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The Success of Chile's Privatized Social Security

by José Piñera

It's an honor for me to share with you some of the experiences we have had in Chile with our new private pension system. I would like to comment on how the new system works, how we were able to make the transition from the old system to the new one, and what have been the main economic, social, and political consequences of the new system. I will not explain the shortcomings of the old pay-as-you-go system in Chile. Those shortcomings are very well known because that is the system that is failing all over the world.

In Chile we accomplished a revolutionary reform. We knew that cosmetic changes—increasing the retirement age, increasing taxes—would not be enough. We understood that the pay-as-you-go system had a fundamental flaw, one rooted in a false conception of how human beings behave. That flaw was lack of a link between what people put into

their pension program and what they take out. In a government system, contributions and benefits are unrelated because they are defined politically, by the power of pressure groups.

So we decided to go in the other direction, to link benefits to contributions. The money that a worker pays into the system goes into an account that is owned by the worker. We called the idea a "capitalization scheme."

We decided that the minimum contribution should be 10 percent of wages. But workers may contribute up to 20 percent. The money contributed is deducted from the worker's taxable income. The money is invested by a private institution, and the returns are untaxed. By the time a worker reaches retirement age—65 for men, 60 for women—a sizable sum of capital has accumulated in the account. At retirement the worker transforms that lump sum into an annuity with an insurance company. He can shop among different insurance companies to find the plan that best suits his personal and family situation. (He pays taxes when the money is withdrawn but usually at a lower rate than he would have paid when he was working.)

José Piñera, who as Chile's minister of labor privatized the state pension system, is president of the International Center for Pension Reform and co-chairman of the Cato Institute's Project on Social Security Privatization.



Justice Clarence Thomas (second from right) talks with Cato board member David Padden, regulatory studies director Edward L. Hudgins, board member Tucker Andersen, senior fellow Roger Pilon, and health and welfare studies director Michael Tanner at a dinner for Cato's Board of Directors in June.

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As I said, a worker can contribute more than 10 percent if he wants a higher pension or if he wants to retire early. Individuals have different preferences: some want to work until they are 85; others want to go fishing at 55, or 50, or 45, if they can. The uniform pay-as-you-go social security system does not recognize differences in individual preferences. In my country, those differences had led to pressure on the congress to legislate different retirement ages for different groups. As a result, we had a discriminatory retirement-age system. Blue-collar workers could retire at 65; white-collar workers could retire more or less at 55; bank employees could retire after 25 years of work; and the most powerful group of all, those who make the laws, the congressmen, were able to retire after 15 years of work.

Under our new system, you don't have to pressure anyone. If you want to retire at 55, you go to one of the pension-fund companies and sit in front of a user-friendly computer. It asks you at what age you want to retire. You answer 55. The computer then does some calculations and says that you must contribute 12.1 percent of your income to carry out your plan. You then go back to your employer and instruct him to deduct the appropriate amount. Workers thus translate their personal preferences into tailored pension plans. If a worker's pension savings are not enough at the legal retirement age, the government makes up the difference from general tax revenue.

The system is managed by competitive

(Cont. on p. 10)

The Revolt against Big Government

Editorial



In the freest country on earth, the nation whose founding was defined by Thomas Jefferson, 52 percent of Americans think that their government "has become so powerful that it poses a threat to the rights and freedoms of citizens." Pollsters and pundits of the eastern establishment can't believe it: there must be something wrong with the poll. But other polls confirm the news.

A nation born in libertarian revolution is once more outraged at the size and power of government. The skepticism about power that reawakened in the

1960s is now reaching critical mass.

People know government is too big—too expensive, too wasteful, too intrusive, too incompetent—but they're not persuaded that there's any alternative to particular government programs. Disillusioned by government, they have become skeptical of all institutions and all systems, including the alternatives to government. One of the challenges for libertarians, and indeed for all political leaders, is to channel that disillusionment into a healthy skepticism about politics and coercion rather than a dangerous nihilism that cynically rejects all order and authority. Libertarians are well equipped to do that, since our philosophy offers a consistent alternative to almost every aspect of the modern Leviathan while adhering strictly to the ethical principle of nonviolence. The great libertarian Leonard Read made both points in a simple book title: *Anything That's Peaceful*.

The 20th century has been the century of the state. After the glorious 19th century, a century in which liberalism produced unprecedented peace and economic progress in Europe, several factors—technological advances in warmaking; the powerful arguments of Karl Marx and other collectivists; the anti-liberal ideas of militarism, nationalism, and racialism—combined to plunge the world into a nightmare of war and statism, with a frightening array of expansive and intrusive regimes.

Communism, fascism, National Socialism, military dictatorships, and apartheid were the most horrific of the experiments in organized force. But the welfare states and social democracies of the West also amassed more raw power and intervened in citizens' lives more closely than governments had ever done before.

Those experiments have failed, and at the end of the 20th century there is growing hope that the century of the state may be coming to an end. The United States never embraced statism as fully as other countries, so the failure of big government here has been less stark. But the problems are no less real:

- an arrogant elite in Washington that presumes to make decisions for 240 million Americans;
- a crushing tax burden;
- schools that don't educate;

- tens of thousands of pages of new regulations every year, strangling businesses and ensnaring innocent people in a web of paperwork;
- a Social Security system headed for the biggest bankruptcy in history;
- a \$200 billion military establishment designed to protect us from ... what?
- a citizenry increasingly dependent on government benefits;
- crumbling families;
- growing restrictions on our property rights and civil liberties;
- economic growth that seems ever slower for most Americans;
- in short, a government grown so powerful, so removed from the people, so all-pervasive, that 52 percent of Americans say they fear it.

The level of resistance to the political establishment is indicated by the 35 percent support Ross Perot had early in 1992, along with the 58 percent support for "a third party" in 1995 polls. Despite the results of the 1994 election, Americans remain wary of the Republican party, partly because they fear the influence of the religious right. Democrats can't take much comfort from that because voters clearly aren't keen on having secular-left values forced on them by the federal government, either. Because Americans feel they are faced with a choice between Democrats who want to tax productive citizens to subsidize both a nonworking underclass and a new class of cultural elitists and Republicans who project an image of intolerance and don't actually cut government, the key to the political future may be whether people most fear the Rainbow Coalition or the Christian Coalition.

The growing libertarian impulse in American politics offers a way out of that bind. Libertarians reject the idea that either Jesse Helms or Joycelyn Elders should be able to impose one set of moral values on 240 million people. The way to establish that principle is a dramatic reduction in the size, scope, and power of the U.S. government. At the federal level, that means returning to the Constitution of James Madison, a constitution that gave the federal government only a few limited powers and left all other rights and powers in the hands of the states or the people. But it means more than that. It means that after many powers and programs are devolved to the state level, they should be further devolved to the individual. Ultimately we don't want state legislatures making our decisions for us any more than we want Congress doing so. As free and responsible people, we should demand our right to make our own decisions.

This is a program more radical than either the Republicans or the Democrats have offered to the American people. And the time is right. Americans have seen the failure of big government. They learned in the 1960s that governments wage unwinnable wars, spy on their opponents, and lie about it. They learned in the 1970s that government management of the economy leads to inflation, unemployment, and stagnation. They learned in the 1980s that government's cost and intrusiveness grew even as a succession of presidents ran against Washington and promised to change it. Now in the 1990s they are ready to apply those lessons, to make the 21st century not the century of the state but the century of the free individual.

—David Boaz

*Postmaster General Says Service Is Improving***Privatize USPS for 21st Century, Panelists Say**

U.S. Postmaster General Marvin T. Runyon gave the keynote speech at Cato's June 14 conference, "Postal Service in the 21st Century: Time to Privatize?" Runyon maintained that the shortcomings of the U.S. Postal Service, which holds a government monopoly on most mail delivery, are being overcome by sound management practices. Other speakers took exception during a day of lively discussion and analysis.

Economist Rick Geddes of Fordham University pointed out that personal letters and greeting cards, which consumers often consider the most important kind of mail, constitute only 8.4 percent of first class mail. Bills, payments, bank statements, and the like sent between households and businesses make up 15.4 percent of first class mail, and business-to-business communications account for over 30 percent. Advertising constitutes nearly 45 percent of first class mail.

Gene Del Polito of the Advertising Mail Marketing Association maintained that the USPS does not provide timely and reliable service at prices the market is willing to pay and that treating the symptoms will not cure the fundamental problems of the postal monopoly.

Steve Gibson of the Bionomics Institute shed light on market alternatives in his review of the growth of telecommunications and information processing capacity and the spread

of personal computers, fax machines, and e-mail. He observed that as more homes and businesses plug into a national telecommunications network, more routine payments and communications will be handled electronically.

