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Farming in a World without Subsidies

by Dennis T. Avery

Agricultural experts have given little thought to what world agriculture might be like if farm subsidies and trade barriers were eliminated. Such a reform has seemed beyond the realm of possibility.

Recently, however, the world has begun to see a rapid increase in farm productivity, most of it generated by a revolution in plant genetics. Besides raising yields, better seeds have cut the real cost of food production. Grain yields have tripled from Asia to Eastern Europe. Even impoverished African countries have begun to use powerful new seeds and farming systems.

Most affluent countries' markets for food and fiber have been saturated, and the less-developed countries (LDCs) have made only slow gains in economic growth. Thus, huge farm surpluses have been piling up. Without U.S. cropland diversion, the farmers of 40 affluent countries would consistently produce the equivalent of 150 million tons of surplus grain a year. (The entire world trade in grain is less than 190 million tons a year.)

World hunger can no longer be cited as an excuse for farm subsidies. With their farms doing better, the LDCs have accepted only 10 million tons of food aid a year in the past decade. Many African countries have produced grain surpluses in most of the years since the famine of 1983–84. India had its worst monsoon-related crop failure of the century in 1987 but had so much food grain stockpiled that it may not need to import any.

The cost of farm subsidies has increased even faster than farmers' yields. Government farm outlays and higher consumer food prices cost the affluent countries $25 billion in 1970—and $150 billion in 1986. In 1985 the European Communities (EC) spent $30 a ton in export subsidies to sell a ton of grain for $120; in 1987 export subsidies as high as $140 a ton were needed to sell a ton of grain for $70. Most of the subsidizing countries have moved to ease their budget strains by cutting farm prices and putting quotas on farm sales.

With their subsidies stagnating and their market shares shrinking, farmers have begun to rethink their priorities. They have felt they benefited from subsidies, but mainly because their subsidies have been escalating. (The value of a fixed subsidy is quickly dissipated by a higher cost of farmland and a more intensive use of chemicals and equipment.)

Dennis T. Avery is a senior agricultural analyst at the U.S. State Department.

The Impact of Trade Reform

Agricultural trade reform would produce enormous economic gains; there would be billions of winners and, at most, very few losers. Most of the world's farmers (and farmland) would stay in farming, enjoying sharply reduced production costs and increased sales volumes. Consumers would have lower food prices and lower taxes, which would generate off-farm employment and economic growth on a huge scale in both the industrialized countries and the newly industrializing countries (NICs). Although the adjustments necessitated by trade reform would not be easy or cheap, making those adjustments would be far less costly, traumatic, and disruptive than continuing to subsidize farmers and would likely

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Fed Ex's Smith Joins Cato Board

Federal Express founder Frederick W. Smith, newest member of Cato's board of directors.

Frederick W. Smith, founder and chairman of Federal Express Corporation, has joined the board of directors of the Cato Institute.

"For several years now I have admired the work of the Cato Institute," Smith said. "What has impressed me most has been the Institute's ability to maintain an 'outside the beltway' perspective, if you will, in developing a wide range of policy recommendations. Cato's combination of an appreciation for free enterprise and a refreshingly open approach to foreign and military affairs is unique in Washington's policy community. I am delighted to now be formally associated with the Institute and look forward to making a positive contribution to its efforts in the public policy arena."

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An Agenda for Reagan's Last Year

Chairman's Message

In his seventh State of the Union Message, President Reagan outlined an aggressive agenda for his final year in office. In introducing that agenda, which was organized around the objectives identified in the preamble to the Constitution, he stated that "an American President has no more sacred duty than to ensure that the government stays within the constitutional limits that protect individual liberty." So far, so good.

Some of Reagan's proposals addressed the main missed opportunity of his administration: its failure to change the institutions, procedures, and rules that enable the federal government to overstep its prescribed boundaries. For example, the president called for a constitutional amendment stipulating that federal borrowing and taxes could not be increased without the approval of a supermajority of Congress, an amendment authorizing a line-item veto, statutory changes in the budget process, and a procedure for reviewing all proposed legislation and regulations for compliance with the principles of federalism. The casual dismissal of those proposals by the establishment press only underscores their importance.

There are two problems, however, with Reagan's agenda. First, it does not postulate a coherent role for the federal government that would be consistent with both the general objectives in the preamble to the Constitution and the specific limits in the text. Although that failure may reflect the diverse interests of the Reagan coalition, it probably indicates that the president has not sorted out the tensions between the pluralist and centralist strains of American conservatism.

For example, Reagan's obviously genuine commitment to federalism seems inconsistent with his endorsement of a human life amendment, a voluntary school prayer amendment, and stronger federal powers in the areas of organized crime, drugs, and obscenity. The same message that endorsed further decentralization of welfare also endorsed federal coverage of catastrophic health care costs. The same message that endorsed the development of model education-voucher legislation also endorsed increased federal spending for higher education. Barry Goldwater had it right—Republicans who endorse a role for the federal government in an area over which it has no explicit constitutional authority set themselves up for a charge that they are merely "dime-store New Dealers."

The second problem with Reagan's agenda is that the political conditions do not favor its implementation. The Democratic congressional leadership has already declared that the Reagan era is over. The prospect of a weak economy in 1988 and the normal diversions of an election year only compound the problems of a lame-duck president. In order to gain congressional approval for any of his agenda, Reagan will have to sort out his priorities, stress initiatives for which there is a potential consensus, and probably make some deals.

In that spirit, Reagan should propose a final grand compromise to Congress: that he will approve a tax-increase bill *only if* (1) it does not raise individual and corporate tax rates and (2) Congress passes the proposed constitutional amendment limiting the federal government's authority to borrow and tax. That compromise would serve to steadily reduce the federal deficit, channel the pressure for more tax revenues into a continued broadening of the tax base rather than into rate increases, and, most important, break the congressional deadlock over the proposed amendment.

A final note to friends of Cato: my preference, and probably yours, is to reduce the federal deficit entirely through sustained spending restraint. To be realistic, however, we may have to choose between a large future tax increase and a small immediate tax increase along with effective constitutional limits on federal debt and taxes. We need a national debate on that issue among advocates of fiscal responsibility.

William A. Niskanen

—William A. Niskanen

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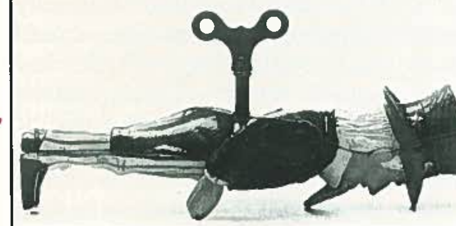
Weaver Sees Corporatism Ebbing, Market Capitalism on the Rise



After Reagan and Reaganism the corporate state will go on losing support. . . . There will be a chance—maybe even a good chance—that the nation will slowly convert from corporatism to capitalism." That's Paul Weaver's conclusion in *The Suicidal Corporation: How Big Business Fails America*, a Cato Institute book published by Simon and Schuster.

The impetus for the book was Weaver's experience at Ford Motor Company, which he joined as economic communications planning director in 1978. Weaver, then a leading neoconservative writer and an editor of *Fortune* magazine, writes, "I went to Ford to defend American capitalism." He soon became disillusioned with the modern corporation, as evidenced by the titles of chapters that recount his days at Ford—"Lies," "Passivity," "Narcissism," "Deals," "Careerism"—and decided to investigate its origins. He was particularly disenchanted by Ford's lack of commitment to the free market and its unwillingness to defend itself in the media.

