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How China Became Capitalist

BY RONALD COASE AND NING WANG

None foresaw that the “socialist modernization” that the post-Mao Chinese government launched would in 30 years turn into what scholars today have called China’s great economic transformation. How the actions of Chinese peasants, workers, scholars, and policymakers coalesce into this unintended consequence is the story we tried to capture. Today, we don’t need to present any statistical data to convince you the rise of the Chinese economy, even though China still faces enormous challenges ahead. Many Chinese are still poor, far fewer Chinese have access to clean water than to cell phones, and they still face many hurdles in protecting their rights and exercising their freedom. Nonetheless, China has been transformed from the inside out over the past 35 years. This transformation is the story of our time. The struggle of China, in other words, is the struggle of the world.

Against conventional wisdom, we take the end of 1976 as the start of post-Mao reform and argue that China basically became a market economy by the end of the 90s before it joined the World Trade Organization in 2001. In the new millennium, the

RONALD COASE is a Nobel laureate and the Clifton R. Musser Professor Emeritus of Economics at the University of Chicago Law School. **NING WANG** is an assistant professor at the School of Politics and Global Studies at Arizona State University. This essay is based on their recent book *How China Became Capitalist*.

Chinese economy has kept its growth momentum and become more integrated with the global economy. As an account of how China became capitalist, our book focuses mainly on the first two decades of reform. Within this time frame, our account is split into two parts by a dividing event, the 1989 Student Movement.

The first part of the story is a tale of two

reforms. One was designed by Beijing; its goal was to revitalize the state sector and save socialism. The other resulted from grassroots initiatives. The state-led reform came in two phases. The first one started at the end of 1976 under Hua Guofeng. Hua was Mao’s designated successor, who consolidated his power base after arresting

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THE WALL STREET JOURNAL.

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Ed Crane’s Freedom Legacy

The cause of limited government is enjoying a political resurgence, and it may even prevail on November 6. But if it fails on Election Day, the fault won’t lie with Ed Crane, who has stepped down this month after 35 years building the Cato Institute and promoting free people and free markets.

With money from Wichita businessman and libertarian Charles Koch, Mr. Crane founded Cato in San Francisco in 1977 with a budget of \$800,000 and a staff of 10. He reluctantly moved the think tank to Washington in 1981 to more effectively communicate the small-government case in the heart of Leviathan. Cato’s annual budget is now \$21 million with a staff of 127, and its scholars have led the battles for entitlement reform, regulatory restraint, free trade and lower taxes.

Unlike some leaders of the libertarian movement, Mr. Crane is not a dogmatist and allowed his scholars wide latitude. We’ve disagreed with Cato’s isolationist approach

to foreign policy, but its ideas and op-eds have regularly informed readers of these pages. Cato’s annual conference on monetary policy is especially influential by airing debates over a subject typically ignored by most of the media and think tanks. Under Mr. Crane, Cato held the first conferences on free markets and the rule of law in China (1988) and Russia (1990).

Mr. Crane’s final months at Cato were marred by an unfortunate row over control with Charles and David Koch. We’re pleased that the battle has been settled with a new governance pact that organizes Cato like a more traditional nonprofit with a self-sustaining board. Mr. Crane is graciously retiring at age 68.

His able successor is the longtime and highly successful former CEO of BB&T bank, John Allison, who has plans for expansion but who will build on the foundation of Mr. Crane’s broad shoulders.

On October 24, a *Wall Street Journal* editorial paid tribute to Edward H. Crane’s “35 years building the Cato Institute and promoting free people and free markets.” Crane stepped down as President and CEO in October and was succeeded by John A. Allison. **PAGE 4**



BY DAVID BOAZ

“Libertarianism is the idea that adult individuals have the right and the responsibility to make the important decisions about their lives.”

Editorial

Top 10 Ways to Talk about Libertarianism

I give a lot of speeches and interviews about libertarianism. Often I have to begin simply by explaining what libertarianism is. Always I'm looking for effective ways to convey the essential libertarian ideas. So today I'm just setting out very briefly my Top 10 Ways to Talk about Libertarianism.

10. When I talk in the broadest terms about Americans who hold libertarian views, I often use the popular journalistic phrase “fiscally conservative and socially liberal”—as in my new ebook with David Kirby and Emily Ekins, *The Libertarian Vote: Swing Voters, Tea Parties, and the Fiscally Conservative, Socially Liberal Center*.

9. I'm also partial to Adam Smith's lovely phrase, “the simple system of natural liberty.” Set up a few simple rules, protect people's rights, and liberty is what happens naturally.

8. The most eloquent piece of libertarian writing in history is Thomas Jefferson's Declaration of Independence, and “life, liberty, and the pursuit of happiness” is a great statement of the libertarian vision.

7. I like this rarely quoted line from Ayn Rand:

If men of good will wish to come together for the purpose of upholding reason and establishing a rational society, they should begin by following the example of the cowboys in Western movies when the sheriff tells them at the door to a conference room: “Gentlemen, leave your guns outside.”

Exactly. Civilized people rely on persuasion, not force.

6. Sometimes I organize a speech around three key ideas of libertarianism:

Spontaneous order: the understanding that most of the order in society, from language and law to the economy, happens naturally, without a central plan; Natural rights: the rights to life, liberty, and property that we have inherently, not as a gift from government; and

Limited government: the political system that protects our rights without infringing on our freedom.

5. At Tom Palmer's urging, I created a speech, or at least a speech opening, around the theme that “Libertarianism is the application of science and reason to the study of politics and public policy.” That is, libertarians deal in reality, not magic. We know that

government doesn't have magical powers to ignore the laws of economics and human nature.

4. Inspired by Robert Fulghum's bestseller *All I Really Need to Know I Learned in Kindergarten*, I like to tell people that you learn the essence of libertarianism—which is also the essence of civilization—in kindergarten:

Don't hit other people.
Don't take their stuff.
Keep your promises.

3. Another pithy explanation I like came from a high-school libertarian newsletter some 20 years ago:

Smokey the Bear's rules for fire safety also apply to government—keep it small, keep it in a confined area, and keep an eye on it.

2. In *Libertarianism: A Primer*, I described the fundamental libertarian principle this way:

The corollary of the libertarian principle that “Every person has the right to live his life as he chooses, so long as he does not interfere with the equal rights of others” is this:
No one has the right to initiate aggression against the person or property of anyone else.

This “non-aggression axiom” is perhaps most associated with Ayn Rand and Murray Rothbard, but its roots go back to Spencer, Mill, Locke, Pufendorf, and even Epicurus.

1. And finally, the number 1 way to talk about libertarianism—or at least a sentence I found effective when I was talking about *Libertarianism: A Primer* on talk shows: “Libertarianism is the idea that adult individuals have the right and the responsibility to make the important decisions about their lives.” Every word is important there: We're talking about individuals. We're talking about adults; the question of children's rights is far more complex. Responsibility is just as important as rights.

Of course, today government claims the power to make many of those decisions for us, from where to send our kids to school to what we can smoke to how we must save for retirement. And that is why it's important for us to promote the ideas of liberty and to do so as effectively as we can.

*IPOs, credit unions, and phone service
in the latest Regulation*

Are We Cracking Down on Scalpers—or Consumers?

Should concert ticket scalpers and secondary markets be reined in for the sake of rewarding genuine fans and artists? In the new issue of *Regulation*, David and Emma Harrington examine the Better Oversight of Secondary Sales (BOSS) Act—noting that the law is “a net designed to scoop up large-volume scalpers while letting die-hard fans and small fish swim on.” By delving into the billion-dollar-a-year concert industry, they conclude that “with so much money at stake, the greater concern ought to be that calls for government intervention are profiteering disguised as consumer protection.”

Pierre Lemieux argues that as fiscal problems deepen at all levels of government, the role of private, voluntary associations will become even more prominent. Lemieux demonstrates how nonprofits like the Appalachian Mountain Club—America’s oldest recreation and conservation organization—can address various forms of market failure. “This should be seen as an opportunity,” he concludes.

Elsewhere in this issue, Victor Stango argues that “despite their claims, credit unions seem unable to offer competitive payday loans,” and Adam C. Pritchard notes that the “conspicuous flaws with [initial public offerings] suggest that we should put an end to them, if we can establish a viable alternative.”