Thomas M. Lenard of the Progress and Freedom Foundation offered evidence that



Postmaster General Marvin Runyon told a Cato conference that the U.S. Postal Service needs modern management, not privatization.

what private delivery is currently allowed, mainly delivery of unaddressed advertising mail and periodicals, costs less than the USPS.

Murray Comarow of American University, formerly executive director of President Johnson's Commission on Postal Reorganization, which resulted in the current form of the USPS, cautioned that proponents must think through the effects of privatization before

making such a drastic move. Thomas DiLorenzo of Loyola College pointed out that many of the arguments made today to justify a federal postal monopoly were used to justify government monopolies in other utilities that now are being privatized.

Rep. Dana Rohrabacher (R-Calif.) set forth his plan to privatize the USPS by giving it to postal workers as an employee stock ownership company. The Postal Service would retain its monopoly on mail delivery for several years to allow it to reorganize. Douglas Adie of Ohio University argued that it would make more economic sense to break up the Postal Service into regional units and sell shares in those new enterprises to workers and public alike.

Whatever its eventual effect, the conference apparently had some immediate impact on the USPS. The day before the conference, the Postal Service used full-page newspaper ads to announce the release of a new study that purportedly found that the monopoly's service has dramatically improved over the past year. The *Washington Post* reported, "The results were announced on the eve of a Washington conference sponsored by the Cato Institute, a libertarian think tank that has advocated privatizing the Postal Service. Postal officials hoped that Runyon's announcement would dampen the enthusiasm of congressional Republicans for such a change." ■

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*Will Regulation Stunt Telecom?***Prof. Epstein, Rep. Armey, Miss Manners Speak At Cato****Cato Events**

April 17: Legislative aides to Sen. Spencer Abraham (R-Mich.) discussed policy issues of mutual interest with the Cato staff at a **Roundtable Luncheon**.

April 18: Two authorities on national security debated "**National Missile Defense: Vital Security Interest or High-Tech Boondoggle?**" at a Policy Forum. Sven F. Kraemer, former director of arms control for the National Security Council, argued that the lack of a space defense against nuclear attack is a shameful and inexplicable failure of U.S. policy-makers. Eugene F. Carroll Jr., deputy director of the Center for Defense Information, said a missile defense would upset the arms-control process, which is aimed at dismantling the Russian nuclear arsenal.

April 19: A Policy Forum looked at "**Earth Day at 25: A Progress Report on America's Struggle to 'Save the Planet.'**" Ronald Bailey, editor of *The True State of the Planet*, said that all indicators of material well-being, including food supplies and air quality, are positive and that a second wave of environ-



José Piñera, who privatized the Chilean social security system, discussed that success at a Cato Policy Forum.

mentalism will be optimistic and in favor of property rights. On the downside, Timothy Lynch, assistant director of Cato's Center for Constitutional Studies, said basic constitutional liberties are being sacrificed in the name of prosecuting environmental crimes.

April 19: Rep. Tom DeLay (R-Tex.) was the keynote speaker at an Institute seminar and dinner entitled "**Toward an American Renaissance**" in Austin, Texas. Also on the program

were Cato president Edward H. Crane, Edward Hudgins, director of regulatory studies, and Michael Tanner, director of health and welfare studies.

April 25: A reception was held in New York City to honor the publication of Cato adjunct scholar Richard Epstein's new book, *Simple Rules for a Complex World*.

April 27: José Piñera, who as Chile's minister of labor privatized the state pension sys-

cated "Miss Manners" column, discussed etiquette as unplanned social order during a **Roundtable Luncheon** with members of the Cato policy staff.

May 9: A black-tie dinner was held on the occasion of the dedication of the **F. A. Hayek Auditorium**. Rep. Dick Armey (R-Tex.) praised Cato and defended immigration as healthy for the nation. Cato senior fellow Gerald P. O'Driscoll Jr., an economist and Hayek scholar, spoke about the importance of the work



Cato adjunct scholar Richard Epstein, author of *Simple Rules for a Complex World*, signs copies of his book after a Cato Policy Forum.

tem, spoke on "**Time to Privatize Social Security: Lessons from the Chilean Experience**" at a Policy Forum. Piñera, president of the International Center for Pension Reform, explained that workers who put money into private investments, rather than the state's pay-as-you-go pension system, fuel economic growth and wind up with larger retirement incomes.

May 2: "**Adoption in Black and White: The Transracial Adoption Debate**" was the subject of a Policy Forum. Rita Simon, author of *The Case for Transracial Adoption*, said her studies over 20 years show no adverse effects or loss of racial identity as a result of transracial adoption. Conna Craig, president of the Institute for Children, noted that tens of thousands of children languish in foster homes while transracial (and other) restrictions keep thousands of potential parents waiting.

May 4: Judith Martin, who writes the syndi-

cated "Miss Manners" column, delivered remarks by videotape.

May 10: At a Book Forum celebrating publication of his new book, *Simple Rules for a Complex World* (Harvard University Press/Cato Institute), Professor Richard Epstein of the University of Chicago Law School explained that government should "establish the rules of the road" but should not "determine the composition of the traffic."

May 18: Bryan Ellison, coauthor of *Why We Will Never Win the War on AIDS*, spoke on "**Does Government Corrupt Science? The Case of HIV**" at a Policy Forum. Ellison argued that centralization of medical research by the federal government reinforces the tendency to assume that all diseases are caused by germs. As a result, AIDS research is devoted exclusively to studying the human immunodeficiency virus despite serious anomalies in the HIV-AIDS hypothesis.



Vic Sussman, cyberspace reporter for *U.S. News & World Report*, discusses regulation of the Internet at a Cato Institute-Media Institute colloquium.

May 25: Cato's 13th Annual Monetary Conference, "Global Monetary Order: What Next?" cosponsored with the Durrell Institute, featured top money and banking economists, including Anna J. Schwartz of the National Bureau of Economic Research, Richard H. Timberlake and George Selgin of the University of Georgia, Steve H. Hanke of Johns Hopkins University, Allan H. Meltzer of Carnegie Mellon University, author Judy Shelton, Leland B. Yeager of Auburn University, Alan Walters of AIG Trading Group, and Jerry L. Jordan of the Federal Reserve Bank of Cleveland.

May 26: Former Brazilian diplomat José Osvaldo de Meira Penna was the guest at a **Roundtable Luncheon**. He talked with Cato staff members and guests about the pace of economic reform in Brazil and the prospects for the future.

May 31: "Telecommunications Haves and Have-Nots" was the title of a telecommunications colloquium cosponsored with the Media Institute. Robert Corn-Revere, an attorney specializing in First Amendment law, said that regulation, in the name of universal access, of new technologies with as-yet-unknown capabilities will stunt development of those technologies. Debra Berlyn, executive director of the National Association of State Utility Consumer Advocates, argued that government regulation is needed to keep prices low enough to ensure access to services for low-income people. Wayne Leighton of the Center for the Study of Market Processes responded that universal-access regulation would require mandated cross-subsidization, which today creates inefficiency in telephone

service. Vic Sussman, senior editor at *U.S. News & World Report*, said regulation of cyberspace is objectionable because it is control of human communication.

June 1: Members of the staff of Sen. John Ashcroft (R-Mo.) discussed a variety of policy issues with Cato policy staff at a **Roundtable Luncheon**.

June 2: Members of the staff of Rep. John Shadegg (R-Ariz.) met with the Cato policy staff at a **Roundtable Luncheon** to discuss issues of mutual interest.

June 5: A Policy Forum entitled **"The Exit Tax: Tax Fairness or an American Berlin Wall?"** looked at the Clinton administration's pro-

cial risk management consultant, said poor decisions about using derivatives do not indict the instruments themselves and warned of the government failures intrinsic to financial regulation. Robert J. Mackay, director of the Center for the Study of Futures and Options Markets at Virginia Polytechnic Institute, said any risk to the economy from derivative investments is small and that the market is educating investors and derivatives managers about the potential risks.

June 6: "The Libertarian Legacy of Thomas Jefferson" was outlined by David N. Mayer, professor of law and history at Capital University, Columbus, Ohio, and author of *The Constitutional Thought of Thomas Jefferson*. Mayer said the key to Jefferson's philosophy was



Ian Vásquez, director of Cato's Project on Global Economic Liberty, accepts an award for *Perpetuating Poverty: The World Bank, the IMF, and the Developing World*, a Cato book he edited with Doug Bandow, from Alex Chafuen, president of the Atlas Foundation, and former Italian foreign minister Antonio Martino.

posed "expatriate tax," which is intended to make money from people who give up their citizenship and leave the country. Steve Symms, former Republican senator from Idaho, said the exit tax violates human rights by confiscating property as people leave the country. He called for cutting the tax rates that induce people to emigrate. According to tax attorney David Rosenbloom, the exit tax simply closes a loophole that benefits wealthy people trying to escape taxation.

