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Economic Reform in Ex-Communist Countries

by James A. Dorn

The events of 1989 and 1990, which led to the collapse of communism and the rise of market liberalism in Eastern and Central Europe and the Soviet Union, brought the Marxist-Leninist vision of a socialist utopia to an abrupt end.

In 1917 Russia began its socialist experiment with the hope of creating a new society where individuals would be free from want and able to realize their full potential. The socialist dream of freedom and prosperity failed to become reality because the Communist party prevented the development of private property and a rule of law. Under communism, there was no wall between the state and the individual. All economic and social decisions became political decisions, and everyone became a ward of the state. The loss of individual responsibility under socialism created what St. Petersburg mayor Anatoly Sobchak called a "parasitic mentality," which destroyed civil society and crippled economic life.

Under socialism, the elite of the Communist party, not the workers, became the new ruling class. Power, not freedom, prevailed in the Union of Soviet Socialist Republics; and corruption, not justice, was the outcome. Thus, at the end of the socialist experiment, Boris Yeltsin could say: "The experience of the past decades has taught us Communism has no human face. Freedom and Communism are incompatible."

In 1985 Mikhail Gorbachev instituted his policy of glasnost to open the Soviet Union to the West and to allow greater personal and political freedom. What he failed to realize was that once the gates of freedom were open, they could not be shut. The fall of the Berlin Wall in November 1989 and the collapse of the Soviet Communist party in March 1990 were death blows to the old political regime. By the end of 1991 the Soviet Union had ceased to exist.

The rapidity of the political revolution that rocked Eastern and Central Europe in 1989 and the Soviet Union in 1990–91 astonished the world, as country after country left communism and adopted democracy without major bloodshed. That political change paved the way for economic reform and the transition to a free-market system.

The course of the transition, however, will depend on how successful the ex-communist countries (ECCs) are in instituting private property, liberalizing prices, opening trade, and establishing sound currencies. More fundamentally, unless the ECCs are able to nourish an ethos of economic liberty, there is little prospect of depoliticizing economic life and creating a private free market. In that sense, the creation of a civil society, in which the rights of persons and property are protected by law, is a process that must evolve naturally

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James A. Dorn is vice president for academic affairs at the Cato Institute and professor of economics at Towson State University. This article is adapted from a paper to appear in the *Handbook of Austrian Economics*, edited by Peter J. Boettke (London: Edward Elgar, 1993).

In This Issue

Cato vice president Jonathan Emord and regulatory studies director Brink Lindsey talk with author George Gilder after a Cato Policy Forum on how government regulation is inhibiting tremendous developments in telecommunications technology.

Time to Replace the Income Tax

President's Message

The huge victory for term limits in November's election may portend more for America than an eventual constitutional amendment making such limits the law of the land, for the term limitation movement represents a fundamental triumph of the people over the special interests and entrenched politicians. A Gallup Poll taken shortly before the election showed that the one group—except politicians themselves—most opposed to term limits was composed of Washington lobbyists, federal bureaucrats, and congressional staff. Inside the Beltway in Washington, D.C., there is what can only be described as a visceral hatred of the very concept of term limits: Who are they to presume to tell us how this system is going to work?

Yet in this effort to reclaim control of government, the people are ignoring the professional politicians, the establishment media, the self-proclaimed "public interest" groups, and others opposed to the "naive" concept of a citizen legislature. And their apparent success may well lead to other radical (in the sense of causing fundamental change) attempts to set things straight in America. Term limits may create a state of mind in Americans that says, "*We* can tell the politicians how things are going to be, rather than the other way around."

One such possibility lies in the fledgling but growing grassroots movement to replace the federal personal income tax, corporate income tax, and capital gains taxes with a federal retail sales tax. Such a move could have a profoundly positive impact on our nation.

It should be stated at the outset that this proposal, if it is to gain popular support and if it is to succeed, must be clearly understood to call for an immediate *replacement* of the income taxes, not something that will be phased in over time or traded off against a (temporary) reduction in income tax rates. The last thing we need is a national sales tax on top of our current tax structure.

The second thing that should be understood about this proposal is that it definitely is *not* a value-added tax (VAT). Because VATs tax goods and services at each level of production, the bulk of the tax is hidden from the consumer (who nonetheless pays his VAT, as well). A major benefit of a federal retail sales tax is that the consumer will see right on his receipt the cost of the federal government to him. VATs are much easier to increase (witness the experience in Europe) than would be a federal retail sales tax. In fact, one of the advantages of the sales tax is that it is so simple it would create taxpayer solidarity. Instead of grabbing for our wallets whenever a politician mentions "tax reform," we could just vote for the candidate who proposed lowering the sales tax.

There is support for replacing the federal income taxes with a retail sales tax within a surprisingly broad spectrum of the economics community. Supply-siders view it as the ultimate boost to incentives, and liberal economists see it as a way to end the manipulation of the tax code by special interests. Virtually all economists agree that such a proposal, if implemented, would result in a massive increase in savings and, hence, productivity. Boston University economist Laurence Kotlikoff, an adviser to President-elect Clinton, has written, "Because of its clarity and simplicity, a uniform federal retail sales tax might be the one tax that would have enough staying power to put an end to our politicians' constant, and very costly, tinkering with taxes."

Kotlikoff estimates that this radical change in the way government is financed would "immediately and dramatically" increase the savings rate, increase real wages significantly, and boost per capita economic output by one-half of a percentage point each year. This summer even the status quo–oriented *New York Times* asked in an editorial, "What about scrapping the personal and corporate income tax codes, which often discourage savings and investment, in favor of a consumption tax that would encourage them?"

Ultimately, what is most hopeful about this tax replacement scheme is not the increased economic efficiency and productivity that would undoubtedly result. Rather, it is the psychological impact it would have on the American people, who would suddenly find themselves living in a nation where it was none of the government's business how much money they made or how they made or spent it. The Internal Revenue Service is today an intimidating force in society. The IRS creates in the citizenry a certain deference toward government that is unhealthy for both our freedom and our prosperity. A free society shouldn't tolerate such an agency, particularly when the government doesn't need it to raise revenue.

Without the income tax, attitudes would change in short order. We would see an awakening of what George Will refers to as the "figure of Hawkeye"—the fictional American folk hero from *The Last of the Mohicans*. At one point in this saga of the war in the colonies between the French and the British, Hawkeye is reprimanded by an effete British officer who shouts, "You call yourself a patriot and loyal subject to the crown?"

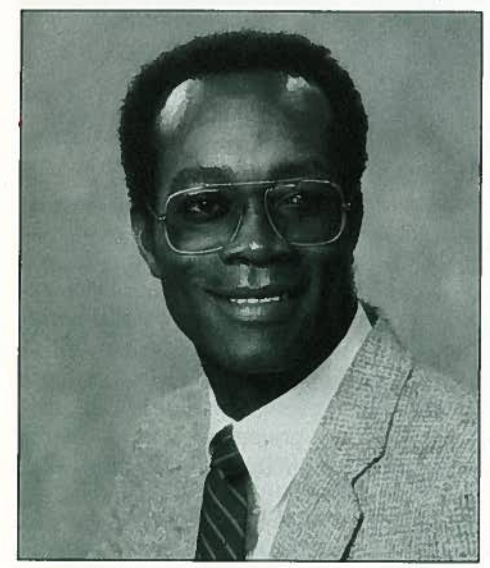
Hawkeye replies dryly, "Don't call myself subject to much of anything." Perhaps term limits and radical tax reform will arouse this healthy sentiment that lies dormant, for the time being, in the American people.

