Cato Policy Report

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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.

Milton Friedman is a Nobel laureate in economics and a senior research fellow at the Hoover Institution. This article is based on his remarks at the Cato Institute conference "Economic Reform in China."

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.

In This Issue

Jack Fay

Dozens of journalists and economists question Milton Friedman at his Shanghai news conference.

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

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Freedom, Peace, and Prosperity for China

President's Message

Last September the Cato Institute organized a major policy conference in Shanghai, China, which we cosponsored 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—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 have historic significance as China continues the courageous process of reform that is currently under way.

A unique confluence of events—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 not 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 prizes of the worldwide 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.

Ed Crane

—Edward H. Crane

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 Chinese people 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.

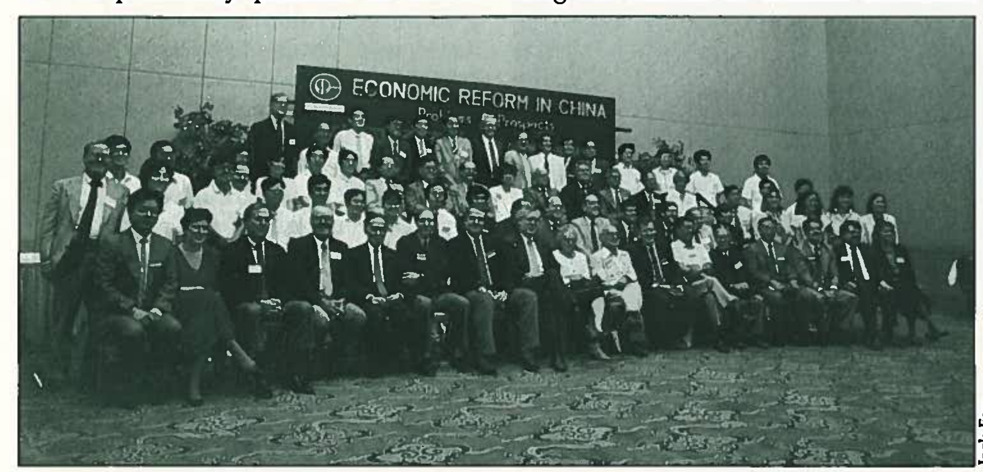
After the conference, Cato president Edward H. Crane said, "We were tremendously impressed by the positive reception that free-market ideas got in China. The enthusiasm of younger Chinese scholars and economic policymakers for Friedman, Gilder, and our other speakers is very encouraging for the long-run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

Conference director James A. Dorn

"The conference was a great success," said Friedman. "Cato is to be congratulated for having put it on."

Jack Fay

Milton Friedman makes a point at news conference as translator June Mei waits.



Jack Fay

Most of the conference participants gather for a group photo.

The conference, organized by *Cato Journal* editor James A. Dorn, was designed to bring together Chinese and Western scholars to discuss the progress of Chinese economic reform and the kinds of market mechanisms that are essential for modernization and development. The conference was cosponsored and hosted by Fudan University, one of the most prestigious universities

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China Conference (Cont. from p. 3)

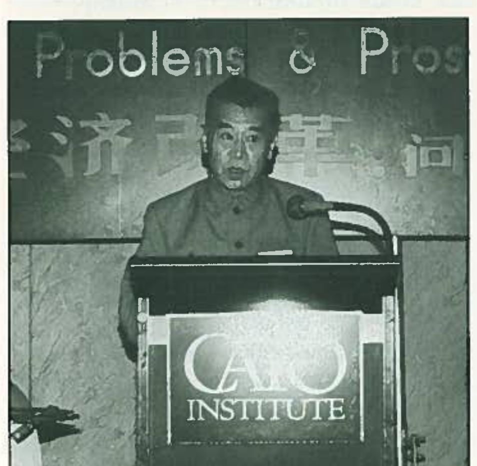
in China.

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. Powelson of 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 Yun-Wing Sun of the Chinese University of Hong Kong and John G. Greenwood of G. T. Management (Asia) Ltd., who discussed Hong Kong's role in Chinese development; Richard Wong of the Centre for Economic Research, 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 Weiling of the Kang Hua Development and International Cooperation Company; Bao Yifang of the China Council for the Promotion of International Trade; He Gaosheng of the Shanghai Economic System Reform Office; Liu Funian of the People's Bank of China; and Lu Yimin, Wang Xi, Chen Wei-Shu, and Zhou Ming-Wei of Fudan.

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



Pu Shan of the Chinese Academy of Social Sciences comments on Milton Friedman's paper.

Media representatives at the conference included the *Beijing Review*, the *Wen Hui Daily*, the *Economic Daily* of Shanghai, Shanghai television, the *China Daily*, the *Jiefang Daily*, the *World Economic Herald* of Shanghai (which printed Gilder's complete talk), the *Hong Kong Economic Journal*, *Newsweek*, 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 heard at the conference will be available to virtually all interested policymakers and individuals in China. ■

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 achieve their intended purposes, 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 show how they differ from their opponents. "Proposals to clean up commercials 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 ad was 1.5 cents; for direct mail, 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 derisively referred to 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 have their 'fullest and most urgent application precisely to the conduct of campaigns for political office.' "

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

Bennett Boosts Educational Choice

Mandated Benefits Are a Hidden Tax, McKenzie Argues

Cato Events

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 Universe 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 plant-closing 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.