June 6: "In Defense of Derivatives" was the title of a Policy Forum that examined derivative financial instruments, which have become controversial in the wake of the bankruptcies of Orange County, California, and Britain's Barings Bank. Christopher L. Culp, a finan-

not his dedication to democracy but his devotion to individual liberty and limited government.

June 14: A Cato conference examined **"Postal Service in the 21st Century: Time to Privatize?"** After a keynote speech by Postmaster General Marvin T. Runyon, a series of speakers, pro and con, looked at the case for turning mail delivery over to private enterprise. They included Rep. Dana Rohrabacher (R-Calif.), Gene Del Polito of the Advertising Mail Marketing Association, Thomas DiLorenzo of Loyola College, Rick Geddes of Fordham University, former senior assistant postmaster general Murray Comarow, and Douglas K. Adie of Ohio University, author of the Cato book *Monopoly Mail*. ■

Creating a World of Free Men

by Rep. Dick Armey

Policy Forum

Fifty years after *The Road to Serfdom*, the closing thought of F. A. Hayek's great treatise (as expressed in the highly influential *Reader's Digest* condensation) still rings true: "The guiding principle of any attempt to create a world of free men is this. A policy of freedom for the individual is the only truly progressive policy."

Sometimes we forget how radical this statement was in 1944. Hayek's little book evoked contempt from his fellow intellectuals. To suggest, in the midst of the Second World War, that central planning does not work and is generally self-defeating and dangerous was a dramatic statement that the political class could not accept. To argue that government should be so limited as to be able to do little beyond protecting life, liberty, and property was antiquated, eccentric, even bizarre. And yet, today, looking back over the decades, who would say that the socialists and central planners were right, and Hayek wrong?

Events, of course, have proved him prophetic. Indeed, he had the good fortune to live long enough not only to see national socialism smashed but also to see Soviet socialism relegated to the ash heap of history. And I'd like to think he is up there somewhere tonight smiling down on us, as big government liberalism follows those two great, tragic "isms" into oblivion.

What was it that so enraged left-wingers about Hayek? It was the assertion that liberal paternalism is just as dangerous to humanity in the long run as fascism or communism. Liberalism, he argued, differs from those evil systems only in degree, not in kind. Hayek was a humble man, genuinely humble before reality. And that humility gave his words the boldness of honesty and the audacity of truth. And the liberals could not forgive him.

Reading back over *The Road to Serfdom*, I could not help thinking of the old quip that a conservative is someone who says, "I'll

believe it when I see it," and a liberal is someone who says, "I'll see it when I believe it." While Hayek always called himself a liberal in the classical sense of "one who is for liberty," he was truly conservative in the sense I'm talking about. He never thought human nature or the constitution of reality could be changed or reshaped by force of will. He was a rarity, an intellectually honest man in an intellectually dishonest age. What an ideal name for an auditorium dedicated to the promotion of human freedom.

And what an ideal think tank to have helping our new majority transform Washington. Your devotion to truth, like that of Hayek, has cast you as mavericks. It has put you at odds with the received opinions of the conventional left and right. But it is that principled consistency that has made the Cato Institute so "hot" these days. I mean, who would have imagined, a year ago, that the leaders of Congress would be looking to those crazy libertarians over at Cato for advice? Who could have imagined we would be discussing abolishing whole programs, turning others back to the states, repealing ill-conceived laws, and dismantling cabinet agencies, just as you've always recommended?

You have been successful because you believe what Hayek never ceased to point out—and indeed what the entire 20th century makes plain—that freedom, and only freedom, works.

What a hopeful time this is. Socialism is finished. The liberal welfare state is passé. And I'm more optimistic than I've ever dared to be that we are entering a new era of limited government. Congress is run by Americans who believe ordinary people can be trusted to spend their own money and make their own decisions. We will send power back from the hallowed halls of Congress to the more hallowed kitchen tables of America, where night after night families bow their heads in thanks and make decisions about education, charity, jobs, spending, debt, and personal behavior with a wisdom and a compassion that no agency head, no cabinet secretary, no member of Congress could ever match.

Just today, we shook the foundations of Washington by doing something that hasn't been done for a quarter century. We proposed a balanced budget.

True to our word, and despite the skeptics, we've produced a specific, detailed plan to balance the budget in seven years. And we get there with real spending cuts. No accounting gimmicks. No tax increases. In Hayekian fashion, we asked basic questions: Does the typical American family really need a Department of Commerce? Could our children learn without an Education Department? Could the Republic survive without a National Endowment for the Arts? Would the economy grind to a halt without an Interstate Commerce Commission?



Rep. Dick Armey (R-Tex.), Majority Leader of the House of Representatives, delivered these remarks at the dedication of the Cato Institute's F. A. Hayek Auditorium on May 9, 1995.

Roger and Juliana Pilon talk with House Majority Leader Dick Armey before his address at the dedication of the F. A. Hayek Auditorium on May 9.

While this budget faces a tough road, we believe the American people demand no less, for the sake of freedom. Americans want not just a smaller government, but the government of the Framers of the Constitution. And that's what we intend to restore.

Can I give you a peek at where we're headed? Just look at Estonia. Three years ago that tiny republic was a typical, ex-Soviet basket case, with negative growth, staggering unemployment, and skyrocketing inflation. But in late 1992 Prime Minister Mart Laar's reform government decided to throw the dice. They abolished all tariffs. They privatized 90 percent of state-owned enterprises. They scrapped every last subsidy, right down to farm subsidies. To create a sound money supply, they threw out the worthless ruble and created a new local currency, pegged to the German mark. Here's my favorite part: They established a flat tax. And yes, they balanced their national budget.

What's the result? Today, the Estonian economy is growing at a vigorous 6 percent a year, twice America's growth rate. Unemployment is just 2 percent. Inflation has collapsed from 1,000 percent to 40. Sixty thousand new private businesses have sprung up in a population of only two million.

Mart Laar came to my office the other day to recount his country's remarkable transformation. He described a nation of people who are harder working, more virtuous—yes, more virtuous, because the market punishes immorality—and more hopeful about the future than they've ever been in their history. I asked Mr. Laar where his government got the idea for those reforms. Do you know what he replied? He said, "We read Milton Friedman and F. A. Hayek."

Ladies and gentlemen, if Estonia is not a vindication of everything we believe in—from free trade to privatization to sound money to balanced budgets—I am at a loss as to how else one *could* validate our ideas. To quote my friend and hero, Thomas Sowell, we don't have *faith* that freedom works. We have evidence.

And by the way, if I can advertise for a moment, it turns out Estonians *love* their flat tax. They like the postcard-size return. Compliance has actually gone up. People are willing to pay their taxes voluntarily now, because they feel the system is fair. Their only complaint: They think the rate is too high. But of course, there's an easy way to cure that.

And speaking of taxes, isn't it amazing

that the debate over how we restructure America's tax system for the next century is coming down to a contest between a flat tax and a consumption tax? How far we've come.

As I say, I'm hopeful for the future of freedom. But I do have concerns. Let me just mention one. More and more these days, immigrants are being viewed as if they were the source of America's problems. It seems the old Malthusian notion that people are a drain is making one of its regular revivals. Well, it's good to know Cato has always held fast against that misguided teaching. At a time when some are turning against immigrants, you continue to view them as human beings, in Julian Simon's beautiful phrase, as the ultimate resource.

Anti-immigration has always been iron-

"We can avail ourselves of much of the world's intellectual wealth by simply opening our doors."

ic, because throughout our history newcomers have been a source of strength, not weakness. America still attracts the world's best talent. And surely that is no liability. Think of it. We can avail ourselves of much of the world's intellectual wealth simply by opening our doors. America never has to grow old. We can always take in new talent and new ideas and new blood. No ruling elite can dominate us for very long, because we always have younger, smarter, more entrepreneurial spirits willing and eager to move up.

The impulse to limit immigration is really a manifestation of the protectionist impulse. And it's misguided. It's a desire to use government's monopoly of coercive power to benefit oneself at the expense of somebody else. And that, as Hayek taught us, is self-defeating. But the biggest problem with the closed-border idea is that it embraces the liberals' world view. And thus it leads logically down the path to bigger government.

