a national currency is one of the foremost attributes of national sovereignty," but that need not necessarily remain so. It is a sad reflection of the pervasiveness of state intervention in our daily lives that the currency we carry in our wallets—and, more important, the ultimate medium of settlement in our payments system—is nothing but a token of state sovereignty.

Lawrence H. White: "We would already have a unified world monetary system if not for the barriers thrown up by the scourge of monetary nationalism."

The determination of the basis for a currency could instead be left to the market. Once it was; commodity money evolved long before nation-states discovered that they could profit by monopolizing the mints and the issue of commodity-redeemable paper currency and ultimately abrogating the central bank's obligation to redeem its currency, thereby eliminating the commodity standard. Thus, a commodity standard (particularly a gold or silver specie standard, but even a nongovernmental commodity-basket standard) can be viewed as an entity quite distinct from the one described in Cooper's paper. He characterizes both a single-commodity and a multicommodity standard as a set of "rigid formulae," urged upon governments by would-be reformers, for linking national currencies to arbitrary commodity baskets. But a commodity standard can instead be viewed as a naturally evolving (and nonpolitical) market mechanism for supplying money.

A single-commodity standard, contrary to Cooper's account, does not characteristically require the money-issuing authority to buy and sell the currency for the commodity at a fixed price. There need not be a monopoly currency-issuing authority. Paper currency (banknotes) could instead be supplied by a number of competing banks. The redeemability of paper currency for a money commodity at a prearranged rate would then be not an imposed requirement but simply a provision of a freely made contract between a bank and the holders of its banknotes.

In the space available here I cannot go into more detail about how such a free-banking system would work, but I want to emphasize that from the perspective of denationalization, a free-market commodity standard is quite unlike the contrived proposals for government-run commodity baskets to which Cooper devotes most of his paper. The most forceful argument for a gold standard is not that it would guide the monetary authorities best but that it would allow us to do without monetary authorities. Even gold advocates who don't go that far generally make a case for a monetary order that would be nonpolitical, self-regulating, and free of both covert inflationary finance (thus, they speak of "honest money") and central-bank-generated instability (thus, "stable money").

As Cooper argues, a commodity standard would not ensure the stability of any particular price index. As I have tried to indicate, however, there is still an important reason for preferring gold: it would be a basic money outside the hands of governments, not subjugated to whatever goal the authorities decided to pursue. Why should the monetary system be hitched by force of law to any centrally planned goal? I am not against price stability, mind you. (As central-bank goals go, it is far from the worst.) I simply believe that in a free-banking environment, consumers would be smart enough, and

(Cont. on p. 8)

Beginning this fall, Lawrence H. White will be an associate professor of economics at the University of Georgia. He is the author of *Competition and Currency: Essays on Free Banking and Money* (New York University Press and the Cato Institute, forthcoming).

Monetary System (Cont. from p. 7)

the market process responsive enough, to endow the monetary standard and payment media with as much purchasing-power stability as they felt was worth having, given the cost of enhancing it.

The punch line of Cooper's paper is a call for a fiat money issued by an international central bank. Having forthrightly acknowledged that any attempt to achieve a genuine fixity of exchange rates among independent national fiat monies would be absurd and unworkable—the fixity of a currency's exchange rate cannot be sustained unless the national monetary authority gives up its independence—Cooper opts for attaining fixity through an international fiat money. One must respect him for being radical (and utopian) enough to take his ideas to their limit instead of shying away from the sweeping institutional changes that would be necessary to implement them.

I am generally sympathetic to the goal of a unified world monetary system because I think that such a system would be the natural child of unhampered international commerce and cross-border banking; we would already have one if not for the barriers thrown up by the scourge of monetary nationalism. But it is not a goal that justifies any and all means. An international central bank issuing fiat money, its power delegated to it by the leading Western industrialized nations, would be a means whose inappropriateness outweighed any progress toward a unified global monetary system that might be achieved thereby. It would render the supply of money no less a creature of politics—and possibly even more of one.

An international central bank's monetary policymaking would be even more muddled than the Federal Reserve's, if that is possible. Certainly the practical experience of the European Economic Community does not hold out much hope for a "Eurocratic" monetary policy. An international central bank would be unlikely to remain aloof from exercises in power politics by national governments anxious to inflate away their fiscal and reelection problems. It would be even more unlikely to resolutely aim toward any academic policy target. Thus, it would hardly enhance the predictability of the monetary system.

Fortunately, there are alternative means of achieving global monetary unification. One, proposed by F. A. Hayek, is to free businesses and individuals everywhere to use and hold whichever national fiat currency they found most attractive, whether it was German marks, Swiss francs, or one of the others. Those verdicts would give us valuable feedback on what sort of monetary policy they preferred. The currency of the best-behaved central bank would probably come to play a dominant role, at least in international transactions. It is difficult to understand why Cooper considers such a currency inferior, as an international medium of exchange and a unit of account, to a currency controlled only 10 percent by the government with the best-behaved central bank and 90 percent by more-inflationary governments.