August 18: **"The Future of Biotechnology."** Fred Smith, president of the Competitive Enterprise Institute, debated Anne Hollander, director of the Conservation Foundation's Biotechnology Project. Smith contended that the political approval process has a severe anti-innovation bias. He argued that the risks of lost knowledge are greater than the risks associated with technological innovation. He also stressed that political rigidity is blocking the major health, agricultural, and environmental gains that could be achieved through further biotechnology entrepreneurship.

Fred Smith and Anne Hollander debate the future of biotechnology.

August 24: **"The Democratic Revolution in Mexico: Problems and Prospects for the Future."** Daniel James, president of the Mexico–United States Institute, contended 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.

Secretary of Education William J. Bennett speaks on educational choice.

August 30: **"Choice or Monopoly: The Future of Education in America."** Secretary of Education William J. Bennett called for a system of educational vouchers or tuition tax credits that would enable middle- and lower-class parents to choose between sending their children to public or private schools. Bennett noted that such a system would improve the performance of all schools, public and private, because competition would force them to improve or fold.

September 12–15: **"Economic Reform in China: Problems and Prospects."** Among the speakers at the Cato Institute conference in Shanghai were Milton Friedman, George Gilder, William Niskanen, and Steven N. S. Cheung.

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 decisionmaking 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 1989 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 new economic era is the age of 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 mouths, but the Chinese people are minds. And the crucial issue of the next 25 years, when the information economy will increase its 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, the new chip technology is based on economies of microscale. The smaller each device on the chip, the more powerful the chip. 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.

Jack Fay

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 previous technology of the industrial era to some extent favored control—control over natural resources, control over territory, control over tax systems; governments could increase national power by increasing their control. On the other hand the new technology favors freedom. Mao said, "Let a hundred flowers bloom." This statement showed his incomparable misunderstanding of the powers of the Chinese people. The rule of capitalism is "Let a billion flowers bloom."

I believe what will happen is an efflorescence of entrepreneurship in China that will make China the richest economy in the world over the next 25 years. How do I know this? Because everywhere else in the world the Chinese people are in the forefront of the information age. In the United States, thousands of crucial companies have been launched by Chinese entrepreneurs. And now there are very favorable signs within China itself. For example, one of the fastest-growing computer firms on the face of the earth is Stone Computer, started by Won Runan. In just four years this company outproduced all the government computer companies in China. Today on a street in Beijing there are 170 high-technology companies, and 1,000 more such companies are applying for licenses. They should get those licenses very fast. Let a billion flowers bloom. ■

George Gilder is the author of *The Spirit of Enterprise*.

Science and Political Economy

by Don Lavoie

Ideas about political economy, like other products of human culture, are likely to be profoundly influenced by 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 "scientific socialism" 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 understandable if many aspects of the Marxian system of thought were tainted by the mechanistic model of the universe in which 19th-century culture was embedded. At that time the great successes 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 thermodynamics 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 over 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 philosophical literature that, for want of a better label, I will simply call the new view of science. This view develops a way of coming to terms with the nonmechanistic nature of the universe. (A useful popular summary of the new view of science is James Gleick's *Chaos*.) The literature constitutes, among other things, a radical re-interpretation of the nature of order and a powerful critique of the Newtonian vision. It carries important implications for a variety of scholarly disciplines, from mathematics to the natural and social sciences, to the humanities, and it has begun to serve as an inspiration for practical proposals in everyday life.

In the contemporary work on "chaos theory" in mathematics, things that would appear to be utterly disorderly by Newtonian standards are seen nevertheless to possess great intelligibility, even mathematical elegance and beauty. The theory is misleadingly named because what is being celebrated here is not really utter disorder but a new kind of order. Scientists have found applications of these ideas in a remarkably wide range of phenomena that exhibit what Erich Jantsch calls a "self-organizing" process and what Ilya Prigogine and Isabelle Stengers call "order out of chaos." Michael Polanyi coined the phrase "spontaneous order" to describe this kind of process, and elaborated on how scientific discovery is itself a spontaneous order. Friedrich A. Hayek has elaborated on this idea in reference to the ordering processes at work in law and the economy.

One thing all of these spontaneous order theorists have in common is an emphasis on the creative aspect of ordering processes. The processes are not merely "equilibrating" in the Newtonian sense, where there is a deducible "target" toward which forces are pulling. From the outset an equilibrating mechanism, like a clock winding down, contains everything necessary to bring about its conclusion. A spontaneous order exhibits essentially novel changes and needs to work itself out through time. The direction things take may be completely unpredictable, and yet an overall pattern emerges and is systematically discernible.

Just as 19th-century socialists constructed a radical vision based on that century's view of science, so the economic reformers in the People's Republic of China are taking our century's views of science as their starting point. The philosophers who seem to have served as the inspiration for these reformers, such as Nobel Prize–winning physicist Ilya Prigogine, are some of the most articulate advocates for the new view of science.

Chinese reformers have already used this new view of science to revise their interpretation of socialism into a more humanistic and decentralized vision. In my conference paper I will endorse the humanistic revision of socialism and will elaborate on how I think one of the classic critiques of orthodox socialism is consistent with the new view of science. I also will argue that the older views of socialism have been subjected to criticisms along essentially the same lines as the older views of science. These criticisms suggest that all the world's governments, whether called socialistic or capitalistic, have been trying to centrally control their economies in a manner that is utterly futile. ■

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

Ed Crane talks with Cornelia and George Gilder at conference reception held at the U.S. consulate.