Should we have an orderly immigration policy? Of course.

Should we give the Border Patrol the appropriate tools? Of course.

But in so doing, should we infringe on the personal liberties of law-abiding Americans? Absolutely not.

We need immigration reform. But our goal should be to make immigration more orderly, not more restrictive.

We have too many immigrants coming here to get on welfare. But the reasonable response is not to build a police state. It's to shrink the welfare state.

We have an educational system that no longer promotes assimilation. But the sensible response is not to exclude foreign children. It's to scrap multiculturalism in the schools and give parents real school choice.

Should we reduce *legal* immigration? Well, I'm hard-pressed to think of a single problem that would be solved by shutting off the supply of willing and eager new Americans. If anything, in the spirit of Hayek, we should be thinking about *increasing* legal immigration.

Should we turn private employers into auxiliary border guards? I think unfunded mandates are bad enough without that.

And as for a national ID card, which I understand the administration is considering, let me just say this. I oppose it. And I will fight it. Let me be clear here. What some are calling a "national computer registry" is just a euphemism for a national ID card. And any system in which Americans would be forced to possess such a card, for any reason, is an abomination and wholly at odds with the American tradition of individual freedom.

Let I close on such a defiant note, let me leave you by saying how much comfort it gives me to know that when it comes to that issue, as so many others, we'll be able to count on our good friends at Cato.

The coming months promise major battles with the liberals over spending, taxes, crime, education, the environment, welfare, property rights, and a hundred other issues. And, as always, Cato will be there for us, arming our legions of righteousness with facts, statistics, policy briefs, and four-color charts.

For like the great man we are celebrating tonight, you have the boldness of honesty and the audacity of truth. You believe, as he always reminded us, that true human progress lies, not in power or planning, but in markets and the rule of law. It is with those safeguards, and those alone, that we may dare hope to avoid the road to serfdom and "create a world of free men."

My Plan to End the Income Tax

by Sen. Richard Lugar

Policy Forum

My vision for America is of a typical American family that actually enjoys better job prospects and more real income. The paychecks are bigger, savings are greater, and hopes for the future abound.

I strongly favor adopting a federal budget plan that offers a clear and reasonable path to balancing the federal budget in the next several years. The younger members of our families will have diminished hopes each year if we continually pile up more national debt and obligate more and more of our annual national budget to simply paying interest on an ever-increasing mountain of debt.

Equally important, I favor abolishing the federal income tax and all of the Internal Revenue Service apparatus that has grown to collect and enforce the income tax. Specifically, I propose to abolish immediately and completely the federal individual and corporate tax, capital gains taxes, gift taxes, and inheritance taxes all at the same time. And with them all of the tax loopholes that have been created for special interests.

I would replace the money obtained from those taxes with money from a national retail sales tax collected in the same way that state sales taxes are now collected in 45 states. I propose that the states be responsible for collection so that the federal IRS apparatus can be dismantled promptly.

That means, for every American, that the money you earn is yours. You may save it or you may spend it, but the paycheck is bigger without the automatic income withholding deduction. You need not account for it, report it, or hide it. If you spend it, you will pay a national retail sales tax.

You regain your privacy. You are no longer guilty until you prove your innocence to the IRS. You regain the freedom of your time and labor. More than 5 billion hours are now spent by American individuals and businesses trying to comply with the federal income tax

requirements each year. That is close to all the work for one year by all people in all jobs in the state of Indiana.

You stop worrying about whether the family farm or store will have to be sold to pay estate taxes because there won't be gift or estate taxes anymore.

This will not be a tax increase. Various economists estimate that to raise the same funds that now come from the income tax, a 17 percent retail sales tax is required. And it is important to note that without the income tax, prices for almost all products will go down before the sales tax is applied.

With savings and investments no longer taxed, Americans will enjoy a capital for-



Sen. Richard Lugar used the Cato Institute on April 5 as the setting to announce his plan to replace the income tax with a national sales tax.

mation boom. There will be increased productivity, higher paying jobs, and new investment from around the world attracted by a policy of no income taxes.

American exports will surge because our prices will be down sharply. An American car or bulldozer will be priced without federal taxes built into the price. We will be much more strongly competitive abroad and create hundreds of thousands of new production jobs.

On the other hand, a foreign product sold in the United States at retail will be taxed at the national and state sales tax level just like an American product.

As president, I will work with and support the efforts of members of the House and Senate to produce legislation implementing a national retail sales tax. Many have already indicated their support and have spoken out.

The legislation must recognize the necessity that a certain number of dollars of purchases per person be tax-free each year, and that certain categories of purchases such as food and medicine be exempt from the sales tax. The problems of low-income citizens must be met simply and clearly.

As much as \$100 billion to \$150 billion in income taxes is not collected each year. The retail sales tax can be much more efficient. Collection problems must be met in the legislation and proper incentives offered to those involved in collection at the grass roots.

The bottom line is new liberty for Americans and dynamic new growth in our job and income prospects.

Our current economic framework simply does not offer that hope for the future to average Americans. Currently, the Federal Reserve Board is striving to hold real economic growth down to 2.5 percent annually by raising short-term interest rates. That growth rate is simply too small to meet the hopes and dreams of most Americans. It is too small to meet our competition abroad. In due course, the interest rate hikes will lead to declining growth and higher unemployment long before middle-Americans have a feeling of confidence about the future.

The federal income tax system taxes savings, investments, and hopes for the future. It is too complex, too intrusive, and it prices our exports too high.

Presidential campaigns offer an opportunity for the American people to make a change in course. Candidates must offer strong and bold programs that give the people solid choices for the better. I advocate the total end of federal income taxes. I advocate a national retail sales tax as the best alternative to obtain the funds to run the government in a direct and easily observed manner subject to constant scrutiny by the people and their elected representatives.

We should achieve that goal in 1997 and be prepared to save, invest, and grow for many years to come. ■

Sen. Richard Lugar (R-Ind.), a candidate for the Republican presidential nomination, delivered these remarks in the Cato Institute's F. A. Hayek Auditorium on April 5, 1995.

*Legality of Mexican Bailout Questioned***Role of IMF Debated at Annual Monetary Conference**

Is there a legitimate role for the International Monetary Fund (IMF) in the post-Bretton Woods era? That question and others regarding the future of the international monetary system were the focus of the Cato Institute's 13th Annual Monetary Conference, "Global Monetary Order: What Next?" held in the F. A. Hayek Auditorium, May 25.

The conference, directed by Cato vice president for academic affairs James A. Dorn and cosponsored with the Durell Institute, attracted over 150 participants and was covered by the *Wall Street Journal*, *The Economist*, Dow Jones TV, and TV Azteca.

Allan H. Meltzer, one of the country's leading monetary economists, opened the conference by calling for an end to the IMF. He pointed to the moral hazard created by the fund's financial aid to Mexico and to ex-communist countries and warned of the inflationary threat posed by Special Drawing Rights. Instead of reforming the fund, Meltzer would abolish it so that it could no longer redistribute wealth at taxpayers' expense.

Steve Hanke, a professor of economics at Johns Hopkins University, called the IMF "an empty shell"—because the U.S. dollar is no longer convertible into gold, and the system of fixed exchange rates (which existed under the Bretton Woods agreement) has long since been replaced by a system of pegged exchange rates.

Judy Shelton, author of *Money Meltdown*, agreed that the IMF should be abolished and argued that the Mexican bailout demonstrated that the fund has become "too politicized ... to have credibility as an independent arbiter."

In sharp contrast were the views of John

Williamson of the Institute for International Economics and Stanley Fischer, first deputy managing director at the IMF. Williamson called for increasing the fund's resources, turning it into a "world bankruptcy court," and having it determine "fundamental equilibrium exchange rates." Fischer, in an impromptu speech at the invitation of panel moderator and deputy editor of *The Economist* Clive Crook, defended the role of the IMF on the grounds that "unfortunately, you

tor of the Center for Free Enterprise Research in Mexico, as a "crisis of confidence" brought about by the Mexican government's discretionary approach to monetary and fiscal policy.

As an alternative to the discretionary approach, which has brought so much instability to the monetary system, Jerry L. Jordan, president and CEO of the Federal Reserve Bank of Cleveland, called for the spontaneous development of monetary standards. "The notion that the best regime or the best standard can be chosen," he said, "implies a great-man theory. . . . An alternative view is that the best regime and the best standard (if a standard is useful) should be allowed to evolve from free competition in the market."