Those who, understandably, feel uncomfortable with the prospect of having a currency managed by the bureaucracy of any foreign city, be it Brussels or Bonn, may prefer a somewhat more sweeping reform: allowing citizens everywhere to use a basic money that was not controlled by a central bank or governmental agency. A commodity standard would make such an international money of the market possible. Whether a single-commodity or a multicommodity standard would be better suited to that role is a secondary issue.

The results of such a reform can be envisioned by considering what would automatically happen if the same commodity monetary standard was allowed to prevail in both the United States and Canada and no barriers to cross-border branch banking were erected. Does anyone doubt that we would have a fully unified international monetary system? Exchanges between New York and Toronto would be no more complex than exchanges between New York and Chicago, especially if the same set of banks operated branch offices in all three cities. Transnational investments would be completely unfettered by exchange rate risk, just as interstate investments are. The advantages of free trade in commodities and capital would be magnified appreciably by that sort of monetary unification.

The similarities and differences between Cooper's approach to global monetary unification and mine can be summarized as follows: Both of us would like the Federal Reserve, the Bank of Canada, and other national central banks to give up their monopoly powers over the supply of currency. Cooper, however, would like their powers to be merged in a central bank cartel—a multinational monopoly issuer. I would like their powers to be surrendered so that no agency would have a monopoly over money. The competitive provision of currency, by banks responsive to the wants of moneyholders rather than to the exigencies of power politics, could then prevail, both within each nation and across national boundaries. ■

Floating vs. Pseudo-fixed Rates

by Gottfried Haberler

In the last two or three years the present system, or nonsystem, as its critics say, of loosely managed floating has again come under increasing criticism. The latest attack came from an unexpected source. His Holiness Pope John Paul II, in his encyclical "The Social Concerns of the Church," said, "The world monetary and financial system is marked by an excessive fluctuation of exchange rates and interest rates, to the detriment of the balance of payments and the debt situation of the poorer countries."

The suggested alternatives to floating are variants of the Bretton Woods system of "stable but adjustable exchange rates," embellished by target zones and guided by commodity price indexes, including the price of gold. There is no reason to assume that in the 1980s a Bretton Woods–type system would have functioned better than it did in the 1960s and 1970s. On the contrary, it is easy to see that it would have broken down, just as it did in the early 1970s.

Gottfried Haberler is a resident scholar at the American Enterprise Institute.

The Achilles' heel of the system of stable but adjustable exchange rates is its vulnerability to destabilizing speculation. Very briefly, if under that system a currency weakens and the country loses reserves, the speculators (market participants) know that the currency can only go down; it cannot go

Gottfried Haberler: "The only realistic alternative to floating is a pseudo-fixed rate propped up by a battery of exchange and trade restrictions."

up. Furthermore, they have learned from experience that a devaluation is bound to be large because the authorities want to make sure that they will not have to go through the painful operation again soon. Therefore, if the speculators have guessed correctly and the currency is devalued, they make a large profit. If they have misguessed, they merely lose transactions costs.

Under floating the situation is different. A currency under pressure goes down immediately. Therefore, the speculators can never be sure whether the market has not already overshot and the currency will go up again. Thus, speculation becomes much more risky. The existence of a target zone does not change the situation unless it is sufficiently wide and otherwise flexible as to approach a free float.

The proposed use of "indicators" has been hailed as a new approach and a major advance of policymaking in general and of international coordination of policies in particular. In my opinion there is nothing new in this approach; not even the term "indicators" is new.

The present international monetary system does not require a radical change; floating should continue, and I think it will. A Bretton Woods–type conference to set up a new fixed rate system, as has been suggested by both socialist and conservative French governments, is out of the question. In the present world the alternative to floating is in most cases direct controls, not fixed rates with free convertibility.

But I do not want to overstate the case for floating exchange rates; in a sense floating is merely a second-best solution. Fixed exchange rates would be the best system. If two or more countries could agree to fix the exchange rates of their currencies, it would be the best arrangement—provided, first, that the currencies were fully and freely convertible into each other at the fixed rate, in other words, that there were no exchange controls and no trade restrictions "to protect the balance of payments," and, second, that the fixed rate did not impose excessive unemployment or inflation on any participating country.

Unfortunately, in the present-day world those conditions are rarely fulfilled among sovereign states. In most cases the only realistic alternative to floating is not a fixed rate with full and free convertibility but a pseudo-fixed rate propped up by a battery of exchange and trade restrictions—the worst possible system. ■

The Futility of Fixing

by Leland B. Yeager

Neither exchange-rate stability nor purchasing-power stability guarantees the other (for example, a domestically stable currency would fluctuate against unstable foreign currencies). The two stabilities could be compatible, however; rates could be fairly stable among currencies of dependably stable purchasing powers.

