INDUSTRIAL POLICY P.5

POLICY REPORT

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Transit Planning in the 1980s

by Peter Gordon

Conventional mass transit in American cities is and long has been a dying industry—despite an elaborate effort by the public sector to save it. The industry provided about 23 billion rides in 1946; that number declined to 8.2 billion in 1980 and has fallen even lower recently. This has been in spite of an elaborate rescue effort by the public sector. Since 1964, the federal government alone has pumped $11 billion into urban transit. Many analysts have not been surprised that public policy failed: Transit flunked the market test for powerful reasons that are not to be reversed by simply subsidizing the sickly.

The reasons why the federal policy failed so dismally are fairly simple. Conventional transit has broken down not because of undercapitalization but rather because the world has changed drastically since the invention of fixed-route mass transit. The layouts of cities have changed, from the single-center pattern to more dispersion. Cheap personal transportation has been the ever more popular complement to the consumption of more living space; lateral trip-making (rather than radial traffic) has grown; perverse pricing and the growth of transportation monopolies have left the consumer with a simple choice, in which conventional transit could not win. Yet it is much easier for politicians to spend large sums than it is for them to challenge monopoly power or to develop new pricing schemes.

When the Reagan administration took office, its spokespeople announced that there would be no "new starts" of expensive urban rail projects. Many inferred from this pronouncement that the message of transportation researchers had finally overcome the many popularly held misconceptions. Now, however—just a couple of years later—there are more new starts in the works than ever before. Los Angeles, Miami, Baltimore, Buffalo, Portland, and Dallas will probably get new rail transit systems (the voters of Houston recently said no to the offer). What happened? Why the about-face?

> "The world has changed drastically since the invention of fixed-route mass transit."

Is Mass Transit Possible?

The nickel-a-gallon federal gasoline tax hike of 1982 allocated 20 percent of new revenues to public transit, despite the fact that it accounts for just 3.5 percent of all urban trips.[1] How are such lopsided allocations made? To put the question into perspective, let us look at reasons showing how hopeless the cause of fixed-route, and especially fixed-rail, transit is.

(1) Transit services are not in great demand. They are not a substitute for door-to-door service. They divert few passengers from the private car and therefore have little impact on traffic levels or air quality: There are no significant external benefits.

(2) Aside from stretch limousines, new subways are the most expensive way of traveling in cities. San Francisco's BART and the Metro system of Washington, D.C., require the largest subsidies—400 to 500 percent on each ride.[2]

(3) The more expensive a system is, the more likely it is to transfer resources regressively.[3]

(4) The great drain on energy sources during subway construction and the fact that few of the subway users have been diverted from private cars indicate that new subways are net energy losers.[4]

(5) Federal subsidies have served simply to enrich transit employees. Between 1974 and 1978, the wages of U.S. transit workers rose 25 percent faster than those of the average worker.

(6) There is no evidence that subways redirect settlement patterns.[5] No one has demonstrated an economic advantage (or even a demand) for recentralization. The journey to work gets shorter as suburbanization and exurbanization proceed.[6]

Upon examining the claims of transit advocates, some people are astonished to find that *all* of them are wrong, and often even backwards. In view of that, it is perplexing that these claims continue to be made—and continue to be accepted by both the media and the public.

Planning for Disaster in Los Angeles

The Los Angeles case illustrates just how far credulity can be stretched in favor of new rail transit. Just why and how is the whole charade taking place?

At this writing, Congress and the president have allocated $127.5 million to start construction of an 18.6-mile starter line for Los Angeles. The capital cost is (for the present) advertised at $3.5 billion—$188 million per mile. To sell the project in Washington, D.C., as

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Is Our Standard of Living Declining?

The average American family is $1,333 poorer than it was 10 years ago, according to the Tax Foundation. Despite an apparent doubling of family income, taxes and inflation have eroded the family's spendable income by 13 percent in real terms.

Such a decline is unprecedented in modern times. It reflects serious fundamental problems in the American economy—problems that political leaders have yet to face up to.

From 1973 to 1983, the median income of a "prototypical" American family (one earner employed full-time, year-round, with a nonworking spouse and two dependent children) rose from $11,895 to $24,000 in nominal terms. This apparent dramatic increase in earnings has made many Americans feel far more prosperous than they really are. Many young workers are now earning as much at the beginning of their careers as their fathers earned at the peak of their careers. But this seeming prosperity is an illusion.

During this same 10-year period, the federal income taxes paid by the average family rose 113 percent, while Social Security taxes soared by 156 percent. Direct federal taxes thus reduced the nominal gain in income by $2,225.

Inflation took an even bigger bite. The Consumer Price Index more than doubled between 1973 and 1983, bringing the purchasing power of each 1983 dollar down to 44 cents in 1973 terms. Thus the family's after-tax income in 1983 was only $8,832 (in 1973 dollars)—a 13-percent decline from the 1973 level of $10,165.

One result of inflation, of course, has been to propel more women into the work force. In the last decade the percentage of women working has risen significantly. While there are many reasons for this besides economic necessity, it is clear that the growing burden of taxes and inflation has forced many women to work outside the home. The traditional one-earner family, then, is no longer the "average" American family.

So, have two-earner families, who are now a plurality of all families, fared better in the past decade? According to the National Taxpayers Legal Fund, they have done only a little better. Instead of seeing their real incomes drop by $1,333, they have suffered a loss of only $902, or 8 percent. Their incomes rose faster than those of the one-earner families—but so did their income taxes.