Cato adjunct scholar Leland B. Yeager dismissed the notion that exchange-rate volatility depends on the exchange-rate system. In his opinion, volatility is a reflection of the very nature of the current national monetary regimes that are based on

government fiat money and discretionary central banks. He suggested that privatization would be "a feasible route to sound money."

The conference concluded with a discussion of monetary union and free trade. Sir Alan Walters, former economic adviser to Margaret Thatcher, said that monetary unions do not necessarily create internal free trade at the cost of external trade. And, given the Mexican bailout following on the heels of the North American Free Trade Agreement, he also concluded that free-trade areas do not imply monetary union.

Other speakers included Owen Humpage of the Federal Reserve Bank of Cleveland; Alan Stockman of the University of Rochester; Kevin Dowd, professor of financial economics, Sheffield Hallam University; George Selgin, Cato adjunct scholar and University of Georgia economist; Barry Eichengreen, professor of economics at the University of California at Berkeley; Richard Timberlake, emeritus professor of economics, University of Georgia; and Cato chairman William A. Niskanen.



Steve Hanke and John Williamson listen as Judy Shelton calls for abolition of the IMF.

need someone to be around to help keep the situation running."

In his closing remarks, Dorn contrasted what he called the "market-socialist" approach to global monetary order, advocated by those who favor expanding the scope and authority of the IMF, with Hayek's market-liberal approach. In the Hayekian approach, said Dorn, there is no pretense of knowledge, and individuals have a right to choose the monetary institutions they prefer.

The role of the IMF was not the only topic of discussion. In another panel, Anna J. Schwartz, from the National Bureau of Economic Research, questioned the legality of the Clinton administration's use of the Exchange Stabilization Fund to bail out the holders of Mexican debt. In her view, "The \$20 billion loan extended to Mexico . . . is foreign aid, which otherwise requires congressional appropriation." The Mexican crisis was characterized by Roberto Salinas-León, direc-



Leland Yeager and Sir Alan Walters wait to speak at Cato's 13th Annual Monetary Conference.

Social Security (Cont. from p. 1)

private companies called AFPs (from the Spanish for pension fund administrators). Each AFP operates the equivalent of a mutual fund that invests in stocks, bonds, and government debt. The AFP is separate from the mutual fund; so if the AFP goes bankrupt, the assets of the mutual fund—that is, workers' investments—are not affected. The regulatory board takes over the fund and asks the workers to change to another AFP. Not a dime of the workers' money is touched in the process. Workers are free to change from one AFP to another. That creates competition among the companies to provide a higher return on investment and better customer service, or to charge lower commissions.

The AFP market opened on May 1, 1981, which is Labor Day in Chile and most of the world. It was supposed to open May 4, but I made a last-minute change to May 1. When my colleagues asked why, I explained that May 1 had always been celebrated all over the world as a day of class confrontation, when workers fight employers as if their interests were completely divergent. But in a free-market economy, their interests are convergent. "Let's begin this system on May 1," I said, "so that in the future, Labor Day can be celebrated as a day when workers freed themselves from the state and moved to a privately managed capitalization system." That's what we did.

Today we have 20 AFPs. In 14 years no AFP has gone bankrupt. Workers have not lost a dime. Of course, we created a regulatory body that, along with the central bank, set some investment diversification rules. Funds cannot invest more than x percent in government bonds, y percent in private companies' debentures, or z percent in common stocks. Nor can more than a specified amount be in the stock of any given company, and all companies in which funds are invested must have credit ratings above a given level.

We set up such transitional rules with a bias for safety because our plan was to be radical (even revolutionary) in approach but conservative and prudent in execution. We trust the private sector, but we are not naive. We knew that there were companies that might invest in derivatives and lose a lot of money. We didn't want the pension funds investing workers' money in derivatives in Singapore. If the system had failed in the first years,

we would never have been able to try it again. So we set strict rules 14 years ago, but we are relaxing those rules. For example, only three years ago we began to allow the funds to invest abroad, which they weren't allowed to do initially, because Chilean institutions had no experience in investing abroad. The day will come when the rules will be much more flexible.

Let me say something about the transition to the new system. We began by assuring every retired worker that the state would guarantee his pension; he had absolutely nothing to fear from the change. Pension reform should not damage those who have con-

"In the future, Labor Day can be celebrated as a day when workers freed themselves from the state and moved to a privately managed retirement system."

tributed all their lives. If that takes a constitutional amendment, so be it.

Second, the workers already in the workforce, who had contributed to the state system, were given the option of staying in the system even though we thought its future was problematic. Those who moved to the new system received what we call a "recognition bond," which acknowledges their contributions to the old system. When those workers retire, the government will cash the bonds.

New workers have to go into the new private system because the old system is bankrupt. Thus, the old system will inevitably die on the day that the last person who entered that system passes away. On that day the government will have no pension system whatsoever. The private system is not a complementary system; it is a replacement that we believe is more efficient.

The real transition cost of the system is

the money the government ceases to obtain from the workers who moved to the new system, because the government is committed to pay the pensions of the people already retired and of those who will retire in the future. That transition cost can be calculated. In Chile it was around 3 percent of gross national product. How we financed it is another story. It will be done differently in each country. Suffice it to say that even though governments have enormous pension liabilities, they also have enormous assets. In Chile we had state-owned enterprises. In America I understand that the federal government owns a third of the land. I don't know why the government owns land, and I don't know the value. Nor am I saying that you should sell the land tomorrow. What I am saying is that when you consider privatizing Social Security, you must look at assets as well as liabilities. I am sure that the U.S. government has gigantic assets. Are they more or less than the liabilities of the Social Security system? I don't know, but the Cato project on privatizing Social Security will study that. In Chile we calculated the real balance sheet and, knowing there were enough assets, financed the transition without raising tax rates, generating inflation, or pressuring interest rates upward. In the last several years we have had a fiscal surplus of 1 to 2 percent of GNP.

The main goal and consequence of the pension reform is to improve the lot of workers during their old age. As I will explain, the reform has a lot of side effects: savings, growth, capital markets. But we should never forget that the reform was enacted to assure workers decent pensions so that they can enjoy their old age in tranquility. That goal has been met already. After 14 years and because of compound interest, the system is paying old-age pensions that are 40 to 50 percent higher than those paid under the old system. (In the case of disability and survivor pensions, another privatized insurance, pensions are 70 to 100 percent higher than under the old system.) We are extremely happy.

But there have been other enormous effects. A second—and, to me, extremely important—one is that the new system reduces what can be called the payroll tax on labor. The social security contribution was seen by workers and employers as basically a tax on the use of labor; and a tax on the use of labor reduces employment. But a contribution to an individual's pension account is not seen as a tax on the use of labor. Unemployment in Chile

is less than 5 percent. And that is without disguised unemployment in the federal government. We are approaching what could be called full employment in Chile. That's very different from a country like Spain, with a socialist government for the last 12 years, that has an unemployment rate of 24 percent and a youth unemployment rate of 40 percent.

Chile's private pension system has been the main factor in increasing the savings rate to the level of an Asian tiger. Our rate is 26 percent of GNP, compared to about 15 percent in Latin America. The Asian tigers are at 30 percent. The dramatic increase in the savings rate is the main reason that Chile is not suffering from the so-called tequila effect that plagues Mexico. We do not depend on short-run capital flows because we have an enormous pool of internal savings to finance our investment strategies. Chile will grow by about 6 percent of GNP this year, the year of the "tequila effect." The stock exchange has gone down by only 1 or 2 percent and will be higher at the end of the year. Chile has been isolated from short-run capital movement because its development is basically rooted in a high savings rate.

Pension reform has contributed strongly to an increase in the rate of economic growth. Before the 1970s Chile had a real growth rate of 3.5 percent. For the last 10 years we have been growing at the rate of 7 percent, double our historic rate. That is the most powerful means of eliminating poverty because growth increases employment and wages. Several experts have attributed the doubling of the growth rate to the private pension system.

Finally, the private pension system has had a very important political and cultural consequence. Ninety percent of Chile's workers chose to move into the new system. They moved faster than Germans going from East to West after the fall of the Berlin Wall. Those workers freely decided to abandon the state system, even though some of the trade-union leaders and the old political class advised against it. But workers are able to make wise decisions on matters close to their lives, such as pensions, education, and health. That's

"The money that a worker pays into the system goes into an account that is owned by the worker."

why I believe so much in their freedom to choose.

Every Chilean worker knows that he is the owner of an individual pension account. We have calculated that the typical Chilean worker's main asset is not his small house or his used car but the capital in his pension account. The Chilean worker is an owner, a capitalist. There is no more powerful way to stabilize a free-market economy and to get

the support of the workers than to link them directly to the benefits of the market economy. When Chile grows at 7 percent or when the stock market doubles—as it has done in the last three years—Chilean workers benefit directly, not only through higher wages, not only through more employment, but through additional capital in their individual pension accounts.