Jeffrey A. Eisenach and Kevin W. Caves ask what happens when local phone service is deregulated, and find that “early returns suggest liberalization benefits consumers just as long distance deregulation did.” Other contributors include Christopher S. Yoo on the trade-offs between clashing regulatory paradigms and A. Barton Hinkle on the embarrassing state of investigative journalism.

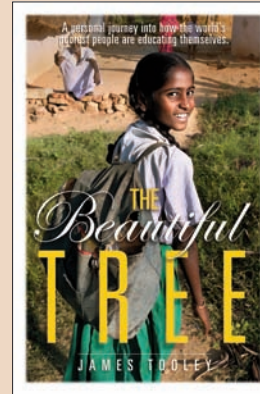
The Fall 2012 issue features reviews of books on the moral limits of markets, a new theory of social justice, and how to cure the health care crisis. As always, it wraps up with Peter Van Doren’s survey of recent academic papers. ■

Regulation is available by subscription or online at www.cato.org/regulation.



Cato News Notes

BEST OF THE BEST



In the latest *Claremont Review of Books*, John Blundell, former director general of London’s Institute of Economic Affairs, named James Tooley’s *The Beautiful Tree* (Cato Institute, 2009) as one of the five best public policy books of the last

50 years. Tooley’s book—which Blundell called “a masterpiece”—recounts his personal journey into how the world’s poorest people are educating themselves through private means. “Reading his work was the single most eye-opening moment of my life in public policy,” Blundell concluded. The book has earned high praise since its release—receiving the 2010 Fisher International Memorial Award from the Atlas Economic Research Foundation—and was also featured in a documentary on BBC.

I SHALL BE RELEASED

“A Treasury economist rummaging in the department’s library has stumbled on a historical treasure hiding in plain sight,” the *New York Times* reported in October. The discovery—a full transcript of the 1944 Bretton Woods conference—was uncovered by Kurt Schuler, an economist who has written for the Cato Institute, and Andrew Rosenberg, a researcher who began his work on the volume while interning at Cato. The transcript lays bare some of the previously obscure details from the World War II conference, during which the allied nations came together to create both the International Monetary Fund and the World Bank. These details, the *Times* added, are “sort of the economists’ equivalent of a Bob Dylan fan finding unknown lyrics.”

THE LEGACY OF

Edward H. Crane



Illustration: Alexander Hunter
for the *Washington Times*

When a young California investment manager named Ed Crane spent 1976 in Washington, he noticed how much influence a few think tanks had despite their relatively small budgets. He thought there ought to be a public policy research organization—a think tank—dedicated to the American principles of liberty and limited government. When he returned to San Francisco, he cofounded the Cato Institute, which opened its doors in January 1977. He served as President and CEO until October 2012.

A genetic libertarian, Edward Harrison Crane was born in the Los Angeles suburb of View Park, California. Once referred to by the *Washington Post* as “the lion king of button-down libertarianism,” Crane has dedicated his life to guiding the Cato Institute from a three-person outfit in San Francisco to one of the most prominent public policy research organizations in the country.

“Ed Crane has taken the different path, a single-minded free thinker whose life has been lived largely out of step with his times—or perhaps a step or two ahead of them,” the *Post* continued.

From the beginning he insisted that Cato stick to firm libertarian principles and take on the big issues.

While many avoided Social Security as a third rail issue, for instance, the Cato Institute, in its 1979 inaugural edition of *Cato Policy Report*, commissioned Carolyn Weaver to argue in favor of privatizing the system. More books and studies followed, and in 1995, on the 60th anniversary of the creation of the program, the Cato Institute established the Project on Social Security Choice. The 2001 President’s Commission to Strengthen Social Security drew heavily on the work of the

ED CRANE TALKS WITH MILTON AND ROSE FRIEDMAN AT A PICNIC TO CELEBRATE THE CATO INSTITUTE'S 25TH ANNIVERSARY (NOTE MILTON'S CAP) IN 2002.



 **Steve Forbes**  @SteveForbesCEO  

Ed Crane has indeed been a consistent, fearless, effective advocate of liberty! See [WSJ on.wsj.com/U2eVnf](http://on.wsj.com/U2eVnf)

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Ed Crane's Freedom Legacy

The Wall Street Journal writes that the Cato Institute's founder Ed Crane has stepped down this month after 35 years of promoting free people and free markets.

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LEFT: CRANE PRESENTS A BUST OF F. A. HAYEK TO YEVGENY PRIMAKOV, THEN CHAIRMAN OF THE COUNCIL OF THE UNION OF THE SUPREME SOVIET AND LATER PRIME MINISTER, AT CATO'S 1990 MOSCOW CONFERENCE, "TRANSITION TO FREEDOM." EDWARD LOZANSKY OF THE INDEPENDENT UNIVERSITY OF MOSCOW LOOKS ON. **TOP RIGHT:** CRANE MET WITH PRESIDENT AND MRS. REAGAN IN LOS ANGELES. **BOTTOM RIGHT:** STEVE FORBES AND THE *WALL STREET JOURNAL* WERE AMONG THOSE CONGRATULATING CRANE AS HE STEPPED DOWN AFTER 35 YEARS.



A FOUR-HOUR MEETING WITH RUSSIAN PRESIDENT VLADIMIR PUTIN (RIGHT) WAS THE HIGHLIGHT OF CATO'S 2004 MOSCOW CONFERENCE, "A LIBERAL AGENDA FOR THE NEW CENTURY."



CRANE AND CATO VICE PRESIDENT ROGER PILON WELCOME JUSTICE CLARENCE THOMAS TO A LUNCH WITH CATO SCHOLARS IN 1994.

Institute's scholars .

Under Crane's leadership, Cato was among the first organizations to hold major conferences in China and the then Soviet Union. These symposiums helped expose those nations to the animating principles behind an open and civil society.

In 1988 the first of four conferences, titled "Economic Reform in China: Problems and Prospects," was held in Shanghai. As a front-page story in the *China Daily* noted, the event centered around one question: "Should China reform its economy step by step or all at once?" It featured speakers such as Nobel laureate Milton Friedman, political scientist Alvin Rabushka, and author George Gilder. The gathering enabled Chinese and Western scholars to discuss the progress of China's reform movement and consider what kinds of market reforms are essential for further modernization and development.

In 1990 Cato held a weeklong conference in Moscow titled "Transition to Freedom: The New Soviet Challenge." The largest gathering of classical-liberal thinkers ever to take place in the Soviet

Union, the event included Nobel laureate James Buchanan, Charles Murray, and numerous Russian scholars and members of parliament. “When Cato’s president Edward H. Crane reminded the large audience that ‘the government that governs least governs best’ . . . hundreds of Russians clapped and cheered wildly,” the *Wall Street Journal* reported. “Only a handful of die-hard Communists sat glum-faced, arms folded.” Crane presented a bust of F. A. Hayek to Yevgeny Primakov, chairman of the Council of the Union of the Supreme Soviet, as more than 1,000 Soviet citizens attended their first open forum.

Today, the Institute has become a leading voice on the national stage. “Cato has managed the difficult feat of becoming both a fount of true-blue libertarian ideas and a reputable source of information even for those who don’t share its views,” columnist Steve Chapman wrote in the *Chicago Tribune* last year. “It may be the most successful think tank in Washington.” And as the *Wall Street Journal* recently acknowledged, the continued success of the Institute moving forward “will build on the foundation of Mr. Crane’s broad shoulders.”

But the most enduring impact of his legacy will remain with the future of the libertarian movement at large. “In the long run, the ideology of freedom will win,” Murray said at the Cato Club 200 retreat in September. “And when the history is written of how it is that, in the last quarter of the twentieth century, the flickering flame of freedom became strong enough to withstand the winds, Ed Crane’s name will figure very largely.” ■

TOP TO BOTTOM: ED AND KRISTINA CRANE MARRIED IN SHANGHAI IN 1988, DURING CATO’S CONFERENCE “ECONOMIC REFORM IN CHINA,” SURELY THE FIRST CONFERENCE ON FREE MARKETS AND THE RULE OF LAW EVER HELD IN THE ANCIENT NATION OF CHINA. CRANE AND LONG-TIME CATO SUPPORTER ANDREA MILLEN RICH, FORMER PRESIDENT OF LAISSEZ FAIRE BOOKS, TALKED AT A BENEFACTOR SUMMIT. CRANE TALKED WITH SEN. RAND PAUL AT CATO UNIVERSITY IN 2011.



