Using the Market for Social Development
by Milton Friedman

An episode during an earlier visit to China impressed me strongly with the wide gulf of understanding that separates people immersed in different economic institutions. That gulf makes it extremely important to stress over and over basic principles and ideas that all of us simply take for granted with respect to the system to which we are accustomed. The episode in question occurred when my wife and I had lunch with a deputy minister of one of the government departments who was shortly going to the United States to observe the American economy. Our host wanted help from us on whom to see. His first question in that connection was, “Who in the United States is in charge of materials distribution?” That question took my wife and me aback. I doubt that any resident of the United States, however unsophisticated about economics, would even think of asking such a question. Yet it was entirely natural for a citizen of a command economy to ask such a question. He is accustomed to a situation in which somebody decides who gets what from whom, whether that be who gets what materials from whom or who gets what wages from whom.

My initial answer was to suggest that he visit the floor of the Chicago Mercantile Exchange, where commodities such as wheat, cotton, silver, and gold are traded. This answer understandably baffled our host, so I went on to elaborate on the fact that there was no single person—or even committee of persons—“in charge of materials distribution.” There are a Department of Commerce and a Department of the Interior that are concerned with materials production and distribution in a wholly different way. But they do not determine who gets how much of what. In consequence, I was forced to answer in terms that my host found extremely difficult to comprehend. Needless to say, that is not a criticism of him. Given his background, it is almost inconceivable that he could have understood how the market can distribute a variety of materials among millions of different people for thousands of uses untouched, as an ad might say, by political hands.

The miracle of the market is precisely that out of the chaos of people screaming at one another, making arcane signals with their hands, and fighting on the floor of the Chicago Mercantile Exchange, somehow or other the corner store always seems to have enough bread, the bakery always seems to have enough flour, the miller always seems to have enough wheat, and so on. That is the miracle of the way the market coordinates the activities of millions of people, and does so in a wholly impersonal way through pricing that, if left completely free, does not involve any corruption, bribes, special influence, or need for political mechanisms.

Let me now turn more directly to the topic. In some ways, referring to “the market” puts the discussion on the wrong basis. The market is not a cow to be milked; neither is it a sure-fire cure for all ills. In literal terms, the market is simply a meeting at a specified place and time for the purpose of

(Cont. on p. 10)
Cato Policy Report

Freedom, Peace, and Prosperity for China

President's Message

Last September the Cato Institute organized a major policy conference in Shanghai, China, which we co-sponsored with Fudan University. Most of this issue of Cato Policy Report is devoted to that conference, including this page, where my opening statement at a well-attended press briefing appears. The liberalization of China's economy and society is an enormously important development for all mankind. It has proved to be a process of uneven progress, of two steps forward and one step back. Recently reported events indicate a diminution of Zhao Ziyang's relative power—a clearly a step back. But it was the firm sense of the Cato representatives who gathered in Shanghai that the reforms have taken on a life of their own that is not likely to be extinguished.

It is an honor for the Cato Institute to be cosponsoring this event with the prestigious Fudan University. We are particularly grateful to Prof. Xie Xide for her enthusiastic and continuing support of the conference since the time it was proposed, more than a year ago. We believe that this conference and the proceedings, which are to be published in both Chinese and English editions, could prove to be historic in significance as China continues the courageous process of reform that is currently under way.

A unique confluence of both internal and external to China's experience—has presented a great nation with a rare opportunity; to establish radical reforms that will ensure a strong leadership role for China in the world community as we approach the 21st century.

It should be obvious that public policy has three broad goals, namely, to bring freedom, peace, and prosperity to the people. Nations throughout the world have increasingly come to realize the limitations of coercive state intervention as a means of achieving those goals.

The initiation of coercion, after all, is the antithesis of freedom.

Attempts to intervene in the affairs of other nations—particularly by the so-called superpowers—more often than not have proved detrimental to the goal of world peace.

But the superpowers are beginning to recognize the wisdom of China's stated advocacy of sovereignty and self-determination for the nations of the world. The conference session on Wednesday afternoon will explore that concept as well as the value of free trade in the maintenance of peaceful international relations.

However, most of the conference is devoted to aspects of economic reform. Given that virtually all observers now acknowledge the failure of centralized economic planning, even Moscow has come to recognize what some of the Chinese economists participating in this conference refer to as the "chaos of a closed society"—we will attempt to demonstrate the difficulties and dangers of even decentralized government control of economic activity.

It is crucial to be cognizant of the information content of prices that result from the tugging and pulling of capital and labor in a free market. Total and rapid decontrol of the economy, according to the outstanding scholars Cato has brought to this conference, is the best course for China to follow. Now is the time to be timid.

Indeed, by joining the worldwide move toward privatization and deregulation, China has become positioned to avoid lingering interventions that have reduced economic prosperity in many Western nations, such as high marginal tax rates and government manipulation of the money supply. In fact, China is positioned to join and lead the economic miracle that is the Pacific rim today.