Weaver writes, "The corporation was a tough sell in the nation of Jefferson, Madison, and Jackson, especially at first. What the large majority of Americans believed in—individualism, limited government, free markets—the corporation scorned and worked against. What corporations wanted—subsidies, industrial policy, protection from competition, governmentally sanctioned monopoly—most Americans hated." The corporatists won that battle, Weaver notes.

Having traced the history of corporatism during the past century, Weaver describes business lobbies in the 1980s. In the last section of the book, "Toward Capitalism," he argues that the corporate state no longer works, either for business or for society as a whole, and outlines a program through which companies could "begin practicing a new capitalist concept of the corporation." His recommendations include opposing protectionism and other entitlements for a firm's suppliers, supporting economic freedom in general (which most corporations fail to do), adopting a private-property justification of the corporation, and working with think tanks whenever possible.

Weaver concludes, "With economic necessity and moral sentiment tugging them away from a century of corporatist heresy, Americans are getting serious about the hopeful, productive, humane vision of Locke and Mill, of Jefferson and Madison. The day may soon be at hand when their country will begin once again to live up to its self-chosen billing as the land of the free."

Sen. Bill Bradley says, "From the 'witches' brew' of tax loopholes in the old tax code to the tariffs and quotas forming the backbone of the 'corporate welfare state,' Paul Weaver documents—often from personal experience—how corporations lobbied for policies that have made U.S. business uncompetitive." Washington consultant Richard J. Whalen calls *The Suicidal Corporation* "the most important and provocative business book of the decade."

The Suicidal Corporation is available in bookstores or from the Cato Institute for $18.95. ■

Protectionism Won't Help High-Tech Firms

Protectionism and government subsidies for U.S. semiconductor firms will not increase America's competitiveness in high technology, says a new Cato Institute study.

Software industry expert Eugene Volokh observes that the "voluntary" Semiconductor Trade Agreement forced on the Japanese in 1986 hurt American computer firms by raising the cost of the chips they use. The agreement was a response to allegations that Japanese firms have been "dumping" chips. Volokh writes, "The bottom line is that 'dumping' is just a pejorative name for a variety of perfectly sound, fair business practices that are beneficial to American consumers."

The agreement called for Tokyo "to ensure that U.S. firms' share of the [Japanese chip] market rose significantly above the 10 percent level," Volokh writes, and thus forced it to "impose controls on private Japanese citizens that few Americans would tolerate from their own government." The agreement broke down, as cartels usually do, because of widespread "cheating."

Volokh contends that a recent Department of Defense report on "defense semiconductor dependency" manages to completely misunderstand the industry. The report warns that a Japanese advantage in chip production indicates that the United States has lost technological leadership, when in fact in the computer industry "it is design advances in fields such as artificial intelligence, software engineering . . . , and execution speed . . . that are important."

According to Volokh, the $2 billion that the Department of Defense proposes to invest in a Semiconductor Manufacturing Technology Institute ought to remain in the private sector. "Taking $2 billion out of the private sector's hands . . . may actually hurt American technological leadership."

Cato Policy Analysis no. 99, "The Semiconductor Industry and Foreign Competition," is available from the Institute for $2.00. ■

Overregulation Makes Us Less Safe, Wildavsky Warns

Cato Events

D*ecember 4:* The Cato Institute and the Social Philosophy and Policy Center of Bowling Green State University cohosted a book party for Aaron Wildavsky, author of ***Searching for Safety.*** Addressing an audience of more than 100 at the National Press Club, Wildavsky, a professor of political science at the University of California at Berkeley, discussed the relationship between safety and risk taking in the development of new technologies. Wildavsky noted that regulators try to preclude every undesirable consequence of a new technology, no matter how unlikely, and often forbid even the limited use of new technologies until they have been demonstrated to be risk-free. That policy, he argued, severely limits consumers' and entrepreneurs' opportunities to profit from technological advancement through trial and error.

Aaron Wildavsky addresses National Press Club luncheon.

Robert F. Hébert discusses railroad regulation.

December 9: **"Fighting Back: The Politics of Free Trade."** I. M. Destler, a professor of public affairs at the University of Maryland, discussed the findings of his recent book, *Anti-Protection: Changing Forces in U.S. Trade Politics.* He asserted that antiprotectionist activity has increased during the past decade as a result of certain industries' efforts to fight import restrictions. Commenting on Destler's remarks was Paula Stern, a senior fellow at the Carnegie Endowment for International Peace and a former chairman of the International Trade Commission.

December 14: **"Asking for Protection Is Asking for Trouble."** Marc Levinson, editorial director of the *Journal of Commerce,* and Carlos Moore, executive vice president of the American Textile Manufacturers Institute, debated Levinson's contention that protection from import competition has hurt U.S. companies more than it has helped them. Levinson argued that protection prevents companies from adapting to change by leading them to concentrate on high-profit protected items instead of pursuing new and more competitive product lines and strategies.

December 15: **"Korea: Time to Withdraw?"** Doug Bandow, a Cato senior fellow and the author of the recent Cato Policy Analysis "Korea: The Case for Disengagement," called for a gradual phaseout of the U.S. military commitment to South Korea. He contended that by removing its troops and lifting its security blanket, the United States could save billions of dollars in defense costs, eliminate a serious and unnecessary risk of war, and affirm its commitment to the autonomy of the Republic of Korea. Larry Niksch, an Asian affairs expert at the Congressional Research Service, commented on Bandow's remarks.

January 14: **"Does the GATT Still Work?"** Michael Finger, chief of the International Economic Research Division of the World Bank, argued that the GATT's "trade remedies," especially the antidumping codes, are often abused by the signatory nations, which view them as a convenient way to restrict imports so as to benefit certain domestic industries and firms. Commenting on Finger's remarks was Michael Gadbaw, a trade attorney at the Washington firm of Dewey, Ballantine, Bushby, Palmer and Wood.

January 21: The Cato Institute hosted a book party for Max Singer, author of ***Passage to a Human World: The Dynamics of Creating Global Wealth.*** Singer, a cofounder of the Hudson Institute, outlined an optimistic scenario for the world's standard of living. Having predicted that most societies would move from their traditional poverty to wealth by the end of the next century, he described how that change would affect America and the rest of the world.

January 28: **"Tort Law: The Enemy of Innovation?"** Peter Huber, a senior fellow at the Manhattan Institute, and Gene Kimmelman, legislative director of the Consumer Federation of America, debated Huber's assertion that the U.S. liability system discourages companies from marketing innovative products. Huber charged that by promoting discrimination against potentially valuable new products and shielding hazardous older products from scrutiny, our current liability laws make life more dangerous instead of safer. ■

Fighting Back for Free Trade

Risks of Protectionism Examined at Policy Forums

The dangers of an increase in domestic and international protectionist activity have been discussed at a number of recent Cato Policy Forums.

"Asking for Protection Is Asking for Trouble" was the topic of a debate between Marc Levinson, editorial director of the *Journal of Commerce,* and Carlos Moore, executive vice president of the American Textile Manufacturers Institute. In the long run, Levinson contended, protection does not help firms compete. "Trade relief curbs an organization's dynamism," he noted. "Profit pressures force managers to focus on the high-profit protected products" instead of adopting strategies that would increase their firms' competitiveness. "While protection is in place, the competitive realities will change, but the flow of profits . . . may make the company less aware of those trends."

