CATO Policy Report

May/June 2000 Vol. XXII No. 3

Business Ethics Gone Wrong

by Alexei M. Marcoux

It arose from the scandals that plagued Wall Street during the 1980s: a growing public support for business ethics as an object of study and teaching in America's colleges and universities. Business ethics courses are offered (and often, for business majors, required) in ever-increasing numbers. The ranks of the academy swell with professors whose principal vocation is teaching and writing in business ethics. Philanthropists endow chairs in business ethics faster than universities can fill them.

Although deriving and explaining the ethical norms that support and lubricate a well-functioning market economy are worthwhile tasks, the intellectual fashion in business ethics is quite a different matter. For among business ethicists there is a consensus favoring the *stakeholder theory* of the firm—a theory that seeks to redefine and reorient the purpose and the activities of the firm. Far from providing an ethical foundation for capitalism, these business ethicists seek to change it dramatically.

Boris Nemtsov, vice speaker of the Russian Duma, listens as Chinese social-insurance administrator Sun Jianyong discusses the need for personal retirement accounts at Cato's second international conference on pension reform, held in New York on March 9 and 10.

Shareholders and Stakeholders

Stakeholder talk is rampant. In Great Britain, Tony Blair's Labour Party came to power promising Britons a "stakeholder society." Perhaps capitalizing on the trend, Yale law professors Bruce Ackerman and Anne Alstott argue for a far-reaching overhaul of the American tax and welfare systems in their recent book, *The Stakeholder Society*. But stakeholder theory, as it has emerged in business ethics, is different.

Stakeholder theory is most closely associated with R. Edward Freeman, Olsson Professor of Applied Ethics at the University of Virginia's Darden School. The theory holds that managers ought to serve the interests of all those who have a "stake" in (that is, affect or are affected by) the firm. Stakeholders include shareholders, employees, suppliers, customers, and the communities in which the firm operates—a collection that Freeman terms the "big five." The very *purpose* of the firm, according to this view, is to serve and coordinate the interests of its various stakeholders. It is the moral obligation of the firm's managers to strike an appropriate balance among the big five interests in directing the activities of the firm.

This understanding of the firm's purpose and its management's obligations diverges sharply from the understanding advanced in the *shareholder theory* of the firm. According to shareholder theorists such as Nobel laureate economist Milton Friedman, managers ought to serve the interests of the firm's owners, the shareholders. Social obligations of the firm are limited to making good on contracts, obeying the law, and adhering to ordinary moral expectations. In short, obligations to nonshareholders stand as *sideconstraints* on the pursuit of

Continued on page 10

Alexei M. Marcoux is assistant professor of management at Loyola University in Chicago.

In This Issue

Larry Elder in Los Angeles, p. 5

The Great Social Security Debate of 2000

George W. Bush's decision to make partial Social Security privatization a major part of his presidential bid could be the most important policy initiative in this or any other presidential campaign in the past two decades. When José Piñera and I met with Governor Bush in Austin several years ago to discuss this issue, he seemed genuinely convinced that it was an important thing to do but uncertain about the political practicalities of such a proposal. Well, he's about to find out.

Historically, Democrats have loved to demagogue Republicans on Social Security—to the point that the GOP became a cheerleader for what is essentially a socialized retirement system. Times change. Today, more than half of all Americans own stocks. Internet access to financial data and advice has made most of them too sophisticated to be scared by "risky investment scheme" mantras. Still, the conventional wisdom inside the Beltway remains that Social Security is the Third Rail of American politics and should not be touched. Most Republicans running for Congress would probably just as soon see Bush stay away from the issue. Democrats, smelling blood, are already on the attack.

"Risk is an issue in this debate, but it cuts in favor of privatization, not against it."

Vice President Gore asserts that Social Security privatization represents a "survival of the fittest" mindset and that it is "an ideologically driven scheme that is bad for families and bad for the economy." New Jersey Democratic Senate hopeful Jim Florio admonishes, "Social Security is a guarantee, not a gamble." With a curious turn of phrase he adds, "Social Security is not about profit maximization. It is securing maximum security." Well. Somehow I think this time around the opponents of privatization are going to have to come up with more compelling stuff.

George W. Bush may have made a very shrewd calculation in raising this issue and expecting Al Gore to rise to the bait. A recent Zogby Poll asks this straightforward question: "How likely would you be to support Social Security privatization if it allowed you to take your Social Security money and invest it in a retirement account of your choosing?" A whopping 68.7 percent of respondents said they support privatization. More than 80 percent of people 54 and younger favor the idea. And that support cuts across demographic lines—gender, race, income level, education level, union vs. nonunion, you name it. Americans want out of what they correctly perceive to be a Social Security system that is a very bad deal.

A quick visit to the calculator on Cato's special Web site, www.socialsecurity.org, reveals just how bad a deal Social Security is. Rates of return based on what Social Security now promises range from minus 2 percent to plus 2 percent. With Social Security's $20 trillion unfunded liability and a negative cash flow looming just 15 years away, one can be certain that the actual return will be much lower for most people. Using very conservative actuarial assumptions, analysts have shown that privatized accounts will yield two to three times the income now only promised by Social Security.

Proponents of Social Security privatization have powerful arguments on their side to ensure that the demagoguery will have little effect on the overwhelming majority that now support the idea.

- First and foremost is the issue of ownership. In *Flemming v. Nestor* (1960), the Supreme Court ruled that Americans have no property right in the money they are forced to pay in Social Security taxes—today 12.4 percent of their wages. What they get back at retirement is entirely up to 535 politicians. Under a privatized system, this indignity is avoided because the payroll tax is used to purchase real assets—stock and bond funds, money market funds, or insurance products—that you own and the politicians can't touch.
- Because you own real assets, you will accumulate wealth over your working life—wealth that will not only yield a more comfortable retirement but that you can leave to your loved ones, which is not the case with today's Social Security system. It is interesting that the people who wring their hands the most over the widening wealth gap between rich and poor, black and white, tend also to be the people who oppose allowing low- and moderate-income Americans to invest their payroll tax in mutual funds. A sociology professor from New York University was recently quoted in the *Wall Street Journal* saying, "The robust stock market has made racial differences in wealth even more pronounced." Really.
- Risk is an issue in this debate, but it cuts in favor of privatization, not against it. There is no 25-year period in American investment history in which stocks have not provided a higher return than the safest money market instruments. Further, while history shows that equities are the safest long-term investment, privatization doesn't require investing in stocks, if one prefers, say, government bonds. Yet over the 64-year history of Social Security, the politicians have increased payroll taxes more than 50 times. Talk about risk! The political risk of higher taxes and lower benefits (making an already paltry return even lower) is enormous.

As for Al Gore's baseless and counterintuitive claim that Social Security privatization is "bad for the economy," a Cato Institute study by Harvard professor Martin Feldstein estimates that the present value of investing in real assets the future flow of the payroll tax is on the order of $10 trillion to $20 trillion. Times have changed and George W. Bush is to be commended for recognizing that they have. Let the Great Social Security Debate of 2000 begin!

Ed Crane

—Edward H. Crane

Participants from 34 countries discuss privatization

"Global Pension Reform Is Inevitable"

"Major pension reform around the world is inevitable," Australian senator Nick Sherry told participants from 34 countries at a March 9–10 conference in New York City on global pension issues cosponsored by the Cato Institute and *The Economist*.

Sherry, a senator of the left-leaning Labour Party, advised politicians not to delay reform. "It is often tempting for governments of the day to ignore or put off reform. This is not an option," said Sherry at the conference, "Solving the Global Public Pensions Crisis II: The Privatization Revolution." Sherry declared that "failure to reform will inevitably lead to a major 'crunch' which will hurt most those who can least afford it, those on low and middle incomes." Successful reform such as Australia's "superannuation" system can lead to large income gains for the least advantaged—for example, the 31 percent projected rise in retirement incomes for low-wage Australians.

In an examination of pension privatization in Latin America, Cato's Jacobo Rodríguez gave a long-term overview of Chile's experience with personal retirement accounts, and Fernando Solis Soberón discussed his role as founder of Mexico's semiprivatized system.

The most promising changes were announced by Boris Nemtsov, vice speaker of the Russian Duma, and Sun Jianyong, deputy director-general of China's Department of Social Insurance Funds Supervision. They said that citizens in their respective countries are coming to see personal retirement accounts as a step forward both for pension reform and for the development of a market economy as a whole.

Australian Labour MP Nick Sherry told attendees that reform is inevitable.

Thomasz Frontczak, president of AIG Poland, spoke of the "flexibility through diversity" that Poland's new private system has brought that former Warsaw Pact nation. Swedish economist Göran Normann outlined changes enacted in 1998 creating a two-tiered pension system with personal accounts funded with 2.5 percent of workers' incomes.