In the course of this conference we will discuss the importance of private property, the privatization of industry, contracts, entrepreneurship, and market-determined prices as keys to China's emergence as a major economic power. As Nobel laureate Milton Friedman will point out in his address on Tuesday, "Peace and widely shared prosperity are the ultimate goals of the world, and the use of voluntary cooperation as the major means of organizing economic activity."

To repeat, the Cato Institute is honored and privileged to have this opportunity to offer guidance to China's enlightened and, I would say, heroic leadership as it undertakes to achieve economic reform.

—Edward H. Crane

Most of the conference participants gather for a group photo.

Cato Policy Report

Enthusiasm for Market Reforms

Friedman, Gilder a Hit at Cato's Shanghai Conference

"Should China reform its economy step by step or all at once?—this was the subject of a heated debate between top Chinese scholars and their American counterparts at yesterday's first session of the conference entitled "Economic Reform in China: Problems and Prospects.""

That's how the front page of the China Daily summarized the Cato Institute's September 1988 conference in Shanghai. In the opening address, Nobel laureate Milton Friedman said, "The way to expedite the transition in China is to proceed with privatization as rapidly and on as wide a scale as possible." Friedman stressed the importance of private property rights in a market economy.

For Cato staff members and other Western observers, the most encouraging aspect of the conference was the fact that none of the Chinese participants disagreed with the goal of moving toward wider use of markets; the disagreement was entirely over how fast it was politically possible to move.

Western speakers and observers reported the same enthusiasm for reform among Chinese citizens that they encountered in shops and parks.

Author George Gilder gave a rousing speech about the opportunities open to China. He proclaimed that "the greatest untapped resource in the world is the Chinese people." Gilder dramatized China's economic potential by pointing out that if the incomes of the people of China had increased one-third as fast over the past 40 years as had the incomes of the people of China outside China, China would be the largest economy in the world and world output would be 25 percent larger. Gilder's speech received a prolonged ovation.

After the conference, Cato president Edward H. Crane said, "We were tremendously impressed by the positive reception that free-market ideas got in China. The enthusiasm of younger Chinese scholars and economic policymakers for Friedman, Gilder, and our other speakers is very encouraging for the long-run success of Chinese economic reform."
Ad Restrictions Unconstitutional

Strict new regulations proposed by Congress and the media to cover political advertising would violate the First Amendment and would still fail to protect the integrity of American elections, charges a new Cato Institute study.

Stephen Bates, a visiting scholar at Harvard Law School and a project director of the Twentieth Century Fund, contends that advertising—including the much-maligned "negative advertising"—gives candidates the best opportunity to explain their positions and to shape the issues. Bates observes, "Proposal to clean up commercial would undercut that opportunity, perhaps eliminate it entirely." Bates writes, "Voters would end up knowing less about candidates...[And] the proposed regulations would almost certainly be ruled unconstitutional."

Bates argues that many of the proposed restrictions would weaken challengers' ability to run competitive campaigns. He cites one study of a 1983 race that showed that a campaign had spent "about .5 cents to reach a voter by television. The cost for a newspaper was 13.6 cents, 25 cents." By limiting television access and reducing TV ads' cost-effectiveness, the proposed restrictions would benefit incumbents and well-financed candidates. An opponent of one such bill described it as the "Incumbent Protection Act."

The report also documents the probable unconstitutionality of the proposals. Bates observes that "the Supreme Court has held that First Amendment protections don't fit the most urgent application precisely to the conduct of campaigns for political office."

Bates concludes: "Political Advertising Regulation: An Unconstitutional Menace?" is no. 112 in the Cato Institute's Policy Analysis Series. It is available for $2.00.

Fred Smith and Ann Hollander debate the future of biotechnology.

Mandated Benefits Are a Hidden Tax, McKenzie Argues

August 24: "The Democratic Revolution in Mexico: Problems and Prospects for the Future?" Daniel James, president of the Mexico—United States Institute, maintained that the recent Mexican elections, in which an unprecedented number of votes were cast for candidates of opposition parties, were a turning point for that country. He argued that despite the victory of the ruling PRI, the closeness of the election returns represents the end of Mexico's one-party system and means that President-elect Carlos Salinas de Gortari is destined to be a transitional president. James discussed the probable consequences of the new political alignment and looked at prospects for the three main political parties.

Bennett Boosts Educational Choice

August 3: "Mandated Benefits: Will Workers Pay a Hidden Price?" Cato adjunct scholar Richard B. McKenzie, an economist at Clemson University and author of The American Job Machine (recently published by Cato and University Books), argued that mandated benefits—legal requirements forcing businesses to provide a range of benefits, including health and life insurance, parental leave, day care, and parent—closed notices—are counterproductive. He charged that such schemes are really a "hidden" tax that will show up in higher consumer prices, lower wages, and lower company profits. In the process, workers will be made poorer through restrictions on their work-related choices and income.

Ed Crane and Ted Galen Carpenter, Cato's director of foreign policy studies, talk before news conference at Fudan University.

China Conference (Cont. from p. 3)

in China.