"Does the GATT Still Work?" was the subject of another recent forum. World Bank economist Michael Finger argued that the "trade remedies" sections of the General Agreement on Tariffs and Trade are counterproductive and that signatory nations often use the GATT's antidumping codes to get an international stamp of approval for protectionist acts. Finger claimed that those provisions are based on bad economic theory and embody unrealistic policy goals. He called for a substantial reform of the GATT that would reflect the fact that trade restrictions are ultimately harmful to the world's economies. Attorney Michael Gadbaw commented on Finger's remarks.

At the forum "Fighting Back: The Politics of Free Trade," I. M. Destler, author of *Anti-Protection: Changing Forces in U.S. Trade Politics,* and former International Trade Commission chairman Paula Stern discussed recent efforts to stem the protectionist tide. Destler noted that as disputes over trade issues have intensified, antiprotectionist political initiatives have grown more effective. He warned that although more people are aware of the benefits of free trade, special-interest opposition remains formidable. Destler predicted further gains for the antiprotectionist movement as the economic hazards of protectionism become clearer. ■

Paula Stern of the Carnegie Endowment discusses the politics of protectionism.

I. M. Destler describes how antiprotectionist forces are organizing to defend free trade.

Anne E. Brunsdale, vice chairman of the International Trade Commission, talks with other guests at forum on trade issues.

Journal Looks at Constitution

The latest issue of the *Cato Journal* (vol. 7, no. 2) features articles on "Government, the Economy, and the Constitution." Editor James A. Dorn writes, "The major question addressed by the Framers of the U.S. Constitution was how best to secure individual rights while providing for republican government."

Economic rules that should be included in a constitution are identified by James M. Buchanan, Gordon Tullock, Dwight Lee, and Thomas Dye. Reflecting on the thesis of Buchanan and Tullock's first book, *The Calculus of Consent,* Buchanan calls for a return to the "social contract tradition" of the Framers. Tullock argues that the rise of the civil service as an interest group and the Supreme Court's increased power to effectively change the Constitution without the consent of either Congress or the public have allowed the federal government to grow far beyond the bounds that the Framers envisioned.

Peter H. Aranson urges courts to recognize that the Framers sought to limit government and protect property rights. Thus, the Supreme Court's duty is to provide substantive protection for economic liberties. Richard Epstein offers a path-breaking analysis of the public trust doctrine, investigating when it is legitimate to move public property into the private domain.

Other contributors to this issue of the *Journal* include Carolyn L. Weaver on provisions for the elderly before Social Security, John R. Lott, Jr., on the rationale for public education, Richard Meyer and Bruce Yandle on the political economy of acid rain, and W. A. Kelly, Jr., Clark Nardinelli, and M. S. Wallace on insider trading.

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

Liability Law: The Enemy of Innovation?

Policy Forum

The Cato Institute regularly sponsors a Policy Forum at its Washington headquarters, where distinguished analysts present their views to an audience drawn from government, the media, and the public policy community. A recent forum featured Peter Huber, a senior fellow at the Manhattan Institute who is writing a book on tort law reform. Commenting on Huber's remarks was Gene Kimmelman, legislative director of the Consumer Federation of America.

Peter Huber: The most intriguing thing about liability debates is noting who stands where on the issue and why. These days there are few issues on which Ralph Nader on one side and Landes and Posner on the other essentially agree, but liability is one of them.

The people who defend the U.S. liability system argue that liability results in safety because people don't like to be sued; it's still considered disgraceful, and litigation is expensive. So to avoid lawsuits, the argument goes, corporations, municipalities, doctors, hospitals, and drug manufacturers conduct themselves more carefully than they would otherwise. And the effect of the liability system is even more subtle than that. It doesn't simply make potentially liable parties stop doing things that hurt consumers; if it did, there would be no court cases, but we would also have a paralyzed and much more dangerous world.

The role of a liability system, according to that argument, is to spur those who might otherwise be hurting consumers to invest enough resources to develop better and safer practices, products, and technologies. In other words, innovation, that is, technological change, provides safety, and a vigorous liability system produces more innovation and thus more safety. The question becomes whether our current liability system is forcing the appropriate individuals to make life safer. After careful consideration, I have concluded that more often than not it does just the opposite: it discourages change and encourages a reactionary, hostile, defensive attitude among those best qualified to move us forward. As a result, it generally undercuts rather than promotes safety.

Let me back up that contention with somewhat anecdotal evidence. If the theories that have been peddled for the last 25 years were correct, we would have been seeing a whirlwind of progress in the development of contraceptives, vaccines, morning sickness drugs, small cars and planes, hazardous waste disposal techniques, and medical procedures. After all, those are some of the areas where there has been very aggressive growth of the liability system in the past decade or two. So let's look at what has happened in several of the areas where the liability system has been the most active.

Peter Huber: "When an AIDS vaccine is developed, all the pharmaceutical companies will refuse to market it until they get protection from the liability system."

In the 1950s U.S. pharmaceutical companies were the world's leaders in contraceptive technology. Today, according to Planned Parenthood and every other serious observer of that market, they are the laggards. A once-a-month pill has been approved in France; a contraceptive vaccine and effective male contraceptives are under rapid development in several other countries. But in the current legal climate there is almost no chance that those products will be sold in the United States.

Consider the record. No truly new chemical contraceptive has been introduced in this country since 1968. U.S. pharmaceutical companies' contraceptive research peaked in 1973 and has plummeted by 90 percent since then. Clinical tests of the contraceptive implant Capronor have been stalled for more than a year for lack of liability insurance. The newest and most effective IUD, the Copper T 380A, has been approved by the FDA for years. For quite some time no U.S. company would touch it, but a few months ago some entrepreneurs decided to set up an undercapitalized company with no liability insurance, using Chapter 11 bankruptcy laws as its shield, in an attempt to peddle that IUD at last—at a very high price.

U.S. companies were also the world's leaders in developing and distributing vaccines, but between 1965 and 1985 the number of U.S. vaccine manufacturers shrank by more than half. By 1986 we had to depend on sole suppliers for vaccines against polio, rubella, measles, mumps, and rabies. Not long ago there were eight U.S. manufacturers of a whooping cough vaccine; today there is only one. For a brief time it looked as if we might be down to zero, and the Centers for Disease Control declared a crisis and began stockpiling emergency supplies.

Companies that get out of risky areas such as the vaccine business tend to stay out. Today only two major companies—Merck and Lederle—are investing serious money in vaccine research. I am fairly sure that when an AIDS vaccine is finally developed, all the pharmaceutical companies, including Merck and Lederle, will refuse to market it in this country until they get congressional legislation that protects them from the liability system.

Because I am a private pilot, one of my favorite examples is small plane design. In the aviation industry, innovation has historically come from the Burt Rutans of this world—the small plane designers. Some of them used to do quite well in the business of selling their designs. But innovation in small aircraft design has just about stopped. Liability insurance accounts for over one-third of the cost of a small plane. Our richest source of aerodynamic research has disappeared.

What about morning sickness drugs? The last one introduced in the U.S. market, Bendectin, is now gone. Again, in the current legal climate it is inconceivable that some other U.S. company will research and market a morning sickness drug. Our pharmaceutical companies simply will not touch the thing. Anything that involves pregnancy and small children is anathema to them. This is not to even begin discussing other explosive areas of medicine, such as anesthesiology, surgery, and biotechnology.

In short, in the areas where the liability system has undergone the most extensive and aggressive growth during the past decade or two, we simply have not been seeing the ferment of innovation and investment that liability, under the current "logic," should have spurred. Indeed, we have experienced just the opposite. We therefore need to take a closer look at the current liability system, which bears little resemblance to the elegant liability models of Landes and Posner.

