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A Strategy for Privatization

by Randy Fitzgerald

Success in transforming government's role in the production of services from that of provider to facilitator—and in the process enhancing efficiency and reducing taxpayer costs—ultimately depends on a strategy of psychological conditioning. Too many opinion makers, public officials, and voters reduce our budgetary options to the alternative of raising taxes or slashing services, just as they narrow the approaches to other public policy issues down to a simple-minded choice between liberal and conservative, Democrat and Republican, or right and wrong. We must therefore fashion a comprehensive strategy for expanding awareness of a broader range of options.

To provide a foundation for that understanding, we must tell taxpayers and voters what politicians at all levels of government are loath to admit: our unmet spending needs, on top of the already-accumulated public debt, will overwhelm this generation and future ones unless the private sector can be persuaded to help relieve government of its fiscal burden. The list of problems seems endless—deficit-plagued mass transit systems, crumbling roads and bridges, overcrowded courts and prisons, bankrupt public hospitals, homelessness, polluted water supplies. By the year 2000, the congressional Joint Economic Committee estimates, the shortage of funds for infrastructure improvements alone will exceed $1.1 trillion.

Even without being aware of the magnitude of the burden, many Americans realize that more must be done to improve services or at least prevent a further decline in quality, yet they do not want their taxes to be raised. Pundits and government employee unions cite that apparent contradiction as evidence that the tough choices must be made without public input. They therefore advocate backdoor tax increases in the guise of "revenue enhancements" or some other Orwellian term.

Randy Fitzgerald is a staff writer for *Reader's Digest* and the author of *When Government Goes Private* (Universe Books/Pacific Research Institute, 1988).

In This Issue

But that "contradiction" in fact represents an opportunity for us to win support for privatization at the grassroots level—as a means of both resolving the conflict between service needs and taxation limits and restructuring the role of government in our lives.

Privatization is a package of approaches in which no single element should be allowed to dominate the whole. It involves relying on the strengths of the private sector to supply our life-support needs through neighborhood self-help organizations, volunteerism, contracting out, asset sales, and load shedding (removing government from the provision of services entirely), thus giving policymakers a wide range of options in solving budgetary and efficiency problems.

Taken together, the various elements of privatization constitute a new model for the provision of services. In the past decade a "quiet revolution" has affected a wide array of services, occurring almost totally out of public view and almost entirely without an

(Cont. on p. 10)

Alan Budd, James M. Buchanan, Alan Peacock, and William A. Niskanen address a London conference cosponsored by the Cato Institute and the Institute of Economic Affairs.

True Patriotism

Editorial

Accusations of insufficient patriotism keynoted the 1988 presidential campaign. The candidates and their supporters may have generated more heat than light on the subject, but they gave us an indication of just how liberals and conservatives perceive the individual's relationship to the state.

Vice President Bush, of course, managed to get the most mileage out of the patriotism issue. He repeatedly criticized Gov. Michael Dukakis for refusing to force Massachusetts teachers to lead the recitation of the Pledge of Allegiance every day, and he said in his acceptance speech that Dukakis "sees America as another pleasant country on the UN roll call, somewhere between Albania and Zimbabwe." Though Bush denied that he was questioning Dukakis's patriotism, his supporters were not hesitant to impugn the patriotism of Dukakis and other liberal Democrats.

Dukakis countered that "the highest form of patriotism is a dedication and commitment to the Constitution of the United States and the rule of law"—a dignified and thoroughly American sentiment for which he was roundly criticized by neoconservative guru Irving Kristol.

Kristol seemed to be suggesting that patriotism consisted of loving one's country and supporting every action of one's government—unless "the patriotic commitment had been nullified" as a result of "extreme circumstances." The example he gave was Hitler's Germany. But surely a true German patriot in the Nazi era would not have ceased to love his country; he would simply have decided that patriotism required him to be disloyal to his government. Indeed, it has been said that—even under less extreme circumstances—a true patriot loves his country and hates his government.

Liberals had great fun mocking the flag-waving, Pledge-reciting brand of patriotism peddled by Bush and his conservative supporters. But Dukakis also resorted to unsavory forms of patriotism in an attempt to win votes. After a primary campaign in which he had courageously resisted joining the protectionist bandwagon, he took a leaf from Rep. Richard Gephardt's xenophobic script. He visited a red-blooded American factory and denounced foreign ownership of U.S. assets—only to discover that the factory was owned by an Italian firm, whereupon he limply explained that he had no objection to "that kind of foreign ownership." What kind? White?