Ed Crane

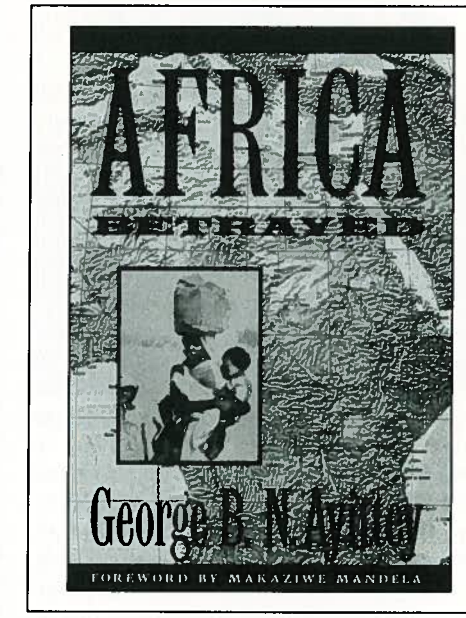
—Edward H. Crane

Africa's Leaders Bring Poverty, Human Rights Abuses; Should Rediscover African Traditions, Book Says

Ghana-born economist George B. N. Ayittey delivers a searing and passionate indictment of political and economic tyranny in black Africa today in *Africa Betrayed*, a new book from the Cato Institute and St. Martin's Press. Ayittey recalls the exhilaration that swept the continent when the colonial era ended. Soon, however, native African leaders began plundering their nations' economies, looting the public treasuries, outlawing rival political parties, canceling elections, and imprisoning political opponents. Their statist policies, Ayittey writes, have contributed in no small measure to the grinding poverty, appalling human misery, and violations of human rights that are rampant across much of Africa.



George B.N. Ayittey



He describes in great detail how African autocrats have run their countries into the ground and violated every aspect of their citizens' liberty. With few exceptions, Africans have not been free to engage in trade and production, to own property, to write and publish what they wish, or to have any say in how they are governed.

The irony is that those leaders rejected capitalism and decentralization of political power because they mistakenly identified those systems with colonialism. They were apparently unaware that Africa had its own tradition of economic and political freedom. Ayittey describes the indigenous precolonial African political and economic systems, which offered much more freedom and democracy than do today's autocracies. He points out that trade was widespread in Africa and that political decisionmaking was local and involved public participation. The postcolonial autocrats who laid claim to African nationalism were actually guided by false economic doctrines, such as Marxism, taught in the European universities in which they were educated.

Ayittey then discusses the colonial era, the march toward tyranny, the de facto apartheid in many African countries, the military regimes, the intellectual repression, the corruption, and the role of the West in ruining Africa. He writes that Africa cannot hope to escape its abject poverty and repression until it discovers its liberal roots.

Ayittey teaches in the economics department of the American University in Washington, D.C. He is the author of *Indigenous African Institutions*, published in 1990, and articles on African politics and economics that have appeared, among other places, in the *New York Times*, the *Washington Post*, and *Emerge*.

Africa Betrayed is available from the Cato Institute for $35.00. ■

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Urban Policy, Welfare Reform, Soviet Union Examined in Cato Policy Forums; Buchanan's Autobiography Feted

Cato Events

September 1: A Policy Forum offered **"An Agenda to Save America's Dying Cities."** Participating were Stephen Kagann, economist for New York City; Stephen Moore, Cato's director of fiscal policy studies; and Walter Williams, professor of economics at George Mason University. Kagann argued that New York has declined because its relatively heavy tax burden has driven out firms and people. Williams said there is no case for increasing federal aid to cities, considering that from 1965 to 1990 the federal government provided $2.5 trillion in aid to cities, enough to purchase all the assets of the *Fortune* 500 companies plus all the farmland in the United States. Moore said the problem with the cities is excessive costs of providing services, largely attributable to powerful public employee unions and corruption.

September 3: **"Welfare Reform in the States: A Reassessment"** was the topic of a noon Policy Forum that featured Charles Hobbs, former deputy assistant to President Reagan, and Charles Murray of the American Enterprise Institute. Hobbs said that proper welfare reform must focus on dependence not poverty since the government's poverty standard defines people as poor whether they are or not. Murray cited problems with any reform proposal, such as work requirements or extension of medical benefits to people finding jobs, and concluded that reform will make little difference. He said the fundamental problem is that many women, influenced by welfare-state incentives, have children they are not financially and otherwise prepared to raise.

September 15: A book party celebrated publication of Nobel laureate James M. Buchanan's autobiographical collection, ***Better Than Plowing and Other Personal Essays.*** In his remarks, Buchanan, a Cato Distinguished Fellow, reminisced about his days as a graduate student and young professor.

John Williamson, Lars Jonung, Steve Hanke, and Kurt Schuler discuss the possibility of currency boards as a remedy for monetary problems in ex-Soviet countries.

September 17: The publication of Karl Hess, Jr.'s book, ***Visions upon the Land: Man and Nature on the Western Range*** (Cato/Island Press) was celebrated at a book party. Hess spoke about his proposal for decentralizing ownership of the federal range so that a single vision of proper management would not be imposed.

September 18: A book party honored publication of David B. Kopel's book, ***The Samurai, the Mountie, and the Cowboy: Should America Adopt the Gun Controls of Other Democracies?*** (Cato/Prometheus Books). Kopel discussed his finding that the level of violent crime in a society depends more on deep-seated cultural factors than on anti-gun laws.

September 21: A Policy Forum examined the appropriateness of **"Currency Boards for the Former Soviet Union."** Economists Steve Hanke and Kurt Schuler of Johns Hopkins University and Lars Jonung, chief economic adviser to the prime minister of Sweden, discussed the merits of currency boards, which would issue new currency backed at a fixed rate by a reserve currency such as the dollar or German mark. John Williamson of the Institute for International Economics outlined his reservations about the idea.

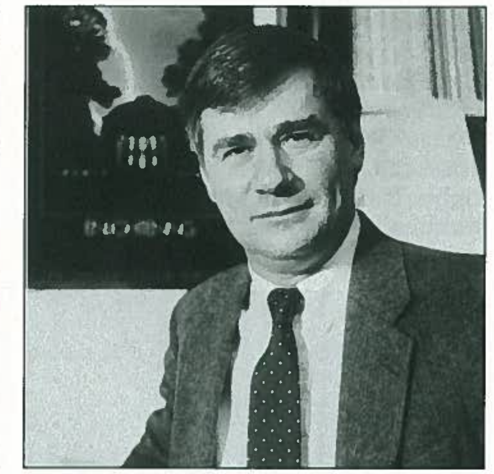
September 28: At a Policy Forum entitled **"American Forfeiture Law: Property Owners Meet the Prosecutor,"** Terrance G. Reed of the law firm Asbill, Junkin & Myers, author of a new Cato study, condemned civil forfeiture, under which the government may confiscate property, including bank accounts, from people never charged with or convicted of crimes. Following forfeiture, which is used in the War on Drugs, a person who seeks to regain his property has the burden of proving that it was not used in the commission of a crime, a reversal of traditional Anglo-American principles. Arthur W. Leach of the U.S. Department of Justice defended the procedure, saying that abuses are rare.

September 29: Publication of the Cato book ***What Has Government Done to Our Health Care?*** was feted at a book party. Author Terree P. Wasley outlined the book's thesis: that government intervention in medical care has caused the current problems and that the only solution is market-based reform that empowers individuals to control their health-care spending. ■

Hess, Powell, Michaels Named Senior Fellows of Cato

Karl Hess, Jr., author of *Visions upon the Land: Man and Nature on the Western Range*, has been named Senior Fellow in Environmental Studies of the Cato Institute. Hess, an ecologist living in New Mexico, is an active writer, speaker, and consultant on environmental issues, especially land use. John Baden, president of the Foundation for Research on Economics and the Environment, said of *Visions upon the Land*, "Hess challenges the exploitation of the West with a strong blend of Thomas Jefferson's political economy and Aldo Leopold's ecology. . . . *Visions upon the Land* is an exceptional field guide to the great remaining mystery of the West—how to preserve the freedom and potential for independence of that region's people while preserving an ecology of which mankind is an integral part." Over the next two years Hess will be working on a book on the connections between the ecology of nature and the economy and society of man.

Karl Hess, Jr.



Patrick J. Michaels

Jim Powell

Patrick J. Michaels, author of *Sound and Fury: The Science and Politics of Global Warming*, has also been named a Senior Fellow in Environmental Studies. Michaels is a professor of environmental sciences at the University of Virginia and the state climatologist of Virginia. His work on global warming has appeared frequently in the *Washington Post*, the *Washington Times*, and numerous journals of climatology and meteorology.