Private pensions are undoubtedly creating cultural change. When workers feel that they own a fraction of a country, not through the party bosses, not through a politburo (like the Russians thought), but through ownership of part of the financial assets of the country, they are much more attached to the free market, a free society, and democracy.

By taking politicians out of the social security business we have done them a great favor because they can now focus on what they should do: stop crime, run a good justice system, manage foreign affairs—the real duties of a government. By removing the government from social security, we have accomplished the biggest privatization in Chilean history—someone even called it, paraphrasing Saddam Hussein, the mother of all privatizations, because it has allowed us to go on to privatize the energy and telecommunications companies.

That has been our experience. Of course, there have been some mistakes. There are some things that should be improved. There is no perfect reform. With time and experience, I know I would do some things differently. But on the whole, I can tell you that it has been a success beyond all our dreams. ■

Studies, Forums, Testimony Back Radical Tax Reform

As Washington and the nation begin discussing what to do about the increasingly unpopular income tax, Cato is poised as a major voice for changes that would make the tax system less burdensome economically and less destructive of civil liberties. In June Stephen Moore, Cato's director of fiscal policy studies, testified before the House Ways and Means Committee, whose chairman, Rep. Bill Archer (R-Tex.), has vowed to radically change the tax system. Cato has become so identified with the cause of repealing the income tax that Sen. Richard Lugar (R-Ind.) used Cato's F. A. Hayek Auditorium to announce that a centerpiece of his campaign

for the Republican presidential nomination would be replacement of the income tax with a national retail sales tax. Cato launched discussion of that option in 1993 with a Policy Analysis (no. 193) by economist Laurence J. Kotlikoff.

In recent months the Institute has documented problems with the Internal Revenue Service and presented the benefits that would accrue from a sales tax in a Policy Analysis and at Policy Forums. Dan Pilla's Policy Analysis, "Why You Can't Trust the IRS" (no. 222), pointed out that the IRS often wrongly assesses taxpayers, provides incorrect information, and commits financial malfeasance. A Policy

Forum on the flat tax featured Alvin Rabushka, long-time advocate of a flat tax at the Hoover Institution.

A Capitol Hill Policy Briefing, cosponsored with Citizens for an Alternative Tax System (CATS), featured a debate between proponents of the sales tax and of the flat tax, including syndicated columnist Jack Anderson; Norman Ture of the Institute for Research on the Economics of Taxation; Cato president Edward H. Crane; *Washington Post* columnist James Glassman; Victor Krohn, CATS executive director; Andy Laperriere, senior tax adviser to House Majority Leader Dick Armey; and Pilla.

*Critiques of Crime Bills, Medicare***SSI Costs Soaring Out of Control, Study Warns****Cato Studies**

Unless costs are controlled, the Social Security Supplemental Security Income (SSI) program will increase 60 percent by 2000, making it larger than Aid to Families with Dependent Children, food stamps, subsidized housing, the earned income tax credit, and all other forms of public assistance except Medicaid. So argues Christopher Wright in "SSI: The Black Hole of the Welfare State" (Policy Analysis no. 224). SSI paid \$20.7 billion to over 6 million people in 1993. Wright calls for major reform and, ultimately, privatization to rein in what he calls a costly and corrupt entitlement program. He documents some of the more outrageous stories about SSI. For example, a Wisconsin father coached his daughter to put gum in her hair, act up in class, and earn bad grades. She won an \$18,000 lump-sum payment from SSI, which allowed her family to buy new clothes and furniture and vacation in Florida. In a drug raid, police found a paper sack containing \$5,000. The drug user later produced documentation showing the money came from SSI payments she received because of her heroin addiction, which qualifies as a disability under SSI.

Wright says changes made to the program in 1994 were a mere nod in the direction of needed reform. Current proposals by House Republicans, he adds, still fall short of the restructuring needed to correct for fraud, abuse, and misuse. Pending eventual privatization of disability insurance, Wright proposed that Congress end automatic cost-of-living adjustments and retroactive lump-sum payments, abolish assistance to substance abusers, and establish an enrollment cap.

Corporate Welfare Should Be Eliminated

A new Cato Institute study recommends eliminating 129 federal programs that funnel \$87 billion of taxpayer money annually to private businesses. Stephen Moore, director of fiscal policy studies, and fiscal policy analyst Dean Stansel wrote "Ending Corporate Welfare As We Know It" (Policy Analysis no. 225) in response to a challenge by Secretary of Labor Robert Reich to identify "corporate welfare" that could be cut from the budget. The study criticizes the very concept of corporate welfare, calling it anti-consumer, anti-

capitalist, and unconstitutional. Moore and Stansel say corporate subsidies create an uneven playing field, foster an incestuous relationship between business and government, and often support industries that would not be viable in a truly competitive business environment.

The subsidies identified by Moore and Stansel for elimination include nearly \$100 million a year to Sematech, a consortium of microchip producers that includes Intel and National Semiconductor, two of the most lucrative companies in the microchip business; over \$430 million for the Advanced Technology Program, the Clinton administration's high-tech version of the Small Business Administration, which last year granted funds to such industry giants as General Electric, United Airlines, Xerox, Dupont, and Caterpillar; and roughly \$2 billion to large, profitable electric utility cooperatives, such as ALLTEL, which had sales of \$2.3 billion last year. According to Moore and Stansel, the most efficient way to promote economic growth is to reduce the overall cost and regulatory burden of government.

Time for a New Aid Policy

Congressional proposals for restructuring U.S. foreign aid programs do not go far enough, according to Cato senior fellow Doug Bandow in "A New Aid Policy for a New World" (Policy Analysis no. 226). Bandow says current proposals, which include merging U.S. AID into the State Department, would keep foreign aid schemes largely intact. Bandow questions noneconomic rationales for foreign assistance and refutes the notion that aid is now or was ever essential to economic progress. He criticizes the Clinton administration's attempts to preserve U.S. AID as well as conservative arguments that foreign aid fosters the development of free markets abroad.

Bandow cites, among other examples, the fact that dozens of countries are in worse economic shape today than they were decades ago when they began receiving U.S. "development" aid. Despite claims that South Korea and Taiwan are foreign aid success stories, economic growth occurred in those countries only after aid was cut off, writes Bandow. He notes that a recent study by the London School of Economics shows that aid does not increase investment or growth in recipient nations. He

also points out that only 14 percent of food aid goes to alleviate emergency conditions; the rest amounts to dumping surplus U.S. agricultural goods on developing countries' markets. Bandow writes that aid disbursed to Russia through the U.S.-financed International Monetary Fund has helped postpone, not promote, free-market reforms.

Alaskan Oil Export Ban Should Go

The Trans-Alaska Pipeline Authorization Act of 1973, which opened vast oil reserves around Prudhoe Bay for production, effectively requires that Alaskan oil be consumed domestically, not exported. As a result, writes Samuel A. Van Vactor in "Time to End the Alaskan Oil Export Ban" (Policy Analysis no. 227), petroleum development on the Alaskan North Slope and in California has been greatly restrained. The natural market for North Slope oil is Japan, Korea, and northern East Asia, to which oil can be shipped for about 50 cents per barrel, but North Slope producers are required to use domestic tankers and market exclusively in the United States and its territories, a mandate that has often resulted in shipping costs of \$5 per barrel. That price distortion, writes Van Vactor, an economic consultant, has led to artificially low domestic prices for heavy crude on the West Coast, discouraging otherwise profitable exploration and production investments in Alaska and California.

The artificial inhibition of U.S. oil production has severe consequences for jobs and economic growth. Over the coming decades the cost could be as high as \$125 billion and the loss of tens of thousands of well-paid jobs in petroleum development, oil-field services, manufacturing, and transportation. Given the massive costs and paltry benefits of the oil export ban, Van Vactor writes that Congress should act immediately to free the Alaskan oil trade and repeal the prohibition on oil exports.

Critics of Medical Savings Accounts Are Wrong

As the movement for medical savings accounts picks up speed in Congress, critics of consumer-based health care reform, led by big insurance companies, are mounting a counterattack. But the criticisms are just plain wrong, writes Michael Tanner, Cato's direc-

tor of health and welfare studies, in "Medical Savings Accounts: Answering the Critics" (Policy Analysis no. 228). In response to claims that buying health care is too complex for consumers, Tanner examines numerous studies that show that health care consumers can and do make cost-conscious decisions when given a financial incentive to do so. Tanner also writes that studies show that MSAs do not deter preventive care. Rather, savings result from reduced use of optional services and cost-based selection among competing providers. There is even evidence that MSAs increase the likelihood of seeking preventive care, particularly among low-wage earners.