Real incomes should show slight increases for 1982 and 1983 because of the 1981 cut in tax rates and the lower inflation of the past two years. It is likely, however, that families will have to scramble to stay ahead of inflation during the next couple of years, and the gains of 1982 and 1983 may well be wiped out.

This is a record of shame. In the wealthiest nation on earth, the average citizen's spendable income is *falling*. Never before in American history has there been a decade-long drop in the standard of living.

These figures do not even take into account the current high levels of unemployment, since they are based on families having one earner (or two) employed full-time, year-round. Nor do they account for state and local taxes, which have risen some 150 percent in a decade, or 50 percent faster than nominal incomes. For the past decade, rising taxes have outstripped income at all levels. It's obvious that when politicians talk about austerity, belt-tightening, and sacrifices, they don't mean government—they mean the rest of us.

Time was in America that a person who worked hard could expect to be a little better off each year. Even if his own skills didn't increase much, rising capital investment and productivity would raise wages and reduce prices, and his real income would rise. Today, however, a man or woman who works steadily and stays at the median income level is actually a little worse off each year. And of course, over the past decade, any money he managed to put away in the bank was eaten away by inflation faster than it accumulated interest.

The rising cost of government and government-created inflation is no longer being subsidized only by means of a reduced rate of increase in our prosperity. Today we are poorer every year because government is richer.

However, perhaps the picture isn't all bleak. Our incomes are smaller and our savings are eroding, but every American can sleep well at night knowing that his or her share of the national debt is increasing at a rate of $1,000 a year. ■

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well as in California (where some of the funding will have to come from), the Southern California Rapid Transit District (RTD) and its consultants developed a promotional campaign whose watchword can only be described as: Anything goes. A few highlights:

(1) Ridership forecasts amount to more passengers per mile of route than on any U.S. subway, including New York's. Southern California is projected to have twice as many riders on 18.6 miles as San Francisco's 75-mile BART.
(2) The project promises to increase long-term savings more than any alternative and will eventually produce the first break-even subway on the planet.
(3) Predictions are that the population densities of Los Angeles will soon exceed those of New York City, so that subway construction is required now.
(4) The project will guide the recentralization of Los Angeles.
(5) The new system will both clear the roads and clean the air.

It is difficult to comment on some of these assertions, they are so fantastic. Hordes of subway riders are not going to materialize. The BART failure is now legend—BART is one of seven "great planning disasters" cited by Peter Hall in his book by that name.[7] In 1968 a warning appeared in *Traffic Quarterly* that if rail transit fails in San Francisco, it is absolutely inconceivable for Los Angeles.[8] New York's transit system, although it leads the country in recovering farebox costs, is losing riders (and decaying). This is despite the fact that New York has much higher population and employment densities than Los Angeles. The population of Los Angeles has actually become more dispersed in the last intercensal decade (on the basis of Gini coefficients of area versus population for 1970 and 1980). Whereas subways do not decongest the roads, deconcentration of settlement does. According to one report, "the New York/Newark area has a lower average speed, a higher percent of time stopped, and more time spent in the low-speed regime than Los Angeles."[9] New York's transit system is approaching the billion-dollar-subsidy mark.[10] These and some of the findings cited above dramatize the disjunction between the record and the declarations of local planners.

Yet the package has been bought by almost everyone in Los Angeles. An unbelievably gullible local press has reported the entire RTD press kit verbatim. Most local politicans, civic activists, environmentalists—almost all who make public pronouncements—have endorsed the whole scheme.

The Political Economy of Mass Transit

How can so many be so wrong about so much? Many people are romantic about the past—especially when it comes to trains. Prejudging the issue, they simply *presume* that subways both divert auto traffic and have positive indirect effects. Others have simply assumed that public transit benefits the poor and the disabled. Further incentive is not lacking: Capital projects convey an image of grand activity—an image that politicians know how to exploit. Unlike the issue of highways, transit is an issue on which builders and environmentalists can hold hands.[11] Perhaps constructing transit systems alleviates a "cultural inferiority complex" that Los Angeles (and other newer cities) suffer from.[12]

All these factors support the most important political and economic fact: Capital projects are costly, but their costs are diffused over many citizens (and/or hidden), while the benefits accrue to a small group. Only that group can be galvanized into an effective lobby.

The issue of quality as it relates to officialdom is particularly bothersome in mass transit. Why are the citizens not getting the quality that they presume they are paying for?

One investigator had this response to the "Global 2000 Report to the President":

> You may wonder: How can (they) get away with work so shoddy? The answer to the question is, I think, another question: Who is there to stop

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In This Issue

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them? In a democratic society, the staff of a government agency with access to a printing budget can publish whatever it chooses. There is no censor. There is no "truth auditor" on the government payroll the way there are financial auditors to monitor money irregularities. As to outside checks, an individual outside the government must have the stomach to get into a long-odds fight against an opposition that is widely presumed to be in the right because it is "official." He or she must be willing to invest the time and energy knowing that the probability of reaching a wide audience is exceedingly slim, especially if the government report says things that are already widely believed. . . . So, *who is there to stop them?*[13]

What is needed is to encourage people to drive in pairs and groups. It has been reported by D. C. Shoup that both free and subsidized parking are inducements to drive solo.[14] "Cashing out" (a cash transportation allowance in lieu of subsidized parking) would reverse these incentives at no cost, if the tax codes were revised. (Health economists have found that the tax break given for employer-paid health insurance has also led to major allocational problems.) The incentives and disincentives now in place must be examined across the board to determine what policies would complement the Shoup proposal. For example, if concrete must be poured, more busway lanes for buses, carpools, and vanpools should be considered.[15] This sort of proposal usually shows up at the bottom of the planners' lists, if at all.