Continued from page 1

the “Gang of Four” and ending the Cultural Revolution. Even though loyal to Mao, Hua was an economic modernizer. With full support of Deng Xiaoping and other Chinese leaders, Hua launched his economic program of modernization, which would be later disparaged as “the Leap Outward.” Essentially, it was a state-led, investment-driven program, with a focus on heavy industry; it is a good example of what economists called “big-push industrialization.” But the program lasted barely over two years. It was called off in early 1979, partly due to its own defects and partly due to leadership change: at the end of 1978 the Central Committee held a meeting, at which Deng Xiaoping and Chen Yun came back to power and Hua was no longer in charge.

Deng Xiaoping is widely known in the West. Ezra Vogel’s recent biography has documented in detail Deng’s role in China’s reform. In comparison, Chen Yun is a shadowy figure. But Chen was China’s top official in charge of economic affairs. He was the architect of China’s first Five Year Plan in 1953 and a strong believer in central planning. Since he grew up and apprenticed in Shanghai before becoming a revolutionary, Chen also saw a limited but critical role for the private sector and market under socialism. Chen lost his position when Mao started the Great Leap Forward in 1958, which Chen opposed. He came back to power along with Deng at the end of 1978 and was handed the job of designing an economic reform program.

Chen believed that the Chinese economy had long suffered structural imbalance: too much investment in heavy industry relative to light industry and agriculture, and state sectors and planning being emphasized at the exclusion of private sectors and markets. In his view, Hua’s economic program, which focused on heavy industry, made the Chinese economy worse. That’s why Chen forcefully ended “the Leap Outward” against strong opposition from the State Council and imposed his economic policy. This marked the second round of Beijing-led reform. This round of

“The first part of the story is a tale of two reforms. One was designed by Beijing. The other resulted from grassroots initiatives.”

state-led reform was two-fold: adjustment at the macro level and state-enterprise reform at the micro level. Structural adjustment was imposed across the economy. For example, more investment was channeled from capital goods to consumer

government was preoccupied with incentivizing state enterprises.

REFORM ON THE MARGINS

There is no doubt that the post-Mao Chinese government pursued a series of reforms. But today, with the benefit of hindsight, we know that the economic forces that were really transforming the Chinese economy in the first decade of reform were private farming, township and village enterprises, private business in cities, and the Special Economic Zones. None of them was initiated from Beijing. They were marginal players operating outside the boundary of socialism. For these marginal forces, the Chinese government was happy to leave them alone as long as they did not



At a Cato Book Forum for *How China Became Capitalist*, NING WANG of Arizona State University spoke and was joined in a video presentation by coauthor RONALD COASE (left), a Nobel laureate from the University of Chicago. The two authors discussed China’s extraordinary journey in transforming itself into a powerful economic force.

goods production. More money was allocated to agriculture. The government raised the purchasing prices for agricultural products by more than 20 percent in 1979 and significantly increased grain import. Beijing also took steps to decentralize foreign trade and gave more fiscal autonomy to provincial governments. At the micro level, the emphasis was squarely placed on what was seen as the economic foundation of socialism, the state-owned enterprises. The strategy was to devolve some rights to state enterprises and allow them to keep some profits. Beginning in 1979 and throughout the 1980s, the Chinese

threaten the state sector or challenge the Party’s political power. This created a room for what we called the “marginal revolutions” that brought entrepreneurship and market forces back to China during the first decade of reform.

One such marginal revolution is private farming. Private farming was certainly not new in China. Before 1949, it had existed for millenia. In the early 1950s, Mao tried ruthlessly to collectivize farming. Some peasants believed in Mao and hoped collectivization would offer them a way out of poverty. After 20 years of collective farming and 40 million famine deaths, they knew

“The Chinese government has understandably promulgated a state-centered account of reform, projecting itself as an omniscient designer and instigator of reform.”

better. Many went back to private farming after Mao died, even though Beijing was still trying to beef up the commune system. In September 1980 Beijing was forced to allow private farming in areas where “the people had lost their confidence in the collective.” But once the floodgates of private farming were opened, it could no longer be controlled. By early 1982 it became a national policy. Chinese agriculture was decollectivized. Later in the official account of reform, Beijing would credit itself for launching agricultural reform. But the reform enacted by Beijing merely raised the purchasing prices of grain and increased grain import; private farming, which really transformed Chinese agriculture and freed Chinese peasants, did not come from Beijing.

Township and village enterprises were industrial operations located in rural areas. During the first two decades of reform, they were the most dynamic sector in the Chinese economy. Since they operated outside the state plan, they did not have guaranteed access to raw materials controlled by the state but had to purchase them from the black market at a higher price. They were also excluded from the state-controlled distribution system to sell their products, but had to hire their own sales teams to travel all over China to find markets for their products. In other words, they had to operate like real business firms. This is what they did. And it did not take long for them to outperform state enterprises, which had all the privileges and state protections that they simply stopped being enterprising.

The first private businesses in Chinese cities were started by people who did not have a job in the state sector. Most were city youths recently returned from the countryside. During Mao’s era, 20 million middle school graduates (ranging from 15 to 18 years old) in cities were sent to the countryside partly because the government could not create enough jobs. After Mao died, they came back, but found no job in the state sector. Young, jobless, and restless, they took to the streets and even blocked the railway. This mounting pressure forced the government to open the door for self-

employment. Private shops started to emerge in Chinese cities; they quickly ended state monopoly of the urban economy.

Among the four marginal revolutions, the Special Economic Zones were the most controversial. They were established to co-opt capitalism to save socialism. The idea was to allow them to experiment with the market economy, importing advanced technology and managerial know-how, selling goods to the global markets, creating jobs and stimulating economic growth. But the experiments were confined to a few enclaves and strictly controlled so that they would not undermine socialism elsewhere, and if the experiments failed, their damage to socialism would be negligible.

REGIONAL COMPETITION

The presence of two reforms was a defining feature of China’s economic transition. The failure to separate the two is a main source of confusion in understanding China’s reform. The Chinese government has understandably promulgated a state-centered account of reform, projecting itself as an omniscient designer and instigator of reform. The fact that the Chinese Communist Party has survived market reform, still monopolizes political power, and remains active in the economy has helped to sell the statist account of reform. But it was marginal revolutions that brought entrepreneurship and market forces back to China during the first decade of reform when the Chinese gov-

ernment was busy saving the state sector.

The second part of our tale began in 1992 after Deng Xiaoping’s southern tour. While marginal revolutions brought market forces back to China in the previous decade, regional competition became the main transformative force in the second decade, turning China into a market economy at the end of the century. Regional competition was not new; it existed in the first decade of reform. But then it created trade barriers at provincial borders and fragmented the Chinese economy. China implemented price reform in 1992, tax reform in 1994, and began to privatize state enterprises in the mid-1990s. These reform measures paved the way for the rise of a common national market, which was able to impose market discipline on all economic actors, turning regional competition into a transformative force.

Here, our account differs from the one presented by Huang Yasheng in his book, *Capitalism with Chinese Characteristics*. A controversial argument of Huang is that China was more capitalistic and entrepreneurial in the 1980s than in the 1990s. If the argument means that private entrepreneurship prevailed against the state in the 1980s, it is in full accord with our tale of “marginal revolutions.” But if it suggests that China moved away from a free market economy in the second decade of reform, it misses a fundamental change in the economy in the 1990s; the emergence of a common national market, which was a precondition for regional competition to work.

Identified with repetitive investment, regional competition is often faulted for distorting comparative advantage and hindering economies of scale. A more nuanced picture emerged in our account. What regional competition did was to translate China’s advantage in space as a continental country into the high speed of industrialization. How this happened can best be seen from a Hayekian perspective, which stresses the growth of knowledge as the ultimate force driving economic change. In Mao’s time, education was under attack and knowledge became a political liability; China isolated itself from the West and cut itself off from its own traditions. Mao’s rad-

ical ideology impoverished the Chinese economy and, worse, closed Chinese minds.