Tanner answers the criticism that MSAs would drive up the cost of traditional insurance by attracting the healthy away from such policies by pointing out that companies currently using MSA-style health plans have not had significant problems with adverse selection. Indeed, Tanner says that the chronically ill may be among those who benefit most from MSAs. Tanner also argues that the poor would benefit significantly from MSAs. He concludes that, while MSAs may not be perfect, they represent a significant step in solving the problems facing the health care system.

GOP Crime Bills Threaten Liberty

The 1995 GOP crime bills introduced in the House and the Senate have flaws similar to those of past Democratic efforts to interject the national government into local crime prevention and law enforcement. So writes Jarett B. Decker, a Minnesota criminal defense attorney, in "The 1995 Crime Bills: Is the GOP the Party of Liberty and Limited Government?" (Policy Analysis no. 229). Moreover, the Republican bills contain unprecedented provisions that would threaten freedom and undermine the fair administration of justice. For example, writes Decker, the Senate crime bill would vest federal prosecutors with the power to have their opposing counsel indicted, without any finding of misconduct by the court, whenever the prosecutor claimed that counsel had made a false statement of fact or law in written arguments filed in opposition to the government. The Senate bill also includes a provision that would exempt federal prosecutors from the rules of legal ethics.

Both the Senate and the House crime bills would enable federal agents to invade homes, raid businesses, and conduct humiliating body searches without legal justification and

to use evidence collected through such illegal searches. Victims of illegal searches could seek to recover only civil damages. Decker points out that the Senate bill would further enable federal agents to detain citizens, hold them incommunicado, interrogate them for days or weeks or months, and use any statements extracted during an illegal detention in a subsequent prosecution. He writes that if the crime bills pass, judicial authority will contract drastically, reducing judges to bureaucratic functionaries.

Congressional Remedies for Medicare Fall Short

Congressional proposals to fix Medicare by increasing the payroll tax, raising premiums, pushing the elderly into managed care, and restricting payments to doctors and hospitals will not work, write Doug Bandow and Michael Tanner in "The Wrong and Right Ways to Reform Medicare" (Policy Analysis no. 230). The combination of the latest report from the trustees of the Medicare Trust Fund and the debate over balancing the federal budget has moved the need for Medicare

reform to center stage. The trust fund, which finances Medicare Part A, will be bankrupt by the year 2002. Medicare Part B, which pays for physician services, diagnostic tests, and other outpatient services, is funded through general revenues and premiums from the elderly and therefore is not going broke. However, its rapidly escalating costs will add more than \$100 billion per year to the federal deficit by the year 2000.

In response, many members of Congress have fallen back on the traditional remedies. But, write Bandow and Tanner, there is little evidence that any of those proposals will succeed in restraining the growth of Medicare spending. Many of those approaches will actually harm the economy, the health care industry, and the elderly. The authors say that Congress should seize the opportunity to fundamentally reform the Medicare system, transforming it from a first-dollar insurance plan to a back-up catastrophic program combined with medical savings accounts. Only through such a transformation of the Medicare system can the elderly be assured of access to the health care they need. ■

Cato Scholars Work with Congress on Constitution, Social Security

Since the 1994 election, Cato Institute scholars have been working more closely than ever before with members of Congress. Cato staffers have testified more than 30 times before congressional committees.

Roger Pilon, director of the Center for Constitutional Studies, advised freshman Rep. J. D. Hayworth (R-Ariz.) on the formation of the Constitutional Caucus in the House, which is designed to "explore ways to return power to the states and the people and restore a limited, constitutional government" and encourage members of Congress to consider whether there is constitutional authority for each piece of proposed legislation.

Jerry Taylor, director of natural resource studies, chaired a task force that made recommendations to House Republican freshmen on the elimination of the Energy Department. He has testified on the issue several times and continues to work with Reps. Sam Brownback and Tom Tiahrt, both Kansas Republicans, on abolition.

Michael Tanner, director of health and welfare studies, is also heading up the new Cato Project on Social Security Privatization, which will be unveiled in August. He briefed the leader of a congressional delegation that recently visited Chile to look into how that country privatized its social security system. The report from the delegation to House Speaker Newt Gingrich urges Gingrich to meet with privatization architect José Piñera when Cato brings him to Washington in August. Rep. Mark Sanford (R-S.C.) plans to introduce a privatization bill soon, and Sens. Alan Simpson (R-Wyo.) and Bob Kerrey (D-Neb.) have included a partial privatization measure in their reform bill. Several members of Congress attended a dinner with Piñera at Cato in April, and Tanner has briefed others on the issue.

Stephen Moore, director of fiscal policy studies, has been a whirlwind of activity on tax issues. He briefed Sen. Richard Lugar (R-Ind.) and then acted as host when Lugar

The Captive Press

Global Interventionist Foreign Policy Threatens Press Freedoms, Carpenter Charges in New Book

There is an inherent tension between the press freedoms guaranteed by the First Amendment and a global interventionist foreign policy that places a premium on secrecy, rapid execution, and lack of public dissent, writes Ted Galen Carpenter in *The Captive Press: Foreign Policy Crises and the First Amendment*, just published by the Cato Institute.

Carpenter, director of foreign policy studies at the Institute and the author or editor of numerous books on defense and foreign policy issues, contends that a high priority of the national security bureaucracy is to manipulate or obstruct the news media, thereby thwarting critical coverage of military and foreign policy initiatives.

The government's restrictions on the press during the Persian Gulf War and the outright exclusion of journalists during the most important stages of the Grenada and Panama invasions were especially flagrant examples of the government's "iron-fist" tactics, according to Carpenter. Concerted campaigns to impugn the patriotism and integrity of journalists who file stories critical of Washington's foreign policy have also been waged with disturbing frequency.

Carpenter emphasizes, however, that such crude forms of coercion by the national security bureaucracy are not the only source of danger to a vigorous, independent press. An equally serious threat is posed by the government's abuse of the secrecy system

to control the flow of information and prevent disclosures that might cast doubt on the wisdom or morality of current policy. Frequently, overclassification is combined with coercive strategies, most notably threats to prosecute for violating espionage statutes both those who leak classified information and those who publish such information.

Most insidious and corrosive of all, Carpenter contends, is the attempt by officials to entice journalists to be members of the foreign policy "team" rather than play their proper role as skeptical monitors of government conduct. All too often, members of the media have succumbed to such appeals and have become little more than cheerleaders for dubious foreign policy initiatives. That

was clearly the case during the Gulf War and, until disaster struck and produced sober second thoughts, the intervention in Somalia.

Government efforts to either convert the press into a conduit for propaganda or silence critics were once confined to "emergency" situations in which the nation was battling for survival—most notably during the two world wars. In the course of the Cold War, however, such policies became the norm during minor conflicts and even during peri-

ods of peace. Those habits of manipulation and intimidation have continued in the post-Cold War period, with alarming implications for the vitality of the First Amendment.

Carpenter argues that although freedom of the press has not been killed in action during the many international crises of the 20th century, it has been seriously wounded. One of the most important tasks of the post-Cold War era is to restore it to health.

Accomplishing that goal will require reforms to prevent misuse of the classification system and to lift the threat of espionage prosecution of those who dare to reveal government misconduct in foreign affairs. Equally important, Carpenter insists, is the adoption of a new, less interventionist U.S. foreign policy. That step is essential to end the garrison state mentality that has dominated the country for the past half century and continues to endanger press freedoms.

Jonathan Kwitny, author of *Endless Enemies*, says, "No sooner had the Department of State notified me that I couldn't see World War II era documents from Poland for my biography of Pope John II because 'national security' was at stake, than Ted Galen Carpenter's book arrived, like aspirin for a headache—or therapy for a cancer. *The Captive Press* is both easy to read and massively documented. The Clinton administration has promised to stop concealing our politics and our history, and maybe Carpenter's engrossing and thoroughly documented case will make the government—for once—live up to its word."

The Captive Press is available from Cato Institute Books for \$24.95 cloth, \$14.95 paper. Call 1-800-767-1241 toll-free.



Cato and Congress (Cont. from p.13)

spoke at Cato unveiling his proposal to replace the federal income tax with a sales tax. Moore testified before the House Ways and Means Committee on the advantages of a sales tax and briefed dozens of senators and representatives privately. He also took a leave of absence to draft the House Republicans' book

Restoring the Dream, which describes their agenda after the Contract with America.