Today's world exhibits both types of *in*stability, most conspicuously in exchange rates. Bilateral rates have fluctuated by 10 and 20 percent over weeks and months and sometimes by several percent from day to day or even within days. Over hours, days, months, and perhaps even years, gross capital transactions—transactions to reshuffle asset portfolios, including speculative transactions—have far overshadowed trade in goods and services. The *daily* volume of foreign-exchange trading in the United States, Britain, and Japan alone is estimated to total nearly $200 billion.

One apparent source of rate volatility is "noise." High-technology communications and data-processing bring facts and figures and rumors to the attention of traders more frequently and in more discrete bits than in the past, causing frequent shifts in noise-oriented trading decisions. The special role of the U.S. dollar as the predominant transactions, vehicle, reserve, and intervention currency places it in a particularly conspicuous and vulnerable position. Participants in sensitive markets must eagerly watch each day's economic and political news and not only form their own interpretations but also guess what other people's interpretations are likely to be. No wonder quasi-speculative capital movements, and exchange rates in consequence, are so volatile.

Leland B. Yeager: "Barring reform of the currencies themselves, attempts to manipulate exchange rates will do more harm than good."

Official market intervention, though it would ideally smooth exchange-rate movements, contributes to the noise. It is an unsettled issue whether intervention, together with news and rumors of its being started, altered, or suspended, has made exchange rates more or less volatile on the whole than they otherwise would have been. For several years I have been collecting stories from the *Wall Street Journal* and other financial publications purporting to explain hour-to-hour, day-to-day, and week-to-week jumps in exchange rates.

(Cont. on p. 12)

Leland B. Yeager is the Ludwig von Mises Distinguished Professor of Economics at Auburn University.

Reagan Revolution (Cont. from p. 1)

assuming, of course, that Congress doesn't tamper with the tax code again, which is an awfully big assumption. But if the debate in 1988 goes well, the reduced rates will remain in force, and that's going to have a powerful impact on our economy and those of the Western world.

One of the shortcomings in the economic policy of the Reagan years is that the administration did not push privatization, in every area from the Postal Service to Pentagon procurement, as early or as persuasively as it should have. In terms of cutting back programs or eliminating bad programs and curbing the growth of spending, the administration's record, to be charitable, is very mixed. Its monetary policies have been rather erratic, its approach to Third World debt rather disappointing. The administration doesn't seem to realize that Third World countries are in trouble not because of their indebtedness—which is not much worse than, say, that of Canada or Australia at the turn of the century—but because of being overtaxed, overbureaucratized, and overregulated. The Baker plan showed promise, but unfortunately there was very little effective follow-through on it. But in an imperfect world, the administration can be excused for those shortcomings, grave though they may be, because of what it has done on the tax front.

Economic Hypochondriacs

The success of the administration's tax reforms is evident from the vitriol of its opponents. Certain scholars, policymakers, and politicos seem to be prone to a kind of hypochondria when it comes to looking at the U.S. economy. From what those people write about trade, for example, you would think that America was in the red and Japan was in the black. What gets overlooked is that a trade deficit or surplus is simply a number and that its significance depends upon the particular situation. During the first 100 years of its existence, for example, the United States routinely ran trade deficits. Fortunately, in those days we didn't have an IMF or a World Bank to tell us that we were doing the wrong thing. As a result of our ignorance, we became a great industrial nation.

Japan ran big trade deficits in the 1950s and the early 1960s. It's very amusing to read what some of our experts wrote about Japan in the 1950s. They didn't write about the emergence of a giant that would humble many of our traditional industries. They wrote about what a hopeless basket case Japan was, and they often cited its large trade deficits. The Japanese were wise enough not to translate that analysis into their language, and we can see what being unaware of it did for them. By contrast, Mexico and Brazil have trade surpluses, but I doubt that even Louisiana or Texas would trade its economy for that of Mexico or Brazil.

Our large trade deficit is a sign of our strength, not our weakness. In the past four or five years our economy has grown more than those of most other nations. We've had enough money and credit to buy more goods and services from them than they have been able to buy from us. If it had not been for the American market, Europe's economy would be even more stagnant than it is, the Third World would be in even worse financial shape, and even Japan would have had considerably lower growth rates.

> **"Change, not stability, is the chief characteristic of the U.S. economy."**

We've done what a great power is supposed to do: we've carried the rest of the world with us, and we've benefited from doing so as well. If the economies of other nations had grown as much as ours has, if they had done to their tax codes what we have done to ours, and if they had pushed deregulation the way we, at least sometimes, have, they would now be in a position to buy more goods and services from us, and our trade deficit would go the way of the oil shortage.

In short, a trade deficit is neither a good thing nor a bad thing per se; it depends on the circumstances. Look at West Germany. Its economy is weak in many critical respects. Its unemployment rate is high, its job-creation record is unimpressive, and it trails the United States in many areas of technology. But West Germany does have a trade surplus, and it sometimes acts as if it were the Tarzan of the international economy. Because of that one number, the West Germans think they're doing very well.