After Mao died, China re-embraced pragmatism. “Seeking truth from facts” became the Party’s new guideline; getting rich became glorious. Then the most restrictive constraint for economic growth was the lack of knowledge. This included technical knowledge, knowledge about institutions—how various market-supporting institutions work, and local knowledge—what Hayek called “knowledge of the particular circumstances of time and place.” The solution to this problem was found in regional competition. When China’s 32 provinces, 282 municipalities, 2,862 counties, 19,522 towns and 14,677 villages threw themselves into an open competition for investment and for good ideas of developing the local economy, China became a gigantic laboratory where many different economic experiments were tried simultaneously. Knowledge of all kinds was created, discovered, and diffused fast. Through the growth of knowledge, the enormous scale of Chinese industrialization made its rapid speed possible.

CONCLUSION

Given our account of how China became capitalist, what can we say about the form of capitalism that has emerged in China? A persisting feature of China’s market transition is the lack of political liberalization. This is not to say that the Chinese political system has stood still over the past 35 years. The Party has distanced itself from radical ideology; it is no longer communist except in name. In recent years, the internet has increasingly empowered the Chinese to exercise their political voice. Nonetheless, China remains ruled by a single political party.

This continuity hides a fundamental change in China’s political reality. With the death of Deng Xiaoping, “strongman” politics was brought to a closure. Under Jiang Zemin and Hu Jintao, China is no longer ruled by a charismatic leader. In that sense, Chinese politics today is qualitatively different from the time of Mao and Deng. But the Chinese government has not come to terms with this political change on the ground; there have been few efforts at institution-building to prepare

“Our book provides a different diagnosis of the main flaw of the Chinese market economy: China has developed a robust market for goods, but it still lacks a free market for ideas.”

China for the new political reality.

The combination of rapid economic liberalization and seemingly unchanged politics has led many to characterize China’s market economy as state-led, authoritarian capitalism, which many people have rightly recognized as fragile and unsustainable. When and how China will embrace democracy, and whether the Party will survive democratization, are the main questions asked about China’s political future. In our book, a different perspective is offered. It provides a different diagnosis of the main flaw of the Chinese market economy: China has developed a robust market for goods, but it still lacks a free market for ideas.

The market for ideas points to an alternative way of thinking about China’s political future. Our reasoning is mainly based on the following two considerations. First, multi-party competition does not work unless it is cultivated and disciplined by a free market for ideas, without which democracy can be easily hijacked by interest groups and undermined by the tyranny of the majority. The performance of democracy critically depends on the market for ideas, just like privatization depends on the market for capital assets. Second, multi-party competition had virtually no precedent in Chinese history. Indeed, the Chinese word for the “party” (党) has a strong negative connotation in traditional Chinese political thinking. “Forming a party and pursuing self-interest” (结党营私) has been consistently denounced as undermining the political ideal, which is “what is under heaven is for all” (天下为公). In contrast, the market for ideas

has a deep and revered root in traditional Chinese thinking; “let one hundred schools of thought contend” has been respected as a political ideal since the time of Confucius. In our view, the market for ideas promises a more gradual and viable approach to rebuilding Chinese politics on the principles of tolerance, justice, and humility.

Over the past 35 years, China has embraced capitalism not just in the economy. *The Theory of Moral Sentiments* has more than a dozen Chinese translations; the book has won the heart and mind of premier Wen Jiabao. The message of Adam Smith resonates strongly with the Chinese, not least because of its striking affinity with the traditional Chinese thinking on economy and society. A surprising outcome of China’s transition to capitalism is that China has found a way back to its own cultural roots.

“Seeking truth from facts” is a traditional Chinese teaching, which Deng Xiaoping mistakenly called the “essence of Marxism.” But many facts are still covered in China because a free market for ideas does not exist yet. We are cautiously optimistic that China may well embrace a market for ideas in the decades to come, just like the way it embraced the market for goods in the recent past. As our modern economy becomes more and more knowledge-driven, the gains from free exchange of ideas are too great; the costs of suppressing it are too high.

China’s embrace of both its history and globalization leads us to believe that Chinese capitalism, which just started its long journey, will be different. This is desirable not just for China, but for the West and everyone else as well. It is also desirable for the global market economy. Today, biodiversity is recognized as vital for sustaining our natural environment. Institutional diversity plays a similar role in keeping human society resilient. Capitalism will be much more robust if it’s not a monopoly of the West, but flourishes in societies with different cultures, religions, histories, and political systems. While trade in the global market for goods makes war too expensive to fight, a global market for ideas can accommodate and thrive on the clash of ideas but steers us away from the clash of civilizations. ■

America: Down the Drain and Caught in the Greece Trap

The election is over—and regardless of the winner, America lost. Barack Obama ran on a platform sitting atop a gigantic government that gives away everything for free. Mitt Romney didn't have the wit to point out that the handouts are stolen—and worse yet, *they're stolen from you*. So says P. J. O'Rourke, America's leading political satirist and an H. L. Mencken research fellow at the Cato Institute. In October, at a City Seminar in New York, O'Rourke discussed the perils of "committee-brain," how local government is like a hot shower, and his own plan for stimulating the economy.

Ladies and gentlemen, I just love being in New York City. The capital of the free world. The Statue of Liberty! Huddled masses! I lift my lamp beside the golden door! Yes, freedom is what New York is all about.

Well, I was just out in the lobby drinking a 32 oz. Big Gulp, smoking a cigar, sprinkling salt on my extra large, triple cheese, meat lover's pizza—and I have to ask: What is that yappy Miniature Schnauzer of a mayor going to ban next? Why not just ban everything that's bad for people—like watching Bloomberg Business channel? That was pretty bad for me. I got right in on that Facebook IPO...

Or is it just our physical health that the mayor is worried about? If that's the case, he better ban voting for Democrats—otherwise Obamacare is going to kick in and health care will cost nothing. And when something costs nothing, trust me, it's worth it.

To hell with you, Mayor Bloomberg, and to hell with politics. People have a tendency to believe that the Cato Institute is a political think tank. It's not. It's an *anti-political* think tank. We're not here today to fix politics—well, I take that back. We are here to "fix" politics—the way you fix a cat. The way you spay a dog. The way you castrate a dangerous bull. We mean to tame these political sons of bitches. We are going to teach them not to beg at the table. We're going to teach them not to bark at the moon.

We're going to teach them to heel and

come when they're called. We're going to teach them domestic policy: Stay off the furniture! No politics in my bed! We're going to teach them foreign policy: Stop making messes in other people's yards!



We're going to teach them to roll over and play dead, because we're going to give them a lesson on term limits. When we toss our political power to a politician, he is going to bring that political power right back here and drop it at our feet. Good boy! Now back in the kennel.

It isn't going to be easy to housebreak this political mess. The floors of both houses in Congress are going to have to be covered with a lot of newspaper. (But not the editorial section of the *New York Times*. We don't want our political puppies reading *that* stuff.)

Ladies and gentlemen, we are going to win this fight. It won't be simple. It won't be quick. And we're going to lose a lot of battles along the way. But eventually, voters go back to work—and they find that their paychecks are being taxed to hell, their jobs and business opportunities are being regulated away, and their hopes for the future are being tied to the millstone of the federal deficit. Then they remember that government is all taking and no making. And that's why we will win this fight. But only if we keep fighting.

People know that politicians are thieves. People know that politicians are liars. But we nevertheless have to continue leading the charge. We have to remind people *how* politicians are thieves and *when* politicians are liars. We have to pass the ammunition so that people can take aim at the theft and the lies. Our duty is to help our fellow citizens realize in their minds what they already know in their guts. Take just one example. Everybody knows that the government costs too much. But thanks to two of our patron saints, we're able to explain *why* government costs too much.

More than 30 years ago, in their book *Free to Choose*, Milton and Rose Friedman used a very simple graph to show that, mathematically, there are only four ways in which money can be spent.