There are four major elements of the system that discourage innovation and the concomitant processes that historically have made life safer. First, our liability law demands that the relevant parties issue exhaustive, gilt-edged safety warnings. It is not enough for them to mention the risk of death; they must also mention the risk of, say, stroke or serum sickness. It is not enough for them to warn the prescribing doctor of a risk; they must somehow get the warning to the patient as well. A whole host of excruciatingly specific and highly demanding warning requirements have been spelled out by the courts over the years.

Now, there is only one way to meet those requirements, and that is to be in the marketplace for so long that one learns every possible side effect, abuse, and misuse of one's product. The ability to tool a warning to the point that it will provide effective protection in court requires a wealth of marketplace and litigation experience; there is no substitute.

The warnings for oral contraceptives, a particularly vivid example, have been very well honed over the 30 years that they have been on the market. Today the package inserts consist of several pages of fine print, and the few manufacturers of oral contraceptives do pretty well under the liability system. They're sued quite often, because oral contraceptives are risky, as are all contraceptives, but because their warnings have been lawyered to a very high degree of precision, they win quite a few cases. No new manufacturer of oral contraceptives could hope to compete with them.

The second element of the liability system at work against innovation is the insurance requirements. Our liability laws force manufacturers, surgeons, and the others to sell insurance contracts along with their goods and services. The requirements aren't stated in such terms outright, but that is their effect.

Unless a manufacturer is General Motors, it has to buy that contract from an insurance company, and insurance companies are conservative, for some very good reasons. They are not in the technology assessment business; they are actuaries, and they price insurance by looking at accident records and market history. Once again, then, the system accommodates companies that have been in the marketplace for a long time. Insurance companies shy away from innovation—from the sudden technological leap—because they simply cannot price the insurance in such cases.

The so-called orphan drugs illustrate the problem operating under particularly tragic circumstances. No more than 200 U.S. children suffer from cystinosis, a fatal kidney disease. About 2,000 Americans suffer from Charcot-Marie-Tooth disease, an incapacitating nerve disorder (which, incidentally, has nothing to do with teeth). About 1,000 of us suffer from leprosy, which can cause extremely painful skin ulcerations.

All told, there are about 5,000 diseases that bring death or tragic suffering to a very small number of people. Medicines, most of which are in highly experimental stages, are available for about 500 of them, but the liability laws make it all but impossible to get those products to market. The manufacturers can't just sell the medicines; they have to in effect sell insurance too, and it's especially hard for them to get insurance, because the diseases are rare. Their products are essentially perpetual newcomers to the market. They simply don't have the actuarial records behind them; consequently, innovation is all but impossible.

The third element is the lack of time limits. Over the past 20 years time limits for suing a manufacturer or a doctor have all but disappeared from the liability system. Before that there were very strict statutes of limitations in liability law. Today it is almost never too late to sue, and that has made innovation downright dangerous. The liability system is obsessed with product defects, but the standards for technological defects, like the standards for negligence in human conduct, vary with the time and the place. The best-designed cars of 1950 are clearly defective by 1980 standards, and the same is true of the best medical procedures, pesticides, and home appliances.

Because of the demise of litigation time limits, however, each innovation in method, material, or design has effectively set a new standard of liability against which everything companies did before is measured. So each company has a strong, though tremendously subtle, incentive not to rock the technological boat. I can say with great certainty that this is the single strongest force that has impelled many insurance companies and other businesses to resist the passage of any legislation that would require them to inform workers of past exposures—including long-past exposures—to toxic chemicals. Firms are terrified that what they did long ago will get them whisked into court—that their past actions will be measured against today's standards, most of which are more stringent. So the infinite time limit, and the demise of a rather obscure evidentiary rule against subsequent remedial measures, is another hindrance to innovation.

The final element of liability law that hinders innovation is perhaps also the most insidious. It is strict liability, and the shift from negligence to strict liability has had a profound psychological effect on jurors. Until the 1960s if one wanted to sue, say, Du Pont over a pesticide that it manufactured, one had to prove that the conduct, education, training, or supervision of a Du Pont employee was substandard. One had to really impugn the employee; it would be a person-against-person lawsuit. Then a small but influential group of

(Cont. on p. 8)

Liability (Cont. from p. 7)

jurists and academics decided that it would be simpler and more efficient to have such lawsuits proceed not against people, under a negligence standard, but against products. The jury would have to decide whether a product was defective in itself.

Now, the psychological dynamic is all-important in any case that goes to trial. When people were up against people, both sides had a reasonable chance of coming out ahead. Jurors knew that an innovator was likely to be one of the best-trained people in his field and therefore unlikely to be a negligent person. So innovators had a fighting chance under the old liability system. But now that the technology itself is on trial, defense lawyers have to contend with the most basic and primitive of all human instincts, the feeling that what is old and familiar is safe and what is new and unfamiliar is dangerous. I can't imagine that any trial lawyer has not observed that phenomenon.

So if I am to defend the manufacturer of a contraceptive alleged to have caused an illness, please let that contraceptive be a pill, preferably the one formulated more than 10 years ago. Don't let it be a brand-new IUD, sponge, or, heaven forbid, once-a-month pill, and certainly not a male contraceptive. If I am to defend a utility company after a power plant accident, please let the fuel be coal or oil, because when nuclear power is involved, the fear factor is about a thousand times larger, whatever the actual magnitude of the defect or risk.

We must learn to look beyond the illusion of progress. Companies may say that the liability system is a tremendous burden to them and that they have a team of researchers working day and night, attempting to minimize their liability, but let me tell you what kind of work they're likely to be doing. Johnson & Johnson may have 100 pharmacologists trying to see if by reducing the estrogen level in one of their pills by, say, 5 percent, they can reduce the risk even slightly while maintaining its effectiveness. An appliance manufacturer may have a staff of psychologists and human-factor engineers trying to decide how to phrase a warning and where to paste it. We still get tiny incremental changes, but we lose the bold leaps, the kind of innovation that has historically brought us real benefits.

I would like to conclude by asking Mr. Kimmelman a question. I can assert with absolute confidence that an AIDS vaccine cannot get onto the U.S. market unless there is an act of Congress like the one that was needed to get the swine flu vaccine onto the market back in 1976. Consider also that the swine flu vaccine law had a no-profit clause, which meant no money for the producers of that vital commodity. The CEOs of all the major pharmaceutical companies know that, so why should they spend a penny to develop an AIDS vaccine? If this situation is the result of our liability system, it has been truly horrifying and disastrous for everyone.

Gene Kimmelman: I appreciate the opportunity to take the high ground of

Gene Kimmelman: "The function of the liability system is to internalize the cost of accidents."

the marketplace, particularly here. Let me start by saying that I'm curious about Peter's focus on innovation. Obviously, innovation is important, but it strikes me that it's often viewed as a goal in itself instead of being pursued in tandem with other goals.

We at the CFA view the liability system as the legal arm of the marketplace. When it works effectively, there isn't government intervention; there's a balancing process in which the cost of an accident is assigned to its probable originator. So the function of the liability system is to internalize the cost of accidents. Even if there is absolute liability, as some have claimed, in certain instances the cost of accidents goes into the price of products, which is an appropriate process.

In the good old days of greater innovation there was not an adequate internalization of cost. The cost was there, but it was not imposed in such a way as to take advantage of the incentives of the marketplace. Our current liability system has piggybacked on marketplace incentives and made it possible to avoid government regulation in areas where our courts can deal with dangerous products.