The Institute's greatly expanded activities have given Cato's ideas a real boost toward implementation, but they have also been very time-consuming for the policy staff. Fortunately, early in 1995 Cato hired its first legislative liaison, director of external affairs Leanne Abdnor, who has worked to make members of Congress and their staffs aware

of Cato's work and has coordinated dozens of Capitol Hill meetings for Cato policy experts. The *Cato Handbook for Congress* has been an important part of Cato's involvement with Congress. It has been widely cited as influential and was seen most recently on two different editions of the CBS television show *Sixty Minutes*, first on Budget Committee chairman John Kasich's desk, then on House Majority Leader Dick Armey's desk.

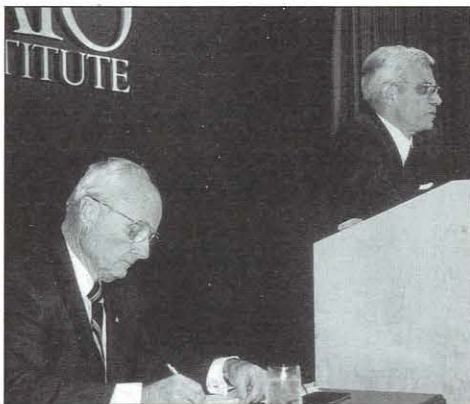
Is an ABM System Feasible?

Missile Defense Debated at Cato Policy Forum

"National Missile Defense: Vital Security Interest or High-Tech Boondoggle?" was the question examined at an April 18 Cato Policy Forum featuring a debate between Sven F. Kraemer, former director of arms control for the National Security Council, and Eugene F. Carroll Jr., a retired rear admiral and deputy director of the Center for Defense Information, over whether the United States should install a space-based defense against an intentional or accidental missile launch. Kraemer called ballistic missile defense "the highest single national security imperative of our country and . . . the highest ethical imperative." He rejected the traditional nuclear strategy, known as mutually assured destruction, under which offensive nuclear weapons are used to deter an offensive nuclear strike by another nation. He said it was inexplicable and shameful that the U.S. government has failed to carry out its constitutional duty and implement a defense against nuclear attack, which continues to be a threat from Russia and China and could become a threat from rogue states in an era of nuclear proliferation. Kraemer argued that a space-based system that could shoot down missiles while they were still in the boost phase was entirely feasible and affordable.

Carroll responded that construction of a strategic missile defense would violate the

1972 Antiballistic Missile Treaty with Russia and thus would upset the continuing effort to reduce offensive nuclear arsenals through arms control agreements. He called the threat from rogue nations unrealistic, saying the real threat was the Russian missiles, which require



Retired admiral Eugene Carroll listens as Sven Kraemer makes the case for strategic missile defense at a Cato Policy Forum.

arms negotiations to dismantle. He also said he doubts whether the kind of defensive system Kraemer advocates is technologically possible. He called the space-based system "ill conceived" and a "boondoggle." He also maintained, contrary to Kraemer, that construction of a national missile defense would

stimulate a race to build offensive weapons.

Ted Galen Carpenter, Cato's director of foreign policy studies, who moderated the debate, has written that "it is essential for the United States to augment its strategic deterrent with robust air and missile defenses." Writing in the *Cato Handbook for Congress*, Carpenter said, "An ABM system would not require fully implementing Ronald Reagan's ambitious Strategic Defense Initiative, since repelling an onslaught by a massive missile fleet, such as that possessed by the Soviet Union, is now an extremely improbable mission. The more likely danger is an accidental launch of a few dozen missiles or a deliberate attack by a new nuclear power with a limited arsenal. Even a 'thin layer' ABM system could offer crucial protection from such threats. As a collateral benefit, it would reduce the likelihood of nuclear blackmail."

Carpenter called on Congress to restore the funds for ABM defense that were eliminated under pressure from the Clinton administration. "The long-range goal should be the deployment of a comprehensive ABM system within eight years," he wrote. "Congress should insist on modifications to the ABM treaty that would permit such a deployment. If Russia refuses to agree to such revisions, the United States should give the required notice and renounce the treaty." ■

Tax Reform (Cont. from p. 11)

An edition of *Cato Forum*, the Institute's weekly television show on NET, the Political News Talk Network, also carried a debate over whether the sales tax or the flat tax was the best alternative to the present income tax. Crane contributed to a *Reason* magazine symposium on the two approaches to tax reform, and Moore argued for trading the IRS and most federal taxes for a sales tax in *National Review*.

In his testimony before the House Ways and Means Committee, Moore noted that the sales-tax and flat-tax proposals would have much in common: simplicity, a flat rate of 17 to 20 percent, an absence of special-interest exemptions, and consumption as the tax base. But, Moore said, "I favor a national sales tax because I believe that the income

tax is incompatible with a free society. The IRS routinely intrudes on our basic civil liberties and privacy rights—and its intrusions are getting worse all the time. I want an America where it is no longer the government's business how much money you make and what you do with it." He concluded, however, that enactment of the flat tax might be a good intermediate step, with the transition to the sales tax coming later.

Moore set out a sales-tax proposal that included an 18 percent rate (gradually declining to 15 percent) on all final-use goods and services except housing and securities, a rebate for every American on the tax paid on the first \$5,000 of purchases, collection at the state level, and a requirement for a two-thirds supermajority in both houses of Congress to raise the tax. Under the proposal, the IRS would be largely disbanded.

The news media and commentators have

noticed the widening interest in lifting the weight of taxation on savings and investment so that the economy can grow and raise living standards. Cato will be in the forefront on the issue that will soon come to dominate public discussion. ■

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"To be governed..."

Actually, it was an antitrust arrest

The same police pressure that produced Friday's capture of a Cali cartel kingpin also contributed to a decentralization of the drug trade, bringing to the fore smaller traffickers who have the potential of maintaining the current level of drug production, Colombian officials say.

—*Washington Post*, June 11, 1995

Essential services

In the midst of a hiring freeze that has left schools with temporary principals and classrooms with substitute teachers, the Montgomery County [Md.] Board of Education took out help-wanted advertisements to fill a pair of board staff positions at salaries of up to \$98,000.

—*Washington Post*, June 8, 1995

As long as they have a dime left in their pockets

President Clinton yesterday refused to rule out raising taxes again. . . .

"I'm going to ask the wealthiest Americans to pay more, not because I'm for class warfare, but because they can afford to."

—*Washington Times*, April 14, 1995

And keep your thermostat at 68 degrees—no, that was Carter

For two years, travelers in North Korea have reported increasing hunger around the nation. The government reportedly has

posted signs in many cities saying "Let's Eat Two Meals Per Day, Not Three!"

—*Washington Post*, May 27, 1995

... and great opportunities of rewarding those who had helped to raise us

Maryland Gov. Parris N. Glendening has asked General Assembly leaders to consider spending \$1.5 million in taxpayer funds to rescue a financially troubled Prince George's County high-technology firm headed by one of his political supporters.

—*Washington Post*, May 27, 1995

Rights proliferation

Debra DiCenso . . . was arrested Wednesday for working out in the men's weight room. . . .

The problem, DiCenso explained, is that the heaviest dumbbells in the women's weight room are 30 pounds—compared with 65 on the men's side—and that the other equipment for the ladies is, well, lightweight stuff.

"It's my constitutional right to work out with weights I can lift," said DiCenso, a political science major at Northeastern University and aspiring lawyer.

—*Washington Post*, June 3, 1995

Sidwell Friends: What a great place to enjoy socialism

It's the perfect summer break for seri-

ous young activists: a week-long bicycle trip in Cuba, coupled with some communal service for the greater glory of Fidel Castro's revolution.

"I like to consider myself a socialist," says Jody Avirgan, 14, a freshman at the prestigious Sidwell Friends School. He's one of four Sidwell students who intend to flout federal law by entering Cuba as tourists.

—*Washington Post*, June 3, 1995

Austerity in government claims another victim

In April [Nina Solarz, wife of ex-congressman Stephen Solarz] pleaded guilty to bouncing a check drawn on her husband's House Bank account (she actually bounced hundreds of checks) and to stealing money from the American Friends of Turkish Women, a charity that brought medical equipment to assist women in rural Turkey. . . .

As Nina Solarz explains it, much blame lay with the now-defunct House Bank—for lax rules that let her overdraw her husband's account in the first place. . . .

And [being a congressman] costs money. "There are financial pressures. There's no question about that," she says. The government "provides virtually no money to take care of the constituents in the way that I'm talking about."

—*Washington Post*, June 5, 1995

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