Other Western speakers included Cato chairman William A. Niskanen, who discussed the lessons Chinese policymakers might draw from the U.S. experience with deregulation; John P. Morgan's from the University of Colorado and Jo Kwong of the Institute for Humane Studies, who discussed property rights and land reform; Peter Bernholz of the University of Basel, who discussed the need for monetary stability, Thomas R. Dye of Florida State University, who discussed regional development; and Gabriel Roth of the Services Group, who discussed privatization. Alvin Rabushka of the Hoover Institution contributed an important paper on the economic successes of Hong Kong, Taiwan, and Singapore but was unable to attend the conference.

Several speakers from Hong Kong helped bridge the gap between Chinese and Western scholars. They included: Kun-Wing Sun of the University of Hong Kong and John G. Greenwood of C. T. Management (Asia) Ltd., who discussed the lessons of the Pacific Basin economies; George A. Selgin of the University of Hong Kong, who discussed the benefits of private alternatives to the central bank; and Steven N. S. Cheung of the University of Hong Kong, who warned of the obstacles that Chinese reformers are now facing.

Chinese speakers included Pu Shan of the Chinese Academy of Social Sciences; He Welling of the Kang Hua Development and International Cooparation Company; Bao Yifang of the

China Council for the Promotion of International Trade; He Gaosheng of the Shanghai Economic System Reform (2001) of the People's Bank of China; and Li Yimin, Wang Xi, Chen Wei-Shui, and Zhou Ming-Wei of Fudan.

Media representatives at the conference included the Beijing Review, The World Economic Herald of Shanghai, Shanghai television, the China Daily, the Jiefang Daily, the Wall Street Journal, the Los Angeles Times, and the British Broadcasting Corporation.

The proceedings of the conference will be published in Chinese by Fudan University Press and in English by the Cato Institute. The large press run planned by Fudan ensures that the ideas presented at the conference will be available to virtually all interested policymakers and individuals in China.

Joel Kotkin (right) discusses his book The Third Century: America's Resurgence in the Asian Era.

September 28: The Cato Institute hosted a book party for Joel Kotkin, coauthor with Yoriko Kishimoto of The Third Century: America’s Resurgence in the Asian Era. Kotkin, the West Coast editor of Inc., presented a thoughtful rebuke to those who argue that American economic power is declining. He observed that the entrepreneurial-based American economy has a number of inherent advantages, and he contended that successful economic competition can be had only through the exploitation of those free-market virtues, not through tariffs and quotas, subsidy programs, or European-style government-business partnerships.

September 29: "Politics and Ideology: Do Ideas Matter?" Tibor Machan, a professor of philosophy at Auburn University, challenged the assertions of some economists that all that matters in political decision-making is self-interest and the bargaining process. He argued that ideas play an important role in bringing about lasting political change.
Economic Reform in China

Policy Forum

The Cato Institute and Fudan University recently cosponsored a conference, "Economic Reform in China," held in Shanghai. Participants included scholars and businesspeople from the United States, Europe, Hong Kong, and China. Cato Policy Report is pleased to present excerpts from some of the papers delivered at that conference. In 2009 a complete set of conference proceedings will be published in book form in both English and Chinese.

Let a Billion Flowers Bloom by George Gilder

We're on the threshold of a new economic era that will be a great benefit for China, because China almost entirely missed the last economic era. If the incomes of the Chinese people in China had grown just one-third as fast in the past 40 years as the incomes of Chinese in other countries, China today would be the world's largest economy and the global economy would be 25 percent bigger than it is.

Today's China is the most饿 for information. Forget oil, gold, land—forget all those material things; the single greatest untapped natural resource in the world is the Chinese people. Sometimes other people treat the Chinese people as if they're mouthes, but the Chinese people are minds. And the crucial issue of the next 25 years, when the Chinese figure out the importance across the world, is whether the minds of the Chinese people are emancipated.

This new era involves a new technology—the microchip. The substance of a microchip is the silicon in sand. What matters is the content, the idea, the design, the function of the device. What this new technology means for China is that one of Chairman Mao's great dreams can now come true: power to the people. Twenty-five years ago, Chairman Mao launched a program of steel mills in every backyard. This was very stupid. Steel mills require huge economies of scale and thousands of regimented workers to produce efficiently. However, this new chip technology is based on economies of microscale. The smaller each device on the chip, the more power it can produce. Not only can a single workstation create value in the new economy greater than that created by a huge steel mill, a workstation can also transmit more value around the world in microseconds than a fleet of supertankers can transport in months.

A former official of the Chinese central bank makes a point at the conference.

To fulfill Mao's dream of industrial power distributed to the people, however, we must give up his other dream of central planning of an economy. The law of the microcosm—the law of the microchip—is that the power of individual workstations always grows much faster than the power of large computer systems. The long dream of socialists that the computer will allow you to plan the economy has been confounded at the heart of the computer itself. The power of the chip always grows faster than the power of the larger system.

The next civilization will be computer-based, with power flowing from the minds of the Chinese people to the world. The most important question is what will happen when the Chinese people learn to use their minds to do things that no one else can do.