The Ossified Order

by He Weiling

According to the new view of science, there are two kinds of orders: ossified and alive. Economic planning is a kind of ossified order that cannot accommodate the social division of labor and intelligence needed for economic development. Therefore, it is only a primitive order, suited for a simple economic system. This order will totally collapse in the progress of new technological developments and new divisions 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 *National Economic Planning: What Is Left?*, it is not the unavailability of information that leads to the ills of planning. It is because the planning system cannot do as the highly integrated market mechanism does: It cannot make any new adjustment for new economic conditions. Such problems can be solved only by the market mechanism, which can automatically and spontaneously adjust itself by using all kinds of economic means. By adjusting, the collective or social intelligence can replace individual intelligence, and the social

He Weiling is a senior fellow at the National Economic System Reform Institute of China.

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Economic Reform (Cont. from p. 7)

economic structure can reach a higher-level order that can stand the test of time.

Theoretically and practically, the establishment of a market-oriented economic system is the prerequisite for modern economic development. Only by openly acknowledging this spontaneous and self-organizing process 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 isn't 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 them. Each and every person 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 individuals 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 every sector of activity in a society. Nor is it possible for a government to operate public services to the benefit of tens of thousands of citizens, 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, increasingly we 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 have felt that a highly centralized, rigid administrative apparatus is a key feature of socialism. Without competition even a service like weather forecasting is going to be totally useless and meaningless. 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 is a higher level of material well-being, a widespread system of private ownership, and a democratic political process.

Certainly one direction that we feel we should be undertaking is the "socialization" of government functions. But this process is going to take some time. Even in the West this process took a couple of hundred years, and there's no reason why it should succeed in China in only three to five years. ■

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

Peter Bernholz of the University of Basel, Switzerland.

Richard Y. C. Wong of the Chinese University of Hong Kong

Privatization vs. Special Interests

by Steven N. S. Cheung

China has reached a point where piecemeal tactics are not likely to be effective in advancing her economic reforms. During the past decade this approach served China well, often brilliantly. While cadres and citizens alike agree that the "common rice wok" and the "iron rice bowl" are detrimental to productivity and must be discarded, those people have little understanding of how a market system based on private property rights operates.

With the Marxian doctrine nearly dead, there was, and still is, an ideological vacuum in China. The piecemeal approach thereby adopted is impressively pragmatic; it uses common sense rather than theory to correct the economic ills that have become all too evident. Indeed as experts on the shortcomings of a communist system, the Chinese have no peers. Piecemeal tactics guided by common sense and the economic forces at work have, by and large, been the policy guideline for one decade. And in spite of the political opposition and occasional backslidings that have often occupied 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 gone into retirement. In areas subject to intense competition, previous hierarchical rights based on rank regardless of productivity have become valueless. In other areas, these privileges have been transformed into monopoly and regulation rights. An attempt to protect a state monopoly is an attempt to protect a rank.

I can cite numerous instances to support this view. But if we must single out one example of prime importance, the financial sector would be the natural choice because of the wide-ranging implications involved, and because its problems make the headlines almost every day.

Take the city of Wenzhou, for instance; any impartial observer must stand in awe of its economic success. A number of small private savings-and-loan institutions cropped up to finance small businesses and had brilliant success. But this booming enterprise was soon restrained by the banking authority, which imposed interest and licensing regulations. Again, in the area of foreign exchange, the monopoly long enjoyed by the Bank of China has reaped handsome profits through exchange controls and rationing. But when black market activity became prevalent and hard to control, the authorities themselves started exchange centers dealing in near-free-market

rates. It is difficult to say in what sense exchange control now exists in China. Certainly all arguments in favor of control have been flatly contradicted by the government's own behavior.

Indeed the pattern is replete that where competition is severe and where monopoly power can hardly be maintained, the authorities routinely opt for a freer market and for more private property protection. But where monopoly is protected, the policies adopted always tend to benefit special interest groups. Thus, along with price and wage controls, the superiority of socialist ownership is again upheld as unquestionable.

Nothing is further from the truth. The arguments, often heard from the same authorities, for freer markets and for the necessity of maintaining controls reveal such glaring contradictions that one must infer that the prime motivation of controls is to benefit privileged groups. There is no conceptual difference among the monopoly and controls in silk, steel, machinery, foreign trade, foreign exchange, and banking. The problem is general, although inflation and the difficulty of feeding state employees (as well as students) are placed in the spotlight, which tends to obscure the nature of the problem.

Monopoly protects; state ownership facilitates controls; the right to control generates income to the privileged. This is as true in the production of goods and services as in the banking and financial sectors. The piecemeal tactic of decontrolling a few prices, of restraining the growth in money supply, or of curbing government expenditure does not get to the heart of the matter. A general problem calls for a general solution: Privatize state enterprises and allow free entry for all.

More fundamentally, therefore, my view is that whereas the formation of private property by contracting has been relatively smooth in areas subject to active competition, the process fails in areas where monopolies are fostered. It is time for China to consider creating private property by mandate. Then it may follow one simple rule: For anything that is salable, sell. This is the most straightforward way to create private property, and the selling prices may be adjusted as special cases demand. The proceeds may be used to compensate individuals who suffer greatly from the changes, to invest in the infrastructure, and, above all, to establish a judicial system based firmly on the principle of equality before the law. ■

Steven N. S. Cheung is a professor of economics at the University of Hong Kong and the author of *The Future of China*.

Learning from Hong Kong

by John G. Greenwood

Both management and technology are attributes or skills that are themselves responses to a whole set of market incentives and opportunities. It is unlikely that they would have emerged independently without the framework of a free-market economy. It is therefore questionable how far these attributes can be imported into China and applied without China making fundamental changes in its institutional arrangements.