Jim Powell, author of *The Gnomes of Tokyo*, has been named a Senior Fellow. Powell is working on two books, one a historical and cultural examination of the benefits of open markets and the other a detailed critique of attempts to use trade retaliation to achieve free trade or prosperity. Powell is the editor of Laissez Faire Books and frequently contributes articles to magazines.

Other Cato fellows include Nobel laureate James M. Buchanan, a Distinguished Senior Fellow; author P. J. O'Rourke, the Mencken Research Fellow; and senior fellows Doug Bandow and Christopher Layne. ■

EPA's New Figures Confirm Jones's Charges in Cato Study: Urban Smog Is Mainly a California Problem

In February the Institute published a study by K. H. Jones entitled "The Truth about Ozone and Urban Smog" (Policy Analysis no. 168), which concluded that urban smog, as a health problem, has nearly disappeared outside California and that further regulatory controls are unnecessary in most cities. Jones contended that the EPA was misrepresenting the true extent of smog in America by not moving rapidly to release and not assuring the quality of the 1991 ozone data and by continuing to rely on obsolete air quality data. His findings were based on a *preliminary* analysis of 1991 data from all 114 urban areas the EPA monitors (Jones gathered those data, independent of the EPA, by telephone from state and local air quality agencies).

Since publication of the Cato study, the EPA has collated and made available to Jones the 1991 ozone data in its central data storage and retrieval system. Those data confirm the conclusions of Jones's study. Only a few discrepancies were found between Jones's and the EPA's data from the 114 urban areas Jones surveyed for his report (Jones had anticipated those discrepancies). Many of the discrepancies were accounted for by the EPA's use of different air monitors to judge attainment status.

Thus, at least 52 urban areas across America are today being subjected to overly stringent regulations under the Clean Air Act despite the fact that the air over those areas fully meets federal air quality standards. Moreover, 18 cities are required to implement the expensive and onerous federal clean fuels program because of their erroneous serious or severe nonattainment classification, whereas only 4 cities should actually be required to do so under the Clean Air Act. ■

An Agenda to Save America's Dying Cities: More Taxes, More Spending Are Not the Answer

Policy Forum

The problems of America's cities have a prominent place in the current debate on public policy, especially since the riots in Los Angeles. The conventional wisdom is that the cities are starved for revenue thanks to cuts in federal aid and that the solution to urban problems is massive infusions of money. To present an alternative perspective, on September 1, the Cato Institute held a Policy Forum featuring Stephen Kagann, chief economist for the Comptroller of New York City; Stephen Moore, Cato's director of fiscal policy studies; and Walter Williams, professor of economics at George Mason University. Excerpts from the forum follow.

Stephen Moore: Two or three days after the Los Angeles riots, the front page of the *New York Times* carried these words:

> Despite trillions of dollars spent over the years on thousands of different government social programs, politicians and scholars are no closer to agreement today than they were a generation ago about the best way to lift people out of poverty and to make cities better places to live. . . . Some government programs have distinctly failed. No one today defends the high-rise public housing projects, for instance, that were built in the 1950s.

That was not the Cato Institute, remember; it was the *New York Times*. Another quote from the article: "'The problems are just so intractable in the central cities,' said Tom Joe, director of the nonprofit Center for the Study of Social Policy in Washington. 'I hate to say it, but the programs that work, the ones that really work, are the ones that get people out of the inner cities.'" That is a sad commentary on the condition of America's cities and one that does not bode well for their future.

Let me start this discussion by telling you about a study we're doing at the Cato Institute. One of our conclusions is that millions of people and thousands of businesses are voting with their feet against the social policies and economic conditions of the cities. Over the last 25 years, a period during which the U.S. population has increased by 60 million, 15 of our largest 20 cities have lost 4 million citizens. According to the 1990 census, the flight from the cities can no longer be called white flight. It's black flight. In the 1980s middle-class blacks left the cities in larger numbers than any other group.

Stephen Moore: "We should turn Galbraith around and say that there is nothing wrong with American cities that cutting their budgets in half wouldn't solve."

Fifty to 100 *Fortune* 500 companies have left New York City for other locations in the last 12 years. Since the 1950s Cleveland's population has dropped from over a million people to less than half a million. In the last 10 years Chicago has lost 150,000 manufacturing jobs. Since 1955 St. Louis has lost two of every five jobs it had in the early 1950s.

The flight of people and business from the central cities has caused some horrifying social and economic problems, including declining incomes. Newark, New Jersey, for instance, has a lower real per capita income than it did in the 1960s. Then there is the problem of financial insolvency. Philadelphia is running a deficit of $250 million and has to borrow from a state agency because its bond rating is so low.

Violent crime is also a problem that plagues America's cities. In the last year there were almost 500 murders in the nation's capital, which is now described by Washingtonians as the murder capital of the world.

And finally, there is the breakdown of the family. The 1990 census shows, for example, that in Detroit 48 percent of all households are now headed by females. The father is literally becoming an endangered species there.

If money could solve these problems, most Americans would support spending it, because such conditions shouldn't exist in the United States. They are the kind of conditions you'd expect in Third World countries. Unfortunately, the second conclusion of our study is that it is unlikely that more money will solve the problems of America's cities. The cities have many problems, but lack of money is not one of them.

Twenty-five years ago John Kenneth Galbraith said, "There's nothing wrong with New York City that doubling the city budget wouldn't solve." City officials have been trying that approach ever since, and it has not produced the happiest of results. Back then New York City was spending about $14 billion in 1990 dollars. Today its budget is $30 billion, which means that the city has a larger budget than all but two states and many countries. New York also has 330,000 city employees. That workforce is larger than the populations of most American cities. New York has three times more city employees as a percentage of population than the average U.S. city. In other words, it takes three times as many people to collect the garbage, clean the streets, and educate the children as it does in the average city.

And it's not just New York. Philadelphia's budget went from $1.6 billion to $3.5 billion in the last 25 years (constant dollars)—a 130 percent increase. Over the same period Philadelphia lost 25 percent of its population, so spending per person rose at a fast pace.

In 1950 American cities spent, in 1990 dollars, $435 per resident. By 1965 that amount had risen to $570 per resident. Today cities spend about $1,005 per resident. Of course, the larger the city, the more money it spends per capita.

The point is that if spending more money were the solution to cities' problems, New York City would be a modern-day Garden of Eden. Yet what we find is not a Garden of Eden but people heading for the New Jersey Turnpike.

The third finding of our study is that not all cities in the United States are doing poorly, not even all *major* cities. Many major cities are flourishing. From 1970 to 1990 many cities did incredibly well by any measure of economic well-being: population growth, job growth, increases in personal income, or poverty rates. Those cities include Phoenix, Raleigh, Sacramento, San Diego, Austin, and Jacksonville.

Washington Post reporter Joel Garreau's book *Edge City* points out that the 1980s, the decade of alleged disinvestment in the cities, probably witnessed the demise of central business districts in major cities. Garreau also says that there is no overall urban crisis. During the last 15 years 200 new "edge cities" have been created, and they are growing in population and affluence.

Why are Raleigh and Austin and Sacramento different from New York and Philadelphia and Detroit? Granted, the weather is nicer, but that is not the decisive difference. The significant difference is that taxes and spending are much lower in the growing cities than in the declining cities.

Our study looked at 70 major cities and at such variables as increases in per capita income, poverty, jobs, and population. We reached five major conclusions:

- First, the growth cities spend about half as much per capita on city services as a percentage of personal income as do the declining cities.
- Second, taxes are about twice as high for families living in the declining cities as they are for families in the high-growth cities.
- Third, local bureaucracies are about twice as large in the declining cities as in the high-growth cities. In virtually every declining city there is a bureaucracy so entrenched that it almost seems that those cities exist to promote the well-being of city workers rather than that of the people who pay the taxes.
- Fourth, the low-growth cities are more likely to have city income taxes than the high-growth cities. None of the 15 fastest growing cities with populations over 150,000 has an income tax. Twelve of the 15 fastest declining cities have an income tax. And most major cities in decline have high income tax rates.
- Finally, the per student cost of education in the declining cities, such as Washington or Detroit or Philadelphia, tends to be 30 to 50 percent higher than in the growth cities. Obviously, the difference cannot be accounted for by quality. No one would argue that the schools in Washington or Newark are 30 to 50 percent better than those in San Diego or Sacramento.