The chief reason for our budget deficit is not that we have had insufficient revenues but that until two years ago there was a rip-roaring increase in government spending. However, our revenues have grown considerably in the past four or five years. Moreover, if you look at what might be called the net government deficit—the combined federal, state, and local deficits and surpluses—as a proportion of GNP, you'll find that we've probably done better than the Japanese and not much worse than the West Europeans. That doesn't mean that we've done a good job; it just means that almost everyone else in the world has done as bad a job as we have.

In addition, the federal, state, and local governments' combined investment is very high. (Of course, that raises the question of whether governments should be making those kinds of investments. Much of that investing should probably be done by the private sector.) So if you compare the net government deficit with the net government investment, you'll find that our books are almost in balance on an expense level.

The economic hypochondriacs claim that we are a spendthrift nation. You'd never know it from reading what they write, but the net wealth of the American people in real terms is higher today than it's ever been. Our assets have been growing much faster than our liabilities. They also claim that we don't invest enough, but as Alan Reynolds, George Gilder, and others have pointed out, whereas our investment rate has been going up in recent years, those of Japan and Western Europe have been going down.

Contrary to the economic hypochondriacs, manufacturing is the same proportion of our economy today as it was 30 years ago. What we make and

how we make it have changed, but our ability to make things has remained basically unchanged. Since the 1982 recession 13½ million jobs have been created, a very large percentage of which have been high-paying jobs. Even though we really misused and abused the economy during the 1970s, in the past 18 years or so we've created over 30 million jobs—more jobs than exist in West Germany, which has the largest economy in Western Europe.

The Intellectual Debate

The administration has failed not in the areas to which the economic hypochondriacs point but in the intellectual debate—the ideological battle. Its opponents have raised the concern that we lack compassion. In our inner cities, we see more illegitimacy, more illiteracy, more crime, more broken families, and more members of a permanent underclass today than ever before. Those conditions, as Charles Murray and others have demonstrated, can be traced directly to social engineering on the state and federal levels. And yet the policies that have had such miserable results remain in effect because they reassure us that we are compassionate. If a law has a "compassionate" purpose, we overlook the fact that the people it was intended to help have actually been hurt by it.

The administration's opponents have been allowed to get away with promoting that way of thinking. It's sort of the equivalent of the days of religious wars, when they would burn you at the stake and you weren't supposed to mind that because it was going to save your soul. The administration has given its opponents a free ride in the intellectual debate.

Unfortunately, even in circles that should know better, people have been buying the notion that the prosperity we've enjoyed during the past few years is the result of selfishness and therefore lacks moral legitimacy. They read about the Ivan Boeskys of the world, and somehow those incidents seem to cast aspersions on our economic gains.

If we're going to succeed in preserving our recent gains and making new gains, we must get across the notion that the free enterprise system does not appeal to the worst part of human nature but brings out the best in people. We must get across the notion that free enterprise gives basic rights to the individual and that letting people develop their talents to the fullest so as to meet the needs and wants of others, whether perceived or unperceived, is moral as well as productive. We must get across the notion that the free enterprise system encourages people to channel their energy into constructive paths instead of the destructive paths that we see being followed in other nations' economies. Some progress has been made in those areas, but not nearly enough.

When people say that we can't let things be determined by the market, we've got to ask, "What is the market?" The market consists of people.

> **"If we interfere with change in an attempt to preserve a mythical past, we will diminish not only our present opportunities but our future ones."**

When we talk about the discipline of the market, we're talking about individuals deciding whether to buy what's being offered to them. The nation is a democracy in terms of economics as well as politics, but until we get that point across to the public, we're going to be vulnerable to counterattacks by our ideological opponents.

Members of the administration have been weak on attacking mercantilism and beggar-thy-neighbor policies. They know that the proposed trade bill would probably have bad results. They know how much damage the Smoot-Hawley tariff did in the 1930s. But they've allowed their opponents to set the terms of the debate, and they've failed to refute the argument that we need protectionism in order to preserve jobs. We have to start pointing out that protectionism is a tax and that a protectionist trade policy would make it a crime for working people to buy a VCR. We have to bring it down to the individual level.

Progress and Change

Change, not stability, is the chief characteristic of the U.S. economy. Progress always involves change, and change is sometimes unsettling. Throughout American history there have been periods that seemed like a hurricane of change, yet the nation has always emerged from those periods the stronger for having weathered the storm.

If we learn to cope with change, virtually all of us will have a chance to advance. If we interfere with change in an attempt to preserve a mythical past, we will diminish not only our present opportunities but our future ones. What makes that fact so difficult to get across is that people don't know what they will miss if they succeed in preventing change. If we had blocked the development of the automobile, we wouldn't know that it could have increased our mobility and transformed society. The real danger is that we will fail to make people understand that they will deprive themselves of future benefits if they keep change from happening.