George Gilder is the author of The Spirit of Enterprise.

Economics in the Weberian条例

Science and Political Economy by Don Lavoie

Idea about political economy, like other products of human culture, are like weather, in that they do not exist independent of the environment that give rise to them. In the underlying conceptions of the nature of science, Socialist political economy was not just influenced by the 19th-century view of science, it was modeled on it. Marxism has been widely interpreted as a "scientistic socialism" by both Marxists and other socialists. In a strictly Newtonian sense, a study of the "laws of motion of the capitalist system" analogous to the physical laws of motion of planetary systems.

It would certainly be understanda- ble if many aspects of the Marxist system of thought were tainted by the mechanistic model of the universe in which 19th-century culture was em- bedded. At that time the great suc- cesses of Newtonian mechanics made them a natural object for emulation in the study of human society. But other, non-Newtonian sciences have by now been successful too. Even thermo- dynamics and organic chemistry exhibit features that do not fit well in the mechanistic Newtonian view of the universe.

If we consider biology, anthropology, intellectual history, or psychology, we find fields that have made enormous accomplishments in the past century without coming close to the Newtonian model. The argument from success no longer makes a good case for the mechanistic view of the world. There is now a wide body of explicit questioning of the assumptions of the best-selling computer firms on the face of the earth is Stone Com- puter, started by W. K. B. In just four years this company outproduced all the government computer compa- nies in China. Today on a street in Beijing there are 170 high-technology companies, and 1,000 more such compa- nies are applying for licenses. They should get those licenses very fast. Let a billion flowers bloom.

Don Lavoie is a professor of economics at George Mason University and the author of National Economic Planning: What Is Left?

The Assiessed Order

by He Weiling

According to the new view of science, there are two kinds of order: assessed and alive. Economic planning is a kind of assessed order that cannot accommodate the social division of labor and the need for economic development. Therefore, it is only a primitive order suited for a simple economic system. This order will totally collapse in the process of new technolo- gies and the social division of labor. The chaos arising out of the centrally controlled planning is self-evident, especially during the process of the economic reform.

As Don Lavoie points out in Na- tional Economic Planning: What Is Left?, it is the unavailability of informa- tion that leads to the loss of planning. It is the complexity of the economy and the dynamic system that cannot do as the highly integrated market mechanism does. It cannot make any new adjustment for new economic con- ditions. Such problems can be solved only by the market mechanism, which can automatically and spontaneously adjust itself by using all kinds of economic me- diums. By adjusting, the collecti- ve or social intelligence can replace individual intelligence, and the social system can change at its own pace.

He Weiling is a senior fellow at the Na- tional Economic System Reform Institute of China.

The Cato Policy Report

Cato Policy Report

The Cato Policy Report is pleased to present excerpts from some of the papers delivered at that conference. In 2009 a complete set of conference proceedings will be published in book form in both English and Chinese.

Let a Billion Flowers Bloom by George Gilder

We're on the threshold of a new economic era that will be a great benefit for China, because China almost entirely missed the last economic era. If the incomes of the Chinese people in China had grown just one-third as fast in the past 40 years as the incomes of Chinese in other countries, China today would be the world's largest economy and the global economy would be 25 percent bigger than it is.

Today's China is the most hungry for information. Forget oil, gold, land—forget all those material things; the single greatest untapped natural resource in the world is the Chinese people. Sometimes other people treat the Chinese people as if they're mouthes, but the Chinese people are minds. And the crucial issue of the next 25 years, when the Chinese figure out the importance across the world, is whether the minds of the Chinese people are emancipated.

This new era involves a new technology—the microchip. The substance of a microchip is the silicon in sand. What matters is the content, the idea, the design, the function of the device. What this new technology means for China is that one of Chairman Mao's great dreams can now come true: power to the people. Twenty-five years ago, Chairman Mao launched a program of steel mills in every backyard. This was very stupid. Steel mills require huge economies of scale and thousands of regimented workers to produce efficiently. However, this new chip technology is based on economies of microscale. The smaller each device on the chip, the more power it can produce. Not only can a single workstation create value in the new economy greater than that created by a huge steel mill, a workstation can also transmit more value around the world in microseconds than a fleet of supertankers can transport in months.

A former official of the Chinese central bank makes a point at the conference.

To fulfill Mao's dream of industrial power distributed to the people, however, we must give up his other dream of central planning of an economy. The law of the microcosm—the law of the microchip—is that the power of individual workstations always grows much faster than the power of large computer systems. The long dream of socialists that the computer will allow you to plan the economy has been confounded at the heart of the computer itself. The power of the chip always grows faster than the power of the larger system.

The next civilization will be computer-based, with power flowing from the minds of the Chinese people to the world. The most important question is what will happen when the Chinese people learn to use their minds to do things that no one else can do.

George Gilder is the author of The Spirit of Enterprise.