Klaus Friedrich, chief economist for Germany's Dresdner Bank, said that a traveler to Germany could declare, "I have seen the future and it doesn't work." With a worker-to-retiree ratio approaching one to one and little political leadership for reform, Germany may be hard-hit as the demographic chickens come home to roost. Milton Ezrati, former chief investment officer for Nomura Capital Management, said that Japan faces similar problems but expressed confidence that Japan will move to reform quickly once the pressure of national demographics becomes unavoidable. Many workers are evading Japan's payroll taxes, currently at 17.35 percent and slated to rise to over 34 percent by 2025. When the usually law-abiding Japanese act this way,

Continued on page 14

Chilean reformer José Piñera delivers the keynote address at Cato's "Solving the Global Pension Crisis" conference on March 9.

Cato Policy Report is a bimonthly review published by the Cato Institute and sent to all contributors. It is indexed in *PAIS Bulletin*. Single issues are $2.00 a copy. ISSN: 0743-605X. ©2000 by the Cato Institute. • Correspondence should be addressed to *Cato Policy Report*, 1000 Massachusetts Ave., N.W., Washington, D.C. 20001. • INTERNET: cato@cato.org • WEB SITE: http://www.cato.org or call 202-842-0200 or fax 202-842-3490.

Gun makers targeted by abusive lawsuits

End Cuban Embargo, Sanford and Donohue Say

◆**February 3:** Rita J. Simon of American University discussed the late Julian L. Simon's new Cato book ***The Economic Consequences of Immigration*** at a Cato Book Forum. In discussing her husband's book, she observed that Americans tend to view immigration in the present with alarm but see immigration in the past as a benefit to the economy. Stephen Moore, director of fiscal policy studies at Cato, argued that the dire predictions made by immigration's opponents in the last few decades have proven inaccurate. Mark Krikorian, executive director of the Center for Immigration Studies, contended that reduced levels of immigration would, paradoxically, result in pro-immigration policy. Michael Barone of *U.S. News & World Report* noted that immigrants tend to find job growth areas without help from government. Demetrious Papademetriou of the Carnegie Endowment for International Peace argued that immigrants contribute greatly to the ability of some countries to remain affluent.

◆**February 15:** The United States should reverse its policy on Cuba to allow Americans to travel there, argued Rep. Mark Sanford (R-S.C.) at a Cato Policy Forum, **"The Cuban Economic Embargo: Time for a New Approach?"** Sanford noted that the government's inconsistent policy allows Americans to travel to such countries as Afghanistan, North Korea, and Iran but not to Cuba, which is no longer a military threat. Thomas Donohue, president of the U.S. Chamber of Commerce, said the embargo hurts American businesses, workers, and farmers, who would benefit from trading with Cuba, and provides Fidel Castro an excuse for the failure of his centralized economic policy. Phillip Peters, vice president of the Lexington Institute, argued that scrapping the embargo would allow American ideas to spread throughout Cuba.

◆**February 16–20:** The Cato Institute held its annual **Benefactor Summit** in Key Largo, Florida. The guest speakers included syndicated columnist Robert Novak, Harvard professor Richard Pipes, technology pioneer William Schrader, Charles Murray of the American Enterprise Institute, and Star Parker of the Coalition on Urban Renewal and Education. Cato's William A. Niskanen, Ed Crane, David Boaz, Ted Galen Carpenter, James A. Dorn, Robert A. Levy, Brink Lindsey, Darcy Olsen, Tom Palmer, Roger Pilon, Michael Tanner, and Jerry Taylor discussed the Institute's accomplishments during the past year as well as Cato's future plans.

◆**February 29:** Lawsuits filed by dozens of citizens in cahoots with the federal government tilt the system in favor of the government and against legitimate businesses, said Sen. Mitch McConnell (R-Ky.) at a Cato Institute conference, **"Guns in America: Public Nuisance, Defective Product, or Constitutional Right?"** The government-sponsored lawsuits against gun makers undermine the separation of powers by regulating and taxing citizens through litigation, said McConnell, who is the sponsor of the Litigation Fairness Act of 1999. David Yassky of Brooklyn Law School argued that the Second Amendment was originally intended to keep state militias from being disarmed by the federal government. Nelson Lund of George Mason University said that the Second Amendment "unambiguously" protects an individual's right to own and bear arms. Michael Beard of the Coalition to Stop Gun Violence contended that there is no evidence that the Second Amendment was intended to provide individuals the right to own guns unrelated to militia service. Glen A. Caroline of the National Rifle Association argued that enforcement of current laws would be better public policy than would passing more gun control laws. Robert A. Levy, senior fellow in constitutional studies at the Cato Institute, argued that the real goals of the gun suits are (1) to bypass the legislative process and (2) to warn other unpopular industries that they could also have multiple government entities targeting them. Dennis A. Henigan of the Center to Prevent Handgun Violence argued that using the courts to punish negligent gun makers will motivate the firms to add safety features. Mark A. Behrens of Crowell & Moring LLP said that the issue should be resolved in legislatures because the different regions of the country have different beliefs about the danger of guns. Larry Rosenthal, deputy corporation counsel of Chicago, argued that the gun industry must be given incentives to invest in safety.

◆**March 9–10:** The Cato Institute hosted a two-day conference, **"Solving the Global Public Pensions Crisis II: The Privatization Revolution,"** in New York. The speakers included Charles Murray of the American Enterprise Institute; Tim Penny, former congressmen (D-Minn.) and a Cato Institute fellow in fiscal policy studies; Jack Kemp, codirector of Empower America; Sun Jianyong of the Department of Social Insurance Funds Supervision in the People's Republic of China; Klaus Friedrich, chief economist of the Dresdner Bank AG in Germany; Milton Ezrati of Jamison, Eaton & Wood; David Willetts, MP, shadow secretary of state for social security of the United Kingdom; and Boris Nemtsov, vice speaker of the Duma, Russian Federation.

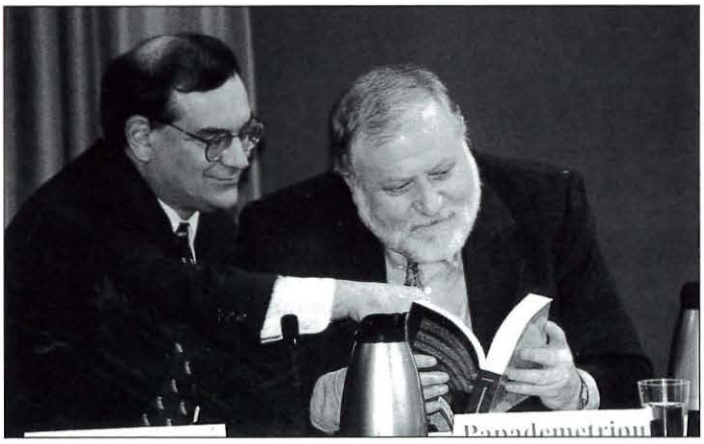
◆**March 14:** The Clinton administration should work on containing Saddam Hussein rather than becoming further entangled in a flawed covert action that is doomed to fail, argued Cato adjunct scholar David Isenberg at a Cato Policy Forum, **"What Should the United States Do about Saddam Hussein?"** David Wurmser of the American Enterprise Institute said that Washington must aggressively work with opposition groups to topple Saddam while Russia is still weak, Europe is still introverted, China is still not ready to confront America, and nobody in the Middle East has a real advantage. Daniel Byman of RAND contended that current policy on Iraq is working well. He noted that the country is militarily weak and has not invaded its neighbors recently and that its weapons of mass destruction program is limited.

◆**March 14:** Tibor Machan, distinguished fellow and professor at the Leatherby Center of Chapman University in California, and Douglas J. Den Uyl, director of educational programs at Liberty Fund, discussed their recent books on philosopher Ayn Rand at a Cato Institute Book Forum, **"Two New Books on Ayn Rand's Legacy."** Machan, author of ***Ayn Rand***, argued that

Development economist Peter Bauer discusses his new book at a Cato reception in his honor on March 15.

Rep. Mark Sanford (R–S.C.) tells a Policy Forum that the ban on travel to Cuba should be ended.

Sen. Mitch McConnell (R–Ky.) tells a Cato conference that coordinated lawsuits against gun makers undermine the separation of powers and abuse the legal process.



Mark Krikorian and Demetrious Papademetriou check a point in the late Julian Simon's *Economic Consequences of Immigration* at a Book Forum on the release of the second edition.

Rand was never considered a mainstream philosopher because of her classic economics themes that challenged the reigning political orthodoxy. Den Uyl, author of ***The Fountainhead: An American Novel***, argued that *The Fountainhead* upholds the model of what America should be, whereas *Atlas Shrugged* gives up on America in favor of Galt's Gulch.