Critics of the system like to point out that in 1962 there were no million-dollar verdicts and in 1984 there were over 500. But if a young person is injured and deprived of the wages he would have earned during the rest of his life, how should he be compensated? His compensation should clearly be based on today's dollars, today's medical costs, today's wage rates, and today's life expectancy—and the courts have recognized that principle. What's astonishing is that the increase in liability costs, in terms of both insurance premiums and payouts, is quite small once those factors are taken into account.

The four elements that Peter criticized didn't emerge overnight. They emerged during an era when numerous federal safety agencies were created and society's expectations of the marketplace were rising. It's not surprising that the liability system would change in response to that new societal demand and that such changes would show up in the economic arena.

I'm also curious about Peter's conclusion that our liability system has discouraged safety. It's true that no one has demonstrated that there is a link between any of our liability laws and any incidence of safety or, for that matter, between the creation of any safety agency and any incidence of safety. But if you look at the record of the last decade or two, when the elements of the liability system that Peter described were gaining acceptance in the courts and when the safety agencies were created, you'll see a significant decrease in the rate of accidents, both at home and at the workplace. Even corporate executives who are very critical of our liability system admit that it has led them to focus on safety much more than they did before 1970. Corporations have been buying safety.

It seems to me that many of the examples Peter used to demonstrate a lack of innovation are special cases. They involve long-latency diseases that we were not aware of years ago. They involve chemicals that were not used in products as widely as they are today. They involve pharmaceuticals, pesticides, and other products that utilize new combinations of chemicals and whose dangers we have therefore discovered only recently. It would have been impossible to internalize the cost of accidents related to them 20 years ago. Such special cases may require a special solution.

Besides, there is a ripple effect in the pharmaceutical field, as we have seen with the Dalkon Shield. There have been only a few cases of egregious behavior that most corporations would not condone, yet they have created a widespread perception that the whole pharmaceutical area is a dirty field that one should not get into. There is also a certain dysfunction when tremendous publicity is given to a bad product or a product with a serious problem, such as the Dalkon Shield. I believe that the marketplace, where there is an incentive for profit and an opportunity for profit, will ultimately offset those effects.

Now I'd like to discuss some of the specific problems that Peter pointed out. In the area of drugs, the predominant standard for liability is still negligence, not strict liability. So in a lot of pharmaceutical cases people try to demonstrate negligence by claiming that a manufacturer failed to provide them with an adequate warning. The courts have generally ruled that a pharmaceutical company does not have to warn anyone other than the physician. And I have to say again that although diseases with long latency periods have become a public policy issue, they are a special case. And once again the market has worked well without government intervention; it has enabled us to discover a problem that needs to be looked at more carefully.

I agree that insurance companies have an incentive to stick with known commodities and refrain from covering new entrants in the marketplace. But I'm surprised that there's been so little analysis of the insurance industry, which has many dysfunctions of its own.

Liability law has certainly changed with regard to the statute of limitations. There is now a discovery rule, but what's unfair about that? It means that people are not barred from suing after they've had a reasonable opportunity to discover the nature and probable cause of their injuries. That rule is particularly applicable to the special cases—for example, when someone has had lung problems but didn't know that they could have been caused by asbestos. Many states have instituted a statute of repose, under which the right to sue is automatically cut off after a certain number of years. It's not always applied in cases involving chemicals, but it tends to balance the expanded statute of limitations.

Peter is right about the shift to strict liability and its psychological effect on jurors, but I believe that the shift reflects the community's wishes—that is, it fills a demand in the legal marketplace.

In conclusion, I think that in areas of massive litigation—contraceptives, toxic chemicals, and so on—we might have safer products today if we had pursued innovation in tandem with other goals. But I don't think that warrants condemning the safety incentive that is built into our liability system; it usually provides the right signal about safety.

What we find in our liability system is a rather efficient marketplace. When special cases have arisen, the marketplace has let manufacturers represent their products as being unique. Other corporations have sometimes misinterpreted that market signal. They have overreacted and concluded that a lawsuit over one area means that the whole industry is going to be sued up and down.

I predict that the legal marketplace will continue doing precisely what it has been doing: bringing products that can create special difficulties to the fore, which highlights the fact that public intervention is needed only in the most extreme, particular circumstances. I also predict that at least one U.S. company will put an AIDS vaccine on the market. Americans do not believe that "profit" is a dirty word, and as long as there was money to be made in such a venture, I think that if consumers were given a very lengthy warning and possibly asked to sign documents in which they assumed certain risks, pharmaceutical manufacturers would go ahead. Even the worst-case scenario would be that they would seek special protection from Congress in an attempt to limit the amounts payable for side effects and ensure the speedy resolution of claims. That would be the marketplace working at its best—calling for government intervention only after the market fails. ■

Cato president Edward H. Crane has been elected to the board of directors of the Institute for Research on the Economics of Taxation. Here Crane talks to IRET president Norman B. Ture at Cato's annual monetary conference.

Farming (Cont. from p. 1)

preserve more family farms.

Lower food prices and lower taxes would stimulate world food consumption, particularly the consumption of resource-intensive high-protein foods. The greatest increases would occur in regions where those foods have been fairly costly, such as Japan and Western Europe, and in regions where they have been virtually unaffordable, such as the NICs. Moreover, by freeing consumer spending power for nonfarm goods and services, lower food prices and lower taxes—along with the deficit reductions made possible by lower government farm spending—would stimulate broad economic growth.

Environmental gains would be registered wherever high farm prices have forced farmers to cultivate crops on fragile soils and stimulated a heavy use of agricultural chemicals. Farmers would benefit from higher demand, the elimination of surpluses, and lower costs, though they would need help in adjusting to lower land values. Governments could continue giving payments to small-farm families—as long as the amounts were not tied to production quotas—and most would do so.

For Western Europe, the most significant benefits of trade reform would include freedom from the high cost of subsidized farm exports. Not only would high-protein foods become cheaper, but exporting such regional specialties as wines and cheeses would become more profitable. Fewer family farms would be displaced by "factory farms." Because the demand for nonfarm goods and services would be boosted by lower taxes and food costs, unemployment would decrease.

For Pacific Rim industrialized countries such as Japan, the most significant gains would include a lower cost of living and a higher domestic demand for goods and services. Japan's consumers would have about 6 percent of their incomes freed for nonfood items and could better afford to vary their diets. More land would be available for desperately needed housing, parks, and roads. Japan's industries would grow and jobs would be created—even as trade tensions were eased.

For the NICs, the greatest gains would include achieving higher economic growth rates as their consumers got increased access to stable, low-cost diet upgrades. Moreover, the NICs' treasuries would be spared the cost of farm subsidies, which typically begin in the early stages of industrial growth, their savings and productive investment would gain momentum.

The United States and other exporters would be freed from the specter of increasing food self-sufficiency throughout the world. Without reform, protected above-market farm prices would continue to rise until new investment and technology permitted most countries to produce virtually all of their own food.

> "Although the adjustments necessitated by trade reform would not be easy or cheap, making those adjustments would be far less costly and disruptive than continuing to subsidize farmers."

The LDCs' farmers would quickly double their exports of cane sugar, which would displace high-cost sugar beets. That expansion would result in much larger numbers of jobs and important gains in foreign exchange earnings. The cessation of cut-rate food shipments from OECD countries would encourage the LDCs' farmers to exploit their comparative advantages in domestic and export food production.