Economics in the Weberian条例

Science and Political Economy by Don Lavoie

Idea about political economy, like other products of human culture, are like weather, in that they do not exist independent of the environment that give rise to them. In the underlying conceptions of the nature of science, Socialist political economy was not just influenced by the 19th-century view of science, it was modeled on it. Marxism has been widely interpreted as a "scientistic socialism" by both Marxists and other socialists. In a strictly Newtonian sense, a study of the "laws of motion of the capitalist system" analogous to the physical laws of motion of planetary systems.

It would certainly be understanda- ble if many aspects of the Marxist system of thought were tainted by the mechanistic model of the universe in which 19th-century culture was em- bedded. At that time the great suc- cesses of Newtonian mechanics made them a natural object for emulation in the study of human society. But other, non-Newtonian sciences have by now been successful too. Even thermo- dynamics and organic chemistry exhibit features that do not fit well in the mechanistic Newtonian view of the universe.

If we consider biology, anthropology, intellectual history, or psychology, we find fields that have made enormous accomplishments in the past century without coming close to the Newtonian model. The argument from success no longer makes a good case for the mechanistic view of the world. There is now a wide body of explicit questioning of the assumptions of the best-selling computer firms on the face of the earth is Stone Com- puter, started by W. K. B. In just four years this company outproduced all the government computer compa- nies in China. Today on a street in Beijing there are 170 high-technology companies, and 1,000 more such compa- nies are applying for licenses. They should get those licenses very fast. Let a billion flowers bloom.

Don Lavoie is a professor of economics at George Mason University and the author of National Economic Planning: What Is Left?

The Assiessed Order

by He Weiling

According to the new view of science, there are two kinds of order: assessed and alive. Economic planning is a kind of assessed order that cannot accommodate the social division of labor and the need for economic development. Therefore, it is only a primitive order suited for a simple economic system. This order will totally collapse in the process of new technolo- gies and the social division of labor. The chaos arising out of the centrally controlled planning is self-evident, especially during the process of the economic reform.

As Don Lavoie points out in Na- tional Economic Planning: What Is Left?, it is the unavailability of informa- tion that leads to the loss of planning. It is the complexity of the economy and the dynamic system that cannot do as the highly integrated market mechanism does. It cannot make any new adjustment for new economic con- ditions. Such problems can be solved only by the market mechanism, which can automatically and spontaneously adjust itself by using all kinds of economic me- diums. By adjusting, the collecti- ve or social intelligence can replace individual intelligence, and the social system can change at its own pace.

He Weiling is a senior fellow at the Na- tional Economic System Reform Institute of China.
Economic Reform (Cont. from p.7)

economic structure can reach a higher—indeed, an order that can stand the test of time. Theoretically and practically, the establishment of a market-oriented political and economic system is the prerequisite for modern economic development. Only by opening up and resolutely changing our institutions and our entrepreneurial and self-organizing potential can we fully understand and accept the basic law on our way to a higher order.

Political Reform Is Needed by Zhou Ming-Wei

The present political structure of China is not compatible with the needs of economic growth. If the people of a country are going to have greater participation in the administration of society, they must have greater and greater power to use assets and to control the market. At every stage, every step must have some right to participate in the political, economic, and social life of the nation. This participation can be ensured only if there is both political and economic democracy. And so, before we talk about allowing more private or collective enterprises to provide public services, we must look at the more fundamental question of political democracy. As human civilization develops and as societies become more complex, the functions of government should become fewer and simpler. Many Western countries have already experienced this process. Our experience teaches us that it is impossible for government to arrange the detail of events that occur within a society. Nor is it possible for a govern- ment to provide public services to the benefit of tens of thousands of citi- zens, all according to some sort of a very finely detailed plan. To do something like that will only cause things to get worse.

As we feel our way toward the direction of Chinese economic reform, we increasingly find that a highly centralized government is the root cause of a lot of administrative problems. There are many reasons why such a highly centralized system has come into being. One problem is that people feel that a highly centralized, rigid ad- ministration has a tendency to reduce the sense of socialism. Without competition even a service like weather forecasting is going to be totally useless and mean- ingless. But when we consider why in the West the private sector has been so much more able to participate in providing public services, we find that there are property rights that operate. With the Marxian doctrine nearly dead, there was, and still is, an ideology vacuum in China. The pseudo doctrine is impressively pragmatic; it uses com- mon sense rather than theory to con- front the difficulties that have al- ready cropped up. Indeed as experts on the shortcomings of a communist system, they know that the property rights of the state and the public are something amoral. Piece- meal tactics guided by common sense and the economic factors, in other words, have guided the policy guideline for one decade. And in spite of the political opposition and occasional backsliding, the often haphazard news headlines, progress has been phenomenal.