Let me illustrate my point with two examples from Hong Kong. The first is taken from my own industry, namely investment management. In the investment management business we employ skilled investment managers, investment analysts, economists, marketing staff, accounting and computer staff, and so on. Many of these individuals work with computer screens that have access to state-of-the-art software, which provides financial information and enables them to conduct rapid and sophisticated analysis of newly announced financial data. The basic business of investment management is the investment of individual or institutional savings and pensions in various financial instruments such as bonds, equities, and deposits in order to maximize the return, and we derive our income from a fee that is based on the value of funds under management. We would not employ all of these skilled individuals in a whole range of activities unless we thought that each person individually contributed to increasing the returns to the funds we manage or that each employee otherwise served the needs of our customers and hence enhanced the income of the firm.

Now contrast our business with the management of a government-run pension fund, such as the Central Provident Fund in Singapore. The CPF employs a mere handful of people, and virtually all proceeds from the employees' contributions are invested in Singapore government bonds. Besides a few accountants, almost no technology is required for this business. As a result the returns from the CPF have been no better than the returns on government bonds, and certainly no technological progress results from competitive pressures in this industry in Singapore.

Another example concerns Hong Kong's postal system. In Hong Kong, as in many other countries, the postal system is owned and operated by a government department. As a result, there has been very little technological innovation in the postal service over the past 100 years. Aside from a few improvements in sorting techniques, the industry operates very much as it did 100 years ago.

Again, contrast that example with developments in the private sector. In recent decades we have seen the emergence in the private sector of companies specializing in the delivery of private packages and documents both within and between countries. These companies normally guarantee delivery within 24 hours inside a country and within 48 hours to almost any part of the globe—something that government-run postal systems have never been able to guarantee. Furthermore, we have seen an attempt in recent years to overcome the inefficiency of government-run mail systems by developing facsimile machines and computer-based information networks that enable written messages to be transmitted by telephone line or data line virtually instantly around the world. The incentive to do this has been the prospect of profits. It is inconceivable that this set of technological developments could have occurred in the government sector.

What are the key elements of these two examples? Both have three components in common. First, both industries have private ownership that has stimulated the introduction of sophisticated management and improvements in technology. Second, there is free pricing in terms of setting wages, of setting product prices, and the prospect as a result of profits to the business owners. Third, in both areas competition has

(Cont. on p. 13)

John G. Greenwood is chairman of G. T. Management (Asia) Ltd.

Using the Market (Cont. from p. 1)

making deals. Needless to say, "meeting" and "place" are often euphemisms; they do not involve physical getting together. As of the moment, there is a market in foreign exchange that encompasses the world. People get together through satellites, telephones, and so on. Moreover, the deals made in or through a market are not restricted to those involving money, purchases, or sales. Scientists who cooperate with one another in advancing their discipline, whether it be physics, chemistry, economics, or astronomy, are effectively making deals with one another. Their market is a set of interrelated journals, conferences, and so on.

The market is a mechanism that may be mobilized for any number of purposes. Depending on the way it is used, it may contribute to social and economic development or inhibit such development. Using or not using the market is not the crucial distinction. Every society, whether communist, socialist, social democratic, purely capitalist, or what you will, uses the market. Rather, the crucial distinction is private property or no private property. Who are the participants in the market and on whose behalf are they operating? Are the participants government bureaucrats who are operating on behalf of something called the state? Or are they individuals operating directly or indirectly on their own behalf?

That is why, in an earlier paper delivered in China, I advocated the widest possible use of not the market but "free, private markets." The words "free" and "private" are even more important than the word "market."

Many specific problems arise when a society tries to replace a command economy with the invisible hand of the market, of which I shall discuss only a few. Those problems are not restricted to societies that have tried to use command as their basic economic mechanism, such as China and Russia; they also arise in Western economies such as the United States, Great Britain, and Germany, in which command elements have become more extensive over time and in which there are attempts to reverse that process. Eliminating government-owned enterprises in the West, such as the postal service in the United States and railroads and utilities in other countries, raises problems that are identical with those that arise in replacing command and public ownership by voluntary cooperation and private ownership in China, Russia, and so on.

Partial versus Total Decontrol

Introducing a greater role for private market mechanisms in one sector of an economy may be partially or completely frustrated by the limited scope of the change. Consider what has been regarded as a major move toward wider use of the market, namely creation of the European common market and the attempt to achieve free trade among the common market countries. It has now been nearly 40 years since the Schuman plan for a coal and steel community was adopted, yet no observer will dispute that free trade within the common market is still an ideal rather than a reality. The latest bit of evidence is the recent agreement to *really* eliminate all barriers by 1992. Had the initial common market agreement been successful, that would have been achieved many years ago.

> **"Why not make public ownership a reality rather than a rhetorical flourish?"**

What was the problem? Why is there no real United States of Europe? In my view, the answer is that decontrol was adopted even in principle only for goods and services but not for money. The separate countries retained full authority over their national moneys. More important, they refused to adopt a system of freely floating exchange rates—that is, the free exchange of one currency for another at whatever rates of exchange were voluntarily agreed to in free private markets. The refusal to let the private market determine the rates of exchange among currencies was a fatal weakness.

Currently, China is faced with precisely the same problem. But my purpose in discussing it here is not to present again the case for a system of freely floating exchange rates but rather to give a striking illustration of how limiting decontrol or privatization to one area, while not extending it to closely related areas, can largely frustrate the basic objective.