Affordability and feasibility should be paramount. Yet the Southern California Association of Governments has just unveiled a plan front-loaded with expensive rail projects. The plan proposes to spend $60 *billion* on maintaining existing transportation systems and on new projects. It contrives to suggest all sorts of benefits (better air, less congestion).[16] Where can this kind of money be found in a state so recently on the brink of doing business with IOU's?

The roads of Los Angeles County groan under 25 million trips each day. The average vehicle occupancy rate there has been reported as being as low as 1.1 (a bit lower than the national average for the largest cities of 1.3 for the work trip and 1.9 for non-work-related travel). If just a few people could be induced not to drive alone, so as to raise the average vehicle occupancy just to the national average, more than a million trips could be taken off the county's roads each day! Mass public transit cannot offer anywhere near that result.

Then why spend more on public transportation? Its costs far outweigh its benefits. Furthermore, the political-economic arrangements are such that the public will always be doomed to spend more for less. ■

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[1]U.S. Department of Transportation, Federal Highway Administration, Office of Highway Planning, *1977 Nationwide Passenger Transportation Survey*, 1981.

[2]M. Webber, "The BART Experience—What Have We Learned?," *The Public Interest*, no. 45 (Fall 1976).

[3]A. Altshuler, *The Urban Transportation System* (Cambridge, Mass.: MIT Press, 1979).

[4]Congressional Budget Office, *Urban Transportation and Energy: The Potential Savings of Different Modes* (Washington, D.C.: Government Printing Office, 1977).

[5]R. L. Knight, "The Impact of Rail on Land Use: Evidence and a Change of Perspective," *Transportation* 9, no. 1 (March 1980): 3-16.

[6]P. A. Morrison and A. Abrahamse, *Is Population Decentralization Lengthening Commuting Distance?* (Santa Monica: The Rand Corporation, 1982).

[7]Peter Hall, *Great Planning Disasters* (Berkeley: University of California Press, 1980).

[8]George W. Hilton, "Rail Transit and the Pattern of Modern Cities: The California Case," *Traffic Quarterly* 21, no. 3 (July 1967): 379-93.

[9]M. Chang and R. Herman, "An Attempt to Characterize Traffic in Metropolitan Areas," *Transportation Science* 12, no. 1 (February 1978):58-79.

[10]J. B. Ramsey, "Selling the Subways in New York: Wild-eyed Radicalism or the Only Feasible Solution?," New York University Department of Economics, 1981.

[11]R. Ellickson, "Comment," in *Transportation Alternatives for Southern California*, ed. P. Gordon and R. Eckert, University of Southern California Center for Public Affairs, 1976, pp. 132-35.

[12]M. Wachs, "The Case for Bus Rapid Transit in Los Angeles," in *Transportation Alternatives*.

[13]Julian L. Simon, "Global Confusion 1980: A Hard Look at the Global 2000 Report," *The Public Interest*, no. 62 (Winter 1981): 19-20.

[14]D. C. Shoup, *Free Parking as a Transportation Problem*, University of California Graduate School of Architecture and Urban Planning (Los Angeles), 1979.

[15]P. Gordon and P. Muretta, "The Benefits and Costs of the San Bernardino Busway: Implications for Planning," *Transportation Research* 17A, no. 2 (March 1983):89-94.

[16]Southern California Association of Governments, *Draft Regional Transportation Plan Summary*, Los Angeles, 1983.

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David Boaz,
Editor

Does the United States Need an Industrial Policy?

Every month the Cato Institute sponsors a Policy Forum at its Washington headquarters, where distinguished analysts present their findings to an audience drawn from government, the public policy community, and the media. A recent Forum featured Bruce Bartlett, executive director of the Joint Economic Committee. Commenting on Bartlett's talk was Kent Hughes, legislative director for Senator Gary Hart (D-Colo.).

Bruce Bartlett: It was on June 30, 1980, that I realized that industrial policy was an important issue. On that date *Business Week* published a full-length issue on the question: Does America need reindustrialization? The gist of the argument in that issue has been repeated over and over again in the industrial-policy debate.

The argument is that in some sense our industrial capacity is declining. We are somehow becoming a nation of fast-food restaurants rather than doing the "macho" thing of producing steel and automobiles. One of the principal pieces of evidence is that employment in the manufacturing sector has declined very sharply over the last few years. This is true. However, if you check the data, you find that *output* has not fallen. In 1950 the percentage of the gross national product originating in the manufacturing sector was 24.5 percent. In 1980 it was 23.8 percent. It has been up and down within a percentage point or two of those numbers throughout the last 30 years.

So there's no evidence to suggest any widespread decline in our ability to produce manufactured goods. To the extent that employment has fallen, it simply means that productivity has risen.

There's also a notion around that ours has now become a service-oriented economy. I checked the numbers on that, too; in 1960 as a share of GNP the output of goods was 45.6 percent, output of services was 42.4 percent, and output of structures was 12.1 percent. In 1981 goods were 45.8 percent, almost exactly the same as 1960. Services had increased slightly, to 46.3 percent, but the increase had come not at the expense of goods output but rather at the expense of structures, which had fallen to 7.8 percent of GNP.