In the process, a substantial number of comrades have lost their privileged status. The more astute ones have turned to trade and industry and have done well because of connections, while others have become ordinary citizens and have more to retire. In areas subject to intense competition, previ- ous hierarchy and social rank of productivity have become meaningless. In other areas, these privi- leges have been retained and the "mon- opoly and regulation rights. An at- tempt to protect a state monopoly is an attempt to protect a rank. I can cite numerous instances to sup- port this view. But if we must single out one or two instances, the bank- ing sector would be the natural choice because of the wide-ranging importance of the banking industry. Its problems make the headlines almost every day. China is not Wenzhou, for in- stance; any impartial observer must stand in awe of its economic success. A small town, Wenzhou has its loan institutions cropped up to finance small businesses and had brilliant suc- cess. But this booming enterprise was soon restrained by the banking authori- ty, which imposed interest and licen- sing. Despite these restrictions, the foreign exchange, the monopoly long enjoyed by the Bank of China has reaped handsome profits through ex- change controls and rationing. But when black market activity became severe, the people involved in the auth- orities themselves started exchange centers dealing in near-market rates. It is difficult to say in what sense exchange control now exists in China. Certainly all arguments in favor of con- trol have disappeared, all demand for freedom on the principle of equality before the law.

Learning from Hong Kong

by John G. Greenwood

Both management and technology are attributes or skills that are them- selves responses to a whole set of mar- ket incentives and opportunities. It is unlikely that they would have emerged independently without the framework of the market economy, that is, a free-market environment. Before the question of what role technology, for instance, is seen in the market, a number of questions must be raised. What is the extent of what the market can provide? Where does the market compete? What is the extent of what the firm can provide? What are the rules of the market? How do these questions affect the potential development of technology and the management role? As for the generation of new knowledge, one can see that the generation of new knowledge is a very complex process. It is difficult to know whether it is a simple process or whether the innovation in the public sector over the past 100 years. Aside from a few improvements in sorting techniques, the industry operates very much as it did 300 years ago. Again, contrast that example with developments in the private sector. In recent decades we have seen the emer- gence of new scientific and technol- ogies specializing in the delivery of private packages and documents both in the United States and in Japan. These companies normally guarantee delivery within 24 hours inside a country and within 48 hours to the rest of the globe—something that government- run postal systems have never been able to provide. There has been an attempt in recent years to over- come the inefficiency of government- run systems in a number of other areas: simple machines and computer-based information networks that enable writ- ten messages to be transmitted by tele- phone line or data line virtually instant- ially around the world. The incentive to develop such systems is based on the potential cost savings. It is inconceivable that this set of tech- nological developments could have occurred in the government sector.

What are the key elements of these two examples? Both have three com- mon denominators. First, both indus- tries have private ownership that has stimulated the introduction of sophis- ticated technology and innovations; second, there is a very clear base of technology. Second, there is a free pric- ing in terms of setting wages, of setting prices, and of the return as the result of profits to the business owners. Third, in both areas competition has

Peter Bernholde of the Uni- versity of Basel, Swit- zerland.

Richard Y. C. Wong of the Chinese Univer- sity of Hong Kong.

Zhou Ming-Wei is a research fellow at the Center for American Studies at Fudan University.

Steven N. S. Cheung is a professor of eco- nomics at the University of Hong Kong and the author of The Future of China.

(Corr. on p. 13)
In discussing this it is here not to present again the case for a system of freely floating exchange rates but rather to analyze how the current international system of limiting decontrol or privatization to one area, while not extending it to the rest of the world, has so largely frustate
the basic objective.

A partial solution to the problem of major world market power will be a determination to grant sufficient exchange rate flexibility to allow more efficient allocation of resources. This will be necessary if the world is to achieve a system of free markets, and not to have further exchange controls and distortions. It is also important to note that such a system is necessary for the operation of the international monetary system. The need for a flexible exchange rate system is well recognized by most economists, and the international community has agreed to work towards this goal. However, the implementation of such a system is not without its challenges, and it will require ongoing efforts to monitor and adjust the exchange rates as needed. The ultimate goal is to create a system that is efficient, flexible, and responsive to the needs of the global economy.
Using the Market (Cont. from p. 11)

Direct controls over prices—whether through exchange rates or trade barriers—must always end at once. Margaret Thatcher properly ended them in Britain overnight and completely. Gradual adjustment only prolongs the harm done by imposing a mixed economy on the market. The rapidity of the transition is necessary to ensure that benefits to "insiders." The short-ages, queues, and other distortions produced by trying to hold prices below their market level would continue though they might be reduced, and additional problems would arise. Nationalism encourages speculation about an eventual return and encourages opponents to seek revenge. A similar proposition holds for attempts to maintain prices above market levels—as is so amply demonstrated by the agricultural polices of the United States, Japan, and the common market.

Overcoming Political Obstacles

This subject has already inevitably intruded into the current general issue here is to overcome political obstacles to widening the market. The danger in some of these obstacles will frustrate the attempt to free the market but equally that overcoming political obstacles is the key to the advantages of freeing the market. The challenge is to find ways to overcome political obstacles that will not destroy the benefits of the market.

The West's experience with privatization is particularly helpful in this regard. The key to understanding this process is to get at the core of the experience of the British with privatization, and I strongly recommend to our Chinese friends seeking to adopt measures to broaden the evidence of privatization in Britain.