One Dukakis ad warned of the dangers of foreign ownership and featured a huge Japanese flag. But the British own the most American assets, followed by the Dutch and then the Japanese. Why didn't the ad feature a Union Jack? Could it be that Dukakis was appealing not only to xenophobia but to racism? (Of course, Japan doesn't own any American companies; various people who are citizens of Japan do.) It seems that liberal nationalism is no more high-minded than the conservative variety.

And consider a related issue in the campaign: both candidates proclaimed, "I'm on your side." What did they mean? Dukakis used the line first, and he was much praised for getting back to the bedrock of the Democratic party: class hatred. "I'm on your side" was meant to imply that the GOP was the party of big business, of Wall Street, of yuppie investment bankers and plutocratic landlords—and that if we all got together, there'd be enough of us to outvote the rich and take their money.

Being on the rich side of a rich-poor battle line is not a good idea in an electoral contest, so Bush had to look for an alternative way to frame the debate. He went out the next day and proclaimed, "*I'm* on your side." In his formulation, the divide was cultural, not economic, and "they" were the Harvard elitists, the busers and social planners, the intellectuals. Both candidates' attempts to rally the masses against a nefarious "other" recall Henry Adams's observation that "politics, as a practice, whatever its professions, has always been the systematic organization of hatreds."

When a liberal talks about patriotism, it's a good idea to watch your wallet. *New Republic* editor Michael Kinsley, for instance, criticized both Bush and the Democratic Leadership Council for invoking patriotism without demanding higher taxes or any other sacrifice from the average citizen. Aside from the question of whether increasing taxes would be good economic policy, why should loving a free country require one to be taxed more, or to be drafted?

Despite political candidates' abuse of the concept, there is a sound basis for patriotism in American tradition. Patriotism, properly understood, isn't a matter of loving a piece of land or hating foreigners but rather an attitude that Abraham Lincoln summed up in his eulogy of Henry Clay. Lincoln said that Clay "loved his country partly because it was his own country, but mostly because it was a free country; and he burned with a zeal for its advancement . . . because he saw in such, the advancement . . . of human liberty, human right, and human nature."

—David Boaz

'Thought-provoking and Timely'

Cato Offers *An American Vision* for the 1990s

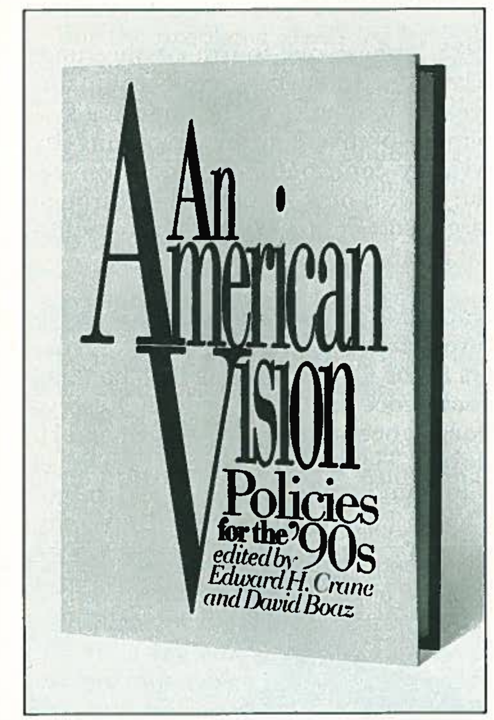
Cato president Edward H. Crane introduces the authors of *An American Vision* at reception.

Many commentators decried the 1988 presidential campaigns for focusing on personalities and images rather than issues, despite the voters' apparent longing for a substantive discussion of America's future. The contributors to *An American Vision: Policies for the '90s*, a new volume from the Cato Institute, take up crucial questions that the candidates ignored.

Edited by Cato president Edward H. Crane and Cato vice president David Boaz, *An American Vision* is designed to address the systemic defects that are at the root of many public policy problems. Its proposals reaffirm the ideals on which the nation was founded by emphasizing individual rights, market processes, and peace.

"Political vision, at bottom, is an ideological concept," Crane and Boaz write in the introduction. "It is an integrated, internally consistent set of proposals that work as a *process*, rather than as discrete solutions to what are generally systemic problems." Thus, they have selected 21 essays in which noted policymakers, scholars, and policy analysts outline a series of proposals that constitute a cohesive agenda for the United States in the next decade and beyond.

The contributors stand back from the day-to-day tinkering of Washington analysts to address the fundamental flaws of U.S. public policy. Some of the nation's most insightful and imaginative thinkers are represented, including George Gilder on the global economy, William A. Niskanen on trade, S. David Young on capital markets, Peter J. Ferrara on social security, Pete du Pont on education, and Earl C. Ravenal on military spending.



Cato vice president David Boaz talks with education analyst Myron Lieberman at book party.