◆**March 15:** T. J. Rodgers, president and CEO of Cypress Semiconductor Corporation, discussed the theme of his recent study at a Cato Policy Forum, **"Should Silicon Valley Normalize Relations with Washington?"** Rodgers argued that the political scene in Washington is antithetical to the core values of Silicon Valley. Michael Maibach, vice president of government relations at Intel Corporation, was less hostile toward the relationship between Washington and the high-tech world.

◆**March 15:** The Cato Institute hosted a reception in honor of Peter Bauer to celebrate the publication of his book ***From Subsistence to Exchange and Other Essays***. James Buchanan, Nobel laureate in economics, gave brief comments about the importance of Bauer's work.

◆**March 21:** Cato's Edward H. Crane, Ian Vásquez, and Jerry Taylor were among the speakers at a Cato **City Seminar** in Los Angeles. Columnist and talk-show host Larry Elder gave the luncheon address, "Limited Government: Built on the Foundation of Personal Responsibility."

◆**March 30:** At a Cato Policy Forum, **"Trouble in the Taiwan Strait,"** Cato senior fellow Doug Bandow argued that America should avoid offering to defend Taiwan but should, by selling it weapons, help it to defend itself. Adm. Eugene Carroll (Ret.) said that the China-Taiwan crisis has been exaggerated and that America should refrain from harsh rhetoric that could worsen relations. Ross Munro, author of *The Coming Conflict with China*, argued that China is driven by its ambition to control the sea routes to Japan and access to the South China Sea and to undercut American credibility in Asia. ■

The Pension Privatization Revolution

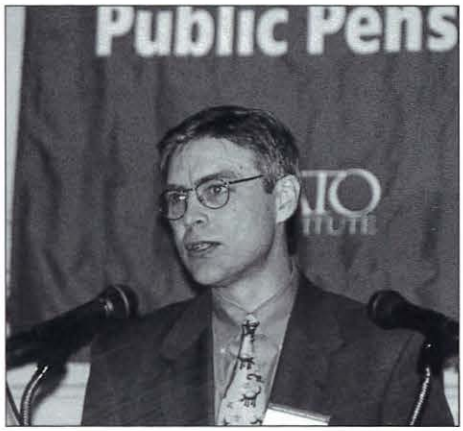
Recently the Cato Institute held its second international conference on pension reform, this one in New York on March 9–10. Participants from 34 countries attended "Solving the Global Public Pensions Crisis II: The Privatization Revolution," cosponsored with The Economist. *Among the speakers were former congressman Tim Penny, now a Cato fellow in fiscal policy studies; Michael Tanner, director of Cato's Project on Social Security Privatization; and Milton Ezrati, author of* Kawari: How Japan's Economic and Cultural Transformation Will Alter the Balance of Power among Nations *(1999).*

Tim Penny: I look at my four children every day and realize the cliff that we're sending them over in terms of the Social Security system. What are we telling our children today? We're essentially telling them this: Here is a retirement insurance program for you. We take 12 percent of your income now and at least that much or more throughout your working lifetime and we spend it. In exchange you get at some future time (age 67 or possibly older) our promise to pay you an undefined rate of return. It may in fact be a negative rate of return. And you will get this money only if you live long enough to collect it. And when you die your heirs will not get a cent. And, by the way, we can raise your level of contribution by any amount at any time. That's essentially what we're saying with this current system, and clearly we ought to be able to do better for our children than that.

The numbers in this system are relentless. There are about 24 million Americans over 70 years old today; by the year 2030 when the baby boomers are fully retired there will be 48 million seniors over 70 years old. About 10 percent of our population were over 65 in 1970. That's up to about 14 percent today. It will reach 20 percent by the year 2030 when the baby boomers are fully retired. Life expectancy in 1965, when Medicare was enacted, was 70 years. It's now risen to 78. Today if you reach the age of 65 you can expect to live another 17 years, and those numbers will increase as time goes by.

Is it any wonder that Americans are becoming more and more dubious about the Social Security system? Sixty percent of Americans in a recent Gallup Poll said that the system needs either a complete overhaul or major changes. That's a pretty remarkable statistic. Seventy-five percent of Americans are comfortable with the idea of some degree of privatization so they can have more control over their Social Security investments. Only 12 percent of those under 30 years of age expect to receive all or most of their benefits from the system.

In other words, younger Americans really understand what's happening to them in a fundamental way. I think in some respects this is manifested in the increasing detachment that young people have from the political system. As a Democrat I think that



Tim Penny: "Democrats who protect the status quo on Social Security are losing touch with younger voters."

detachment is contributing greatly to the degree to which my party is not resonating with younger voters because we essentially articulate the status quo when it comes to the Social Security system.

In Minnesota's most recent gubernatorial election, Hubert Humphrey, the son of Sen. Hubert Humphrey, was the Democratic candidate for governor and received 16 percent of the vote of those 30 and under. Jesse Ventura received 50 percent of the votes of that segment of the electorate and in fact inspired many, many young people who had not voted before to participate. Democrats who protect the status quo on Social Security and other social and domestic programs are losing touch with younger voters.

So the question is, why privatize Social Security? I guess the way I would answer that is to say because the alternatives are so bad. The alternatives are horrendous. I call the standard response to Social Security by many people in my party the Alfred E. Neuman School—"What, me worry?" It's to pretend that the problem isn't there. It's to pretend that the trust fund is real. But in doing so we obligate future generations to one of two realities. Either we will have to increase debt dramatically or we will have to raise payroll taxes significantly. We've been down that path before, and we're already at a point at which we're promising future retirees a negative return, so these are not options that resonate well with the average worker. But that's largely the response of my party, the Democrats.

There are others who say, "Well, maybe markets can help us through this problem, so let's just take the Social Security surplus and invest it in the markets." I don't want government bureaucrats sitting around deciding how to invest my Social Security money. We've seen states like Minnesota put a fence around public pension funds so that they can't be used for a variety of investments. You can't use them for investments that might somehow be tainted by tobacco money. You can't use them for investments that might somehow tie us to foreign nations that have bad human rights records. We don't need to go down that path.

The Clinton plan is, of course, to pay down debt with our current surplus, which on one level makes some sense, but he double counts the money. He first puts it in the trust fund, pretends again that the money will be there when we need it, and then pays down debt. He also talks about taking the interest saved by paying off debt and putting those savings into the trust fund, which is essentially a general fund transfer into the Social Security system, so it undercuts the basic premise of Social Security, which is a pay-as-you-go structure. Clinton also discusses creating new retirement funds—not allowing us to use payroll taxes for those retirement funds but giving us new money that we can invest for that purpose. None of this does anything to address the underlying problems with the Social Security system. Furthermore, none of this means anything to the poorest of the poor, because absent their Social Security payroll checks

"Bob Kerrey says he trusts the American people to decide whether they can better invest a portion of their Social Security taxes in a system that will give them a better return."

there is precious little money in disposable income that they can use to supplement that Social Security income.

As Bob Kerrey, a senator from Nebraska, has said about his ideas for partial privatization of Social Security, he believes in the dignity, not the density, of the American people. In other words he trusts them with the truth. He doesn't insult them and doesn't believe we ought to insult them with nostrums like "save Social Security first" and "pay down the debt." He's content to let the people decide whether they can better invest a portion of their Social Security taxes in a system that will give them a far better return and a far more secure retirement than will the government system. And I'm convinced that if the American public sees this sort of debate and if more of our political leaders are willing to put these options on the table, those leaders will find resonance within the electorate. I'm encouraged by this election cycle in which a variety of candidates, including the apparent nominee of the Republican Party, George W. Bush, are willing to talk about this sort of a fundamental change in the Social Security system.

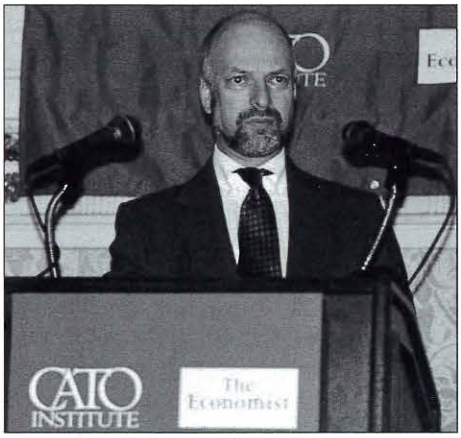
Winston Churchill said that you can trust the Americans to do the right thing after they've tried everything else. Well, we've been talking about a lot of other options that will take a bad situation and make it worse. But the right thing is to move in the direction of private investments to the benefit of the American worker, and I think the American public is ready for that alternative.

Michael Tanner: The reasons for privatizing Social Security are much more fundamental than just financial issues. First, even if Social Security were solvent, it is a bad deal for most young workers. The return will be abysmal for most people, even if Social Security pays every penny promised.