I'm an optimist. I believe that if the debate is properly framed—if the right people take up the right cudgels—we will have an environment in which we can build on the administration's success in reducing tax rates and make more progress in promoting free enterprise. My feeling is that when historians look back on this period, they will conclude that the nation's economy and political system had once again confounded the critics, the skeptics, and the crepe-hangers, thus enabling America to reassume its rightful role as the leader and inspiration of the world. ■

Call for Papers

The Cato Institute seeks papers on a wide range of public policy topics for publication in the *Cato Journal*, *Cato Policy Report*, the Policy Analysis series, or Cato books. Send manuscripts or proposals to David Boaz, Vice President for Public Policy Affairs, Cato Institute, 224 Second St. S.E., Washington, D.C. 20003.

Monetary System (Cont. from p. 9)

Remarkably often the stories have pointed to changes in intervention and to rumors and supposed clues about it, including statements and offhand remarks of government officials. I wonder how the foreign-exchange market would have behaved without such disturbances.

Floating rates have exhibited not only short-run volatility but also medium-run misalignments, resulting—critics plausibly allege—in distorted patterns of trade and production and in wasteful shifts of resources between domestic industries and exporting and import-competing industries. Only in a tautological, Pollyannaistic sense can one say that the exchange rate of the dollar has been "right" all along, even at its trough of mid-1980, its peak of early 1985, and its current depressed level.

It is superficial to conclude that we should have kept exchange rates fixed 15 years ago and that we should fix them again now. Prodigious efforts to keep them fixed simply collapsed. But if those efforts had somehow prevailed a while longer, what even more immense foreign-exchange crises would have destroyed the system in the face of the even more unstable "fundamentals" of the 1970s and 1980s, including the oil situation and swollen national budget deficits? (One can plausibly argue, however, that even OPEC's predation was triggered largely by worldwide inflation tracing, in turn, to the last-ditch defense of the Bretton Woods system.) More recently, even efforts to peg exchange rates loosely within fuzzy and unannounced ranges—the Louvre accord of February 1987—collapsed later that year. What is the point of saying that something should have been done or should now be done if in fact it could not and cannot be done?

It is also superficial to argue against floating exchange rates by deploring the apparent consequences of first the strengthening and then the weakening of the U.S. dollar in the 1980s. A legitimate comparison between floating and fixed exchange rates must refer to otherwise similar circumstances—if, indeed, circumstances could have been kept otherwise similar. It is illegitimate to compare actual experience with a hypothetical situation lacking the circumstances (such as those of the U.S. government budget) that made the dollar swing as widely as it in fact did.

If we want to consider how things would have worked out if the dollar had been prevented from rising to its peak of early 1985, for example, we must specify how its appreciation would have been prevented. Monetary expansion accomplished either by unsterilized exchange-market intervention or by Federal Reserve policy would have inflated the prices of domestic goods relative to the prices of internationally traded goods—that is, would have lowered the latter prices relatively—and so would have affected resource allocation and the country's trade balance in a way similar to what in fact occurred. Preventing dollar-strengthening capital inflows, conceivably through direct controls, would have relieved domestic producers of internationally traded goods from some adversity, but it would have allowed interest rates to rise and government deficit spending to crowd out some interest-sensitive investment activity, including housing.

It seems absurd to let so pervasively influential a price as a country's exchange rate jump around in response to investors' and speculators' changeable whims about their asset holdings. It seems absurd that changes in, and expectations and rumors about, monetary and fiscal policies, trade policies, and market interventions should be allowed to exert such quick, magnified, and pervasive effects. But we should be clear about just *what* is absurd. It is not the free flexibility of exchange rates (they are not *freely* flexible anyway). It is not the free-market determination of prices on the exchange markets.

The absurdity consists, rather, in what those prices are the prices *of*. They are the prices of national fiat moneys expressed in each other, each lacking any defined value. The purchasing power of each national money depends on confrontation between a restricted quantity of it and the demand for holdings of it. At bottom, the unit of account in the United States is whatever value supply and demand fleetingly accord to a scruffy piece of paper, the dollar bill. The value of each money thus depends on conjectures about the good intentions of the government issuing it and about its ability to carry through on its good intentions. Those conjectures are subject to sharp change, quite understandably.

It is an absurd system in which people cannot count on money's future purchasing power, in which money's value simply emerges as the by-product of the monetary authorities' doing whatever seems best to them month by month and day by day. It is an absurd system in which the Federal Reserve gets badgered daily by diverse unsolicited advice in *Business Week* and the *Wall Street Journal* from such people as Alan Blinder, Paul Craig Roberts, Irving Kristol, Milton Friedman, and miscellaneous editorial writers.

Given this fundamental absurdity, it is irrelevant to propose changes in the mere details of how governments manipulate exchange rates. (The proposal for "target zones," it seems to me, is hardly more than a superficially attractive combination of words, words calling for all of the advantages and none of the disadvantages of both floating and fixed exchange rates.)

A fundamental solution would give defined values to currencies. A meaningful definition of a currency's value must consist of something more than a specified rate of exchange against one or more foreign currencies, each of which continued to lack a defined value. The most familiar and plausible kind of meaningful definition would run in terms of one or more commodities.