A second example is from the United States. Although nominally private, U.S. airlines were subject to extensive government control with respect to the prices they could charge and the markets they could serve. Deregulation of the airlines in 1978 has resulted in very much enhanced competition, widespread and substantial reduction in prices and increase in the range of services, and, in consequence, major expansion in the volume of traffic. However, while airlines were deregulated, or, as I would prefer to put it, privatized, airports were not. They remain government-owned and -operated. Private enterprise has had no difficulty in producing all the planes the airlines find it profitable to use. The private-enterprise airlines have had no difficulty in finding pilots to fly them and attendants to service them. On the other hand, planes filled with passengers are often delayed because facilities or provisions for landing them at government-run airports are inadequate. Naturally, the government responds by trying to blame the private airlines: it has started requiring them to report delays in meeting their scheduled arrival times and publishing summary reports on the on-time performance of the several airlines. Repeated proposals have been made that, even if government retained the ownership and operation of the airports, at the very least rights to gates, with respect both to number of gates and to the times at which they are to be used, should be auctioned off. Unfortunately, the opposition of airlines that have vested interests in the gates and times assigned to them by government entities has prevented the adoption of even such incomplete reforms. Of course, a far better solution would be to privatize the airports.

A third example is privatizing some areas of manufacturing while keeping the production or pricing of the raw materials under government control.

Let me cite some obvious examples for China. Introduction of a considerable element of privatization in agriculture has produced a remarkable increase in agricultural output and productivity—the most dramatic manifestation of China's success in widening the use of the private market. But it is clear that the very success has created a real problem. The overwhelming majority of the Chinese population is employed in agriculture. Even a relatively small improvement in agricultural productivity obviously means release from agriculture of labor that it is no longer productive to employ. It is in China's interest to use that labor in more productive areas, such as industry. Yet the bulk of industry remains in the command economy; it has not been privatized, deregulated, or fully subjected to the market process.

There has been a real attempt to change the way government-owned enterprises operate. The people in charge have been told to use market mechanisms, and an attempt has been made to provide incentives for them to do so. However, as long as bureaucrats run government-owned industries, their ability to respond to market pressures effectively will be severely limited. In the case of China, the most serious limitation is on their flexibility, their willingness or ability to be venturesome, to undertake risky projects that have a likelihood of failure but a real, if small, chance of spectacular success. Again, the problem is universal. Every study of the United States or the United Kingdom demonstrates that small enterprises—not the megacorporations that are household names—are responsible for most of the new jobs. In China, the scope for such private enterprises is extremely narrow.

A much wider privatization of economic activity would greatly reduce the difficulty of absorbing the workers released from agriculture. Private enterprises would then spring up all over the place to absorb the workforce.

A second example for China is similar to the problem I described for the common market: the difference between the extent of freedom in the production and distribution of goods and services and in the production and distribution of money. The substantial freeing of many prices, particularly those of agricultural and similar goods, has not been accompanied by the privatization of the banking system. As I understand it, the Chinese government indirectly determines what happens to the money supply through the credits it grants state enterprises. The results include a rapid increase in the quantity of money and, not surprisingly, a rapid upward pressure on prices, so that inflation, both open and repressed, has reared its ugly head.

When should reform be gradual, and when is radical and immediate change appropriate? One alternative is illustrated by the tale of the tortoise and the hare, when the "slow but steady" tortoise reaches the finish line ahead of the much speedier but more erratic hare; the other is illustrated by the maxim, there is no sense in cutting a dog's tail off by inches. This is one of the most difficult problems encountered in widening the scope of the market. Let me illustrate with foreign trade. Suppose a country that has had high levels of tariffs decides to move to a free trade position. The case for moving gradually is clear. Capital has been invested in ways that will no longer represent an effective use of private resources under the new conditions. Much of that capital is in the form of machinery, buildings, human skills, and the like. Is it not clearly both more equitable and more efficient to reduce the tariffs gradually? That would give the owners of specialized resources the opportunity to withdraw their capital gradually and thus would reduce the costs imposed on them by the change.

> **"A greater role for market mechanisms in one sector of an economy may be frustrated by the limited scope of the change."**

The case for eliminating the tariff in one fell swoop, that is, for shock treatment, is more subtle, yet at the level of economic efficiency, compelling. Insofar as it is economically efficient to use the specialized resources in the absence of a tariff, they will be used. If any return over marginal cost can be obtained by continuing to use the specialized human and other resources, it is better to get that return than to get nothing. The burden would be imposed on the owners of the specialized resources immediately, but technical disinvestment would proceed only as rapidly as the specialized labor and other resources could be employed more productively elsewhere. On the other hand, gradual reduction in the tariff makes it privately profitable to continue using the specialized resources at a higher level than is socially efficient, thereby imposing unnecessary costs on the community.

Ending an ongoing inflation raises similar problems. Eliminating inflation at one fell swoop, if not anticipated long in advance, may cause widespread capital losses. Long-term contracts entered into with one expectation about the likely rates of inflation may now suddenly be rendered inappropriate. The case on equity grounds for a gradual transition is far stronger for moderate degrees of inflation than for tariffs. The effects of both the prior inflation and its unanticipated ending are more pervasive and affect more people who have not only been harmed rather than benefited by the prior inflation but would be harmed again by its abrupt end. Reducing inflation gradually eases the transition and reduces the cost of achieving noninflationary growth.

However, much depends on the height of the inflation. If inflation is extremely high—at annual rates in triple digits—the situation is very different. Almost all participants in the market will have adjusted their arrangement so that any longstanding commitments are fully indexed. Abrupt disinflation will impose few costs because financial and other institutions have been adapted to radical changes in the rate of inflation—indeed, such adaptations represent a major cost of high and erratic inflation. Gradual elimination is sometimes not even feasible because there is not time enough—the dog will be dead before its extra-long tail can be cut off by inches.