In addition to losing money in real and actual dollars, there is the huge opportunity cost. People could be earning a higher rate of return elsewhere if they weren't forced to put their money in the Social Security system. With Social Security you're lucky if you can get a 1 or 2 percent rate of return. The real before-tax rate of return to capital in this country is about 9.3 percent on a real basis, and that's what you're not able to invest in.

Orlando and Leah, a couple I recently met in south central Los Angeles, illustrate this point. Orlando works part-time helping to put together pegboards for computers, and Leah is a waitress. They each earned about $20,000 last year. Right now they are paying over $5,000 a year in Social Security taxes.

If they invested that $5,000 in real assets and it earned the historic rates of return—7 percent or so a year—for the next 45 years, when they retired they would have more than $1.5 million in the bank. The interest



Michael Tanner: "There is no legal right to your Social Security benefits."

payments on that amount would be more than what Social Security paid, and when they died they could leave that money to their son, little Orlando. That is the loss they're suffering under the current Social Security system—and that's the reason to privatize Social Security even if Social Security were solvent and even if it could pay every dime in benefits that it has promised. The RAND Corporation has concluded that Social Security actually transfers money in the United States from the poor to the rich, from blacks to whites, and from men to women. Poor black men end up supporting rich white women on Social Security, and I suspect that is not the type of system we intended.

The World Bank has concluded that most pay-as-you-go social security systems around the world are actually regressive and that, despite progressive benefit formulas, those systems actually all end up transferring money from the poor to the rich because the poor start work earlier and don't live as long. Likewise, the system penalizes working women; because of the interaction between spousal benefits and the benefits women earn on their own, they receive exactly the same benefits they would receive if they hadn't worked outside the home and hadn't paid any Social Security taxes. All the tax money they paid their entire life is just lost.

Another problem with the current Social Security system is that it doesn't allow for the accumulation of wealth. I am deeply concerned about a society in which there are savers and investors and other people who do not get to participate in savings and investment. The people who can save, invest, and accumulate money can pass it on to their heirs. The people who have nothing but Social Security cannot.

Harvard University's Martin Feldstein estimates that the privatization of Social Security would result in a 50 percent reduction in the disparity of wealth in this country—that is, the gap between rich and poor in this country would close by almost half.

Finally, it's a simple question of dignity. In a pay-as-you-go social security system in the United States and around the world there is no legal right to your social security benefits. It's entirely a matter of politics and whether the politicians want to give you retirement benefits. Twice, in *Flemming v. Nestor* and *Helvering v. Davis,* the Supreme Court ruled that Social Security is a tax-and-spending program. The government determines your Social Security benefits and is free to cut them and take them away any time it wants. Someone entering the workforce today is gambling. What will the president or Congress decide to give me for retirement 45 years from now? In many countries around the world it is even worse. There are countries in Eastern Europe and elsewhere where the government made explicit promises to provide pensions and retirement benefits, and the checks aren't coming. That's the problem when you have to depend on politicians for your retirement instead of owning your retirement benefits.

Social Security was invented in the 19th century in Prussia. Here we are in the 21st century, and a lot has changed in the world. It's time we change Social Security as well and had a 21st-century Social Security

Continued on page 8

"The Keidanren has proposed a private system with individual accounts similar to the Chilean one."

POLICY FORUM *Continued from page 7*

system—one that is based on savings, investment, personal property rights, ownership, and the ability to pass the savings on and to accumulate wealth from generation to generation.

Milton Ezrati: Japan is about to enter an age of deregulation and privatization that will extend beyond the pension area. I'm not going to forecast that Japan will adopt a Chilean privatized scheme, but a market-oriented one is not out of the question. My confidence comes from two sources. One is the demographic issue. By 2020, one person in four in Japan will be over the age of 65. As a consequence the nation will have fewer than two workers and possibly only one worker for each retired person. In economic and financial terms, that situation is about twice the burden that will face the United States. It will be impossible to maintain the present system, and Japan will have to change.

There is also a growing awareness in Japan, even among the government bureaucracy, that the situation is critical. That awareness is a basis for my rather optimistic view that Japan will change from an extremely statist approach to a more private approach in the future. Japan's unfortunate luxury, much like the United States, is that it is an extremely rich country. This has allowed procrastination. The demographic pressure, however, will make that procrastination impossible. Japan will change or it will sink, and I don't think the Japanese will choose the latter path.

Despite being statist, the Japanese pension system is actually better suited to privatization now than is the system in the United States. The Japanese system has a two-tiered approach: One, the basic structure is effectively a redistribution, or a welfare safety net—a set rate is applied to everyone who is working. It's a minimal amount and is purely a safety net. Then on top of that the Japanese have what they call their employees' pension scheme, which looks a lot like Social Security in the United States.

This two-tiered approach separates the welfare redistributive function of the retirement system from the actual pension plan. And that is something that has muddied the debate in the United States.

What also helps the Japanese is the opt-out option for corporations or multiemployer groups who can reduce their contributions if they provide a pension scheme that is at least as good as that offered by the state. To help compete for better workers, corporations can, for no or little more cost, offer superior retirement benefits to employees.

As the demographic pressures build, Japan will be able to quickly move toward a privatized scheme. Recent surveys reveal that one-third of new workers are refusing to enroll in even the basic plan because they don't expect to get their benefits. This is tax evasion in a country that is renowned for its discipline and law-abiding nature. The old expression that more American youth believe in UFOs than believe they're going to get their Social Security benefits was alluded to in Japan as applicable there as well.

Milton Ezrati: "By 2020, one person in four in Japan will be over 65, about twice the burden that will face the United States."

One ironic blessing for Japan is that, unlike the United States, Japan does not have a budget surplus. In fact, Japan is running a huge budget deficit, so it cannot kid itself that it can fund one government obligation with another. The Japanese cannot pretend that the surplus can fix their system, and that is a benefit.

The pension system is officially underfunded by half of gross domestic product. The Keidanren, Japan's major employers group, estimates that underfunding is actually about equal to GDP. Put another way, the Ministry of Health and Welfare (which oversees social security) has indicated that, to fund the social security system as it is currently structured, 30 percent of GDP will have to be devoted to that particular activity by 2025. Currently, it is 16 percent, already a large figure. Again, Japan's wealth is allowing procrastination.

According to the Ministry of Finance and the Ministry of Health and Welfare, payroll taxes would have to be 34 percent to keep the system as currently structured. The employee system would need to be funded by a hike in the consumption tax of an additional 3.7 percent. Overall, the average tax rate would be about 60 percent. Even the most docile population could not stand for that.

There have been the standard reform proposals: delay the retirement age, reduce spousal benefits, and index to inflation instead of wages. Fortunately, some groups have proposed some form of privatization. The Keidanren has proposed a system similar to the Chilean one that would end the current employee system while maintaining the basic system as a welfare safety net. The Keidanren would amortize the implicit debt of the existing public system over a long period of time and set up a private system with individual accounts. As an alternative the group has proposed a similar ending of the system with amortizing the burden and a 401(k) approach.

These proposals are truly remarkable, when you consider that the Keidanren is part of the "iron triangle" of government, business, and bureaucracy that is said to run Japan. Yet, sometimes when I read the Keidanren's material I think I'm reading Cato's stuff. Of course, it's more guarded and doesn't inspire me the way José Piñera's work does, but nonetheless it has the same flow to it. For an organization like the Keidanren to propose this in Japan today suggests to me that we are not very far from a turn in Japan and that the demographic pressure is tremendous not only for the pension system but also for the whole economy.

The reality of having fewer than two people working for every retiree is going to force Japan to change its entire economic model. That radical change is going to make privatization in public pensions an easy step compared with the other radical economic and financial changes that are going to have to take place in Japan. ■

Unconventional wisdom on foreign aid, population

Bauer Criticizes Development Orthodoxy

Economists often neglect major determinants of the economic performance of developing nations, according to a new Cato Institute book written by a pioneer in development economics.

Peter Bauer, Professor Emeritus of Economics at the London School of Economics, challenges standard explanations of Third World poverty, including colonialism, lack of capital, and population growth, in *From Subsistence to Exchange and Other Essays*, published by Princeton University Press.

Bauer argues that the study of developing countries suffers from a disregard of the crucial role of domestic trade in poor countries even though economists recognize the importance of such trade in the rise of Western nations. Economists also regularly disregard the impact of history, culture, and institutions on material progress, Bauer writes.

The reasons for that, Bauer says, include feelings of guilt and an overreliance on quantitative methods, which "has brought with it a regrettable atrophy of close observation and simple reflection."

Foreign aid is often counterproductive and fails to reach destitute people, Bauer writes. He notes that foreign aid, which expanded from a few hundred million U.S. dollars a year in the 1940s to well over $50 billion a year by the 1990s, often ends up in the hands of "governments hostile to the donors, whom they embarrass and thwart whenever they can." He cites Nkrumah's Ghana in the 1950s and Nyerere's Tanzania and Mengistu's Ethiopia in the 1980s as examples.