Stephen Kagann: "Responsibility for New York's economic troubles rested, not on some mysterious law of nature that dooms New York and other cities, but overwhelmingly with Albany and City Hall."

Many people will respond that high taxes and big budgets are the consequences, not the causes, of poverty in the declining cities. To test that proposition we looked at the level of taxes and spending at the beginning of the 1980s and then at subsequent growth. Clearly, spending at the beginning of the period cannot be caused by subsequent performance. The results were the same: cities with high growth rates in the 1980s tended to have much lower spending and taxes in 1980 than cities that were declining.

Cities are in a vicious circle of taxing and spending. The causality probably runs both ways. Low-growth cities tend to start out with high spending and taxes that cause business people to leave for low-tax areas. That exodus increases poverty and joblessness, which forces the cities to spend more money and further raise taxes, which forces more people to leave. Low-growth cities are not going to reverse their decline until they find a way to get out of the cycle of spending and taxing. We should turn Galbraith around and say that there is nothing wrong with America's cities that cutting their budgets in half wouldn't solve.

Stephen Kagann: In the 1950s and 1960s, New York City was the unquestioned center of international business, finance, manufacturing, shipping, transportation, pharmaceuticals, merchandising, fashion, publishing, broadcasting, telecommunications, art, and culture. Quite a place. As a young man, I used to marvel that I could walk the streets, read the corporate names on the buildings in Manhattan, and choose virtually any occupation in any industry. The city was the hub of opportunity for the ambitious, the bright, and the talented. But in the 1960s the city began to unravel. The first casualties were the sectors of the local economy that manufactured and distributed goods.

Manufacturing, with 1.1 million employees in the 1950s, provided opportunities for generations of immigrants and unskilled workers. It began to leave town in the late 1950s. The decline in industrial production was paralleled by declines in rail transportation and shipping and in wholesaling. Yet no one noticed the deterioration in the 1960s. The loss of manufacturing jobs was more than offset by an increase in the number of state and city government jobs. Government was the exciting new growth industry. While the governor in Albany built and spent and taxed and borrowed, the mayor of New York added 100,000 people to the city's bureaucracy.

In 1969 losses in the city's private sector turned into a rout. From 1969 to 1977, 550,000 private-sector jobs were lost. The decline amounted to 17 percent of the job base. While the city was sinking, national private employment swelled by 9 million, an increase of nearly 16 percent, and that despite two

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Cities (Cont. from p. 7)

national recessions.

While manufacturing led the local decline with a loss of 300,000 jobs, widespread losses also occurred elsewhere: construction, financial services, wholesale and retail trade, transportation, and public utilities all shed employees. The broadly defined service sector turned in the best performance in the 1969–77 era—unchanged.

Why was the business capital of the world so vulnerable to an economic collapse of Great Depression proportions? I would argue that the responsibility rested, not with some mysterious law of nature that dooms New York and other cities, but overwhelmingly with Albany and City Hall. In the 1960s state and city fiscal policy simply went out of control. And the growth of government did not end when the private sector collapsed in the 1970s. From 1969 to 1974 local government continued to grow, even as the private economy, which had to support local government, collapsed.

The combined burden of city and state taxes had already risen from 8.5 percent of gross city product in the 1950s to 11.5 percent in 1967, and further to 12.5 percent in 1969. New York's leaders apparently observed that revenues equal rate times quantity. When the quantity, the number of taxpayers, declines by 1 million, simply raise the tax rate on those who remain. By 1977, the trough of the decline, the tax burden had risen to 16.8 percent of gross city product. New York state now has 26 distinct taxes. New York City has 28, many of them created during the 1960s and 1970s. The annual ritual of creating new taxes and raising the rate of existing taxes did not provide enough revenue to feed the voracious appetite of government. The city sold billions of dollars in bonds while dissembling about the use of the funds. What is referred to as the fiscal crisis of 1974–77 began when the city could no longer sell those bonds. The fiscal crisis led to new tax increases, but it also temporarily brought the ax down on government spending. Fifty thousand city government jobs were eliminated virtually overnight. Afterwards, the rates of a few taxes actually declined, something that doesn't happen very often in New York.

The city economy began to expand, driven by growth in financial services and media spending. The flow of money into the city created a real estate boom of fairly impressive proportions. By 1984 city and state government had returned to a growth mode. The sight of real estate values skyrocketing was too much for government to bear. New real estate taxes were enacted and standard property taxes were raised. The city's fiscal fortunes were hitched to an extraordinary speculative bubble. By the end of the 1980s local government employment had again climbed by nearly 60,000. In the 1980s, while we were all feeling so giddy, the lesson of the 1970s was quickly forgotten. Not many people noticed that corporate headquarters continued to leave; that manufacturing continued to leave; that warehousing, trucking, and shipping continued to leave; that back-office operations continued to leave; and that retailing never really recovered from the decline of the 1970s.

The expansion had a narrow base, and the stock market crash of 1987 signaled another downturn. Yet city government employment continued to rise for another three years, and so did taxes. A new administration took over in January 1990 and raised employment during its first year, refusing to admit that anything was fundamentally wrong. A new fiscal crisis in October 1990 froze city government employment. But to maintain spending levels, the new administration piled on three major tax increases in the 13 months between July 1990 and July 1991. Albany also raised taxes. The tax burden went up another $3 billion to new record levels. That burden, which pierced its 1977 record of 16.8 percent of gross city product in 1990, now stands at 17.8 percent. The equivalent figure for the rest of the nation is 9.5 percent.

Now imagine for a moment a national recession with unemployment rates over 10 percent. Also imagine that a federal administration proceeds to solve its problems by raising taxes by record amounts during that deep national recession. Imagine further that there is no debate and no substantive press coverage of those actions and their implications. The increase is passed, virtually without dissent. That is the way fiscal policy is set in New York City.

At the time taxes were being increased, my colleague in the city comptroller's office, Zheng Gu, and I produced a report that showed that raising taxes during a downturn was egregiously bad policy. We estimated that, other things being equal, each $1 billion in tax increases would lead to the loss of 110,000 private-sector jobs. Our work was denounced by government officials as garbage. Everyone knows that taxes are not a determinant of business location decisions. There's an entire academic literature on the subject. The New York mantra is, "Taxes do not matter."

Since 1989 the city's private sector has been collapsing at rates that exceed those of the 1970s. In little more than three years, the city's private sector has lost 350,000 jobs—an 11.5 percent decline. If we exclude private industry supported by tax revenues or by public policies, such as social services and the health industry, which are the only growth industries in New York, the redefined private sector has fallen by over 15 percent.

By any measure, I am describing failure on a massive scale, both in the long run and in the short run. Why is that failure occurring? Simply put, a government that spends somewhere between 50 and 100 percent too much imposes a burden that has a number of obvious effects. The extra burden of taxation has virtually ensured that only firms with very high profit margins can afford to remain in New York City. Either by reducing after-tax income or increasing the cost of everything we buy in New York, the large tax burden reduces New Yorkers' standard of living.

In addition, by making it more difficult for employers to survive, the city has increased the probability that any given citizen will join the unemployment lines. The city government claims to represent the poor and the children. That's a noble claim, but it should be examined in the light of who is most likely to become unemployed in New York. Among the hardest hit industries are retailing and manufacturing. Marginal workers, immigrants, members of minority groups, and teenagers are disproportionately represented in those industries. Immigrants and native-born minority members are losing their jobs at a sickening pace. Teenage employment has virtually ceased to exist in New York. A government that claims to speak for the children is putting their parents out of work.

So what is to be done to save New York? First, the city and the state must stop pointing the finger of blame at the rest of the nation and at Washington. The preponderance of the responsibility for the decline of New York rests in Albany and in City Hall. We need to adopt a new attitude toward the role of state and local government.

We need a government that puts the needs of the 3 million New Yorkers who still get up and go to work every morning to support their families, and the hundreds and thousands of New Yorkers who've been put on the unemployment lines, before the needs of the special interests who feed at the public table. We need to show that the city's wounds aren't mortal, as many now believe. We need a government that views the economic security of its people as its number-one priority—a revolutionary concept in postwar New York City. A concerned government would announce a credible economic recovery plan.