So I don't see in the macroeconomic data anything to support the idea that we need an industrial policy. I've concluded that the whole drive for an industrial policy comes from the bankruptcy of the Keynesian philosophy, which was the dominant view in economic policy after the 1930s.

A Cato Institute Policy Forum

The problem with the Keynesians was that they used to say things like "all you need to do to reduce unemployment is increase the budget deficit" and "you can't have inflation and unemployment at the same time." These ideas have now been totally discredited. There are both conservative and liberal Keynesians; the difference is that conservative Keynesians worry more about the inflation side of the inflation/unemployment tradeoff and the liberal ones worry more about the unemployment side. Into the intellectual vacuum that followed the breakdown of Keynesianism came new ideas like supply-side economics, rational expectations, public choice—ideas that really couldn't have been developed as long as the Keynesian consensus held.

The supply-side view has fallen on hard times lately, and this has created a new vacuum, into which the industrial-policy advocates have moved. Their basic notion is that if you can't fine-tune the macro economy, let's fine-tune the micro economy. They just discard macroeconomics altogether. This allows them to dismiss supply-side economics with the same brushoff the post-Keynesians used to dispatch Keynesian economics. In his latest book, Lester Thurow essentially says that all macroeconomic policy making is a failure because no one can predict or fine-tune the macro economy. He also states that the problems facing our economy today are new and different problems; they're really not susceptible to the broad-brush tax-and-spend policies that have been used during the last 30 or 40 years.

What the industrial-policy advocates are saying is, "If we have a problem with the steel industry, let's devise a package that helps that industry rather than trying to cut tax rates across the board as the supply-siders want, or pumping up aggregate demand as the Keynesians prefer."

Unfortunately, with this approach come the inevitable ripple effects. A policy to help the steel industry, if it includes import restrictions, results in increased costs for steel consumers. One of the primary consumers of steel is the automobile industry. High-priced steel makes that industry less competitive, and next you have to have an automobile-industry policy to deal with the problems created by the steel-industry policy.

This microeconomic notion of industrial policy—which has been put forward most strongly by Felix Rohatyn—says that we need some nonpartisan group to run a Reconstruction Finance Corporation of sorts. (Not coincidentally, such a body would be modeled upon Rohatyn's greatest success—or failure, as the case may be—the Municipal Assistance Corporation in New York City. That monolith essentially ran the city for many years without any accountability to the electorate.) These industrial-policy proponents want to

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use objective standards to pick winners and let losers die, as we are told that the Ministry of International Trade and Industry (MITI) does in Japan.

There are two problems with this attitude. For one thing, it is just ridiculous to assume that government bureaucrats—no matter how well-meaning or even skillful they are—can in any way duplicate what entrepreneurs try to do in the market every day.

Second, we have a very incorrect view of the Japanese situation. They've been very successful economically, and they have a Ministry of International Trade and Industry. So we conclude that MITI must be the cause of the success. But we tend to ignore MITI's failures. Many of the Japanese economy's successes have come in spite of MITI's direction. We also ignore many of the other factors that more fundamentally underlie the Japanese success—such as their policy of essentially not taxing capital gains and interest. That policy has given them the highest investment and savings rate in the world. The fact that the country has the lowest rate of taxation of any industrialized country is of far more importance than anything MITI has been able to do.

All in all, the arguments for an industrial policy really boil down to political arguments. People running for office have to have some kind of program. If the one you've been running on in the past becomes discredited, you just find another one.

The only industrial policy that can work is a free-market policy. Just recently, in fact, I heard some interesting evidence that I think strongly supports this belief. Barry Bluestone, a very strong advocate of industrial policy and a particular advocate of plant-closing laws, mentioned that during the 1970s, 38 million specific jobs were destroyed in this country in the normal course of events. Some companies went into business, some companies went out of business, certain jobs were created, others were eliminated, yet we *didn't* have 38 million unemployed in this country. Those people found other jobs in other industries.

So the ultimate solution to the problems that spawn discussions of industrial policy is simply to institute a growth-oriented policy. We should examine the barriers to growth, and figure out how to increase the rate of return on saving and investment.

Inflation is probably the single most important reason why the industrial sector in this country has been suffering over the last few years. One of the reasons for this is outmoded tax laws that force companies to depreciate on the basis of previous cost. That is unrealistic because the dollars being written off in taxes every year are not equivalent to the dollars that were spent to build the plant in the first place. It is mainly because of these antiquated depreciation laws and inflation that we have had an insufficient level of capital investment in this country.

Bruce Bartlett

But there is no conceivable way that an industrial policy can deal with these problems. Where would the new saving come from? It's certainly not going to come from creating a Reconstruction Finance Corporation that's going to go into the market and borrow in the name of the government just as all the other governmental agencies do—a situation that everybody (rightly) complains about. Short of doing something to encourage creating net capital, and creating real saving, there really isn't any way to direct the existing stock of capital more efficiently than the market does.

Kent Hughes: The remarks I'm going to make are my own opinions and do not necessarily represent those of my employer, Senator Gary Hart.