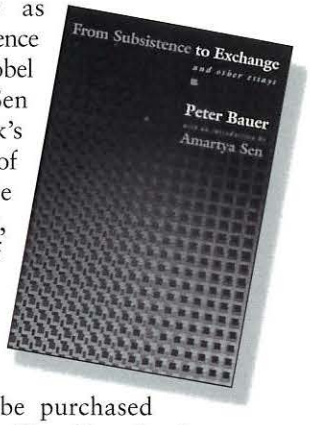
Bauer warns that foreign aid has been a cure worse than the disease. "Foreign aid is demonstrably neither necessary nor sufficient to promote economic progress in the so-called Third World and is indeed much more likely to inhibit economic advance than it is to promote it," he writes.

He argues that the population explosion is a crisis that has been "invented" by intellectuals, politicians, and international aid workers. He says there is no correlation between population density and poverty, citing examples of affluent countries with high population densities and poor countries with low population densities.

"Economic achievement and progress depend on people's conduct, not on their numbers. The central issue of policy is whether the number of children should be determined by the parents or by agents of the state," writes Bauer.

He concludes that "official government-to-government subsidies ought to be terminated or at least drastically altered." Until that occurs, he writes, aid should be bilateral, not multilateral; it ought to take the form of straightforward grants rather than subsidized loans; and it should go only to governments most likely to promote the economic progress and general welfare of citizens.

Bauer calls for more freedom for people in developing countries and for an end to the "alarming retrogression" in development economics. Because of Bauer's continued influence in fields as diverse as political science and anthropology, Nobel laureate Amartya Sen writes in the book's introduction, "Many of Bauer's claims, while resisted at the time, have become a part of the new 'establishment' of ideas."



From Subsistence to Exchange and Other Essays can be purchased (cloth, $19.95) by calling Cato Institute Books at 1-800-767-1241 or through the Cato Institute's online bookstore, www.cato.org. ■

"One wonders why firms are obligated to give something back to employees, customers, and communities to whom they routinely give so much already."

ETHICS *Continued from page 1*

shareholder interests. This is the view that informs American corporate law and that Friedman defends in his 1970 *New York Times Magazine* essay, "The Social Responsibility of Business Is to Increase Its Profits."

Corporate Social Responsibility and Stakeholder Theory

Stakeholder theory seeks to overthrow the shareholder orientation of the firm. It is an outgrowth of the corporate social responsibility (CSR) movement to which Friedman's essay responds. According to CSR, the firm is obligated to "give something back" to those that make its success possible. The image of the firm presented in CSR is that of a free rider, unjustly and uncooperatively enriching itself to the detriment of the community. Socially responsible deeds (such as patronizing the arts or mitigating unemployment) are necessary to redeem firms and transform them into good citizens.

One wonders, however, why firms are obligated to give something back to those to whom they routinely give so much already. Rather than enslave their employees, firms typically pay them wages and benefits in return for their labor. Rather than steal from their customers, firms typically deliver goods and services in return for the revenues that customers provide. Rather than free ride on public provisions, firms typically pay taxes and obey the law. Moreover, these compensations are ones to which the affected parties or (in the case of communities and unionized employees) their agents freely agree. For what reasons, then, is one to conclude that those compensations are inadequate or unjust, necessitating that firms give something *more* to those whom they have already compensated?

Stakeholder theory constitutes at least something of an advance over CSR. Whereas CSR is fundamentally antagonistic to capitalist enterprise, viewing both firm and manager as social parasites in need of a strong reformative hand, stakeholder theory takes a different tack. Rather than offer stakeholder theory as a means of overthrowing capitalist enterprise, stakeholder theorists profess to offer theirs as a strategy for improving it. As Robert Phillips of the University of Pennsylvania's Wharton School writes, "One of the goals of the stakeholder theory is to maintain the benefits of the free market while minimizing the potential ethical problems created by capitalism."

On the theory that "you'll catch more flies with honey than with vinegar," stakeholder theorists ostensibly praise corporate leaders and maintain that firms *are* social institutions and their managers *are* community leaders. Given appropriate latitude, firms and managers are disposed to serve the social good. Corporate law and the market for corporate control, however, preclude firms and managers from following their inclinations and serving their social missions. Stakeholder theory seeks to free both firm and manager from their exclusive attention to the narrow, parochial concerns of shareholders so that they can focus on a broader set of interests.

But although the diagnosis of the problem with capitalist enterprise is (at least, on the face of it) different from that advanced in CSR, the stakeholder theorists' remedy is largely the same: the elevation of nonshareholding interests to the level of shareholder interests in formulating business strategy and policy. The stakeholder-oriented manager is admonished to weigh and balance stakeholder interests, trading off one against another in settling on a course of action. Stakeholder theorists seek a reorientation of the corporate law toward the interests of stakeholders and the insulation of managers from the market for corporate control.

Problems

Whatever the appeal of the stakeholder theory's inclusiveness of and sensitivity to the myriad interests that affect and are affected by firms, there are several powerful reasons to resist the theory's adoption and embodiment in a reformed corporate law.

Equity Capital. Because it undermines shareholder property rights, stakeholder-oriented management denigrates and discourages equity investment. In the stakeholder-oriented firm, equity investors bear the same downside risks that they bear in the traditionally governed, shareholder-oriented firm. The upside potential of their investment, however, is diminished significantly; for in distributing the fruits of the firm's success, equity investor interests are only some among many to be considered and served. In short, when the firm loses, shareholders lose; when the firm wins, shareholders might lose anyway if other interests are deemed to be more weighty and important.

Stakeholder-oriented management effectively eliminates issuing shares as a means of financing the firm's growth and new ventures. By diminishing the orientation of the firm toward shareholder interests, stakeholder-oriented management will presumably lead investors to discount sharply the value they attach to shareholdings. So stakeholder-oriented management essentially entails a near-exclusive reliance on debt as the fuel of expansion.

But the problems do not stop there. Debtholders, whether banks or bondholders, typically use equity holdings, returns to equity, and appreciation in the market price for shares as signals of financial health, and hence as mechanisms for pricing debt capital. Widespread or legally mandatory adoption of stakeholder-oriented management threatens to undermine well-established, stable, and efficient market norms for pricing capital in favor of a regime under which capital is more costly for firms to acquire because investment (whether in the form of equity or debt) is an inherently riskier proposition. That, in turn, threatens prospects for economic growth, stable employment, and the liquidity of financial markets. In short, stakeholder-oriented management promises poorer, static, risk-averse firms and hence a poorer, static, risk-averse economy. Stakeholder-oriented management is contrary to the interests of the very stakeholders it is intended to help.

Managerial Accountability. People recoil in horror at corporate officers' and directors' salaries, perks, and other bonuses that at times bear no relation to the performance of the firms they manage. This sorry state of affairs results from the confluence of a number of recent trends in corporate law that make it more difficult for shareholders to discipline self-serving managers:

"Defending the market economy from the 'stakeholder' attack requires a principled defense of the shareholder-oriented firm."

- The decline of the *ultra vires* doctrine (under which shareholders could sue managers for embarking on projects contrary to the corporate purpose).
- The emergence of so-called corporate constituency statutes (which permit managers to consider and appeal to a broader range of interests in determining how and whether to fend off a takeover bid—and thereby hamper the smooth operation of the market for corporate control).
- The expansive reading given to the business judgment rule (which shields some managerial actions from substantive review by courts) by the Supreme Court of Delaware—where many firms are incorporated.

But whatever the impediments to disciplining self-serving managers under current law and public policy, they pale in comparison with those promised by stakeholder-oriented management (and a stakeholder-oriented corporate law). Whereas under the current corporate law much self-serving managerial behavior is recognizably self-serving but shielded from substantive review, under stakeholder-oriented corporate law such behavior would be considerably more difficult even to detect, as well as to deter.

It would be more difficult to detect because all but the most egregious of self-serving managerial behavior will coincide with the interests of *some* stakeholding group, and hence the self-serving manager may point to the benefited and burdened stakeholders and argue that, in his estimation, this was the optimal way to balance competing stakeholder interests. Absent a powerful principle of balanced distribution of the benefits of the firm (something stakeholder theorists have been notoriously slow to sketch), stakeholder theorists must acquiesce in self-serving managerial action that can plausibly be said to accomplish some sort of balance among competing stakeholder interests. That point is made with admirable clarity by Frank Easterbrook and Daniel Fischel in their 1991 book, *The Economic Structure of Corporate Law*: "A manager told to serve two masters (a little for the equity holders, a little for the community) has been freed of both and is answerable to neither. Faced with a demand from either group, the manager can appeal to the interests of the other."