(Cont. on p. 12)

Using the Market (Cont. from p. 11)

Direct controls over prices—whether general or specific, e.g., on rents or exchange rates—are almost always best ended at once. Margaret Thatcher properly ended exchange-rate controls in Britain overnight and completely. Gradual adjustment only prolongs the harm done by controls and provides unjustified benefits to "insiders." The shortages, queues, and other distortions produced by trying to hold prices below their market level would continue though they might be reduced, and additional problems arise because gradualism encourages speculation about reversal and encourages opponents to seek reversal. A similar proposition holds for attempts to maintain prices above market levels—as is so amply demonstrated by the agricultural policies of the United States, Japan, and the common market.

Overcoming Political Obstacles

This subject has already inevitably intruded into the preceding section. The general issue here is how to overcome political obstacles to widening the market. The danger is not alone that these obstacles will frustrate the attempt to free the market but equally that overcoming political obstacles may destroy the advantages of freeing the market. The challenge is to find ways to overcome obstacles that do not have those effects. The West's experience with privatization is particularly helpful in this connection. Perhaps the most extensive body of experience and the experience that has been most widely analyzed is the British experience with privatization, and I strongly recommend to our Chinese friends seeking to widen the market that they examine the evidence of privatization in Britain.

A simple case from the United States that illustrates the problem is privatizing the post office. The U.S. Postal Service has a monopoly in first-class mail because of the private express statutes, which make it a crime for individuals to offer common-carrier first-class service. Various attempts to do so have only succeeded in prosecution, which has ended the attempts. Privatization has been creeping in at the margin, first in the form of alternate parcel service. The United Parcel Service and other parcel delivery companies have taken over the bulk of the Postal Service's prior business. In addition, private messenger services have developed, of which the best known is Federal Express, which has been so successful that numerous competitors have emerged. Developments that technological advances would have encouraged no matter how postal service was organized have doubtless been speeded up. Examples are electronic mail via computers and telephones and facsimile service, again over telephones. These examples illustrate the ingenuity of private markets in exploiting the opportunities offered by the inefficiency of government enterprises.

> "Using or not using the market is not the crucial distinction. The crucial distinction is private property or no private property."

Repeated attempts have been made to seek the repeal of the private express statutes so that private individuals and enterprises could compete with the Postal Service. However, such attempts always bring violent protests from the postal employee unions, from the executives of the U.S. Postal Service, and from rural communities that feel they would be deprived of postal service. On the other hand, few people have a strong and concentrated interest leading them to favor repealing the private express statutes. Entrepreneurs who might in fact enter the business if it were open to private entry do not know in advance that they would do so. Hundreds of thousands of people who would doubtless obtain employment in a privately developed postal system do not have the slightest idea that they would do so.

One way to overcome the opposition to privatization, widely used in Britain, is, as described by Robert Poole,

> to identify potential opponents and cut them in on the deal, generally by means of stock ownership. Two specific applications of the principle are (1) employee stock ownership, and (2) popular capitalism. . . .
>
> The opportunity to become shareholders can dramatically change the incentives of unionized civil servants, as illustrated in the case of British Telecom. Union officials denounced the planned privatization of Telecom, telling their members not to purchase the shares which were being offered to 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 their shares for at least six months. And to prevent institutions and large firms from buying up the lion's share, initial purchases were limited to 800 shares per buyer.

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

My own favorite form of privatization is not to sell shares of stock at all but to give government-owned enterprises to the citizens. Who, I ask opponents, owns the government enterprises? The answer invariably is, "The public." Well, then, why not make that into a reality rather than a rhetorical flourish? Set up a private corporation and give each citizen one or one hundred shares in it. Let them be free to buy or sell the shares. The shares would soon come into the hands of entrepreneurs who would either maintain the enterprise, for example, the postal system, as a single entity if it was most profitable to do so or break it up into a number of entities if that seemed most profitable.

A final example illustrates the point in another way. The Russians have permitted small private plots in agriculture. Those private plots are estimated to occupy about 3 percent of the arable land in the Soviet Union, and roughly one-third of all domestic food products in the Soviet Union are sold as coming from those private plots. I have chosen my words carefully. I did not say that one-third were "produced on those private plots," because in my opinion that would not be correct. Much of the food sold as coming from the private plots has indeed been produced on them, but I strongly suspect that much has also been diverted from collective farms.

For decades, it has been clear to the rulers of the Soviet Union that they could increase the domestic output of agriculture substantially by increasing the size and role of the private plots. Why have they not done so? Surely not because of ignorance. The answer clearly is that privatization would tend to establish independent centers of power that would reduce the political power of the bureaucracy. The rulers regarded the political price they would have to pay as higher than the economic reward. As of the moment, largely I suspect under the influence of the extraordinary success of such a policy in China, President Gorbachev is talking about a considerable expansion in private plots. It is by no means clear whether he will succeed.

Tyranny of the Status Quo

The problems of overcoming vested interests, of frustrating rent-seeking, apply to almost every attempt to change government policy, whether the change 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.