Bruce has quite accurately summed up recent economic history: Economic analysis has gone beyond focusing simply on macroeconomic policy. The supply-side approach, quite popular at the beginning of the Reagan administration, has not worked as well as its proponents promised. So people have been searching for something else. This state of affairs is partly a product of stagnated productivity growth in the late 1970s, and also a function of four shocks that we've been trying to overcome.

One shock is that certain industries in the United States that had been preeminent for much of the postwar period were suddenly under strong attack from foreign competition and were suffering from the effects of rapid technological change. Second, several our high-technology industries realized how formidable foreign competition had grown.

Third, we were astounded by the outsize success of Japan, a small country endowed with virtually no natural resources. In compensation, its principal resource has been a resourceful, highly motivated, and well-educated people. Japan is a country that seems to have done well by violating many of our old saws. Whereas we were told to always keep markets open to foreign competition, Japan has prospered by keeping its markets closed, using a rolling infant-industry strategy. Whereas we were told that government intervention should be minimal, in Japan the government had a tremendous role in directly and indirectly allocating capital.

Finally, caught off guard by the surprising example of Japan on one side, America was disturbed by the specter of British industrial decline on the other. Our response to these shocks has been to search for a helpful policy. Many of the alternatives come under the rubric of "industrial policy."

In fact, there are many different policies under that umbrella. Let me give you less of a caricature and more of a characterization of industrial policy. I will cite a few examples, remarking on some of their complexities.

For instance, in the steel industry the problem may well be more complex than can be remedied by opening or closing up the American market. Several industrial countries, including Japan, are gradually adjusting their steel-making capacities. Several nations are attempting to share the burden of that adjustment process fairly. A free-market advocate might say, "The best thing is simply to let the process run its course in the United States, regardless of how many workers are displaced or what happens to communities and so forth." Another perspective would be to say, "Why should the United States bear the full brunt of this adjustment?"

Looking at the Japanese example, I came to realize that the popular image of the brilliant MITI bureaucrat who puts his feet up on the desk and says, "Well, next week we'll invest in fiber optics" is entirely the opposite of the truth. In fact, what the MITI bureaucrat does is pay attention to the particular industry for which he is responsible and attempt to see in which direction the market—domestic and international—is heading. It's a market-complementing process; in many instances it seems to have worked very well. Japan has become gradually more like the United States as it has grown and prospered. The capital market, which was virtually nonexistent in the early postwar period, is now growing more complex and is opening to foreign investment. Some of the more advanced firms are now providing their own capital and are not as dependent on the banking system as they were.

Parenthetically, Japan is often cited as an example of how low taxes on capital, which increase the return on capital, are able to increase the rate of saving. That may be the case, but there are different schools of thought. A number of Japanese scholars argue that what the Japanese are attempting to do is to restore the position of wealth that they held before World War II. That theory holds that for several years there will be an aberration in which the rate of savings is very high. As home ownership and other types of accumulated wealth grow, we expect that savings rate to fall. That at least is consistent with what's happening right now.

Bruce argues for changing the tax laws to increase the rate of return on capital, and through this mechanism to increase the rate of saving. This may not work. In the 20th century in the United States, the savings rate has been remarkably stable overall. (There are different views as to why.) So I doubt that changing the rate of return on investment will necessarily increase the overall savings rate, even if it did increase investment in certain fields.

In the second place, Bruce stresses the operation of the free market so exclusively that he ignores the necessary role of government in a policy for balanced growth. Let me sketch out another version of industrial policy. It is based on a balanced partnership of private and public sector. The goal of this alliance is to increase the rate of economic growth, both to take advantage of our assets and to accommodate the realities of the international marketplace.

I think what we need in the United States is a six-step process in which, first, we formulate tax rules and other

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C-SPAN, the national cable network, televised the Cato Policy Forum.

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rules so as to increase the rate of capital formation in new plants and equipment. This should be done in a neutral way, so as to avoid biasing the process toward one industry rather than another. Second, we should recognize the importance of public investment. In a continental economy, the industrial infrastructure is absolutely vital to the process of industrial growth. Third, we should acknowledge that the United States can still benefit greatly from public investment in research and development. Fourth, we ought to take what suits our needs from the lesson of Japan. It is not so much that we should or could imitate the MITI process, but that we must take note of the enormous returns that accrue to any country that invests in its people. In the United States this means making a commitment to effective education, especially at the elementary and secondary levels. By effective education I mean more emphasis on the fundamentals: math, science, languages, and an ability to communicate effectively in English, whether spoken or written. We need to approach inculcating these skills taught at all levels—from elementary schools to universities, including vocational schools—so as to meet the needs of the marketplace, the needs of an economy that can and should grow.

The fifth step in the process is to include what I would call an entrepreneurial bias. The environment (of regulation, taxation, and so on) should not make it more difficult for the individual entrepreneur to go out and start a new firm.

Sixth, I think we *must* pay more attention to the international marketplace. In my view, one of the basic mistakes of the Reagan administration is that its monetary policy is entirely geared to controlling domestic inflation. But this is not 1950, it's 1983. Without modification, the old answers do not apply to today's problems. The United States faces an extremely competitive international environment. We are seeing delayed investment, because of the combination of high interest rates, a recession, and the overvalued dollar. The impact of this troika on such industries as semiconductors, racing to keep abreast or ahead of foreign competition, could be devastating.

Cato Journal editor James Dorn talks with William Poole of the President's Council of Economic Advisers.