Self-serving managerial action would be more difficult to deter under stakeholder-oriented corporate law because stakeholder theory anticipates that good-faith stakeholder-oriented managerial actions will serve some interests and frustrate others in pursuit of an overall balance of interests. Therefore, stakeholder-oriented corporate law must provide protections to managers at least as extensive as those afforded under current business judgment rule doctrine—lest managers be the perpetual object of derivative lawsuits brought by shareholders, employees, customers, suppliers, or communities who believe that their interests were unfairly or improperly weighed and balanced. Between the ability of managers to justify their self-serving behavior in terms of the balanced pursuit of stakeholder interests, on the one hand, and the protections that a stakeholder-oriented corporate law must afford to managers if firms are to be managed at all, on the other hand, the accountability of managers for their actions must necessarily suffer.

Interest-Group Politics. Because stakeholder-oriented management anticipates the weighing and the balancing—and hence often the frustrating—of competing interests, it promises to make the boardroom (populated, per Freeman, by representatives of all stakeholding groups) the site of wasteful, inefficient interest-group politicking. That is, the corporate boardroom will be transformed from a forum in which economically rational strategies are adopted in pursuit of added value into one in which legislative and bureaucratic political maneuvering will be the order of the day. Surprisingly, stakeholder theorists recognize and, apparently, *welcome* this. In a 1998 issue of *Business Ethics Quarterly*, communitarian thinker Amitai Etzioni is comforted by the thought that there "is no reason to expect that the politics of corporate communities would be any different from other democratic systems."

One can scarcely imagine how firms, whose resources are far more limited than are those of governments (and unsupported by the taxing power), can remain viable if their decision procedures are characterized by the strategic bargaining, logrolling, and other wasteful tactics that are the hallmark of democratic politics. If a camel is a horse designed by a committee, then what misshapen beast is a firm shaped by the strategic interactions of its stakeholder representatives?

Small Victories

The market economy, the liberty it safeguards, and the prosperity it secures are threatened not, as in the recent past, by firebrands who seek to abolish it, but by more modest tinkerers who seek to "improve" it in the name of myriad social concerns. Defending the market economy from this attack requires more than cataloging the defects of alternative economic systems and the merits of markets. It requires a principled defense of the shareholder-oriented firm—the basic productive institution on which the market economy is constructed.

Despite its worrisome implications, stakeholder-oriented management and its accompanying rhetoric encounter little systematic opposition in philosophy departments, business schools, or boardrooms. The costs of complacency about that state of affairs are potentially high. For although they have so far failed to bring wholesale change to the corporation and the law that governs it, stakeholder-oriented activists have won important piecemeal victories. The passage of corporate constituency statutes in several states has weakened the market for corporate control and, hence, the property rights of shareholders. Federal plant-closing legislation has legitimized among policymakers the idea that firm managers ought to be responsive to a multiplicity of interests. Corporate mission statements in which stakeholders and their interests feature prominently—whether adopted earnestly or as cover for self-serving managers—serve to further legitimize the subordination of shareholder interests to other concerns. If the market economy and its cornerstone, the shareholder-oriented firm, are in no danger of being dealt a decisive blow, they at least risk death by a thousand cuts.

Continued on page 12

ETHICS *Continued from page 11*

Business Ethics Reconsidered

Too often the free-market response to the changes sought by stakeholder-oriented business ethicists has been to denigrate the role of ethics in business—as if stakeholder-oriented reforms are the inevitable consequence of injecting concern for ethics into business. But the partisans of stakeholder theory are not spokespeople for ethics; they are spokespeople only for a particular *conception* of ethics—and a particularly flawed conception, at that. The manifold failings of stakeholder theory should not be taken to reflect poorly on the project of business ethics; rather, they reflect poorly on stakeholder theory itself.

Defenders of the free market, limited government, and the rule of law must articulate an *alternative* business ethics, one that recognizes and provides reasoned argument for the moral merit of the shareholder-oriented firm. Norms of honesty, integrity, and fair play, rather than an albatross around the neck of the free market, are a central, if neglected, part of the story of the success of the shareholder-oriented firm. In short, shareholder-oriented firms are not merely wealth-enhancing, they are good. ■

Silicon Valley will get burned by politics

Avoid D.C., Rodgers Warns

The high-tech world should avoid becoming more entangled in the politics of Washington, D.C., warns a leading Silicon Valley CEO in "Why Silicon Valley Should Not Normalize Relations with Washington, D.C." T. J. Rodgers, president and CEO of Cypress Semiconductor, says that Silicon Valley's attempt to become skilled at politics is self-defeating. "I believe we could make no bigger mistake. Silicon Valley is what it is because of the values that drive our success," he says, adding that politics is "antithetical to—and highly destructive of—our core values." Rodgers writes that lobbying organizations such as Technet, founded to help high-tech companies maneuver through Washington's political jungle, have the potential to "normalize" relations with Washington, much to Silicon Valley's detriment. "A normalized relationship between Washington and Silicon Valley, through organizations such as Technet, offers only disadvantages," Rodgers says. "The collectivism that big government espouses undermines capitalism and therefore the fundamental wealth-producing process of Silicon Valley," he writes. He also advises fellow CEOs to stand together to vigorously defend high-tech firms subjected to antitrust suits. "Nothing is more dangerous to the ethic of success and innovation in Silicon Valley than the antitrust laws," which Rodgers described as "antiquated" and "illogical." CEOs must also ignore calls by political pundits and the media for Silicon Valley to build "industry-government partnerships." Silicon Valley "is an island of capitalism and freedom admired around the world. We must remember that free minds and free markets are the moral foundation that has made our success possible."

T. J. Rodgers at Cato Policy Forum on March 15.

◆Open Federally Funded Research to Scrutiny

Independent review of federally funded research is crucial both for good science and for good public policy, write the authors of "The Case for Public Access to Federally Funded Research Data" (Policy Analysis no. 366). Michael Gough and Steven Milloy argue that Public Law 105-277 of 1998, known as the Shelby Amendment, is the best way to ensure that regulatory law is based on sound science. The authors write that federally funded research has frequently been tainted by poor methodology, dubious analysis, faulty data, politicized conclusions, and even borderline cases of fraud. The law, which has been under attack, guarantees public access to grantee-collected data that are used in support of rules or regulations. The study highlights several important cases in which third-party review revealed shoddy science that the government relied on to justify rules and regulations, including EPA-funded research on airborne asbestos; the National Cancer Institute's research on the herbicide 2,4-D; the FDA's campaign against fen-phen; and the American Lung Association's research on particulate matter. "In many cases, third-party review served to correct or prevent costly regulatory mistakes. In some cases, however, independent review of federally funded science occurred too late to prevent significant economic and consumer harm. Requiring the government 'to show its work' opens up the regulatory process," conclude Gough, a former staff member at the National Institutes of Health, and Milloy, author of *Science without Sense: The Risky Business of Public Health Research.*

◆Social Security Reform Plan Could Lead to S&L-like Bailout

The Archer-Shaw Social Security reform plan would create negative incentives that could lead to large taxpayer liabilities reminiscent of those occasioned by the savings and loan crisis, warns Andrew Biggs in "The Archer-Shaw Social Security Plan: Laying the Groundwork for Another S&L Crisis" (Cato Briefing Paper no. 55). While allowing individuals to make investment decisions, the plan proposed by Reps. Bill Archer (R-Tex.) and Clay Shaw (R-Fla.) would require

the government to protect workers against any investment losses, says Biggs, a Social Security analyst at Cato. "The plan's proposal to privatize profit and socialize risk resembles the incentive structure that led to the S&L crisis of the 1980s, which cost taxpayers hundreds of billions of dollars," Biggs writes. That incentive structure "could again lead to large taxpayer liabilities if allowed to take root in the Social Security system." Economists use the term "moral hazard" to denote the presence of incentives for individuals to act in ways that incur costs that they do not have to bear. "To avoid moral hazard, a Social Security reform plan incorporating personal retirement accounts must give workers a stake in both the gains and the losses of the accounts under their control. Archer-Shaw fails to do so. That lack of true market discipline creates a moral hazard problem every bit as acute as that of the S&L industry," he concludes.

◆Highly Skilled Workers Benefit the Economy

American industry's explosive demand for highly skilled workers is unmet because of the federal quota on H-1B visas for foreign-born highly skilled workers, argue the authors of "The H-1B Straitjacket: Why Congress Should Repeal the Cap on Foreign-Born Highly Skilled Workers" (Trade Briefing Paper no. 7). The quota restrictions are hampering output, especially in high-tech sectors, and forcing companies to consider moving production offshore, write authors Suzette Brooks Masters, an attorney and member of the Board of Directors of the National Immigration Forum, and Ted Ruthizer, professor of immigration law at Columbia Law School and head of the Immigration Law Group at a New York law firm. They argue that "H-1B hiring has contributed significantly to the growth and continued good health of our economy and has helped, not hurt, the U.S. worker." The authors conclude that the market should determine how many H-1B visas are needed. Congress should abolish caps on immigration of highly skilled workers and return to U.S. employers, subject to minimal regulation and unhampered by artificially low quotas, the ability to fill gaps in their workforce with qualified foreign national professionals.