First, your money can be spent on yourself. Let's take cars, for instance. Twenty years ago, I bought a Porsche 911. It's a wonderful car—I still have it—and I got a great deal at the time from a dentist who scared himself with it and bought a Lexus coupe instead. When you spend your money on yourself, you get as nearly as you can exactly what you want. More importantly, you bargain hard to get it.

Second, your money can be spent on other people. Now, you may still bargain hard under these circumstances. But you're not quite as concerned about getting exactly what you wanted—although I'm sure my

wife is very fond of the GeoTracker that I got for her and the kids.

Third, other people's money can be spent on yourself. With those parameters, I'm on the fence between an Aston Martin DBS coupe that goes for \$300,000 and a Maserati GranTurismo convertible, which is a steal at \$145,000.

In the final scenario, you're not involved at all. You're spending other people's money on other people. It's not your dime, and there's nothing in it for you. It might as well be "Billions for Jack," or as the government called it, "Cash for Clunkers." By the way, number four is the way all government programs work.

Everybody knows government costs too much and everybody knows government shouldn't be given too much power. But people forget why. Government should not be given too much power because it has a special kind of power—a comic book supervillain type of power. The political system has a monopoly on the use of deadly force. That deadly force can be brought to bear upon you for any violation of even the most trivial, the most picayune government regulation. If you fall afoul of recycling rules, you'll get a citation from the sanitation department. If you don't pay the fine, you'll be sent to jail. And if you escape from jail, they'll shoot you.

You could be executed for failing to separate the green plastic from the clear plastic in your trash. Now do you think we should give more power to politicians who would do a thing like that?

One of the core principles of libertarianism is that the world is not zero-sum. We can make more things. We can make more money, more food, more energy, more babies. The way I get things is by making them, not by President Obama taking them from you to give to me.

Politics, on the other hand, is zero-sum. There's a fixed amount of political power because there's a fixed amount of me. And the political power that you hold over me—because you're holding me at gunpoint—is obviously power that I lose to you. People know they're losing their power to the political system and they don't like it. But it's still a big temptation to give more

power to that government.

Why? American government is a huge tool—mighty in its operation, nearly irresistible in its movement. Never mind that it doesn't know where it's going. It is tempting to use a tool of this nature when something needs fixing. But the problem is that people don't stop to ask whether the tool suits the task. There is something in the human psyche—and, if I may say, particularly in the male psyche—that just loves big

“People have a tendency to believe that the Cato Institute is a political think tank. It's not. It's an *anti-political* think tank.”

tools. Possessed of a big tool, a man feels a compulsion to use it. We don't need to get rude for examples. Give a man a high-powered cordless electric drill, and you'll get holes all over your house.

In the 1940s, shortly after that enormous tool—the atomic bomb—had been employed on the Japanese, there was a serious proposal in Congress to use atomic bombs to blast a new sea-level canal through the Isthmus of Panama. Men are dangerous when they have big tools. Power of any kind—government power in particular—is dangerous. To put the case differently, the government is a Rottweiler ready to be unleashed on your problems—and you've stuffed raw meat down the front of your pants.

One method of being careful with government power is to think about the government the same way we think about our messy personal lives. There are furious ex-spouses and bitter former lovers and various outstanding child support judgments. And we don't want too much of that in one place, which is why we're moving to

Phoenix. The Founding Fathers knew enough about messy personal lives—Jefferson in particular—to make sure that the Constitution contained federalist decentralization of power. They set up a system in which each branch of the government would check and balance the other branches.

After all, what if all the ex-spouses and the former lovers and the kids whose school fees we're supposed to be paying all became friends—and then got the same lawyer? Our Founding Fathers would have rather moved to Phoenix than let something like that happen. It's important for as much of government power as possible to be distributed to the smallest possible units of government—the states, counties, cities, towns, and townships.

John Sununu, the former governor of New Hampshire, had a good way of explaining this concept. He's an engineer—and he compares reliance on local government to a goal of mechanical engineering known as “short control loops.” The hot and cold faucets on your shower are part of a short control loop. But, instead of them being located in the shower stall, imagine if they were located down in the basement. That would be a long control loop. It's not that a short control loop always works—you may be out of hot water. But it's better to stand there in the shower fiddling with a useless faucet than to march naked and dripping through the house—amazing the children and shocking the cleaning lady—down two flights of stairs and into the grungy basement to fiddle with a useless faucet down there.

If our neighbor on the local sewer commission votes to raise our sewer rates, we can go next door and yell at him or stuff a potato up the tailpipe of his car. But stuffing a potato up the tailpipe of the limousine of the president of the United States, that's a federal crime—or, at least, they'll make it one if I try.

Despite the common sense of the short control loop argument, we're often deaf to it. When something's wrong, we don't consult the sewer commissioner next door—even if the problem is backed up sewage. We go straight to Washington,

and we even bypass the House and the Senate. We expect the president himself to take time off from trying to get his limo started and come over to our house with a plunger.

The expense of politics, the surrender of individual power to politics, the gross inefficiency of politics—it's all bad. But nothing is as bad as the brain of a politician. Now, you might say, "What brain?" Alas, it's worse than a joke. Taken one by one, politicians are of dull normal intelligence. But when you put politicians together in government you get "committees"—and in Congress they even come right out and call them "committees." We've all been on committees. We know what happens to intelligence and common sense when a person becomes a committee member. It's "committee-brain."

Let's say you live in a neighborhood with a playground. The kids in the neighborhood would like to play tetherball, but the playground has no pole. So a committee is formed to raise funds for tetherball—the Committee to Raise Funds for Tetherball, or CRFT.

CRFT is started by a group of pleasant, enthusiastic, public-spirited neighbors. But the minute any of these neighbors become a member of CRFT, he or she will begin to express his or her pleasant, enthusiastic, public spirit by turning into one of the following characters.

The stickler: "We have to draw up a charter and form a nonprofit corporation with a chairman, a president, a vice president, a secretary, a treasurer, a development officer, and a human resources executive. And the tetherball pole has to be exactly four meters high in accordance with North American Amateur Tetherball Association rules."

The dog in the manger: "We need to get permission from the county zoning board, the city council, the parks department, and the adjacent landowners who might complain about tetherball noise. Also, that part of the playground is too damp for tetherball—it might be federally protected wetlands. We can't do any fundraising without advertising, and we can't advertise without raising funds. By the way, the kids

would rather have a tennis court."

The worrier: "Padded pole. Breakaway tether. Light-weight foam ball. Ban on playing after dark, when visibility is poor, and when the sun is shining, to avoid skin damage. Kids should wear helmets, knee pads, and safety belts."

The person with ideas: "Let's set up a challenge grant to erect a second tetherball pole in the inner city. Midnight tetherball could be an alternative to crime for deprived youth! We could also promote tetherball as a way to combat child obesity, which would make us eligible for funding from the Gates Foundation. We'll have a tetherball league—no three!—adults, juniors, and tether tots. This could be a great Title IX addition. If our daughters are varsity level tetherball players, they'll get into Yale."

The person with ideas, none of which have to do with tetherball: "Is the tether biodegradable? Is the pole made from recycled materials? Many playground balls are manufactured in third world countries using exploitative child labor. Let's be sure to utilize organic fertilizer and indigenous plant species when seeding the tetherball play area."

The bossy person—who says the same thing as everybody else on the committee but louder. The person who won't shut up—who says the same thing as everybody else on the committee but more often. The person who won't show up—unless their vote is crucial in which case he or she shows up and votes the wrong way. And, of course, you.