Some say that we already have an industrial policy, in that the accumulation of taxes and trade policies, as well as regulations that have a differential impact on our industrial growth, after all compose a kind of industrial policy, albeit unconscious and uncoordinated. The argument that would follow is: Why not bring some coherence to this process rather than letting our growth curve just proceed haphazardly?

Again focusing on the international marketplace rather than only the domestic economy, some say that in most of the industrial world and much of the developing world we face a decision—whether or not to move into certain industries. For instance, if Japan, which arguably has an undervalued currency, decides to aim at a particular industry—let's say semiconductors—for several years, it will give Japan enormous leverage in relation to the semiconductor industry of the United States. Industry is not a mechanism that can be started and stopped like the engine of a car. Businesses are organic creatures that must proceed through one stage after another. If a business misses a stage or two, it may be out of the game.

Another perspective on industrial policy—just to show how many different views are now under this umbrella—wrestles with the problem of management. How does an industrial country that feels committed to economic growth, social objectives, and foreign policy commitments, deal with the problem of inefficient management? Take the hypothetical case of the automobile industry. One gets the impression that the industry has been slow to innovate, to catch up in quality, to modernize, and so forth. There *is* a free-market way to deal with that problem. The government can simply let imports come in, regardless of the cost in terms of lost jobs and devastated communities. Result: Either management gets the message or management is out of business.

Although that approach can work and would probably be a part of an effective industrial policy, it does entail enormous costs. And those who support domestic-content legislation argue that we should take a leaf out of Europe's book; we should take advantage of good Japanese management and Japanese systems for dealing with employees. Why not temporarily lift U.S. trade barriers, attract foreign capital here, create a more competitive internal domestic market, and force management in various industries to become more competitive? And if this strategy doesn't work, at least it will not have eliminated an enormous number of jobs and eroded the industrial base.

Bruce Bartlett: The charge of bad management was first levied by a couple of professors at the Harvard Business School. They argued that for some unknown reason there is suddenly much bad management, in which managers are emphasizing only the short run. The professors failed to recognize the pressures and the institutional situations that forced managers to operate for the short run. In an inflationary economy, a manager is too constrained to consider the long run. He cannot begin to predict his prices, his costs, or any of the other variables that must figure in his planning. The economic environment that he finds himself in during inflation is unstable.

Critics ask why American companies kept on making big cars while the Japanese were making small cars. The price controls on oil, which kept the U.S. price of gasoline below the world price, explain a great deal about this. People wanted large cars then.

Also, the wages in the automobile industry were a contributory factor. Some analysts have said that virtually the entire difference in the cost of U.S. and Japanese automobiles can be explained by the substantially higher earnings of U.S. workers. Partly as a response to that claim, union advocates of industrial policy frequently talk about Japan's lifetime-job program. Well, first of all this only applies to a small segment of the Japanese population. Only workers in the largest companies have anything like lifetime employment, and these companies vary their labor costs mainly by contracting out much of their work. So when such a firm no longer needs the services of some subcontractor, it just cuts off his contract, thereby costing his employees their jobs. But more important, the Japanese companies have a policy of paying the workers a large portion of their yearly income in the form of bonuses directly related to the profitability of the company. So if profits go down, the bonuses go down. This formula has the effect of an across-the-board wage cut. In this country we have not much used wage cutting as a way of dealing with drops in demand or profits. Instead, we have usually forced companies to lay off workers. It is the only feasible way of reducing their employment costs.

Kent Hughes talks with Cato public affairs director Janet Nelson and Richard Gamble.

Kent said that saving cannot be increased because saving as a share of national income has been about the same year after year. But it certainly stands to reason that if one's interest income is not taxed one will want to save more than if it is taxed. Economists disagree on the magnitude—but there's no question that increasing the rate of return leads to more savings.

The overvalued dollar is an important feature of any discussion about industrial policy. How is it possible to speak of any kind of price being over- or undervalued, outside of a context of government intervention? The price is the price. It is whatever the people in the market are willing to pay. Whoever believes that the dollar is overvalued ought to be shorting the dollar against the yen. People who say that the dollar is overvalued are probably passing up tremendous opportunities to profit.

Kent claims Japan uses the infant-industry argument very successfully. On that subject, there was an interesting article in *American Economic Review* in which Anne Krueger, the reigning expert on this subject, made the first empirical investigation. She found no evidence whatsoever that the infant-industry strategy has ever worked anywhere.

Kent says that we do have an industrial policy. That is certainly true, but why would we want to coordinate and centralize an existing policy that is no good to begin with? Instead we ought to be dismantling our existing industrial policy, not enhancing it. ■

Coming in Policy Report:

James M. Buchanan on the role of economists

Murray Weidenbaum, Melvyn Krauss, Paul Heyne, and Victor Canto on free trade

The UN and the International Economic Order

UNCTAD: An Organization Betraying Its Mission, *by Stanley Michalak Jr. (Washington, D.C.: The Heritage Foundation, 1983), 78 pp., $3.00.*

The United Nations has been moving on a number of fronts to control international resources and regulate international economic activities. Among the most important vehicles promoting what UN Ambassador Jeane Kirkpatrick calls "global socialism" is the United Nations Committee on Trade and Development (UNCTAD).