Few simple maxims exist for overcoming the tyranny of the status quo. But there is one that ties in closely with the earlier discussion of gradual versus abrupt change. If a government activity is to be privatized or eliminated, by all means do so completely. Do not compromise by partial privatization or partial reduction. That simply leaves a core of determined opponents who will work diligently and often successfully to reverse the change. The Reagan administration repeatedly attempted, for example, to privatize Amtrak (the railroad passenger service) and to eliminate the Legal Services Corporation. In each case, it settled for a reduction in budget, achieving a fairly transitory victory. On the other hand, the complete abolition of the Civil Aeronautics Board gives far greater hope that airline deregulation is here to stay.

In conclusion, there are better and worse ways to privatize a command economy, but there is no magic formula for shifting painlessly from a command to a voluntary exchange economy. Nonetheless, the potential rewards are so great that, if the shift can be achieved, transitional costs will pale into insignificance. It is a tribute to the current 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 the main but by no means the only 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. ■

Economic Reform (Cont. from p. 9)

stimulated improvements in service to the consumer.

My conclusion is that perhaps China can import management and technology at some levels and for some period of time, but China cannot expect these skills to develop and percolate in a vacuum, i.e., in the absence of an appropriate institutional framework—namely, the existence of private ownership, free markets, and competition among producers. ■

Reject Central Banking

by George A. Selgin

China had a "free banking" era during the Ch'ing dynasty from 1644 to 1911. 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 15th century, and except for two brief episodes in the 1650s and 1850s, the Manchus also refrained entirely from issuing their own paper money while leaving private banks entirely free to do so. In some places (such as in Shanghai and Fuzhou) the private currency systems that developed were quite sophisticated.

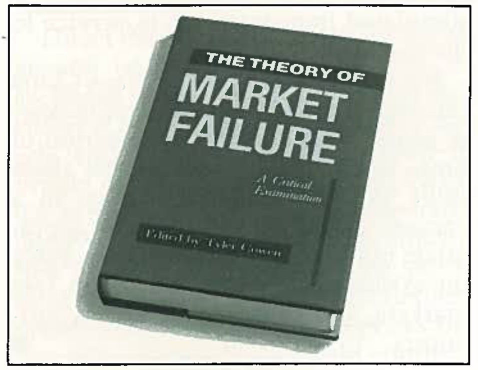
It is still, as Prof. Bernholz says, "an unresolved question why" China should have temporarily abandoned resort to the printing press. But what *is* resolved, in my opinion, is that no present-day government in China or anywhere else will abandon resort to the printing press unless the printing press is taken away from it entirely and divided among competing, private banks.

Various speakers at this conference have stressed the need for China to resist slavishly imitating economic arrangements and institutions 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*.

Economic Theory and Case Studies

Market Can Produce Public Goods, Book Argues



The most important remaining arguments for government intervention in the economy are market failure and public goods theory, the idea that the free market is inherently unable to provide certain vital goods and services, thus necessitating government provision of them. A new book from the Cato Institute offers a persuasive critique of public goods theory.

The Theory of Market Failure: A Critical Examination, copublished by the Cato Institute and George Mason University Press, is edited by economist Tyler Cowen, a Cato adjunct scholar and a professor at the University of California, Irvine. In the book, authors such as Nobel laureate James M. Buchanan, Harold Demsetz, Kenneth D. Goldin, and Robert Axelrod present compelling arguments for revisions of and limitations in public goods theory.

The volume offers a number of case studies that refute traditional arguments against private provision of allegedly public goods. The case studies show how entrepreneurs have successfully provided services that are commonly thought to be feasible only through government provision. The examples here include fire protection, lighthouses, natural resource protection, and education.

In one essay, economist Kenneth D. Goldin writes, "The pure theory of public goods is an elegant theory without significant application. Furthermore, it is a dangerously misleading theory if it suggests to the unwary that government services should be handled *as if* they were public goods."

Sam Peltzman of the University of Chicago said of *The Theory of Market Failure*, "This book is an important step in the evolution of the economics of 'market failure.' Until recently, economists have tended to view any departure from the textbook version of perfect competition as requiring corrective government intervention. We have come to understand that many of these alleged 'market failures' can be and are corrected by 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 failure." Thomas Gale Moore, a member of Reagan's Council of Economic Advisers, shared Peltzman's praise, calling the book "invaluable."

The articles in this edited collection include acknowledged classics along with essays published for the first time. Among the authors are Nobel laureates Paul Samuelson and James Buchanan, as well as Steven N. S. Cheung, Ronald Coase, Robert W. Poole, and Francis Bator.

The Theory of Market Failure: A Critical Examination is available from the Cato Institute in a clothbound edition for $21.75. ■

State Harms Environmental Firms

Environmental 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 the land and water resources it controls. A growing list of travesties on public rangelands, forestlands, and waterways raises questions about whether government is the correct choice for resource stewardship."

Entrepreneurial initiatives to provide outdoor amenities would improve environmental protection. "As recreational and environmental goods become increasingly scarce and [their] values increase, individuals have an incentive to try to capture these values by establishing private property rights. . . . By getting those who benefit from recreation and the natural environment to pay, entrepreneurs are eliminating what has been perceived as a market failure."

Because of the rising values of recreation and environmental amenities, entrepreneurs will continue to develop technologies and institutions for producing and marketing them. The authors conclude that "we must ensure that the legal environment is not inimical to private ownership and provision of these goods."

"Inside Our Outdoor Policy" is no. 113 in the Cato Institute's Policy Analysis series. It is available for $2.00. ■

Cato Institute Conferences

Alternatives to Government Fiat Money
Seventh Annual Monetary Conference
Capital Hilton • Washington, D.C.
February 23–24, 1989

Speakers include James Buchanan, Jerry Jordan, Lawrence White, Richard N. Cooper, Richard Rahn, Stephen Axilrod, Gerald P. O'Driscoll, Jr., George Selgin, Genie Short, Tyler Cowen, Robert L. Greenfield, Leland B. Yeager, Allan Meltzer, Richard Timberlake, Neil Wallace, and Karl Brunner.