◆Stop, Frisk, and Shoot

The controversial killing of an unarmed immigrant in February 1999 by New York City police was neither an act of racist violence nor a fluke accident, according to a new Cato Institute study, "'We Own the Night': Amadou Diallo's Deadly Encounter with New York City's Street Crimes Unit" (Cato Briefing Paper no. 56). Instead, the killing of Diallo, a 22-year-old West African immigrant, was the worst-case scenario of a reckless, confrontational style of policing, writes Timothy Lynch, director of Cato's Project on Criminal Justice. Plainclothes officers brandishing pistols and abruptly confronting city residents in the middle of the night invite disaster, Lynch maintains. Such a strategy carries an extraordinarily high level of risk for the officers, the suspect, and bystanders. The death of or serious injury to an innocent person was just a matter of time, Lynch says. The number of gun seizures increased as a result of a "stop-and-frisk" policy initiated by Mayor Rudolph Giuliani and then–police commissioner William Bratton in 1994 to confiscate illegal weapons from pedestrians. The number of illegal searches also increased. In 1998, for example, 18,000 cases were thrown out by prosecutors—double the number in 1994. Other cases were thrown out by the judiciary at the preliminary stage of trial proceedings.

◆Intervention in East Timor: The Next Kosovo?

The United States must continue to resist intense pressure to intervene militarily in the East Timor crisis, writes Leon T. Hadar in a new Cato Institute study, "Averting a 'New Kosovo' in Indonesia: Opportunities and Pitfalls for the United States" (Policy Analysis no. 367). Australia, Japan, members of the Association of Southeast Asian Nations, and American foreign policy activists have urged the United States to take decisive action to avoid what they say could be a crisis resembling that of Yugoslavia. Hadar, a research fellow in foreign policy studies at Cato, defends the restrained American response, which has had a calming effect. "The surprisingly low-key U.S. involvement in resolving the East Timor crisis averted a Kosovo-like intervention and reduced the danger that the United States would become the focus for anti-Western sentiment in Indonesia and elsewhere in Southeast Asia," Hadar writes. He argues that Australia, Japan, and ASEAN have been excessively timid in dealing with the growing turmoil, hoping that the United States would take action. He concludes that the United States should maintain its detached military and diplomatic approach to end the "free-riding mentality" of its East Asian allies and to help the region to create a stable balance of power.

◆Build Bomber Now

The F-22 fighter aircraft program should be terminated and the development of a new heavy bomber should begin more than a decade ahead of schedule, according to a new Cato Institute study. In "The United States Should Begin Work on a New Bomber Now" (Policy Analysis no. 368), Williamson Murray argues that the Air Force is investing too much in two tactical fighter aircraft—the F-22 and the Joint Strike Fighter—at the expense of bombers and the security of the nation. The service is spending billions of dollars on fighters that depend on access to overseas bases that are increasingly unavailable or are becoming vulnerable to enemy attack by ballistic missiles. "The United States confronts the fact that, at present and for the foreseeable future, far less infrastructure may be available abroad to support its air forces should an important conflict arise," writes Murray, Professor Emeritus of History at Ohio State University. Murray argues that the bombers would be a better long-term option because they deliver greater payloads than do fighters and have the longer range necessary to operate from less vulnerable bases farther away from the front. Yet the bomber force is being allowed to decay while funding accelerates for fighters. The Air Force does not plan to begin research on and development of a new bomber until 2013 and will not commence production until 2034, which means that the B-52 will be more than 80 years old when it is retired. Murray concludes that "the Air Force could cancel the F-22 air-superiority fighter—designed during the Cold War and unneeded after its end—and use some part of the savings to finance the development of the new bomber." ■

PENSION REFORM *Continued from page 3*

Ezrati declared, change is afoot.

Despite differences of time and geography, one point became clear: once a system of personal accounts has been put in place, not even radical changes in political leadership can overcome workers' desire to keep those changes. Chile has elected its first socialist president since Salvador Allende, but repealing personal accounts is not on the agenda. The United Kingdom replaced the Conservative Party with Tony Blair's New Labour Party, but as Conservative member of Parliament David Willetts explained, individual investment is more likely to expand than to contract under Labour. Australia's Sherry, now a member of the opposition, noted that "all research shows that compulsory private superannuation is popular, enjoying a 60 percent plus rating."

In an examination of America's Social Security system, Michael Tanner, director of Cato's Project on Social Security Privatization, outlined the case for a Chilean-style system of personal accounts. Former representative Tim Penny (D-Minn.) discussed the politics of Social Security reform, and author Charles Murray argued that the social welfare system needs to be revised because of its negative effects on human well-being.

Penny's and Murray's remarks are in the April edition of *CatoAudio*. ■

Kroszner, Macedo join Cato Journal

Carpenter Book Widely Reviewed

Randy Clerihue

◆**Randy Clerihue** has joined the Cato Institute as director of public affairs, with principal responsibility for media relations. He succeeds Julia Williams, who was named president of the Education Leaders Council. Clerihue was previously communications director of the Heritage Foundation. He has also been a congressional press secretary and a reporter for *Investor's Business Daily*.

◆**Randall S. Kroszner** and **Stephen Macedo** have joined the editorial board of the *Cato Journal*. Kroszner is a professor of economics at the Graduate School of Business at the University of Chicago. He wrote a Cato Policy Analysis on financial regulation in 1999. Macedo is the Laurance S. Rockefeller Professor of Politics and a member of the University Center for Human Values at Princeton University. He is the author of *Deliberative Politics: Essays on Democracy and Disagreement*.

Randall S. Kroszner

Stephen Macedo

◆**James A. Dorn,** vice president for academic affairs and editor of the *Cato Journal,* has been selected to deliver the commencement address to economics graduates at the University of Rochester on May 14.

James A. Dorn

◆**"To be governed...,"** the popular back-page feature of *Cato Policy Report,* is now available on a more timely basis at the Cato Institute Web site, www.cato.org. From the home page, find it under "Cato Library." The segment will be updated regularly.

◆***Nato's Empty Victory: A Postmortem on the Balkan War,*** edited by Ted Galen Carpenter, has been reviewed by *The Economist, The Spectator,* and the Associated Press. It reached the top half of 1 percent in sales among all the books on Amazon.com. ■

Cato Calendar

The Rule of Law in the Wake of Clinton
Washington • Cato Institute • July 12, 2000
Speakers include Sen. Fred Thompson, David Horowitz, Nadine Strossen, and Roger Pilon.

Cato University
San Diego • Rancho Bernardo Inn • July 29–August 4, 2000
Speakers include Randy Barnett, Tom Palmer, David Boaz, Don Boudreaux, Barbara Branden, and Virginia Postrel.

Globalization, the WTO, and Capital Flows: Hong Kong's Legacy, China's Future • *Cosponsored with Hong Kong Centre for Economic Research*
Hong Kong • September 4, 2000
Speakers include Joseph Yam, K. C. Kwong, Brink Lindsey, Mark Groombridge, John Greenwood, and Justin Yifu Lin.

Perspectives on Liberty: Public Policy 2000
Houston • Four Seasons • September 20, 2000

Perspectives on Liberty: Public Policy 2000
San Antonio • Westin Riverwalk • September 21, 2000

Monetary Policy in the New Economy: 18th Annual Monetary Conference • *Cosponsored with* The Economist
Washington • Cato Institute • October 19, 2000
Speakers include Alan Greenspan, Robert D. McTeer Jr., William A. Niskanen, and Charles Plosser.

Cato University
Montreal • Hotel Omni Mont-Royal October 19–22, 2000
Speakers include Charles Murray, Alan Charles Kors, and Tom Palmer.

Perspectives on Liberty: Public Policy 2000
New York • Waldorf-Astoria • November 17, 2000

13th Annual Benefactor Summit
Cancun • Ritz-Carlton • February 21–25, 2001

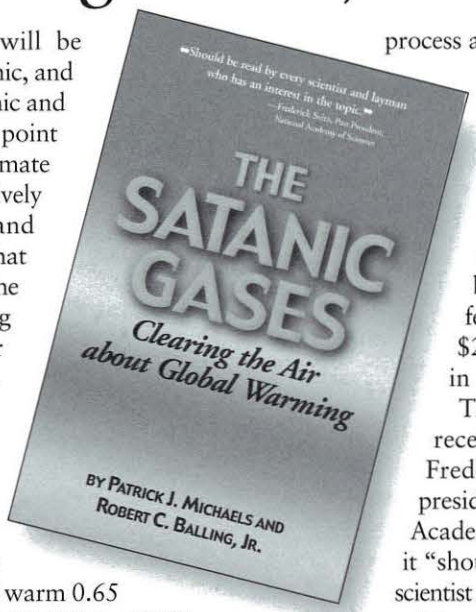
Warming is real but mostly benign

Politics Tilts Global Warming Debate, Book Says

A potentially informative and constructive debate about the costs and benefits of global warming has been lost to "political dramatization," argue the authors of a new Cato Institute book.