As long as national currencies remain distinct fiat units, absurd units whose management is subject to government irresponsibility and shifting political pressures, there just will be no such things as long-run or medium-run or "fundamental" equilibrium exchange rates between them. Actual rates will necessarily be short-run market-clearing rates pushed around by fleeting pressures. Barring reform of the currencies themselves, attempts to manipulate exchange rates will do more harm than good. The misalignments and volatility we observe nowadays may be disillusioning, yet nothing is clearly preferable to letting exchange rates continue to float until we undertake fundamental monetary reform. ■

JCS Reforms Are Cosmetic, Cato Study Argues

A new study from the Cato Institute concludes that the Goldwater-Nichols Department of Defense Reorganization Act of 1986 has failed to significantly increase the nation's defense capabilities. Military analyst David Isenberg argues that although the new law may make the Joint Chiefs of Staff slightly more efficient, "the JCS reforms do not address the fundamental problem . . . : the increasing mismatch between foreign policy goals and resources to meet those goals."

According to Isenberg's study, the JCS remains the prisoner of the services that constitute it. Its emphasis on presenting a "unified view" to civilian policymakers means that its advice usually "reflects the lowest common denominator of what the services can agree on." Isenberg also predicts that most of the weaknesses in the JCS system will be corrected very slowly, if at all. "It will take a long time to develop the necessary corps of officers who have been trained and educated in joint specialties and to overcome the services' history of mistrust and rivalry."

Moreover, there is no guarantee that civilian officials will seek and heed advice from the JCS more often than they did before the reforms; even the best such advice will be "just one opinion among many." Setting U.S. foreign policy, Isenberg observes, is likely to remain "an exercise in bureaucratic decision making."

Isenberg argues that when resources are scarce, "difficult choices must be made. . . . The United States simply cannot afford to be involved in or concerned about every coup and civil war, no matter how remote to essential national security interests." The cosmetic reforms of the JCS system will do nothing to facilitate those crucial decisions.

"Missing the Point: Why the Reforms of the Joint Chiefs of Staff Won't Improve U.S. Defense Policy" is no. 100 in the Cato Institute's Policy Analysis series. It is available for $2.00. ■

Buchanan, Epstein in Book

Public Choice and the Constitution

The 1986 Nobel Prize awarded to Cato Distinguished Senior Fellow James M. Buchanan garnered international attention for the growing field of public choice economics. In *Public Choice and Constitutional Economics*, just published for the Cato Institute by JAI Press, Cato adjunct scholars James D. Gwartney and Richard E. Wagner of Florida State University present a collection of important essays applying public choice theory to constitutional interpretation.

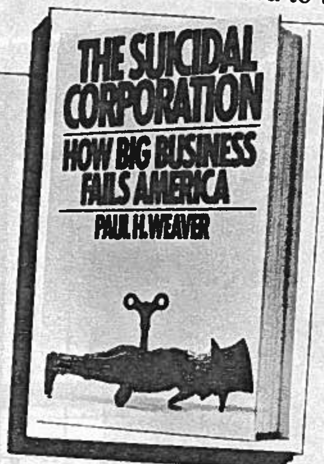
The book includes papers by Buchanan on democracy and constitutional order, Richard Epstein on taxation and regulation, Peter Aranson on the Constitution and government constraints, Forrest McDonald on the political economy of the Constitution, and Peter Bernholz on law and economic theory. Also featured are two essays in which Buchanan and Gordon Tullock each reassess their seminal 1963 work, *The Calculus of Consent*, a path-breaking study of economics and government that has become recognized as the classic exposition of public choice theory.

Cato chairman William A. Niskanen has contributed a foreword to the new book, and a paper by *Cato Journal* editor James A. Dorn offers an insightful analysis of James Madison as a forerunner of the public choice school.

The book's first two essays, cowritten by the editors, are a superb introduction to public choice theory. Gwartney and Wagner argue that "checking democratic pathologies is an even more difficult task than Madison, Hamilton, and Jay envisioned. Nonetheless, the central thrust of public choice theory is congruent with that of *The Federalist*: people are essentially the same when they act publicly as when they act privately; self-interest is dominant throughout human affairs."

Gwartney and Wagner also observe that "the intellectual folly of our age is the view that majoritarian democracy is a sufficient condition for the preservation of a free society based on the consent of the governed. . . . The use of democratic government as an instrument of plunder is as much rooted in human nature as is theft more broadly construed."

A cloth edition of *Public Choice and Constitutional Economics* is available from the Cato Institute for $29.95. ■



A Cato Institute book published by Simon and Schuster

"From the 'witches' brew' of tax loopholes to the tariffs and quotas of the 'corporate welfare state,' Paul Weaver documents how corporations lobbied for policies that have made U.S. business uncompetitive."

—*Senator Bill Bradley*

THE SUICIDAL CORPORATION is a searing critique of big business—by a strong supporter of the free market. Drawing on his experiences at Ford Motor Co., Paul Weaver shows how big business preaches free enterprise but practices big government. Despite the history of the American corporate state that he traces, Weaver ends with an optimistic look at the trends that are leading us, finally, toward a truly free market. $18.95/270 pp.