Adjustment Problems

An immediate result of reform would be a sharp decline in farmland values in the countries whose farmers have received production and price subsidies. That drop in land values is their major objection to reform. The potential of reform, however, must be evaluated in light of the fact that continued increases in farm subsidies would be needed to keep land values at their current levels, and such increases are not likely to be offered to farmers in any of the OECD countries. Escalating farm subsidies have already disappeared in Western Europe and Japan. A few years' experience with capped prices and fixed production quotas would make a government-assisted transition to lower land values—and an increase in market demand—look attractive to most farmers in the OECD countries. A generous adjustment package would cost far less—and would benefit farmers far more—than trying to keep the value of their land inflated through fast-failing subsidy structures.

In the wake of reform, the owners of large farms would find themselves holding more land than they could profitably cultivate. Although they would have lower out-of-pocket costs, the prices of farm products would be volatile. Those farmers, however, would likely get the largest share of the transitional payments made by their governments, because such payments would be based on past production and land ownership. After a land value buydown, the owners of big farms could sell off their excess land to streamline their operations or reduce their debts. (Specialized production equipment such as "hog hotels" and irrigation systems could be treated in much the same way as land.)

The biggest adjustment problem would be faced by the relatively few farmers who have been growing row crops on marginal land because of artificially high prices. They would have to shift to forage and livestock and realize lower per-unit earnings. However, that would be a regional problem and should be so addressed.

Stimulating Worldwide Demand

The first and foremost result of trade reform would probably be lower prices for farm products. The world farm surplus is too large to support the current prices. By diverting cropland, the United States has been cutting its farm output by over 100 million grain-equivalent tons a year, while other countries have been exporting more surplus output. Western Europe's farm surpluses exceed 40 million tons a year, and still more is

added to the world surplus by Japan, Saudi Arabia, and other countries.

It would take time—and more attractive prices—to increase the worldwide demand for food and feed by 150 million tons a year. Farm prices and land values would initially go down, and governments would have to help their farmers through that transition. But farmers haven't truly benefited from high land prices any more than they have from high prices for tractors, pitchforks, and other farm tools. High land values simply present them with high production costs right up to the moment when they sell the land and cease to be farmers. With lower farmland investments and less incentive to use expensive chemicals and equipment, farmers would enjoy radically lower operating costs. Production would decline until it met an increasing demand at profitable price levels.

As lower farm costs were passed to consumers, worldwide consumption of high-protein foods would increase. Japan, for example, has used import controls to keep the cost of such foods three times as high as it would have been in a free market. Although its population is roughly half that of the United States, Japan consumes 1 million tons of poultry a year; the United States consumes 8.5 million tons. Likewise, Japan consumes 100,000 tons of cheese a year, the United States 2.5 million tons.

To produce a kilo of poultry requires the equivalent of 3.5 kilos of grain; to produce a kilo of red meat requires the equivalent of 5 to 8 kilos of grain. Thus, the liberalization of Japan's livestock sector could readily add between 5 million and 10 million grain-equivalent tons to the worldwide demand. Such countries as South Korea and Taiwan would also consume and import more high-protein foods.

Western Europe's 400 million consumers would find meat, milk, and eggs one-third cheaper. They eat only two-thirds as much meat per capita as U.S. consumers. Increased West European meat consumption would largely offset the loss of volume due to subsidized exports—especially if the EC countries' imports of soybeans and nongrain feedstuffs were displaced by low-cost domestic production. The populations of NICs would begin adding high-protein foods to their diets at an earlier stage of economic development and would carry that diet improvement to higher levels.

Keeping Land and Farmers in Farming

Reform not only would create remarkably little immediate suffering for farmers but would give them brighter long-term prospects. Most of the world's farmland and farmers would stay in farming—even in densely populated nations such as Japan, the Netherlands, and West Germany. That is because most farmland has no other economic utility. Thus, although land would be farmed less intensively, it would ultimately be the least costly farm input. Land prices would fall until land substituted for such purchased inputs as fertilizer and pesticides. (For example, legume crop rotation would provide nitrogen for succeeding crops and help break pest cycles without pesticide sprays.)

> "Liberalized farm trade would preserve farm employment and the quality of rural life in more parts of the world than continued protectionism."

Some farmland would be converted to urban uses in densely populated countries, but even there the proportion would likely be small. A huge proportion of the good land would still be required for agricultural uses.

Nor would farmers need to be displaced. Family labor and management would be key inputs for the low-cost farming operations most likely to succeed in a cost-conscious environment. Farmers now specializing in crops would again raise livestock to increase their labor incomes (instead of wintering in warm climates) and do some mechanical cultivation instead of spraying all of their land with herbicides.

Farmers would be able to stay in farming because they too could displace capital investment. Countries in which subsidies have stimulated a heavy displacement of labor by capital might need even more farmers. In the United States and parts of the EC, for example, high-price guarantees have encouraged high-tech farmers who make heavy use of machines and chemicals to buy out owners of smaller, more-labor-intensive neighboring farms.

Thus, one of the biggest immediate changes would be a sharp decline in the use of purchased farm inputs. Farmers would cut their fertilizer application rates, make more use of crop rotation, and have less incentive to invest in automated feeding systems and other labor-displacing equipment. Reduced interest payments and input purchases would drastically reduce their out-of-pocket costs. Thus, reform would likely result in higher net incomes for more farm families.

Opportunities for the LDCs

With no subsidized exports available in world farm markets, agriculture would be stimulated in the LDCs. Many of them have already cut back their food imports, as their production potential improved and as more-realistic exchange rates demonstrated the cost-effectiveness of production.

In the LDCs, the biggest immediate impact of reform would be registered on sugar exports. The OECD countries currently produce 18 million tons of sugar a year from sugar beets, but sugar cane is a far more efficient source of sweetener. Cane sugar growers in the LDCs could expect to increase their exports, which currently total 30 million tons annually, by 60 percent. That shift would create a lot of jobs in areas that have few employment opportunities. Moreover, grassland regions of the LDCs would gradually come to play a larger role in supplying the world's increasing demand for red meat.

Benefits for Efficient Exporters

The United States and other efficient exporters (including Canada, Australia, New Zealand, Brazil, Argentina, and Thailand) would reap particularly significant benefits from the increased high-protein food consumption in the

(Cont. on p. 12)

Farming (Cont. from p. 11)

Pacific Rim countries and from the reduced volume of Western Europe's exports. In the short term, such gains would be offset by the unleashing of U.S. commodity stocks and diverted acreage, but in the longer term, all of the major exporters would gain from improved access to the growth markets for food and fiber products in the NICs.

Several billion consumers are likely to benefit from economic growth and upgrade their diets in the next few decades, and trade reform would provide a level playing field on which all farmers could compete. In addition, infrastructure will become a more important advantage. Real farm production costs are declining, but the costs of roads, railroads, grain elevators, and telephones remain high. The countries that have already built infrastructures—including the United States and Canada—will earn increased rewards from their investments.

The LDCs' farm output would continue to increase in the wake of reform, though uneconomical farm investments would be discouraged in those countries. Consumer choice would be less constrained in most parts of the world.

Food Security

Food security is often identified as a goal of national farm policy. The government of Japan, for example, cites food security as a justification for paying its farmers up to 10 times the world market price for rice—while keeping on hand only a month's supply of the imported commodities that support the Japanese people's standard of eating. Most countries would quickly adopt measures that would make a more valid contribution to food security, including increasing their national storage stocks and their reliance on international forward contracts and agribusiness joint ventures.