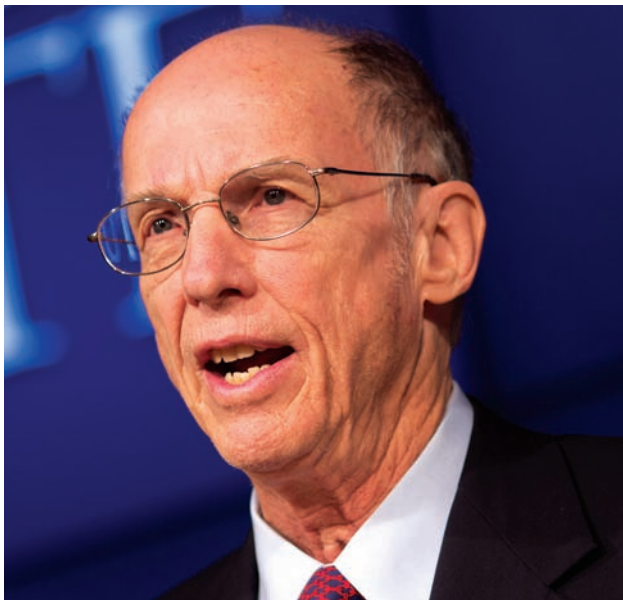
You actually do all of the work. You call 40 people and ask them to donate \$10. Half of them do and

you raise the \$200 needed—only to find out that you actually need \$200,000. As it turns out, the House of Representatives Economic and Educational Opportunities Committee, Select Committee on Opportunities in Physical Education, Subcommittee on Americans with Disabilities Act Compliance requires all tetherballs to be wheelchair accessible no matter how high the tetherballs fly in the air.

Given the complete dominance of politics by committees, the wonder is that anything gets done and the horror is that it does. What the government accomplishes is what you'd expect from a committee. "A camel is a horse designed by a committee"—that's a saying that couldn't be more wrong. A camel is a *see-ing-eye* dog designed by a committee and available free with government grants to people who can see perfectly well but can't walk.

Let it be our mission to show people the danger and the folly of letting their lives be run by committee. And let it be our mission to show people the danger and the folly of all the temptations and empty promises of a government so big and powerful that it can give everyone everything for free. ■

In their new book *Rome's Last Citizen*, authors Rob Goodman and Jimmy Soni deliver the first modern biography of Cato the Younger—a Roman senator and the last man standing when the republic fell to tyranny. Goodman and Soni traced the life of this stirring figure at a Cato Book Forum in October.



At a Cato Book Forum, Judge J. HARVIE WILKINSON III of the U.S. Court of Appeals for the Fourth Circuit spoke about his new book, *Cosmic Constitutional Theory*. Wilkinson strongly criticized the liberal “living Constitution” movement, but also took issue with libertarians who have successfully urged the Supreme Court to apply closer constitutional scrutiny to certain government actions.



In November several experts gathered at a Cato Book Forum to discuss *Mismatch: How Affirmative Action Hurts Students It's Intended to Help, and Why Universities Won't Admit It*, a new book by Richard H. Sander and STUART TAYLOR, JR. The panel included (from left) Taylor, ALAN MORRISON of George Washington University School of Law, ROGER CLEGG of the Center for Equal Opportunity, and ROGER PILON of the Cato Institute.



JONATHAN HAIDT (at podium), author of *The Righteous Mind* and other studies of political psychology, joined EMILY EKINS of the Reason Foundation and DAVID KIRBY of FreedomWorks for a discussion of their Cato study, “The Libertarian Roots of the Tea Party.”



More than 300 guests congregated at The Drake Hotel in Chicago for the Cato Institute’s Policy Perspectives 2012. The event featured Stephen Moore, editorial board member of the *Wall Street Journal*, who spoke on the economic outlook for 2013. Other speakers included John A. Allison, David Boaz, Gene Healy, and Jerry Taylor of the Cato Institute.



On the 10th anniversary of the Sarbanes-Oxley Act, the CR Magazine held an Oxford-style debate to determine whether the law’s requirements have done more harm than good. JOHN A. ALLISON (left) and MARK CALABRIA (center left) of the Cato Institute squared off against LAURALEE MARTIN, CFO of Jones Lang LaSalle, and former senator PAUL SARBANES (right).

Courtesy 2012 COMMITIForum



At a Cato Policy Forum in October, JOCELYN MOORE (left), legislative director for Sen. John D. Rockefeller, and MICHAEL F. CANNON, director of health policy studies at the Cato Institute, discussed whether Obamacare’s Independent Payment Advisory Board represents genuine Medicare reform or just another stop on the road to serfdom.

OCTOBER 9: Time to End Affirmative Action? *Fisher v. University of Texas*

OCTOBER 9: Countervailing Calamity: How to Stop the Global Subsidies Race

OCTOBER 10: Europe’s Crisis and the Welfare State: Lessons for the United States

OCTOBER 11: Is IPAB Medicare Reform? Or Just Another Stop on the Road to Serfdom?

OCTOBER 12: Give Me Regulation: From Samuel Insull to James E. Rogers in the Electric Power Industry

OCTOBER 12: The Economic Effects of Military Spending

OCTOBER 15: *How China Became Capitalist*

OCTOBER 16: The Libertarian Roots of the Tea Party

OCTOBER 17: *The Case against the Davis-Bacon Act: 54 Reasons for Repeal*

OCTOBER 17: Could Oklahoma’s New LawsUIT Strike a Fatal Blow to Obamacare?

OCTOBER 18: The Real Effects of Sequestration

OCTOBER 18: *Why Some Firms Thrive While Others Fail: Governance and Management Lessons from the Crisis*

OCTOBER 19: *Rome’s Last Citizen: The Life and Legacy of Cato, Mortal Enemy of Caesar*

OCTOBER 23: *Africa’s Third Liberation: The New Search for Prosperity and Jobs*

OCTOBER 24: What Can Libertarians Expect from the 2012 Election?

OCTOBER 24: *The Financial Crisis and the Free-Market Cure: Why Pure Capitalism Is the World Economy’s Only Hope*

OCTOBER 25: *Human Capitalism: How Economic Growth Has Made Us Smarter—and More Unequal*

OCTOBER 25: Millennials and the Welfare State: Burden or Blessing?

OCTOBER 26: Cato Institute Policy Perspectives 2012, New York

NOVEMBER 1: Is Judicial Restraint the Proper Response to Judicial Activism?

NOVEMBER 7: The Role of Social Media in the 2012 Election

NOVEMBER 8: *Libertarianism: What Everyone Needs to Know*

Cato Calendar

25TH ANNUAL BENEFACTOR SUMMIT

Scottsdale, AZ • Four Seasons Resort
February 21–24, 2013

Speakers include Vernon Smith, Tucker Carlson, and Sen. Jeff Flake.

CATO INSTITUTE POLICY PERSPECTIVES 2013

New York • Waldorf Astoria
March 15, 2013

CATO CLUB 200 RETREAT

Laguna Beach, CA
Montage Laguna Beach
September 26–29, 2013

NOVEMBER 14: Cato Club Naples—Now What? The 2012 Presidential Election and the Prospects for Liberty

NOVEMBER 14: *The Fire Next Door: Mexico’s Drug Violence and the Danger to America*

NOVEMBER 15: 30th Annual Monetary Conference

NOVEMBER 20: *Wounds That Will Not Heal: Affirmative Action and Our Continuing Racial Divide*

NOVEMBER 28: Cato Institute Policy Perspectives 2012, Chicago

NOVEMBER 28: Obamacare Is Still Vulnerable

NOVEMBER 29: What’s New in State Tax Policy? Pro-Growth Reforms vs. Special-Interest Breaks

NOVEMBER 29: War Generation: How Will a Culture of Permanent War Impact America’s Future?

Audio and video for all Cato events dating back to 1999, and many events before that, can be found on the Cato Institute website at www.cato.org/events. You can also find write-ups of Cato events in Ed Crane’s bimonthly memo for Cato Sponsors.

Leading academics join to discuss the steps needed to avoid future crises

Bubbles, Crashes, and Rules at the 30th Annual Monetary Conference

“All those who wish to stop the drift toward increased government control should concentrate their effort on monetary policy,” F. A. Hayek once said. At no time since the founding of the Federal Reserve nearly a century ago has it been more important to reconsider the policy steps needed to avoid future financial crises. At the Cato Institute’s 30th Annual Monetary Conference, experts came together to examine the links between sound money, free markets, and limited government—and focus in particular on how those links might evolve in the years ahead.

The conference, “Money, Markets, and Government: The Next 30 Years,” was directed by Cato vice president for academic affairs James A. Dorn. In addressing the limits of monetary policy, scholars discussed how the choice between alternative regimes will determine whether economic harmony will spontaneously emerge or government power will continue to grow.