Any serious plan for economic recovery must include tax cuts. The model that Gu and I developed predicted that increasing taxes by nearly $3 billion would lead to 325,000 private-sector job losses over four years, a forecast that was realized in two years. Recently, we used the model to show what might happen if the city cut taxes by $1 billion a year for four years. The private sector would respond by adding nearly 600,000 jobs by 1998. Although our model showed that a tax-cut program would lead to a revenue shortfall for two years, it also showed that in the third and fourth years the improving economy would generate a small net revenue surplus. The surplus would grow substantially in the sixth and seventh years. We believe those results are conservative.

I am concerned about the future of America's premier city. I do not see a normal economic recovery. The post-1977 recovery was the result of fortuitous events rather than city policies. In the absence of another fortuitous recovery, I see the continuing deterioration of the city's job base. The only question in my mind is the rate of decline. Serious action must be taken soon, while the city still has some assets to build on—we do have some left—and before the city is swallowed by its social problems.

I do agree with the city's leaders on one point: while London, Paris, and Tokyo are treated as national treasures, many Americans seem to take perverse pleasure in seeing America's urban treasures sink. When New York City is no longer viable, this nation will be the poorer—economically, socially, and culturally.

Walter Williams: Of what use are cities these days? They used to be the places to which businesses came seeking a ready pool of low-skilled labor and low-skilled labor came looking for jobs. That's not true anymore. Given technological change (fax machines, modems, and other kinds of high-tech devices), people don't have to be physically in the same place to engage in cooperative efforts. So one could make a case that cities are beginning to outlive their usefulness.

Walter Williams: "If cities want to help the poor, they must keep some citizens who put more into government coffers than they take out in services."

But suppose I'm wrong. In that case, what do cities need in order to at least limp along? Regardless of any other objective the city fathers choose to pursue, they must maintain what economists might call a net positive fiscal residual. If cities want to help the poor, they must keep within their borders citizens who put more into the government coffers than they take out in services.

How do you do that? Frankly, I don't believe that it can be done today. For one thing, cities shouldn't aim for equality in the distribution of services. If a city is to keep high-income people, it has to discriminate in the provision of some services. In high-income neighborhoods, for example, the parks must be kept nicer. Streets have to be better lit, better policed. The schools have to be better equipped in high-income neighborhoods than in low-income neighborhoods. If they aren't, the high-income people will leave, taking their tax base with them. Cities have to recognize that they are competing with the suburbs.

My grandmother used to say that if you're doing something you're not supposed to be doing, you're not going to be able to do the things you're supposed to be doing. Today the cities are doing all kinds of things they shouldn't be doing. What are they supposed to be doing? Cities are supposed to be maintaining safe streets for their citizens to walk. They are failing miserably at that task. Cities are supposed to be keeping the streets clean. They are failing miserably at that task as well.

We have to recognize that government has very little capacity to do good but awesome capacity to do harm. Consider the crazy policy of federal aid to the cities. President Bush and Congress want to spend $2 billion on urban aid. Much of that money will go to jobs programs for youth. Somebody ought to tell policymakers that the government has been *destroying* jobs through the minimum-wage laws, occupational licensing, the Davis-Bacon Act, and more.

People who see enterprise zones as a solution to the cities' economic problems are going to be disappointed. Someone should ask Jack Kemp what kind of tax break it would take to make business people willing to risk drive-by shootings in high-crime neighborhoods. Crime is the number-one problem in our cities.

Even to talk about enterprise zones is a disgustingly revealing confession. As a kid I understood that we were supposed to be a free-enterprise zone from ocean to ocean. Now we are talking about creating little islands of free enterprise in a sea of socialism. I think that explains much of the decline of the cities. ■

Economic Reform (Cont. from p. 1)

as the barriers to market exchange are removed and people are free to choose.

The Failed Socialist Experiment

After experiencing a lifetime of socialism, Soviet philosopher Alexander Tsypko wrote, "During 70 years of socialist experimentation in Russia, not one major problem that the country was facing in 1917 has been solved." The reason for that failure is not hard to discern. As Ukrainian physicist Igor Yukhnovsky observed, "When something is ruled from the center, the optimization of life is impossible."

Individuals require freedom to respond to change, to grow, and to learn. By denying individuals their natural rights to liberty and property, the Communist party created an artificial society and blocked the natural evolution of a spontaneous market order. And by substituting distributive justice for a rule of law, socialism violated the rules of just conduct that are the basis of a free society and drive the competitive market process.

At base, communism collapsed in Russia and Eastern Europe because of what F. A. Hayek called the "fatal conceit," namely, the idea that an enlightened individual or group can bring about an outcome that is superior to the unplanned spontaneous order of a private free market. The problem, of course, is that no one person or group of persons—no matter how intelligent—can possess the knowledge that is dispersed among millions of people.

When communism replaces the invisible hand of market competition with the visible hand of government planning, the automatic feedback mechanism inherent in a free-market price system is eliminated. Political power, not economic foresight, then determines who succeeds and who fails. Under such a system, the worst rise to the top.

Without a profit-loss test and without the threat of bankruptcy, socialist firms have little incentive to adapt to changes in wants, resources, or technology. Errors tend to accumulate, and plans are revised only at great cost. Indeed, the longer inefficient state enterprises are allowed to survive, the greater is the ultimate cost of adjusting to the realities of the market. It is ironic that by disallowing individual failure, the socialist system of central planning set itself up for total failure.

That failure was predicted early on by the Austrian school of economics. Ludwig von Mises and Hayek both recognized that rational economic calculation would be impossible without private property, and that the loss of property would mean the loss of freedom.

In sum, socialism failed because its institutions failed. The lack of private property and freedom of contract prevented the emergence of a spontaneous market order; and the lack of a rule of law and free expression prevented the emergence of a civil society. The socialization of risk, the absence of a price mechanism for rational economic calculation, and the lack of any incentive for socialist enterprises to allocate resources to satisfy consumers' preferences combined to make central planning a poor alternative to the private free market.

> "The loss of individual responsibility under socialism created what St. Petersburg mayor Anatoly Sobchak called a 'parasitic mentality,' which destroyed civil society."

Although the Soviets and East Europeans sought in the 1960s and 1970s to reform the ossified system of central planning, their attempts at economic reform were limited by the absence of political reform. They tried to introduce markets and prices on a piecemeal basis, but none of their reforms abolished state property or introduced real competition. To have done so would have reduced the Communist party's hold on economic life.

Likewise, when Gorbachev introduced his policy of perestroika after 1985, he did not seek radical reform; he merely sought to create a hybrid of plan and market so that he and his Communist party would retain a monopoly on power. That is why perestroika failed.

The very nature of socialism means that political reform must accompany economic reform. As Milovan Djilas remarked, "You cannot change the form of property without changing the form of power." Under communism, said Djilas, "the economy is ruled and controlled by politics. You must change the political system first, because it is a tyrannical regime without respect for laws."

The Market-Liberal Revolution

Mikhail Gorbachev was, perhaps inadvertently, instrumental in launching the market-liberal revolution of 1989. He relaxed controls on freedom of expression and lifted the Iron Curtain that had prevented the Soviet people from seeing the vast gap between a planned and a free society. His promise to withdraw Soviet weapons from the countries of the Eastern Bloc created the expectation that Moscow would not interfere with the liberalization movement that was taking shape in Poland and elsewhere. As a result, the liberalization process gained momentum.

In April 1989, Solidarity gained legal status; in September, East Germans were allowed to exit through Hungary to the West; in October, the Communist party was abolished in Hungary; in November, the Berlin Wall was opened and Czechoslovakia ended the Communist party's constitutional monopoly on power; in December, East Germany and Bulgaria also abolished the party's privileged position, and Romania's provisional government was recognized by the United States and the Soviet Union. In 1990 further changes occurred: in January, Poland's Communist party dissolved itself; in May, Poland held its first free elections since World War II; in October, East and West Germany were reunified; and in December, Lech Walesa was elected president of Poland.

The political upheavals in Eastern and Central Europe caused reverberations in the Soviet Union: in March 1990, the Congress of People's Deputies repealed the Communist party's constitutional monopoly on power; in June 1991, Yeltsin was elected president of Russia by popular vote; in August, a failed coup d'état by hard-liners solidified democratic forces behind Yeltsin; in December, the Commonwealth of Independent States (CIS) was formed, Gorbachev resigned, and the USSR was history.