NATO at 40: Confronting a Changing World
Capital Hilton • Washington, D.C.
April 3–4, 1989

Speakers include Irving Kristol, Earl Ravenal, Melvyn Krauss, Josef Joffe, Ronald Steel, William Lind, Paul Bracken, David Calleo, Robert Hunter, Christopher Layne, and Tom Bethell.

For information on all conferences, contact Sandra H. McCluskey, Director of Public Affairs, Cato Institute, 224 Second St. S.E., Washington, D.C. 20003, (202) 546-0200.

Military Costs Reach New High

U.S. military spending has stayed at unprecedented levels throughout the cold war era, says a new study from the Cato Institute.

Robert Higgs, the William E. Simon Professor of Political Economy at Lafayette College, writes, "The past half-century has witnessed a new epoch in the relation of military activity to the political economy of the United States. Before World War II, the allocation of resources to military purposes remained at token levels, typically no more than 1 percent of GNP, except during actual warfare, which occurred infrequently. . . . During 1948–86, military purchases cumulated to $6,316 billion, averaging about $162 billion per year, or 7.6 percent of GNP."

Higgs observes that "throughout the cold war period increases in military spending have tended to come at the expense of the private sector rather than of government nonmilitary spending," a fact that should give pause to those who favor both a large-scale military buildup and the preservation of the market economy.

The paper argues that despite record peacetime defense spending over the past decade, "neither the overall force structure nor the personnel strength of the armed forces looks much different today than it did when the buildup began." Many military analysts "suspect that a large share of the additional spending was simply wasted through congressional patronage and micromanagement, military intransigence and inefficiency, contractor mismanagement and cost padding, and sheer bureaucratic bungling at the Pentagon."

"Ultimately," Higgs argues, "private citizens in their capacities as consumers, investors, and living human beings—not the decision-making elite or the beneficiaries of government's nonmilitary spending programs—will bear the costs of the military activities entailed by policies of ill-considered global interventionism."

"U.S. Military Spending in the Cold War Era: Opportunity Costs, Foreign Crises, and Domestic Constraints" is no. 114 in the Cato Institute's Policy Analysis series. It is available for $2.00. ■

Dennis Named to Board

Pilon, Ferrara Join Cato Staff

Roger Pilon and Peter J. Ferrara have been named senior fellows at the Cato Institute.

Pilon, Senior Fellow in Constitutional Studies, will coordinate the Institute's expanded efforts in the field of judicial philosophy and constitutional interpretation.


Roger Pilon


Peter J. Ferrara

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

"Roger Pilon has had an important influence on the work Cato has already undertaken in the area of judicial philosophy," said Cato president Edward H. Crane. "Cato chairman Bill Niskanen and I are delighted that he will now be working with us on a closer level. This appointment reflects the Institute's commitment to playing a major role in the debate over the constitutional issues of our day."

"As we move toward the bicentennial of our Bill of Rights in 1991," Pilon said, "the importance of a rights-based jurisprudence will become increasingly clear. Calling neither for 'judicial restraint'—the majoritarianism of conservatives—nor for 'judicial activism'—the liberals' jurisprudence of 'evolving social values'—this third position in the jurisprudential debate calls instead for judicial responsibility—responsibility to the moral, political, and legal theory that stands behind the Constitution, alone giving meaning and force to its broad language. I am extremely pleased to be joining the Cato Institute at this time, to help further the reemerging jurisprudence of the classical liberals, and to build upon the vision they gave us."

Pilon holds a B.A. from Columbia University, an M.A. and a Ph.D. from the University of Chicago, and a J.D. from the George Washington University School of Law.

Ferrara, who has been a Cato adjunct scholar for five years, is also an associate professor at the George Mason University Law School.

He is best known for his seminal work on Social Security, including his three Cato Institute books on the subject: *Social Security: The Inherent Contradiction, Social Security: Averting the Crisis*, and *Social Security: Prospects for Real Reform.* His innovative plan to establish a system of super-IRAs to supplement and eventually perhaps to replace Social Security has earned him wide acclaim as one of the country's most knowledgeable and insightful critics of the Social Security system.

In 1987 Ferrara, whom Crane calls "one of the brightest and most energetic policy analysts in America," was the John M. Olin Distinguished Fellow at the Heritage Foundation. He has also served as a senior staff member for the White House Office of Policy Development and as a special assistant for the Department of Housing and Urban Development, where he formulated the Reagan administration's policy proposals on urban enterprise zones.

Chicago commodities trader Richard J. Dennis has joined the Cato Institute's board of directors. Dennis, a well-known philanthropist and sought-after speaker, is one of the most successful traders in the history of the commodities business. He has been a major supporter of Cato's NATO Assessment Project.

In welcoming Dennis to the board, Crane said, "One of our fundamental beliefs at the Cato Institute is that virtually all Americans share the goal of creating public policies that will lead to peace, individual liberty, and widespread prosperity. Therefore, it's important to us to have our policy studies read by people all across the political spectrum, and the makeup of our board—which includes Republicans, Democrats, independents, and even a Libertarian—helps to ensure that. Rich Dennis is a valuable addition to the board because along with his own advice and support he can increase our access to people in the Democratic party." ■

"To be governed..."

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."

—*Washington Post*, Oct. 2, 1988

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 fundmental 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

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