In *The Satanic Gases: Clearing the Air about Global Warming*, climatologists Patrick J. Michaels and Robert C. Balling, Jr., trace the development of global warming, writing that politicians blame the latest thunderstorm, flood, or change in the weather on global warming. They also assert that global treaties, protocols, and other policies are being signed and negotiated despite shoddy science.

Michaels, senior fellow in environmental studies at the Cato Institute and professor of environmental sciences at the University of Virginia, and Balling, director of the Laboratory of Climatology at Arizona State University, analyze the politics of global warming and provide a primer on the science. Acknowledging that industrial emissions of greenhouse gases have warmed the planet and will continue to do so over the next several decades, Michaels and Balling argue that future warming will be moderate, not catastrophic, and will have benign economic and ecological effects. They point out that the effects of climate change are already positively affecting mortality and agriculture, citing data that show the "greening" of the earth may be enhancing plant growth. The year 1998, during which temperatures warmed as a result of El Niño, produced record agricultural output. The authors expect that the earth's average surface temperature will warm 0.65 to 0.75 °C (1.17 to 1.35 °F) by 2050, resulting in a decline in temperature-related mortality and a rise in crop yields that alone would feed one-quarter of today's world population.



The authors find that government funding of research has corrupted the scientific process as scientists compete for funding in a politically charged environment. Total federal spending on global climate change research has ballooned from a few million dollars to $2.1 billion annually in the last 15 years.

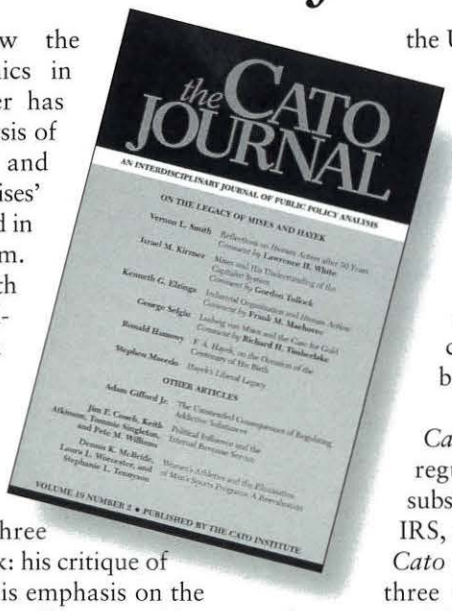
The book has already received much praise. Frederick W. Seitz, past president of the National Academy of Sciences, says it "should be read by every scientist and layman who has an interest in the topic."

The Satanic Gases: Clearing the Air about Global Warming can be purchased in cloth ($19.95) or paper ($10.95) by calling Cato Institute Books at 1-800-767-1241 or through the Cato Institute's online bookstore, www.cato.org. ■

Mises, Hayek Examined in *Cato Journal*

The latest issue of the *Cato Journal* (vol. 19, no. 2) commemorates the 50th anniversary of the publication of *Human Action* by Ludwig von Mises (Yale University Press, 1949) and the 100th anniversary of F. A. Hayek's birth. Editor James A. Dorn writes, "These two giants of market-liberal thought exposed the fallacies of central planning, pointed to the importance of private property rights and limited government in promoting a spontaneous market order, and explained the role of institutions in shaping incentives and behavior."

Papers by Vernon Smith, Israel Kirzner, Kenneth Elzinga, and George Selgin (along with comments by Lawrence H. White, Gordon Tullock, Frank Machovec, and Richard Timberlake) were first presented at the 1999 meeting of the Western Economics Association in a session titled "Mises' *Human Action:* A Critical Appraisal after 50 Years." Smith discusses how the experimental economics in which he is a pioneer has confirmed Mises' analysis of cooperation. Selgin and Timberlake examine Mises' views on the role of gold in the monetary system. Elzinga and Kirzner both note Mises' understanding that the market is a constantly evolving process, not a path to a particular endpoint.



Stephen Macedo of Princeton University discusses three themes in Hayek's work: his critique of political utopianism, his emphasis on the interdependence of law and liberty, and his faith in the power of ideas and institutions. Ronald Hamowy, a student of Hayek's at the University of Chicago, offers some personal reminiscences and an examination of Hayek's history of liberalism. Those papers were delivered at the Cato Institute on May 8, 1999, the centenary of Hayek's birth.

Other papers in the *Cato Journal* discuss the regulation of addictive substances, politics and the IRS, and women's sports. *Cato Journal* is published three times a year. Most articles are available at www.cato.org; subscriptions and single copies are also available. ■

"To Be Governed..."

◆Does that pay better than not growing wheat?

The supervisors in fast-growing Loudoun County [Va.] approved a plan yesterday to pay property owners not to build houses on their land.

—*Washington Post,* Feb. 8, 2000

◆And you should see the "'Hard Copy' bills"

Every year, state legislators introduce dozens of bills directly inspired by accounts of a freak tragedy or minute workaday hassle that they vow should never happen again.

In Maryland's state capital, they call them "'60 Minutes' bills"—legislation narrowly tailored to address the rare, real-life problems so compellingly presented by television programs.

—*Washington Post,* Jan. 22, 2000

◆Thank goodness it's voluntary

The administration is seeking a 9 percent increase in the [Internal Revenue Service] budget... that would allow the I.R.S., whose auditing staff is down one-fourth since 1995, to raise the number of auditors....

The decline in enforcement has become so significant that [Commissioner Charles] Rossotti now warns that it threatens to "undermine our entire system of voluntary tax compliance."

—*New York Times,* Feb. 13, 2000

◆Tax-cutting oddities

Gov. Parris N. Glendening today lambasted lawmakers who want to divert Maryland's share of the national tobacco settlement from cancer research and education for use on myriad smaller, localized and sometimes "odd" projects....

"There are many voices in the legislature today who have a different idea about how we should spend this money," he said. "There are a few that are odd, like build an additional road or cut taxes."

—*Washington Post,* Feb. 26, 2000

◆No bias here: the *Post* frequently refers to the "hard-edge liberalism" of the Democratic Party

With their programs of lower taxes, deregulation and "workfare"—and their willingness to stand up to public employee unions—[Ontario premier Mike] Harris and [Alberta premier Ralph] Klein have challenged the long-held assumption in Canadian politics that voters would never embrace the hard-edge conservatism of the Republican Party in the United States.

—*Washington Post,* Feb. 11, 2000

The bias in the press is not liberal, as so many believe.

—E. J. Dionne Jr. in the *Washington Post,* Feb. 11, 2000

◆So a few businesses have chipped in

Members of a Maryland House committee expressed exasperation yesterday over a proposal to ban or require disclosure of business deals between lawmakers and lobbyists, saying the measure is too burdensome and would feed perceptions that legislators are corrupt.

"It makes me a little upset that we're all perceived as crooks," said Del. Joanne C. Benson (D-Prince George's). "This job can't even begin to pay us for what we do for people. The state would go broke if it had to pay us what we're worth."

—*Washington Post,* Feb. 23, 2000

◆You're free to do what we tell you

As president, [George W.] Bush said, he would seek "fundamental changes" in the relationship between the state and federal government in education. "We will grant unprecedented freedom and flexibility in return for high standards and results," he said.

—*Dallas Morning News,* March 12, 2000

◆Your government at work

That raised one of [Smith & Wesson CEO Ed] Shultz's main anxieties: Could the Feds assure him that if he [accepted the federal government's demands], most of the 29 municipalities that had gone to court [to sue gun makers], as well as New York and Connecticut, would cease hostilities.

They would try. In a separate phone call, [Housing and Urban Development secretary Andrew] Cuomo told Mr. Shultz that if necessary, he would use his legal and fiscal influence on urban issues to persuade recalcitrant local officials.

—*Wall Street Journal,* March 21, 2000

◆*Here* being the operative word

I like the mayor very much, but I still believe in the rule of law here.

—President Clinton, answering a question about the mayor of Miami and the Elián Gonzalez case, press conference, March 29, 2000

CATO POLICY REPORT
1000 Massachusetts Ave., N.W.
Washington, D.C. 20001

ADDRESS CORRECTION REQUESTED

CATO