Farmers and Unemployment

Europeans' biggest fear about reform—that it would force farmers off their farms and onto the urban unemployment rolls—is terribly misplaced. Reform would be more likely to reduce urban unemployment than to drive farmers into the cities. Given higher demand for agricultural products, government assistance in adjusting to lower land values, and a permanent program of direct payments to small-farm families, farmers would have no reason for such an exodus.

Moreover, a farm subsidy phaseout would generate off-farm jobs. It would cut consumers' real cost of living sharply, giving them more discretionary income with which to buy products of nonfarm industries. West Germany's consumers, for example, pay an average of 22 percent of their income for food, compared with 13 percent for U.S. consumers, whose diet is similar. Taxes would also be cut, and capital that has been going into land value and farm chemicals could be channeled into more productive uses.

> "Most of the world's farmers (and farmland) would stay in farming, enjoying sharply reduced production costs and increased sales volumes."

Japan's fear that all of its farmers would go out of business is equally unrealistic. Much of the land would remain agricultural. Japanese farmers would still supply most of Japan's rice and would begin to supply more dairy products, fruits, and vegetables—at attractive prices—to meet increased demand. The average cost of Japanese rice land is $50,000 an acre—20 times as high as the average cost of rice land in other countries. Japan would gain even more per capita than other countries by (1) freeing land to meet its increasingly desperate urban development needs, (2) cutting its farmers' production costs, and (3) stimulating its economy without threatening its national budget.

Reform almost certainly would preserve the livelihood of more of Japan's farmers than a proposed "restructuring" under which the one-acre average rice farm would be combined with others to create a larger unit. That policy would sacrifice about three-fourths of Japan's small family farms, whose owners have been vainly trying to cut their operating costs enough to offset their land costs.

U.S. Agriculture after Reform

U.S. farmers would be highly competitive in a reformed international marketplace. The United States has already installed a massive farm export infrastructure, and the average value of its farmland has fallen by nearly 50 percent since 1981. Moreover, the nation's "surplus" land, most of it good land that is well served by the infrastructure, would be brought back into production. It could produce again at very low per-unit costs.

During its proposed worldwide phaseout of farm subsidies, the United States would have to relinquish its own quotas on dairy products, peanuts, and sugar, but it would ultimately expand the market for the output of its huge tracts of temperate-zone cropland. Without reform, other countries' increasing farm productivity and investment could well drive U.S. farmers out of exporting.

The Dangers of the Status Quo

Most of the farmers in affluent countries are overcapitalized; they have invested more in their land and farming operations than they could earn back in a free market. However, it would cost far less to assist at-risk farmers in gaining market-oriented viability than to maintain the current subsidy systems.

Moreover, farmers have recently realized that they are already at risk. Now that their governments can no longer afford to escalate their subsidies, their prospects are bleak despite high prices.

Liberalized farm trade and a government-assisted transition to free markets would preserve farm employment and the quality of rural life in more parts of the world than continued protectionism. If farm subsidies were gradually decoupled from production, even the overcapitalized farmers could be helped down from their precarious positions. Then there truly would be no losers resulting from the reform. ■

Cato Studies Reprinted in *Public Interest*, *Reason*; Niskanen Joins Shadow Privatization Commission

Cato Institute studies have recently found their way into a number of magazines and journals. The Winter 1988 issue of the *Public Interest* contains Richard B. McKenzie's "American Competitiveness—Do We Really Need to Worry?" In the article, which is based on a chapter in his forthcoming Cato book, *The American Job Machine*, McKenzie criticizes the many proposals that advance central planning and protectionism as means of increasing American firms' competitiveness. He writes, "Competitors need the opportunity to compete, which means the freedom to find their own way in markets, unconstrained as much as possible by external controls and directions."

The latest issue of the *Journal of Economic Growth* (vol. 2, no. 3), published by the National Chamber Foundation, reprints David L. Prychitko's Cato Policy Analysis, "Modernizing Markets in Post-Mao China." Also featured in the issue are Cato senior fellow Doug Bandow on privatizing national airlines in developing countries, Cato associate policy analyst James Bovard on the World Bank's structural adjustment loans, and economist George B. N. Ayittey, whose book on the political economy of Africa will be published by Cato, on African economic reform.

The cover story of the March issue of *Reason* magazine is an excerpt from Paul Weaver's *The Suicidal Corporation*, published for the Cato Institute by Simon and Schuster. And the January issue of *USA Today*, a monthly magazine published by the Society for the Advancement of Education, reprints three Cato studies: "Private Deposit Insurance: Stabilizing the Banking System" by senior policy analyst Catherine England, "Our Trade Laws Are a National Disgrace" by James Bovard, and "Better Now Than Never: Economic and Social Reforms in South Africa" by Peter Spiro. It also includes a new article by Doug Bandow, "Making Judges Accountable."

In other news, Cato chairman William A. Niskanen has become a founding member of the Shadow Privatization Commission, set up to encourage the President's Commission on Privatization to take a bold approach to exploring opportunities for privatizing federal enterprises. The shadow commission will produce a 200-page report on privatization options. Headed by Reason Foundation president Robert W. Poole, Jr., the shadow commission also includes Stuart Butler of the Heritage Foundation, Richard Rahn of the National Chamber Foundation, Fred Smith of the Competitive Enterprise Institute, and Cato adjunct scholar Steve H. Hanke. ■

Cato Institute Conferences

Privatization and the Postal Monopoly

Willard Hotel
Washington, D.C. • April 7, 1988

Speakers include Postmaster General Anthony M. Frank, Office of Management and Budget Director James C. Miller III, Federal Trade Commission chairman Daniel Oliver, Council of Economic Advisers member Thomas Gale Moore, Postal Rate Commission member John Crutcher, Stuart Butler, Douglas K. Adie, James Bovard, and Gene Del Polito.

10th Annual Summer Seminar in Political Economy

Dartmouth College • July 2–9, 1988

Speakers include Charles Murray, Henri Lepage, Earl Ravenal, Israel Kirzner, Roy Childs, George Smith, Ralph Raico, Randy Barnett, Mario Rizzo, Leonard Liggio, and Ted Galen Carpenter.

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.

CATO INSTITUTE

Smith (Cont. from p. 1)

In announcing Smith's election to the board, Cato president Edward H. Crane said, "Fred Smith is perhaps the most admired entrepreneur in America. He represents the best of American free enterprise and is a symbol of what the entrepreneurial spirit can accomplish in a capitalist system. We are honored to have him as a member of our board of directors."

Smith, 43, founded Federal Express in 1972. Since then the company has been credited with revolutionizing the package-delivery business; it controls 57 percent of that market and had revenues of $2.6 billion last year. A 1966 graduate of Yale University, Smith served in the Marine Corps in Vietnam.

Following is a complete list of Cato's board of directors.

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Allow Branch Banking, Study Urges

The U.S. financial system is in dire need of structural reform, and any lasting cure must include nationwide branch banking, according to a new study from the Cato Institute.

George Mason University economists Steven Horwitz and G. A. Selgin argue that ending government restrictions on interstate banking would strengthen the financial industry and provide consumers and businesses with significant advantages. They write that the "benefits of branching include lowering of bank risk through diversification, lessening of bank failures, greater ease of dealing with insolvent banks, greater ease of interbank funds movement, and increased competition in the financial industry."

The authors note that branch banking would also benefit consumers by "allowing depositors throughout the country to deal with the same bank in different states, thereby making it easier for people to move, travel, and do business across state lines."