CATO INSTITUTE

Miller, Oliver Call for Privatizing Postal Service; Postmaster General, Union Pickets Defend Monopoly

Nearly 200 people heard two top Reagan administration officials call for privatizing the U.S. Postal Service at a recent Cato Institute conference, "Privatization and the Postal Monopoly."

In a luncheon speech that was picketed by 100 members of the American Postal Workers Union, James C. Miller III, director of the Office of Management and Budget, argued, "There is no good reason why [the Postal Service] should remain part of the U.S. government and no good reason why it should enjoy a monopoly over the delivery of letter mail—any more than a single company should enjoy a monopoly over such services as banking, insurance, lawyering, or telecommunications."

In the keynote address, Federal Trade Commission chairman Daniel Oliver also recommended privatization and the repeal of the private express statutes prohibiting private delivery of first- and third-class mail. Oliver urged the postmaster general to "stand up and in a loud voice call for an end to the monopoly status of the Postal Service."

Postmaster General Anthony Frank rejected those proposals to privatize the Postal Service. He called it "an old and established public institution that is a vital link in the economic and social life of the United States" and said that his mandate was to make it "a better public service that is provided fairly and equitably" to all Americans. Frank did, however, leave open the possibility of some steps toward reform, such as contracting out more "nonessential" services to private firms.

OMB director James C. Miller III tells Cato conference that "there is no good reason why the Postal Service should remain part of the U.S. government."

Cato Institute president Edward H. Crane expressed satisfaction with the large and enthusiastic turnout for the conference but told the *Washington Post* that he was "disappointed" in Frank's refusal to seriously consider privatization. Cato vice president David Boaz went further, saying, "He was a businessman for 30 years and postmaster general for 30 days, and he's already been captured by the bureaucracy."

The conference also featured Council of Economic Advisers member Thomas Gale Moore, Heritage Foundation director of domestic policy studies Stuart Butler, Cato Institute associate policy analyst James Bovard, Direct Marketing Association vice president Richard A. Barton, private delivery service executive Ken Bradstreet, Postal Rate Commissioner John Crutcher, and other experts on the Postal Service. Papers from the event will be published in a Cato Institute book later this year. ■

William Oliva of Salomon Brothers speaks on privatization options as Bert Ely, Catherine England, and Stuart Butler listen.

Postmaster General Anthony M. Frank says that "the Postal Service is a much more efficient, productive business enterprise than our critics acknowledge."

Federal Trade Commission chairman Daniel Oliver urges Postmaster General Frank to "become a genuine hero to consumers" by calling for the demonopolization of the Postal Service.

Don't Regulate Insider Trading

The Securities and Exchange Commission's proposed statute regulating insider trading is a product of special-interest pressures and should be rejected, concludes a new study from the Cato Institute.

Cornell University law professor Jonathan R. Macey writes that the SEC's proposed statute "cannot be justified on the grounds that it promotes the goal of efficiency, fairness, or market integrity. . . . Instead, the regulation we have been offered reflects a hodgepodge of special-interest concerns," primarily those of three powerful groups: the SEC, investment bankers and other market professionals, and the incumbent management teams of large corporations subject to hostile takeovers.

Macey stresses that "it is [market professionals], rather than the trading public, that benefit from a general proscription on insider trading. . . . The playing field does not become level; it simply tilts in a different direction." If true insiders were banned, other market professionals would stand to gain, since they would be the next in line to learn nonpublic information.

Macey also argues that the SEC "would prefer to return to the days when the very vagueness and incoherence of insider trading law were a significant source of power." The SEC has tried to keep the law as vague as possible "in order to maximize the demand for its services."

According to Macey, "the capital markets are driven by the quest for information. Without the ability to profit from an informational advantage, traders would have no incentive . . . to obtain firm-specific information." He warns that stricter insider trading rules would ultimately harm American securities markets and notes the success and sophistication of the markets in such countries as Japan and Hong Kong, where insider trading laws are either nonexistent or not enforced.

Macey's paper, "The SEC's Insider Trading Proposal: Good Politics, Bad Policy," is no. 101 in the Cato Institute's Policy Analysis series and is available from the Institute for $2.00. ■

Cato Journal Examines Origins, Effects of Banking Regulation

Papers from the Cato Institute conference "The Financial Services Revolution" are presented in the Winter 1988 issue of the *Cato Journal*.

Thomas F. Huertas, Robert E. Litan, and Robert A. Eisenbeis criticize the legally mandated separation of investment and commercial banking and that of banking and other lines of business. Gillian Garcia examines the insolvency of the FSLIC, and Gerald P. O'Driscoll, Jr., details the weaknesses in the federal deposit insurance system.