In his keynote address, Nobel laureate Vernon L. Smith discussed the history of bubbles, focusing in particular on the similarities between those that preceded both the Great Recession and the Great Depression in the United States. In both cases, “the imbalance was fueled by outsized mortgage credit expansion,” Smith argued, adding that there are three fundamental responses to such balance sheet crunches, each of which he detailed in full.

Thomas Hoenig, vice chairman of the Federal Deposit Insurance Corporation, began his panel by asking whether we are sowing the seeds for the next financial crisis. This, he said, was likely. “Incentives matter,” Hoenig explained, “and the incentives toward risk among the largest financial firms remain basically unchanged from pre-crisis times.” Jeffrey A. Miron, senior fellow at the Cato Institute and director of undergraduate studies in economics at Harvard University, followed by asking a different question: Should we try to avoid the next crisis?

“If policymakers focus on this as their



At the 30th Annual Monetary Conference, (1) Spanish economist **PEDRO SCHWARTZ** (at podium) joined (from left) German economist **JÜRGEN STARK**, **GEORGE S. TAVLAS** of the Bank of Greece, and **MARY ANASTASIA O'GRADY** of the *Wall Street Journal*; (2) Nobel laureate **VERNON SMITH** examined the history of bubbles in the United States; (3) **ZHIWU CHEN**, professor of finance at the Yale School of Management, discussed the growing trend toward capital freedom in China; (4) **WILLIAM POOLE** (left), a senior fellow at the Cato Institute, chatted with **JÜRGEN STARK** (center) and **JOHN B. TAYLOR**, former under secretary of the Treasury; (5) conference organizer **JAMES A. DORN** (left), vice president for academic affairs at the Cato Institute, caught up with **KEVIN WARSH**, a member of the board of governors of the Federal Reserve System from 2006 to 2011; and (6) **JOHN B. TAYLOR** argued that monetary policymakers should favor a rules-based regime.

goal, they're going to adopt policies that typically fail to avoid crises and are counterproductive from a long-term perspective,” Miron argued. The treatment, he said, is almost certainly worse than the disease.

John B. Taylor, professor of economics at Stanford University, focused on the past 30 years of monetary policy and what that history indicates for the next several decades. “The most important thing that we can do is find a way for monetary policy to get back to a rules-based strategy,” he concluded.

Other speakers included George S. Tavlas, director of the Bank of Greece; Jürgen Stark, former chief economist of the European Cen-

tral Bank; Eswar S. Prasad of Cornell University; and Gerald P. O'Driscoll Jr., senior fellow at the Cato Institute.

In his closing address, Charles I. Plosser, president of the Federal Reserve Bank of Philadelphia, unpacked the “extraordinary actions” taken by the Fed as of late. He argued in favor of pursuing a systematic approach instead, centered on using “robust simple rules” as a guide to the Fed’s policy decision-making process. “Excessive focus on the short term can result in long-term problems,” he warned. “Avoiding these risks is dependent on the Fed executing a graceful exit from this period of extraordinary accommodation.” ■

Experts discuss lessons from the Continent's woes

Are Europe's Welfare States Sustainable?

Europe has long been the model of the modern welfare state, with many countries providing “cradle-to-grave” protection against the vicissitudes of life. But the economic crisis that started in Greece and now pours through Europe has painfully revealed the true nature of the welfare state—it is unaffordable, stifles economic growth, and has countries drowning in debt.

As the Continent deals with the consequences of its severe fiscal crisis, the United States has an opportunity to gain a wide range of invaluable perspectives. In October, the Cato Institute held a conference—“Europe's Crisis and the Welfare State: Lessons for the United States”—in which leading international experts came together to examine the evolution of the European welfare state and discuss the steps that must be taken if America is to avoid arriving at the same painful destination.

In his keynote address, Josef Joffe, publisher and editor of *Die Zeit*, began by highlighting the myth that the financial crisis was caused by voracious market actors devouring easy credit. “The markets fattened themselves on a rich diet, but the table was set by governments,” he said. Without “the inexhaustible cornucopia of the state,” Joffe concluded, the financial crisis as we know it would not have occurred.

Juhan Parts, the minister of economic affairs and communications for the Republic of Estonia, described how his country managed to reignite its economic performance by reducing the burden of government spending. The strategy involved a balanced approach that went beyond simple austerity, he said. The “three basic pillars” of this approach were budget cuts, targeted stimulus plans, and reforms that focused on the long-term competitiveness of the private sector—all of which helped to restore public confidence in markets, Joffe added.

In a panel detailing the lessons the United States must learn, Desmond Lachman, resident fellow at the American Enterprise Institute, explained what the country may be facing by first offering a diagnosis of the



At a Cato Institute Conference, “Europe's Crisis and the Welfare State,” (1) Spanish economist **PEDRO SCHWARTZ** (at podium) suggested that Europe's welfare states are fundamentally immoral. He was joined by (from left) **ARISTIDES HATZIS** of the University of Athens, **JAGADEESH GOKHALE** of the Cato Institute, and **IAN VÁSQUEZ** of the Cato Institute; (2) **PASCAL SALIN**, professor emeritus at the Université Paris-Dauphine, evaluated the effectiveness of austerity programs using the financial realities now facing Europe as a backdrop; (3) **JOSEF JOFFE**, publisher and editor of *Die Zeit* and a fellow at the Hoover Institution, discussed “the inexhaustible cornucopia of the state.”

crisis in Europe. “The root of the problem,” he said, “is that Europe got itself into the most fixed of exchange rate arrangements in 1999”—and then spent the next decade evading the new rules of the game. Michael Tanner, senior fellow at the Cato Institute and director of the conference, went on to illuminate the magnitude of the problem in the United States.

“The real level of debt facing this country could potentially exceed 900 percent of GDP,” he argued. “If it did, then we are actually in a worse debt situation—less solvent, if you will—than Greece.”

Other speakers throughout the day included Mickey Levy, chief economist at Bank of America; Bruce Stokes, director of the Global Economic Attitudes Project at the Pew Research Center; Miroslav Beblavy, a member of the Slovak Parliament and a senior research fellow with the Centre for

European Policy Studies; and Mark Hallerberg, director of the Fiscal Governance Center at the Hertie School of Governance in Germany.

In his closing address, Richard Fisher, president of the Federal Reserve Bank of Dallas, acknowledged the fiscal pathologies the United States is currently dealing with, while also offering reasons to be optimistic. “One is tempted to conclude that we are but the best-looking horse in the glue factory of hapless economies,” he said. But if the United States can free its economy from the uncertainty surrounding fiscal policy, he added, it will be able to avoid the European trap.

“The fix lies solely in the hands of a government that has the power to shape taxes and spending programs to incent businesses to go out and hire,” he concluded, “rather than ball up into a defensive crouch, or worse, go elsewhere in the world.” ■

Grading the Governors from A to F

The 11th biennial fiscal report card on the governors comes at a time when those leaders have struggled with a sluggish recovery, resulting budget deficits, unemployment, and other economic problems in their states. Many reform-minded governors elected in 2010 have championed tax reforms and spending restraint to get their states back on track. Other governors have expanded government with old-fashioned tax-and-spend policies. In “**Fiscal Policy Report Card on America’s Governors: 2012**” (White Paper), Chris Edwards, director of tax policy studies at the Cato Institute, graded all of the states’ governors and awarded four of them A’s—Sam Brownback of Kansas, Rick Scott of Florida, Paul LePage of Maine, and Tom Corbett of Pennsylvania. Five governors were awarded F’s—Pat Quinn of Illinois, Dan Malloy of Connecticut, Mark Dayton of Minnesota, Neil Abercrombie of Hawaii, and Chris Gregoire of Washington. Edwards

offers short analyses of each governor’s performance in addition to a letter grade.



Chris Gregoire



Pat Quinn

Many states are facing major fiscal problems in coming years. Rising debt and growing health and pension costs threaten tax increases down the road. At the same time, intense global economic competition makes it imperative that states improve their investment climates. To that end, some governors are pursuing broad-based tax reforms, such as cutting income tax rates and reducing property taxes on businesses. This report discusses those trends and examines the fiscal poli-

cy actions of each governor in an attempt to make their records more transparent.