Stanley Michalak has written a book assessing UNCTAD's place "at the center of a struggle to replace the existing international economic system with a new, collectivist order." He begins by detailing the four major issues in controversy between the developing and industrialized nations: the degree of centralized control over the international economic system, the method of setting international prices of goods and services, the responsibility for Third World development, and the role of private investment in developing the Third World. The developing countries have yet to achieve all of their redistributive goals. Michalak warns that UNCTAD will be a forum for "a perpetual war of attrition between the developed and developing countries." The former will accede upon occasion to collectivist proposals that will not bring about either economic growth or equity in the developing world.

The "authoritarian and totalitarian symptoms" of the agency are also detailed in this work. For historical background, Michalak reviews the political culture of the UN and its effect on UNCTAD. He gives the reader some insight into the selectivity and favoritism of UNCTAD's staff and operations.

The bulk of the book then traces how UNCTAD developed and how it has been used as a weapon of international economic and political warfare. The result of that, he says, was the discouraging reality that "almost eighteen years of debate had led to greater rigidity, more hostility, and less likelihood of accommodation on any major issue."

Michalak concludes, "UNCTAD presents the United States with fundamental philosophical, economic, political, and institutional challenges." Athough he presents several options for trying to change the organization, he believes that there is only one real answer, one that gets to the heart of the matter:

> UNCTAD is a mirror of all the ills that have infected the United Nations system. The time has come to look at UNCTAD within the wider context, to face the obvious conclusion that any series of objective studies would warrant, and to adopt the obvious policy implications—selective and minimal participation within the United Nations system.

—Doug Bandow
Inquiry

Policy Report Reviews

Disorganized Crime: The Economics of the Visible Hand, *by Peter Reuter (Cambridge, Mass.: MIT Press, 1983), 256 pp., $17.50.*

The orthodox view of the Mafia, or "organized crime," is that it obtains most of its revenues from such illegal activities as gambling and loan sharking, and conversely, that most of the proceeds of those illegal activities find their way into Mafia coffers. But Yale-trained Rand Corporation economist Peter Reuter rejects both parts of this view. From his work based on police files, interviews with informants, and confiscated records of criminals, he finds that although these contentions may have been true once upon a time, they are true no longer. The modern Godfather now relies on a reputation for violence earned in a bygone era, and simply provides arbitration services to the underworld, using "contingent enforcement" only as needed.

The implication of this analysis for policy making, in the author's opinion, is that if the goal is to reduce organized crime, efforts at suppressing gambling, bookmaking, and numbers games will be a poor means. There is nothing terribly objectionable in this nonnormative thesis. However, there are several unrelated problems that recur continually throughout Reuter's analysis.

First, he never really comes to grips with the doctrine that it is always morally justified for the government to suppress all Mafia-type activities. Within limits, he is willing to challenge the orthodoxy of ends and means. Yet he swallows whole the traditional assumption about ends, namely, that all activities branded illegal by a group of legislators must perforce be prohibited. Evidently, he has either not heard or else refuses to consider the aphorism "no man's liberty or pocketbook is safe when the legislature is in session." Many people, though, think that there is a higher law than what is concocted by politicians. According to the philosophy of natural right, individuals have the right to engage in nonviolent activities between consenting adults. These specifically include gambling, numbers, and lending at mutually agreeable interest rates, however high.

A second difficulty, related to the first, is Reuter's inability to distinguish the morally legitimate activities conducted by criminals (whether organized or not is immaterial) from those that are illegitimate. For example, Reuter considers all of the following to be in the same (im)moral category: "terrorist groups, illicit gun dealers, gamblers, drug dealers, fences, robbers, corrupt police, bookmaking, prostitution, numbers, heroin importation, loan sharking." But surely we can distinguish between such invasive activities as murder, rape, theft, extortion, fraud, and the cases where the Mafia's only "crime" is to provide a service demanded by the citizenry. If the government tomorrow outlawed baroque music or apple juice as being subversive, and Mafiosi supplied these goods in violation of the law, they would be heroes, not villains. In such a case they would have to be applauded, not denigrated. But Reuter does not discriminate as he groups all activities of the Mafia into a single category.

A third problem evident throughout the book is the author's confusion concerning the concept of competition. Reuter takes the orthodox line of perfect competition. According to this view, if there are numerous small, noncoordinated criminals, the underworld is a competitive industry. And this he would accept. However, if there is one single master criminal at work (or if there are several such people) coordinating all or most of the illegal activity, it is monopoly. This is not at all acceptable, in Reuter's view.

The model proposed in this book is both simplistic and unhelpful. The alternative perspective—that initiating violence, no matter how small, is always wrong; acting consensually, no matter how large the scope, is always proper—sheds far more light on human activity.

—Walter Block
The Fraser Institute

New Policies, New Politics: Government's Response to Government's Growth, *a staff paper by Lawrence D. Brown (Washington, D.C.: Brookings Institution, 1983), 71 pp., $5.95.*

It is widely believed that in the last decade the United States has developed a "new politics"—new relationships among major institutions of government, political parties, and outside groups. The new politics is characterized by an overcentralized executive branch, an activist Congress, an intrusive bureaucracy, a proliferation of single-issue interest groups, and a decline of political parties. Simultaneously, the government has embarked on new policies, primarily the policy of growth in the scope and scale of the federal government's agenda. As the federal government has taken on new tasks, its institutional capability to carry them out has become increasingly doubtful. The independent attitude of Congress and the attention demanded by interest groups and bureaucracies have made policy making a rocky procedure.