An American Vision has received considerable praise from members of the Washington community. Peggy Noonan, chief speechwriter for the Bush campaign, called it "compelling and aimed straight at the heart of public policy in the '90s." Rep. Tim Penny (D-Minn.) said that the collection is "thought-provoking and timely." And former budget director James C. Miller III said, "Anyone who believes that the nation's thinkers are running out of ideas should read this book. You'll be challenged, you'll be stimulated, but if you care about America's future, you won't be bored."

An American Vision is available from the Cato Institute, in cloth for $26.95 and in paper for $15.95. ■

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Cato Hosts Visitors from Vietnam to Belize to France

Cato Events

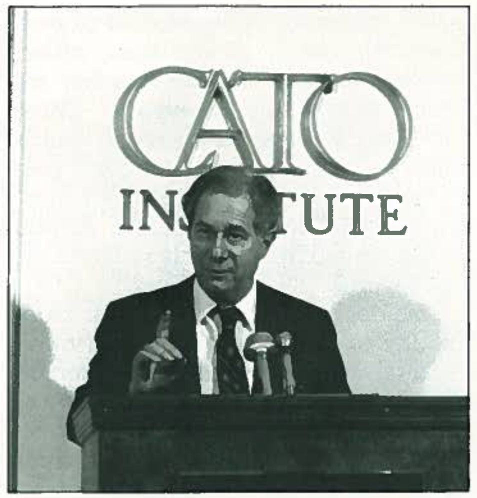
October 5: The Cato Institute hosted a luncheon for representatives of a number of **public policy research groups** based in other countries, including Austria, France, West Germany, Belize, and Guatemala.

October 14: The Institute hosted a book party for Robert Sheaffer, author of ***Resentment against Achievement: Understanding the Assault upon Ability.*** Sheaffer argued that many of America's problems stem from the resentment directed at successful people and the guilt that they feel about their accomplishments. He described how the "resentment morality" manifests itself in education, science and technology, the arts, and politics.

October 17: Cato senior staffers, including president Edward H. Crane, chairman William A. Niskanen, and senior fellow Roger Pilon, met with **Nguyen Xuan Oanh,** a member of the Vietnamese National Assembly and one of his country's leading free-market advocates. The group discussed recent efforts to reform the political and economic institutions of Vietnam, which has been plagued by a repressive communist regime since 1975.

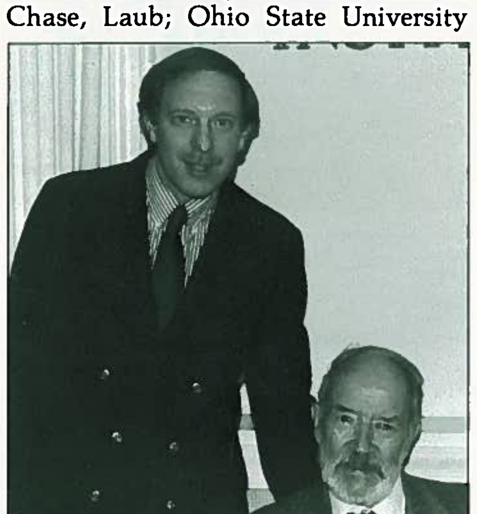
October 25: **"Conflicting Visions of Man and the State."** In the fifth event of the Cato Distinguished Lecturer Series, University of Rochester economist Karl Brunner contrasted the classical liberal's view of man and the state with the modern liberal's view. He explained why the former view is more likely to lay a solid foundation for rational public policy than the latter. The full text of Brunner's talk will be published in the *Cato Journal.*

October 27: **"Reforming the Presidential Campaign Finance System."** Sen. Mitch McConnell (R-Ky.) called for an end to the public financing of presidential campaigns. McConnell argued that although hundreds of millions of tax dollars have been earmarked for presidential campaign financing since 1976, almost one-fourth of the funds have gone to lawyers and accountants seeking loopholes in the financing system. Moreover, influence-buying by wealthy contributors has not been reduced; it is now accomplished through large "soft money" donations to political parties.



Former Reagan economic adviser Murray Weidenbaum offers an economic policy agenda for the post-Reagan era.

November 2: **"Governing Banking's Future: Markets vs. Regulation."** Speakers at the Cato Institute's 1988 banking conference included Federal Reserve Board governors Wayne Angell and H. Robert Heller; Ian Giddy of Drexel Burnham Lambert; P. Michael Laub of Chase, Laub; Ohio State University economist Edward J. Kane; and Walker F. Todd of the Federal Reserve Bank of Cleveland.



Cato Journal **editor James A. Dorn talks with Distinguished Lecturer Karl Brunner (seated).**

November 3: The Cato Institute held a book party in honor of the publication of ***Assessing the Reagan Years,*** edited by David Boaz. Addressing the guests, Boaz contended that although the early days of the Reagan administration were marked by manifestations of terror on the part of the permanent government in Washington, the administration ultimately accomplished little substantive change. A number of the book's 31 contributors were in attendance.