A simple case from the United States that illustrates the problem is privatization of the post office. The U.S. Postal Service has a monopoly in first-class mail, but the monopoly has been challenged by private express services, which make it a crime for individuals to offer common-carrier first-class mail service. Various attempts to do so have only succeeded in prosecution, which has ended the attempts. Privatization as a means of breaking up the monopoly, first in the form of alternate parcel service. The United Parcel Service and other parcel delivery companies have taken over a bulk of the Postal Service's prior business. In addition, privatized express companies have developed, one of which is Federal Express, which has been so successful that it has been able to obtain and retain customers even if they are not a monopoly. Developments that technologically advances have had no influence on the market for the long-term of the companies that the initiatives of unionized civil servants, as illustrated in the case of British Telecom. Union officials denounced the privatized planners of Telekom, telling their members not to work. Individual initiatives were offered, and the companies were offered them at a discount. Yet in the end, sensing the chance to make money, some 96 percent of the workforce bought shares.

Poole also uses British Telecom to illustrate the second technique, popular capitalism.

To encourage telephone customers to buy shares, they were offered vouchers granting them a discount on their phone bills if they held them for at least six months. And to prevent institutions and large firms from buying up the shares, individuals were limited to 800 shares per buyer.

A pivotal role is played by adopting such expedients is to sweep the deal by converting a government monopoly—which may be an improvement but falls far short of the desirable outcome. The U.S. Postal Service illustrates that privatization will fall as well as the fallacy that mimicking the form of private enterprise can achieve the substance. It was established as a supposedly independent regulatory corporation, but it was not subject to direct political influence and that would operate on market principles. It has hardly been the outcome, and understandably so. It remained a monopoly and did not develop any competitive interest in efficiency.

Tyranny of the Status Quo

The problems of overcoming vested interests, of frustrating rent-seeking, apply to almost every attempt to change government policies. Inequality involves privatization, or eliminating military bases, or reducing subsidies, or anything else. The resulting "tyranny of the status quo," as my wife and I entitled a recent book discussing a range of such cases in the United States, is the major reason that political mechanisms are so much less effective than "free-market" mechanisms in encouraging dynamic change, in producing growth and economic prosperity.

For example, many observers are overestimating the tyranny of the status quo. But there is one that ties closely with the discussion of gradual versus abrupt change. If a government activity is to be privatized, or eliminated, all means so completely. Do not compromise by partial privatization or partial reduction. That simply leaves a core of determined opposition to work diligently and often successfully to reverse the change. The Reagan administration repeatedly attempted, for example, to privatize Amtrak (the rail-road passenger service) and to eliminate all of the services. In each case, it settled for a reduction in budget, achieving a fairly transitory victory. In the other hand, the only possible abolition of the Civil Aeronautics Board gives far greater hope that airline deregulation is here to stay.

In conclusion, there are other better and worse ways to privatize a command economy. But there is no silver bullet for shifting painlessly from a command to a voluntary exchange economy. Nonetheless, the potential for shifting so far in the direction is so great that, if the shift can be achieved, transitional costs will pale into insignificance. It is enough for present leaders of China that they recognize that the potential gains dwarf the transitional costs and that they are engaged in a serious effort to make the transition. The Chinese people would be aware of the benefits and the beneficiaries of the success of this effort.

All the peoples of the world would benefit. Peace and widely shared prosperity are the ultimate prizes of the worldwide use of voluntary cooperation as the major means of organizing economic activity.

Interns Needed

The Cato Institute seeks interns for spring and fall 1989. Please contact Gordon Anderson at Cato for more information.

Economic Reform (Cont. from p. 9)

stabilized improvements in service to the consumer.

My conclusion is that perhaps China can learn the lesson of the West at some levels and for some period of time, but China cannot expect these skills and people to exist in a vacuum, i.e., in the absence of an appropriate institutional framework—namely, free markets, law and order, and competition among producers.

Reject Central Banking

by George A. Selgin

China had a "free banking" era during the Ch'ing dynasty from the 1650s to 1850s. This era was the only extended period in China's history during which it did not experience substantial depreciation of its currency. The Ming dynasty abandoned the use of fiat money midway through the 16th century and for two brief episodes in the 1650s and 1850s, the Manchus also re-traced an entirely different from issuing their own money while leaving private banks entirely free to do so. In some places (such as in Shanghai and Macao), development of complex payment systems that developed were quite sophisticated.

It is still, as Prof. Brillartz says, an unresolved question why China should have temporarily abandoned resort to the printing press. But if it did resolve, the results will have been the only evidence of the existence of private banks operating independently from the government. Various speakers at this conference have stressed the need for China to resist slavishly imitating economic systems of the "capitalist" West. Central banking should be high on the list of such institutions of Western origin that policymakers in China should unhesitatingly reject.