Amtrak’s Insatiable Appetite for Federal Funds

When Congress created Amtrak in 1970, passenger-rail advocates hoped that it would become an efficient and attractive mode of travel. But, in “**Stopping the Runaway Train: The Case for Privatizing Amtrak**” (Policy Analysis no. 712), Cato senior fellow Randal O’Toole shows that more than 40 years of operations have disappointed. Amtrak has become the highest-cost mode of intercity travel and remains an insignificant player in the nation’s transportation system. Nationally, average Amtrak fares are more than twice as much, per passenger mile, as airfares. Despite these high fares, per-passenger-mile subsidies to Amtrak are nearly 9 times as much as subsidies to airlines, and more than 20 times as much as those to driving. When fares and subsidies are combined, its costs per passenger mile are nearly

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four times as great as airline costs. “A close look at the data reveal that Amtrak has failed for two primary reasons,” O’Toole notes. First, passenger trains simply aren’t competitive in most markets. Second, government control of Amtrak has saddled it with numerous inefficiencies, including unsustainably expensive labor contracts. “No amount of reform will overcome the fundamental problem that, so long as Amtrak is politically funded, it will extend service to politically powerful states even if those states provide few riders,” O’Toole continues. The only real solution, he writes, is privatization. “Simple justice to Amtrak’s competitors as well as to taxpayers demands an end to those subsidies,” he concludes.

The Transparency Problem

“President Obama has committed to making his administration the most open and transparent in history,” the Whitehouse.gov website declared just minutes after the new president took office on January 20, 2009. Yet, it is now clear that government transparency has not improved materially since the beginning of President Obama’s administration. According to Jim Harper, Cato’s director of information policy studies, in “Grading the Government’s Data Publication Practices” (Policy Analysis no. 711), this is not due to lack of interest or effort. “Along with meeting political forces greater than his promises,” Harper writes, “the Obama transparency tailspin was a product of failure to apprehend what transparency is and how it is produced.” Starting from a low

transparency baseline, this administration made extravagant promises and put significant effort into the project of government transparency. It has not been a success. House Republicans, who manage a far smaller segment of the government, started from a higher transparency baseline, made modest promises, and have taken limited steps to execute on those promises. President Obama lags behind House Republicans, but both have a long way to go. The solution, Harper argues, is to tackle the low-hanging fruit first. Establishing an authoritative list of programs and projects within the basic units of government, for instance, “is like creating a language, a simple but important language computers can use to assist Americans in their oversight of the federal government.” Harper goes on to lay out a variety of good data publication practices, which he insists can help to produce a more accountable, efficient, and responsive government.

The Race for Protection

The world is awash in trade-distorting subsidies. According to Scott Lincicome, a former employee of Cato’s Center for Trade Policy Studies and now an international trade attorney at White & Case, governments have adopted massive “stimulus” packages since the financial crisis of

2008—handouts that have included taxpayer subsidies for various industries including agriculture, alternative energy, and automobiles. In “Countervailing Calamity: How to Stop the Global Subsidies Race” (Policy Analysis no. 710), Lincicome argues that these subsidies have, in turn, “distorted global markets, bred cronyism, and undermined free trade.” They have also encouraged copycat subsidization, which spawned an increase in litigation at the World Trade Organization and led to the frequent imposition of protectionist duties. Trade reform is badly needed. “Unfortunately,” Lincicome writes, “the U.S. government has little credibility on this issue: it is one of the world’s largest subsidizers, funneling billions of dollars annually to chosen industries, causing economic uncertainty, and creating breeding grounds for corruption.” Yet, ironically, with 59 currently active or pending national countervailing duty (CVD) measures affecting over \$11 billion of imports, the U.S. government is also one of the most frequent users of anti-subsidy disciplines. The only answer here, according to Lincicome, is true reform. By curtailing federal subsidies to favored industries and by changing CVD procedures to ensure that they serve the rule of international trade law—rather than protectionist objectives—“the U.S. government can reduce market distortions, restore some faith in free markets, and lead national and international subsidy reform initiatives,” he concludes. ■



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CATO POLICY REPORT

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“To Be Governed...”

BOY, NOBODY SAW THAT COMING

Most of the arms shipped at the behest of Saudi Arabia and Qatar to supply Syrian rebel groups fighting the government of Bashar al-Assad are going to hard-line Islamic jihadists, and not the more secular opposition groups that the West wants to bolster, according to American officials and Middle Eastern diplomats.

—*New York Times*, October 15, 2012

PARTY SCHOOL: IT MEANS SOMETHING VERY DIFFERENT IN CHINA

For decades, professors at the Central Party School have safeguarded the ideology of China's Communist Party, indoctrinating each generation of officials in the teachings of Marx, Lenin and Mao.

The school has persevered in its mission despite massive changes in society and the economy. But in recent years, it has faced a new and insidious threat: students intent on networking.

The students—largely middle-age government officials looking for promotion—no longer see their mandatory time at the school as a chance to immerse themselves in the wisdom of communism. Instead, it's become a prime place to cultivate allies with whom they can trade future favors and backdoor deals to further their careers and wealth. That means calculated friendships, luxury dinners expensed to local governments and boozy nights on the town . . .

Besides the central school in Beijing, there are more than 3,000 party schools throughout China, and they trace their roots to a program created by Communist forces in 1933 at their Jiangxi mountain base during the country's long civil war.

The most prestigious and influential branch, however, is the Central Party School, which accepts roughly 3,000 mid- to high-level officials as students

each year—many tapped by the party's powerful Organization Department, which controls officials' assignments and promotions.

The students are mostly in their early 40s to late 50s. And campus life sometimes resembles a communist reality show gone awry—middle-aged men shoved into campus dorms, largely confined to campus and forced to discuss their ideological forebears.

—*Washington Post*, October 12, 2012

THE INTENDED CONSEQUENCES OF GOVERNMENT ACTION

Democrats had expected to make major inroads in the Inland Empire [Riverside and San Bernardino counties] 10 years ago. [Former State Senate Republican leader Jim] Brulte said that was blunted by a deal cut by Republicans and Democrats in Sacramento to ensure that the 2001 redistricting process protected incumbents. (After that remapping, 264 of 265 congressional elections in California were won by the incumbent party.)

—*Los Angeles Times*, November 11, 2012

DEPENDING ON WHETHER YOU IDENTIFY WITH THE TAXERS OR THE TAXPAYERS

Here's the thing about patching the AMT [Alternative Minimum Tax]—it's expensive, which is why Congress hasn't made the fix permanent.

—*Morning Edition, NPR*, November 6, 2012

IS THE NANNY STATE PRO-LIFE?

The most “pro-life” politician in America is New York City Mayor Michael Bloomberg. While he supports a woman's right to choose, he has also used his position to promote a whole set of policies that enhance everyone's quality of life—from his ban on smoking in bars and city parks to reduce cancer, to his ban on the sale in New York City of

giant sugary drinks to combat obesity and diabetes, to his requirement for posting calorie counts on menus in chain restaurants, to his push to reinstate the expired federal ban on assault weapons and other forms of common-sense gun control, to his support for early childhood education, to his support for mitigating disruptive climate change.

—*Thomas Friedman, New York Times*, October 27, 2012

HOW TO FUND A POLITICAL PARTY

Tennessee Democrats, who'd watched their conservative voters drift to the GOP, finally lost the state House in 2010. That had been a financial lifeline for Democrats, since the legislature has broad powers over patronage.

“That pretty much was the end,” said Cheek, the executive committee member. “Because we have nothing left. In the other low points, we had the Election Commission, we had the Building Commission . . . If you wanted to get state deposits into your bank, those were all ours. And that's where you'd raise your money.”

Losing those powers “really kicked the props out from under the financing of the party,” Cheek said.

—*Washington Post*, October 22, 2012

IS THE CONSTITUTION IDEOLOGICAL?

[Former Democratic National Chairman and 2013 gubernatorial candidate Terry] McAuliffe is known as “a dealmaker,” said Jennifer Duffy, who analyzes gubernatorial races for the nonpartisan Cook Political Report, and [Virginia Attorney General Ken] Cuccinelli “is far more ideological in a lot of ways.”

“I think [Cuccinelli] walks around with a copy of the Constitution, and McAuliffe doesn't,” she said.

—*Washington Post*, November 28, 2012