Those dramatic political changes broke the grip of the Communist party on economic life and provided a window of opportunity to make the transition from a planned economy to a free market.

Transition from Plan to Market

The collapse of communism and the failure of central planning created the opportunity for real reform. A free-market system, however, requires privatization, price liberalization, and a sound currency—all of which were lacking in Soviet-type economies. It would not be enough to tinker with central planning; the entire system would have to be scrapped to revitalize economic and social life.

Private ownership is characterized by a bundle of rights: the exclusive right to use one's property, the right to sell property, and the right to partition property rights so that specialization in ownership or management is possible and risk can be diversified. When the rights associated with private ownership are protected by law, owners will bear responsibility for the uses of their property; they will capture the rewards from efficient use and incur the losses from inefficient use. The linkage between private property and individual responsibility is an important element of private ownership; it provides private owners with an incentive to search for new opportunities for mutually beneficial exchange. Private property, therefore, extends the range of market activity and is essential to a free-market price system.

Private property rights will not be effective unless they are enforced. The newly emerging market economies in the East, therefore, must create a constitutional legal framework that safeguards the rights of property and creates a healthy environment in which the market can grow naturally without the threat of government intervention.

But the law can only go so far; people themselves must develop respect for private property, for the rights of others, for freedom of contract, for keeping promises, for honesty in business, and for a rule of law. That psychological change requires abandoning socialism in spirit as well as in deed and recognizing that true justice is found in defending liberty, not in using the force of government to destroy property in the name of "social justice."

The Marxist-Leninist ideology imbued people with the notion that only government can create order and that market liberalism is a recipe for chaos. Experience has taught different lessons—namely, that government failure is more prominent than so-called market failure and that when individuals are free to choose within a private market setting, a natural spontaneous order will arise that is beyond the comprehension of any central planner.

> "The law can only go so far; people themselves must develop respect for private property, for freedom of contract, for keeping promises, and for a rule of law."

People in the East may not understand the logic of the price system, but they certainly understand the failure of central planning and the need for change. The question is not the direction change will take, but its magnitude and pace. Three reform strategies can be distinguished: the "big bang" strategy, the Shatalin strategy, and the market-socialist strategy. The first approach is characterized by radical and rapid reform, the second by comprehensive and evolutionary reform, and the third by gradual piecemeal reform.

The idea behind the big-bang strategy is to make the transition to a market system in one fell swoop by privatizing, liberalizing, and stabilizing the economy as rapidly as possible. Poland's reform strategy was of that sort.

The Shatalin strategy, devised by Russian economist Stanislav Shatalin and his reform group, is to create an environment in which market institutions can evolve naturally. In his original 500-day program, Shatalin proposed that stabilization, privatization, price liberalization, and other measures be *initiated* within 500 days, not that the transition to a market system be completed in that brief period of time. The idea was to get the reform train moving by enacting comprehensive reform measures and then let the market determine the pace of change. The task of reform, as viewed by the Shatalin working group, was that "of taking everything possible from the state and giving it over to the people." The Marxist-Leninist vision was to be replaced by a market-liberal vision, and a primary principle of the "new economic system" was to have been "the maximum freedom for economic subjects." Gorbachev at first supported the Shatalin program but later backed off under pressure from "conservatives" who preferred a gradualist approach that might allow them to retain their power base.

The gradualist piecemeal strategy is to sequence the steps to a market economy and to negotiate with entrenched interests on the way to a market system. In contrast to the big-bang and Shatalin strategies, this approach places expediency before principle; and the result is apt to be a regulated market, not a private free market.

Most ECCs have followed this route and, as a result, have ended up with market socialism not market liberalism. An exception is Czechoslovakia, where Vaclav Klaus has taken a principled stand in favor of market liberalism and has followed a Shatalin-like strategy.

Roadblocks to Reform

If the ECCs are to create a free-market order and not just another pseudo-market order, they will have to overcome four major barriers: (1) the rule of special interests, (2) the anticapitalist mentality, (3) the credibility

(Cont. on p. 14)

GSEs Could Be Next Taxpayer Disaster, Study Says; Term Limits Are Constitutional, So Is Economic Freedom

If government-sponsored enterprises (GSEs), such as the Federal Home Loan Mortgage Corporation, had to pay users' fees for their government subsidies, they would function more like private enterprise and offset the potential burden on taxpayers, says a new study by economists James F. Gatti and Ronald W. Spahr. "The Burden of Government-Sponsored Enterprises: The Case of the Federal Home Loan Mortgage Corporation" (Policy Analysis no. 176) argues that the collapse of the Farm Credit System and the savings-and-loan fiasco have made it imperative that the financial safety and soundness of GSEs be increased.

The authors, who recommend that the federal government be relieved of responsibility for closing insolvent institutions, are concerned that proposals made by the Treasury in 1990 might simply confer windfall gains on existing shareholders; encourage inefficient organizational structures; and reward management, not for efficient allocation of capital, but for skill in shaping regulations.

Nothing to Fear from Islamic Fundamentalism

Islamic fundamentalism, the so-called Green Peril, poses no serious threat to the present or future security of the United States, says adjunct scholar Leon T. Hadar in "The 'Green Peril': Creating the Islamic Fundamentalist Threat" (Policy Analysis no. 177). Hadar, author of a new Cato book, *Quagmire: America in the Middle East*, says that the numerous cultural, political, and economic divisions in the Islamic world preclude Islamic fundamentalism's becoming an effective monolithic movement. He explains that any political clout Islam may now have is due, not to the Arabs' desire to live in Islamic republics, but to their sense that the existing political order has failed them. Islamic fundamentalism simply serves as an umbrella for a number of quite diverse political ideologies.

According to Hadar, political players in both the United States and the Middle East fan the fear of the Green Peril as a way of maintaining public support for policies that serve their self-interest, which is not necessarily the same as the interest of the American people. Washington's hostility to democracy in the Middle East stems from fear that free elections in Iraq, the Arab gulf states, Jordan, and North Africa would threaten the interests of some very influential groups.

The United States should not be searching for new enemies, Hadar concludes; instead, it should view regional conflicts with detachment, realizing that they will rarely pose a danger to America's security.

Term Limits Are Constitutional

The Constitution allows states to limit the terms of their members of Congress, despite claims to the contrary by opponents of term limitation, argue attorneys Neil Gorsuch and Michael Guzman in "Will the Gentlemen Please Yield? A Defense of the Constitutionality of State-Imposed Term Limitations" (Policy Analysis no. 178). According to the authors, the Framers' debate during ratification of the Constitution proves that they considered rotation in office necessary to prevent a stagnant and unresponsive legislature. The only reason rotation was not incorporated into the Constitution was that the custom of the time already dictated that members of Congress should represent their fellow citizens for a short time and then return to private life.

Article I, section 4 of the Constitution explicitly allows the states to determine the time, place, and manner of congressional elections; Gorsuch and Guzman use a detailed analysis of existing case law to argue that term limits fall under the "manner" provision and are thus constitutional.

Civil Forfeiture Needs Radical Reform

American forfeiture law, which is used as a weapon in the War on Drugs, allows zealous law enforcement officials to seize homes, cars, boats, airplanes, bank accounts, and businesses from people never charged with crimes, writes Terrance G. Reed in "American Forfeiture Law: Property Owners Meet the Prosecutor" (Policy Analysis no. 179). Reed shows how, on the basis of the legal fiction that the property was somehow "guilty" of criminal conduct, federal, state, and local governments can seize property—often from innocent individuals—on a showing of mere probable cause that the property "facilitated" or was otherwise related to a crime. To get their property back, owners face an uphill battle to prove their innocence, sometimes without the money to defend themselves—because it may have been seized.

Reed calls for using forfeiture only in criminal cases. Short of that, he suggests reform consistent with three principles: (1) innocent property owners should not be harmed by forfeitures; (2) forfeiture laws should not rely on the unreviewable discretion of law enforcement officials; and (3) forfeiture should be a law enforcement weapon, not a revenue-raising device.