To explain the correlation between the restructuring of politics and the change in policies, Brown theorizes that the changing policies are at the root of the new phenomena. As the government's agenda grows larger, new problems arise from the new programs (how to make them work, how to fund them, how to preserve previously established domains). The changing policies then inspire new political efforts to find solutions. For example, interest groups become more vocal to make sure they do not get stepped on; Congress writes more detailed and inflexible legslation; and bureaucracies increase because of their growing job of sorting out and executing the details of the new legislation. Over time, these inspired efforts and the groups behind them become prominent in the universe of political actions. Finally, the new politics generate new policies because the executive branch undertakes more direct actions in hopes of circumventing the new complexity of the political arena.

Brown's analysis of how structural changes occur is interesting. The discussion completely lacks, however, any perspective on the fundamental individual motivations involved in the transformation. The groundwork of personal motivation is crucial to explaining any social phenomenon. On this score, Brown would have done well to follow the lead of James Buchanan, Gordon Tullock, and other theorists of the "public choice" school of political economy. These theorists begin their investigations with the assumption that political officials act in their own self-interest, just as participants in the market do. The hypothetical goals of these actors (the goals utilized in analysis) are to maximize their income, departmental spending, departmental budget, fringe benefits, power, and leisure. No one with a libertarian understanding of society would find these assumptions scientifically inappropriate.

By incorporating personal motives into their analysis, the "public choice" theorists provide an integrated explanation of "micro" (choice making) and "macro" (structural, institutional) phenomena in the political world. Brown's study, on the other hand, deals only with "macro" events. The reader does not feel fully informed or convinced by the study, because the "micro" underpinnings of the issue are absent. ■

WORLD DEBT AND THE MONETARY ORDER

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"To be governed . . ."

Perfectly redundant

The nation's gasoline market is nearly perfectly balanced between supply and demand, a condition that should keep prices stable, oil industry analyst Dan Lundberg said yesterday.

—*The Washington Post*, Sept. 26, 1983

What's government for if not to help people in trouble?

Last year, when the eyes of Texas were focused on a torrid gubernatorial race between incumbent Republican William Clements and Democrat Mark White, the GOP-controlled [U.S. Department of Agriculture] found a way to channel about $200 million in low-yield disaster payments to Texas cotton farmers hit by bad weather. . . .

Iowa, in contrast, where farmers were hit by a similar disaster, couldn't get any help. But there was no hot election going on there.

—*The Washington Post*, Sept. 26, 1983

Got to play by the rules

[Jim] Mattox, the first sitting attorney general in Texas history to be indicted criminally, is accused of threatening to use his office to ruin the municipal bond business of Fulbright & Jaworski, a 320-member law firm in Houston.

The alleged threat came as Mattox and senior partners of the firm were feuding over a $1.7 billion mineral rights suit that the state and a south Texas rancher-oilman, Clinton Manges, brought last year against Mobil Oil, a client of Fulbright & Jaworski. . . .

According to a telephone conversation taped by J. Wiley Caldwell, a senior partner at the firm, Mattox allegedly threatened to cut off or delay 17 municipal bond sales involving the firm unless it agreed to back off the subpoena. . . .

Many firms that compete for the no-bid [municipal bond] work help bankroll the election campaigns of the public officials who control it—and Fulbright & Jaworski, the nation's 11th-largest firm, is no exception. Its partners raised substantial funds in 1982 for Mattox, among others. . . .

Manges gave more than $1 million in political contributions last year, most of it to progressive Democrats, and his business affairs keep him in commerce with the state.

—*The Washington Post*, Sept. 15, 1983

But do taxes begin at conception?

In an otherwise bland discourse against abortion, William E. Dannemeyer (R-Calif.) suggested that as the nation's fertility rate drops, abortions threaten the nation's ability to produce more taxpayers to help pay off the national debt.

—*The Washington Post*, Sept. 23, 1983

She's such a strong believer in precedent, next she can be a judge

Former mayor Jane M. Byrne spent more than $180,000 in tax revenues to pay for airline tickets for her daughter, gifts for bodyguards and flowers for funerals, a newspaper says.

The Chicago Sun-Times reported that Byrne fought all the way to the state Supreme Court to have the expenditures kept secret, finally losing her battle a few weeks ago. "I was just following the precedent of past mayors," Byrne said.

—*The Washington Post*, Sept. 1, 1983

Staying in touch with the grass roots of Paris

While preaching the gospel of government austerity, the Reagan administration has watched a number of its flock run afoul of federal travel rules. . . .

A number of federal officials have accepted travel expenses from companies and trade associations that are affected by their decisions. Others have conducted a remarkable amount of business in the vicinity of their home towns, particularly during weekends and holidays. . . .

Many officials routinely fly first class or on government and military planes, rent private charters, take the supersonic Concorde and are met at each stop by limousines.

Dozens of officials also have found a need for frequent travel abroad, especially to the capitals in Europe and Asia. . . .

One voucher submitted by then-Deputy Transportation Secretary Darrell M. Trent explained his $3,219 first-class ticket from Washington to Paris by saying: "Coach class would not have enabled [Trent] to reach his destination on time." . . . .

Another official who traveled in style was then-Deputy Energy Secretary W. Kenneth Davis, who spent nearly $35,000 in air fare during two years. Most of it was for first-class travel to Europe and 17 trips to his home town of San Francisco, where he has since rejoined the Bechtel Group.

—*The Washington Post*, Sept. 25, 1983

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