George A. Selgin and Kevin Dowd discuss free banking—that is, the private issuance of currency. George G. Kaufman looks at the incidence of bank runs before New Deal banking legislation took effect, and William F. Shughart II describes the passage of the Glass-Steagall Act of 1933 from a public choice perspective. Catherine England, Cato's director of regulatory studies, contends that depositors could protect their assets in the absence of regulation and deposit insurance.

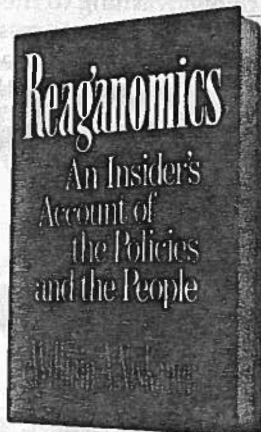
Other authors represented in the issue include Anna J. Schwartz, Richard H. Timberlake, Susan Woodward, William S. Haraf, and A. James Meigs.

James A. Dorn, editor of the *Cato Journal*, has announced the addition of two new members to its editorial board: Donald McCloskey, a professor of economics at the University of Iowa, and Robert L. Higgs, the William E. Simon Professor of Political Economy at Lafayette College.

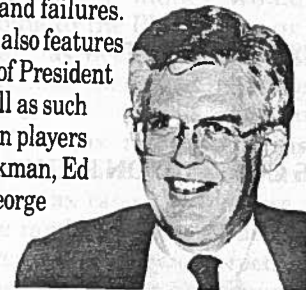
The *Journal* is available for $7.00 an issue or $21.00 a year. ■

"A lucid analysis of Reagan's economics by that rare creature, an objective insider."

HERBERT STEIN, *Former Chairman, the Council of Economic Advisers*



The outspoken former member of the Council of Economic Advisers, now chairman of the Cato Institute, offers an inside view of policymaking in the Reagan administration and a blunt assessment of its successes and failures. *Reaganomics* also features candid views of President Reagan as well as such administration players as David Stockman, Ed Meese, and George Bush.



William A. Niskanen, Chairman, Cato Institute

CATO INSTITUTE

A Cato Institute book published by Oxford University Press
200 Madison Ave., New York, New York 10016 $22.95/363 pp.

"To be governed..."

The essence of what it means to be a Democrat

Some Democratic lawmakers want to make these plans mandatory—and free.

—*Wall Street Journal*, Mar. 30, 1988

Unlike, say, the streets

Nationwide, there are 70,000 vacant apartments in public-housing projects. . . . HUD calculates that those units could house 350,000 people. . . .

However, matching homeless people to empty apartments isn't as simple as it might seem. Federal officials say that most of the vacant units fail to meet minimum standards for habitability.

—*Wall Street Journal*, Feb. 10, 1988

Could you run that by us again?

Dairymen in less prolific areas have turned their ire toward California, where dairy farms tend to be large-scale.

For instance, Jim Nichols, agriculture commissioner in Minnesota, a major dairy state where farms generally are small, complained recently, "We just can't compete with that kind of production. California is going to blow us away because states like ours are the ones that are best suited for dairy farming."

—*Washington Post*, Mar. 28, 1988

The specter of economics

Mr. Bovard sidesteps such social issues as whether we are willing to let economics determine where food is produced in the world or whether countries will make the social commitment to maintain an agriculture that can support their own populations.

—Jack Odle, editor of *Progressive Farmer*, in the *Wall Street Journal*, Mar. 17, 1988

Solidarity can be difficult

The "old Herb's" [restaurant], as it's known, got its start when authors Barbara Raskin and [Dan] Moldea wanted "an Algonquin roundtable" where members of Washington Independent Writers could gather in their free time. "The National Writers Union more or less started there," [Herb] White recalls. "They're not supposed to meet in non-union restaurants, but in D.C. [unionized restaurants] are too expensive for writers."

—*Washington Times*, Mar. 30, 1988

Or we'll hold our breath till you turn blue

Federal Reserve Board Chairman Alan Greenspan yesterday issued an unusual public warning to the Reagan administration to stop pressing the Fed to lower interest rates and boost the nation's money supply. Otherwise, he said, Fed policymakers might have to demonstrate their independence by tightening credit and raising rates even if economic conditions did not call for it.

—*Washington Post*, Feb. 25, 1988

Not *those* drugs

The Bureau of National Affairs will celebrate its new publication "Drug Free Workplace" by serving champagne and high tea at a book-signing party.

—*Wall Street Journal*, Jan. 26, 1988

A right we exercise vigorously, I might add

Iowa Republican Charles Grassley, an outspoken advocate of judicial restraint, added: "We do have a right to pass stupid laws."

—*Washington Times*, Feb. 26, 1988

At last, a vision

As Vice President Bush strolled the aisles of the World's Fishing Fair . . . [he] delivered what could easily qualify as the world's shortest campaign speech:

"I'll tell you something. If this country ever loses its interest in sports or ever loses its interest in fishing, we got real trouble and I don't think that's going to ever happen."

—*Washington Post*, Mar. 8, 1988

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