Because it would encourage portfolio diversity and facilitate interbank funds transfers, interstate banking would tend to prevent or mitigate crises and panics. Horwitz and Selgin observe that "in the early 1930s, while U.S. banks failed everywhere, no Canadian bank failed, even though the Canadian economy was also depressed." Canada has never restricted branch banking.

The authors argue that although some observers fear increased concentration in the financial industry, "the issue is whether we prefer a situation with a large number of little, local monopolies, unaffected by competitive pressure, or a smaller number of larger, branched banks constantly under the competitive gun and better at meeting the needs and demands of consumers .... As long as firms are legally able to enter and exit a market as they please, the benefits of competition will be reaped."

"Interstate Banking: The Reform That Won't Go Away" is no. 97 in the Cato Institute's Policy Analysis series and part of the Institute's Financial Deregulation Project. It is available for $2.00. ■

Rail Reregulation Would Help Special Interests, Raise Costs

Reregulation of the railroads would "thwart the public interest by raising costs for millions of shippers and consumers and jeopardizing the security of the U.S. rail system," warns a new study from the Cato Institute.

Auburn University economists Robert B. Ekelund, Jr., and Robert F. Hébert write that since the passage of the Staggers Act in 1980, railroads and their customers have been adjusting to a more competitive environment. They argue that the purpose of congressional proposals to reregulate the industry is "merely to placate special interests—a small number of coal-mining companies and rent-seeking utilities."

The authors note that by the mid-1970s regulation had driven the rail industry into an extremely weak financial position. Although the Staggers Act failed to solve all of the problems caused by regulation, it was a giant step toward exposing the railroad industry to market forces. Since 1980 service quality has improved, industrywide profits have increased despite a dramatic decline in real revenues, and the railroads have ended the practice of deferring maintenance, thus making rail travel much safer.

Ekelund and Hébert observe that the Staggers Act "guaranteed neither profits nor adequate revenues to the railroads; it merely gave them an opportunity to survive within the competitive environs of the marketplace." They note that substantial competition from trucks, barges, and coal slurry pipelines gives railroads market incentives to keep their prices down.

Ekelund and Hébert's study, "Railroad Reregulation: Is the C.U.R.E. Cure Worse Than the Disease?," is no. 98 in the Cato Institute's Policy Analysis series and is available for $2.00. ■

Un-common policy sense.

Economic Liberties and the Judiciary edited by James A. Dorn and Henry G. Manne. The major question addressed in this volume is whether or not the judiciary will restore its protection of economic liberties or continue to allow majority rule to subvert individual rights. Contributors include Antonin Scalia, Richard Epstein, Alex Kozinski, Bernard H. Siegan, and Stephen Macedo. 1987/392 pp./$28 cloth/$15.95 paper

The Rule of Experts by S. David Young. In this highly readable book, Young argues that licensing serves to protect those already in a particular occupation from competition. It delivers monopoly profits to practitioners at the expense of consumers and freezes minorities and the poor out of many occupations. 1987/99 pp./$7.95 paper

The Search for Stable Money edited by James A. Dorn and Anna J. Schwartz. Perhaps no issue is more basic to the workings of a free economy than monetary policy. In this classic volume, distinguished economists such as F. A. Hayek, Milton Friedman, James M. Buchanan, Karl Brunner, and Allan H. Meltzer debate how policymakers can bring about a more stable, less inflationary monetary system. 1987/408 pp./$13.95 paper

The Suicidal Corporation by Paul H. Weaver. This searing critique—by a strong supporter of the free market—shows how big business preaches free enterprise but practices big government by lobbying for subsidies and protection from foreign competition. 1988/224 pp./$18.95 cloth

Making America Poorer by Morgan O. Reynolds. Economist Morgan O. Reynolds has carefully studied the legal and economic costs of federal labor law and has uncovered some shocking facts. Readers will be astounded when Reynolds adds up the lost GNP attributable to above-market wages, wage inflexibility, work rules, delay of new technology, and strikes. 1987/218 pp./$9.95 paper

The Financial Services Revolution edited by Catherine England and Thomas Huertas. Outmoded regulations limit the international competitiveness of U.S. banks and deprive consumers of high-quality services. Contributors include George G. Kaufman, Richard H. Timberlake, James R. Barth, Gillian Garcia, Robert E. Litan, and Robert A. Eisenbeis. 1988/361 pp./$17.95 paper

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CATO INSTITUTE

"To be governed..."

Horsenost

Soviet leader Mikhail Gorbachev . . . again served notice that open debate is permissible only within the bounds set by the party. "We are for openness without reservations, without limitations, but for openness in the interests of socialism."

—*Washington Post*, Jan. 13, 1988

They never asked us how we felt about power

Members of Congress don't like their working conditions, think they're underpaid, hate the budget process, resent the amount of time taken up by fund-raising and lobbyists, regret they don't see more of their families—and want to remain in office as long as possible [according to] interviews with 114 House and Senate members.

—*Washington Post*, Jan. 13, 1988

Cranberry subsidy—Bonker's idea

Congressmen who represent the cranberry bogs of America saw red yesterday over President Reagan's State of the Union attack on a $260,000 appropriation for research into how to increase cranberry crop yields. . . .

"Frankly, I don't see what's so funny about cranberry research," said Democratic Rep. Don Bonker, whose district in Washington includes the majority of cranberry growers in that western state.

—*Washington Times*, Jan. 27, 1988

Well, you can't have everything

Funding of services for the homeless and money for a study of Long Island Sound were among projects included in the $600 billion spending package approved by Congress on Tuesday.

"It's going to be a nice holiday season for Westchester County," said Rep. Joseph DioGuardi, R-New Rochelle. "We got everything we went after."

Among the highlights:

- $73 million to New York state . . . for the homeless. . . .
- $2.2 million to fund a study of the Long Island Sound. . . .
- $475,000 [for] the Mamaroneck Flood Project.
- $50,000 for dredging the Eastchester Creek. . . .

[DioGuardi's] only disappointment about the budget signed by President Reagan: "We did not make an adequate attempt at cutting the deficit."

—*Gannett Westchester Newspapers*, Dec. 23, 1987

Tipper Goreski

Soviet rock music, one of the first areas to thrive under Soviet leader Mikhail Gorbachev's new policy of *glasnost*, or openness, is now being reined in by a campaign orchestrated by Yegor Ligachev, the Kremlin's leading conservative voice. . . .

At the Communist Party Central Committee . . . it was decided that permissiveness in music had gone too far. . . .

Rock music—loud, brash and imported from the West—is viewed by many here as antithetical to Soviet values. . . . The thumping beat and outrageous outfits . . . have upset members of the older generation.

—*Washington Post*, Nov. 27, 1987

Annual failure-of-last-year's-forecasts article, presented as a sidebar to annual article on this year's forecasts

The forecasts made a year ago showed a decent grasp of the forces shaping the 1987 economy. . . .

Nearly everyone was wrong about how much tax reform would hurt the economy. . . .

They failed to foresee what would happen in the financial markets.

—*Business Week*, Dec. 28, 1987

It's illegal to abuse a child on U.S. soil

The State Department yesterday asked the Supreme Court to lift a stay blocking the return home of a 9-year-old boy from Zimbabwe who was allegedly beaten by his father, a diplomat. . . .

The State Department ordered his father—Floyd Karamba, who worked in Zimbabwe's United Nations mission—to leave the country because of the alleged child abuse.

—*Washington Post*, Jan. 13, 1988

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