War on Drugs a Destructive Failure

The 10-year War on Drugs has gutted the Bill of Rights; invaded our privacy; ravaged our inner cities with narcoterrorism; corrupted law enforcement officials and the judiciary; compromised judicial independence through mandatory minimum sentences; and overcrowded prisons with nonviolent first offenders while murderers, rapists, and robbers get out early. So writes Steven Wisotsky in "A Society of Suspects: The War on Drugs and Civil Liberties" (Policy Analysis no. 180). Even so, the war has not stanched the flow of illegal drugs, which are more available than ever.

Since the war began, Congress has increased the budget for drug-law enforcement nearly 10-fold, to $11.7 billion in 1992. Today, the war is being waged domestically and internationally, by both civilian and military forces. Yet the most striking accomplishments of the war, Wisotsky says, are city streets ruled by drug gangs, where innocent victims die every day; a prison population double what it was a decade ago; and "a society of suspects"—all of us—whose constitutional protections have been substantially eroded.

Those results were predictable, Wisotsky argues, from the very economic theory the Reagan administration relied on for its domestic policy. That theory shows that a war on drugs will drive up the price of drugs—which creates financial incentives, especially for inner-city youth, to enter the drug business. Thus, in a perverse way, the War on Drugs has encouraged the very explosion of crime in our inner cities that it was intended to eliminate.

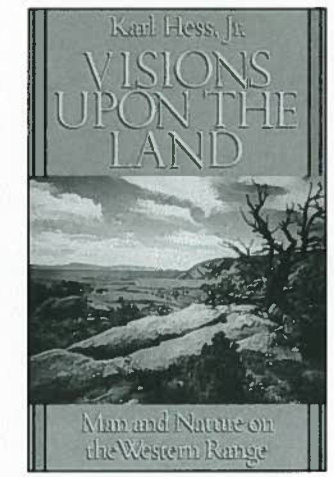
Economic Liberty Deserves Equal Protection

A recent Supreme Court decision indicates that the Court may be willing to reassert its constitutional responsibility to protect not only personal and political liberty but economic liberty as well, writes David Bernstein in "Constitutional Protection of Economic Liberty: An Idea Whose Time Has Returned" (Policy Analysis no. 181). Unlike some of the rights the Court currently protects, economic liberties are grounded explicitly in the Constitution—in its principle of enumerated powers, in the commerce clause, the contracts clause, and the takings clause. Since the New Deal, however, the Court has refused to protect those rights, preferring to defer to the political branches of government.

In recent years the Court has shown signs that it may be ready to reexamine its New Deal restraint, Bernstein argues. Taking his lead from the Clarence Thomas confirmation hearings of a year ago, when Senator Biden grilled Thomas about the proper role of the judiciary in protecting economic liberty, Bernstein reviews economic liberty jurisprudence and shows how the Court might expand its role along lines barely sketched in the final opinion of the Court's 1991 term, *Lucas v. South Carolina Coastal Council*. ■

Karl Hess, Jr., Calls for Depoliticizing Western Lands, Traces American Ideas from Jefferson to Edward Abbey

In *Visions upon the Land: Man and Nature on the Western Range*, Karl Hess, Jr., an ecologist and lover of the land, presents an eloquent plea for decentralizing and depoliticizing the Western range. Published by the Cato Institute and Island Press, *Visions upon the Land* examines the American view of land and ecology from Thomas Jefferson to the Progressive Era to the modern environmental movement.



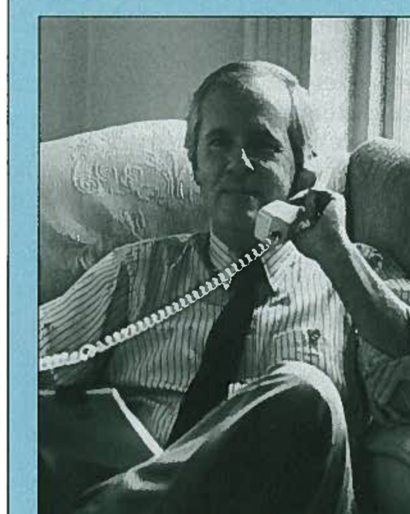
Hess, a consulting ecologist based in New Mexico, challenges the assumptions that "the lack of a national land ethic" is responsible for environmental problems and that increased federal control over the environment is needed. He shows how federal mismanagement has been responsible for the environmental decline of one-third of the surface land in the United States and attributes that decline to factors usually ignored in traditional analyses—to fundamental failures in government policy, to ecological destablization caused by government intrusion, and to the destructive effects of sweeping ideologies. Hess calls on the federal government to divest itself of the Western range.

Rather than look to the popular but ultimately futile solution of more laws and regulations to control natural resources, *Visions upon the Land* proposes a laissez faire approach. Hess writes that the damage wrought by the forcible imposition of a single vision of land management can be reversed by "a market of landscape visions" that would allow different Americans to protect different parts of the Western range in their own ways. "Healthy landscapes and free markets," he says, "are two sides of the same coin; one is the biological and the other is the human face of self-regulating ecological systems."

This is the first book to challenge the "environmental welfare state" from an ecological perspective. Grounded as firmly in free-market economics as in ecological science, *Visions upon the Land* demonstrates that freedom and vibrant rangeland are not conflicting ideals.

Ed Marston, publisher of *High Country News*, says, "Karl Hess, Jr., combines a vision of the Western range with a vision of society. And he does it brilliantly and compassionately."

Visions upon the Land is available from the Cato Institute for $22.00 cloth. ■



Brian W. Smith has joined the Cato Institute as vice president for administration. A graduate of the University of California, Berkeley, he has a career background in real estate project administration. Most recently he was vice president for construction at a California real estate development company.

Economic Reform (Cont. from p. 11)

problem, and (4) the market-socialist syndrome.

In the absence of a rule of law, the rule of special interests is a powerful force in the ECCs. The ruling elite under communism—managers of state-owned enterprises, directors of state and collective farms, top government bureaucrats, and military commanders—continue to exercise considerable influence and have a strong incentive to protect their privileged positions. As a result, the effort to privatize state property in industry, trade, and agriculture has been painfully slow.

If postcommunist reform is to be successful in establishing a real market system, it will be necessary to embark on constitutional change and create a legal framework to insulate economic life from political life. Such a change, however, must be accompanied by an intellectual revolution that replaces the ingrained anti-capitalist mentality, which has been part of the culture of communism, with a market-liberal perspective. That perspective sparked the 1989 revolution, but the "new thinking" needs to be cultivated and nourished if it is to survive. As the Russian liberal economist Larisa Piyasheva noted, "Unless we protect the fragile plant of liberal thinking now budding in our society, it will be very difficult to change things here."

The leveling instinct is still very strong in the ECCs and stands in the way of the competitive market process. Democracy, if unconstrained, could turn the former Soviet republics and other ECCs into giant welfare states. Thus, if a spontaneous market order is to emerge from the ashes of central planning, the parasitic mentality that Sobchak pointed to must be replaced by a widespread acceptance of the principles of market liberalism.

Another barrier to liberalization is the nearly universal lack of confidence in government. Meaningful reform requires a credible, long-run commitment on the part of the ECCs to limiting government and protecting individual rights. The legacy of communism is mass distrust of government. To gain credibility, the ECCs must establish constitutional safeguards for private property and freedom of contract, create an independent judiciary, allow state enterprises to fail, stop printing money to finance government deficits, create a stable convertible currency and a competitive banking system, and institute a tax system that does not discourage free enterprise and foreign investment.

Once economic and personal liberties are secure, individuals will be free to choose and to plan for the future without fearing government intervention and policy reversals at every step of the way. Thus far the ECCs have failed to depoliticize economic life. In the former Soviet republics, for example, laws have been passed, but there is still no rule of law. No one knows what will happen next, or if the property that is being privatized today will be renationalized tomorrow. Such uncertainty is a major stumbling block to making the transition to a free society and a private market system.

A final problem is that of leaving the market-socialist path and taking the road to a real market system. True markets are impossible without transferable private property rights. As long as the state controls property or regulates market prices, the information, incentive, and allocative functions of the price system will fail to operate. The fatal conceit is to think that postcommunist governments can plan the transition to a private free market. They must get out of the way and let voluntary exchange, under rules of just conduct, establish economic and social harmony.