George A. Selgin is a professor of economics at the University of Hong Kong and the author of The Theory of Free Banking.
Market Can Produce Public Goods, Book Argues

The most important remaining arguments for government intervention are that the market is incapable of providing the public goods, that they are essential to the operation of a competitive government intervention. We have come to understand that many of these alleged ‘market failures’ can be explained using market forces. The essays in this book include some of the classic articles in this intellectual odyssey along with interesting examples of how market forces prevent market failures.” Thomas Gale Moore, a member of Reagan’s Council of Economic Advisers, shared Peltzman’s praise, calling the book “invaluable.”

Economic Theory and Case Studies

State Hams Environmental Farms

Environmental protection could be dramatically improved by allowing and promoting more private sector con- servation initiatives, according to a new study from the Cato Institute. Environmentalists Terry L. Anderson and Donald R. Leal argue that “government often has proved negligent in caring for endangered species and other natural resources it controls. A growing list of travesties on public rangelands, forests, and wetlands raises questions about whether government is the correct choice for resource stewardship.”

Cato Policy Report

Pilon joins the Institute as serving as the director of the Asylum Policy and Review Unit at the Justice Department.

Miltary Costs Reach New High

U.S. military spending has stayed at a high level for the past two decades. After the cold war era, says a new study from the Cato Institute.

State Hams Environmental Farms

Financial protection could be dramatically improved by allowing and promoting more private sector conservation initiatives, according to a new study from the Cato Institute. Environmentalists Terry L. Anderson and Donald R. Leal argue that “government often has proved negligent in caring for endangered species and other natural resources it controls. A growing list of travesties on public rangelands, forests, and wetlands raises questions about whether government is the correct choice for resource stewardship.”

Cato Policy Report

Pilon joins the Institute as serving as the director of the Asylum Policy and Review Unit at the Justice Department.

Miltary Costs Reach New High

U.S. military spending has stayed at a high level for the past two decades. After the cold war era, says a new study from the Cato Institute.

State Hams Environmental Farms

Financial protection could be dramatically improved by allowing and promoting more private sector conservation initiatives, according to a new study from the Cato Institute. Environmentalists Terry L. Anderson and Donald R. Leal argue that “government often has proved negligent in caring for endangered species and other natural resources it controls. A growing list of travesties on public rangelands, forests, and wetlands raises questions about whether government is the correct choice for resource stewardship.”

Cato Policy Report

Pilon joins the Institute as serving as the director of the Asylum Policy and Review Unit at the Justice Department.

Miltary Costs Reach New High

U.S. military spending has stayed at a high level for the past two decades. After the cold war era, says a new study from the Cato Institute.
In fact, per capita aid is increasing. The Reagan administration is not considering cutting or re-assessing economic aid to the minority Tutsi government of Burundi, according to the State Department, despite the recent massacre of an estimated 20,000 people of the majority Hutu tribe.
—International Herald Tribune, Sept. 9, 1988

All encouragement flows from the barrel of a gun
The IRS and others are fond of noting that the U.S. tax system is basically voluntary—people compute their own taxes and pay them.... [IRS task force chairman Richard C. Stark said,] "We're taking the perspective that the penalties are there to encourage voluntary compliance."

Leveraged liberalism:
a seven-letter word beginning with F and ending with M
What Dukakis offers ... is a version of what [some] policy analysts have come to call "leveraged liberalism"—the use of government leverage to direct the energies of the private sector toward achieving public goals.
—Los Angeles Times, Sept. 11, 1988

Find the dark lining in every silver cloud
The Philippine government has cracked down again on a controversial import liberalization program.... Apples, normally a special Christmas-season treat which sell for 95¢ and up... were selling for as low as 24¢ each.
The program... worried Philippine economists because it was gobbling up the country's already low foreign exchange reserves.
—San Francisco Chronicle, Aug. 15, 1988

Socialism we can live with
The Communist Party of Great Britain has launched one of the most fundamental rethinks undertaken of British Marxism....
The new version of the Communist Party's guiding manifesto—The British Road to Socialism—[argues] that the free market is certain to play a continuing role in any pluralistic socialist state "simply because it is the best way to co-ordinate lots of economic decisions, and to ensure that production responds to consumer choices."...
On specifics, the paper advocates the left form an anti-Thatcher coalition around opposition to the poll tax.
—Hong Kong Standard, Aug. 29, 1988

Except in countries where they have it Intellectuals... will never be satisfied with anything less than constitutional democracy.
—New Republic, Sept. 26, 1988

To put it mildly
A U.S. appeals court panel [in Washington] ruled that United Airlines must turn over a lucrative Seattle-Tokyo route to Continental Airlines....
The 2-1 ruling was a blow not only to United... but also to.... American Airlines. A senior Transportation Department official recommended this month that the route be awarded to American....
The three carriers have been fighting for the route since October 31, 1985, when the Transportation Department approved United's purchase of the Pacific routes of Pan American World Airways. The department also began a proceeding then over whether United must give up the Seattle-Tokyo route to preserve competition.
The proceeding has taken on a farcical air at times.
—Wall Street Journal, Aug. 28, 1988

The Reagan revolution goes global
While Denmark's minority government coalition is nominally right of center, it is strongly committed to maintaining the welfare state.
—Washington Post, Aug. 28, 1988