The Postcommunist Challenge

In his Nobel Memorial Lecture, Hayek argued:

> If man is not to do more harm than good in his efforts to improve the social order, he will have to learn that in this, as in all other fields where essential complexity of an organized kind prevails, he cannot acquire the full knowledge which would make mastery of the events possible. He will therefore have to use what knowledge he can achieve, not to shape the results as the craftsman shapes his handiwork, but rather to cultivate growth by providing the appropriate environment.

The postcommunist challenge is to cultivate an ethos of economic liberty; to remove the remaining barriers to a market-liberal order; and to establish a new constitutional order based on individual, not state, sovereignty. ■

CATO INSTITUTE CALENDAR

New Perspectives for the Nineties
San Francisco • Sheraton Palace • December 8, 1992
Speakers include Milton Friedman and Gordon Getty.

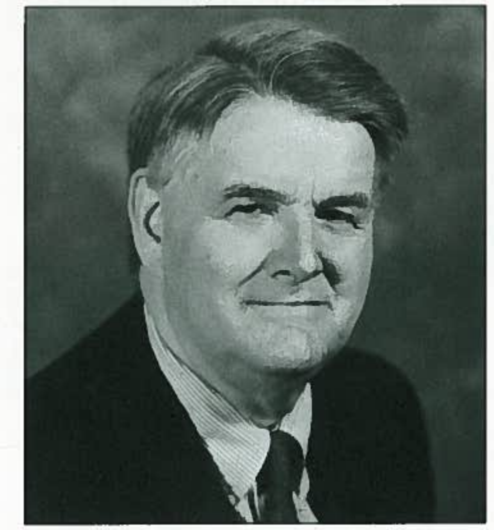
New Perspectives for the Nineties
Seattle • Stouffer Madison Hotel • December 9, 1992
Speakers include Anne Brunsdale, Paul Heyne, and Edward H. Crane.

Fifth Annual Benefactor Summit
Rancho Mirage, California • Ritz-Carlton • February 4–7, 1993
Speakers include Chris Whittle, Patrick Michaels, and Michael Medved.

The Natural Gas Act: Reform or Repeal?
Cosponsored with the Institute for Energy Research
Washington • Carlton Hotel • March 4, 1993
Speakers include Robert L. Bradley, Jr., David Teece, Jerry Ellig, Kenneth Lay, Arthur De Vany, and Cathy Abbott.

Financial Deregulation in a Global Economy
Eleventh Annual Monetary Conference
Washington • Carlton Hotel • March 18–19, 1993
Speakers include Lawrence Lindsey, Anna Schwartz, George Selgin, Jerry L. Jordan, Edward J. Kane, Lee Hoskins, and Yoshio Suzuki.

Cato Launches Fellowship To Honor Warren Brookes



Warren T. Brookes

The late Warren Brookes embodied the best of American journalism: a love of liberty, skepticism about the pretentions of politicians, a kind and generous spirit, and an utterly incorruptible commitment to the truth. A persistent critic of politics as usual, he was widely respected even by many of his arrows' targets.

Warren Brookes was also long a friend of the Cato Institute, which saw, and continues to see, its mission as injecting the same kind of skepticism about political solutions and commitment to freedom into the policy process as did Brookes. Warren Brookes regularly participated in Institute programs and was beginning work on a book on the environment for Cato before his tragic death.

To both honor Brookes and keep his style of journalism alive, the Cato Institute is inaugurating the Warren Brookes Fellowship. The fellowship will run six months. Fellows will work in residence at the Cato Institute in Washington, D.C., be reimbursed for their travel expenses, and receive a $1,000 monthly stipend. The fellowship will be open to anyone interested in journalism, but the program is designed principally for college students or recent graduates who hope to make journalism—electronic or print, reporting or opinion—a career. Moreover, applicants should be committed to the same values as Warren Brookes and to keeping his approach to journalism alive.

Warren Brookes Fellows will work under the direction of Doug Bandow, Cato senior fellow and nationally syndicated columnist. Bandow will assist fellows in selecting topics, researching issues, participating in conferences and seminars, and placing articles in newspapers and magazines. The fellowship program will emphasize practical journalism, particularly the use of quality research, trenchant analysis, and persuasive writing to influence policy. Other fellows' activities will include

- reading a large selection of Brookes's columns and his book *The Economy in Mind;*
- consulting journalists, government officials, and other policymakers who worked with Warren Brookes, to develop an appreciation of the full impact of Brookes's style of journalism and the potential for younger writers to follow his lead; and
- expanding important themes of Brookes's writing, such the politicization of environmental policy, on which his work was cut short by his death, to ensure the continuation of his legacy.

Fellows will be selected by a committee of journalists and Cato scholars. Application procedures will be announced in a forthcoming issue of *Cato Policy Report.* Applications may be requested from Warren Brookes Fellowship, Cato Institute, 224 Second St., S.E., Washington, D.C. 20003. ■

Call for Papers

The Cato Institute seeks papers on public policy issues for the *Cato Journal, Cato Policy Report,* and the Policy Analysis series. Send papers or proposals to Sheldon Richman, Cato Institute, 224 Second St. S.E., Washington, D.C. 20003.

"To be governed..."

They commit your money, not their kids

The two teachers' unions . . . co-sponsored a reception featuring Senator Edward M. Kennedy. . . .

In his speech, Senator Kennedy spoke of his family's long commitment to education, and specifically to public schools.

—*Education Week*, Aug. 5, 1992

More like Ferrari revenues and Rolls-Royce programs

Under [Pete] Wilson's predecessor, Gov. George Deukmejian (R), [California] steadily spent more money than it collected, postponing a day of reckoning with various budgetary and accounting gimmicks. . . .

"We have Cadillac programs and Ford revenues," said David Doerr, a longtime Democratic legislative analyst.

—*Washington Post*, Aug. 9, 1992

Meanwhile, back at the ranch, the *Post* supports reactionary legislators who resist market-oriented reforms

The free-market reforms launched by President Boris Yeltsin at the beginning of the year have become the focus of a political battle, as the government's market-oriented policies have come under fire by leading industrialists and reactionary legislators.

—*Washington Post*, Aug. 21, 1992

The environmentalist vision

"I'd say the biggest hope that we have right now is the AIDS epidemic," offers [novelist] William Vollmann, sipping from a glass of dark rum in his living room in a quiet section of Sacramento, California. "Maybe the best thing that could happen would be if it were to wipe out half or two-thirds of the people in the world. . . . In time maybe the world would recover ecologically, too."

—*Publishers Weekly*, July 13, 1992

You pays your taxes, you takes your chances

Public school officials have no constitutional duty to protect students from harm during school hours, a divided federal appeals court . . . has ruled.

The 7–5 en banc ruling by the 3d U.S. Circuit Court of Appeals on Aug. 11 upheld the dismissal of two 1990 civil rights suits filed by two teenage girls who were sexually assaulted by fellow students at a suburban Philadelphia vocational school.

—*National Law Journal*, Aug. 24, 1992

The train, the skyscraper, the personal computer . . .

The ballot box is the place where all change begins in America.

—Sen. Edward M. Kennedy, Aug. 7, 1992

Surprise, surprise, surprise!

The District [of Columbia] government paid at least 308 bills, totaling more than $1 million over 18 months, for fuel that was never delivered by its major supplier.

—*Washington Post*, Aug. 5, 1992

The D.C. Housing Finance Agency spent [more than $750,000] on political contributions, employee bonuses, mopeds, tickets to social events, flowers, gold frames, limousine and Cadillac rentals and other "questionable expenses," according to an audit provided to city investigators.

—*Washington Post*, Sept. 16, 1992

The District reiterated that it wants to encourage small business

College students Chris Ziener and Colin McKay, who operate their own neighborhood produce stand . . . sell to morning commuters near American University. . . .

The business's first license, for street vending, was subsequently challenged by a city official who drove by the stand and announced that it could not remain in the same spot all day. So Fat Fruit exchanged its *street* vending license for *sidewalk* vending, an important distinction in the District's vernacular.

—*Washington Post*, Aug. 4, 1992

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