November 17: The Institute hosted a reception in honor of its two new senior fellows, **Roger Pilon** and **Peter J. Ferrara.** Pilon discussed Cato's newly established Center for Constitutional Studies, which he heads. Ferrara, an associate professor of law at George Mason University, described the expansion of Cato's work in the area of entitlement reform.

November 29: Book party for Murray L. Weidenbaum, author of ***Rendezvous with Reality: The American Economy after Reagan.*** Weidenbaum, director of the Center for the Study of American Business and a former chairman of the Council of Economic Advisers, considered the Reagan administration's economic legacy and set forth a policy agenda for the post-Reagan years. His proposals were designed to cut federal spending, increase the nation's competitiveness, and improve the tax system.

November 30: **"Should We Restrict Foreign Investment in the United States?"** Jim Powell, author of *The Gnomes of Tokyo: Japanese Financial Power and Its Impact on Our Future,* refuted the widely held notion that foreign investment in the United States is a dangerous phenomenon. He argued that foreign investment provides lower-cost capital and more-advantageous markets for U.S. companies and that restricting it would undermine America's prosperity and security by jeopardizing vital alliances, destroying jobs, reducing exports, and devaluing U.S. assets. ■

We Told You So

S&L Crisis Is No Surprise to Cato

Catherine England, director of Cato's Financial Deregulation Project

The burgeoning crisis in the savings and loan industry came as no surprise to the Cato Institute. As early as February 1982 Cato published a Policy Analysis, "The Savings & Loan Industry: Averting Collapse," in which Joe Stilwell pointed out that the assets of the industry were overvalued and called it "an ailing giant on the brink" of disaster.

As a lead editorial in the *Washington Times* noted recently, "The Cato Institute reported in 1982 that the industry had a net worth of negative $70 billion."

Stilwell also identified the principal reason for the industry's deterioration, which many commentators still fail to do. He argued that government restrictions not only prevented S&Ls from diversifying their portfolios by reducing their dependence on home mortgages but also prevented them from controlling their risk by offering long-term deposits and matching the economic lives of their assets and their liabilities.

Meanwhile, Catherine England, soon to be a Cato staffer, was also warning of the dangers of government intervention in the financial services industry. In December 1982 the Heritage Foundation published "Replacing the FDIC: Private Insurance for Bank Deposits," which she coauthored with John Palffy. England and Palffy argued that federal deposit insurance fosters excessive risk-taking and long-term instability among depository institutions by relieving depositors of the obligation to monitor their performance. They advocated an increased reliance on market discipline and the eventual termination of the federal deposit guarantee system. "The troubles facing depository institutions will not disappear as the economy begins its recovery," England and Palffy predicted. "The inherent defects of the existing system will continue to haunt the banks and savings and loan associations."

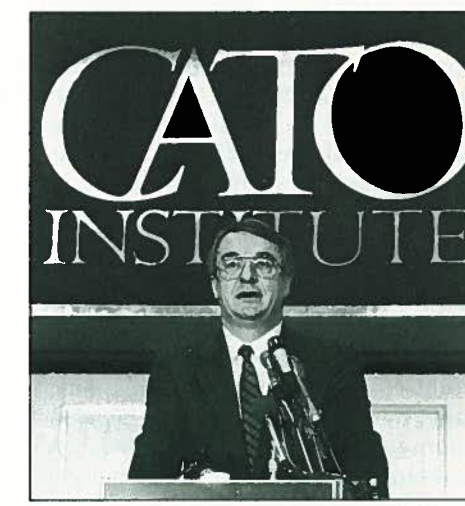
But the problems identified by Stilwell, England, and Palffy have not been addressed. One-third of the thrift industry is now insolvent or nearly so, and the S&Ls are losing $1 billion every month. The federal government continues to support hundreds of insolvent institutions by providing below-market-rate loans and arranging subsidized mergers. Federal deposit insurance continues to encourage money to flow to the sickest institutions. Moreover, their instability is spreading to the rest of the economy.

Congress may finally be ready to heed Stilwell's warning: "Additional subsidies will further insulate poor managers from the effects of poor decisions. The quality of management will decline. And such support will only perpetuate financial misallocations. The S&L industry will turn into a bottomless pit into which government pours huge sums of money." ■

Regulation and The Future of U.S. Banking

During the Cato Institute's November conference "Governing Banking's Future: Markets vs. Regulation," representatives of the banking industry, academia, and the Federal Reserve System addressed issues prominent in the continuing debate over the future of the industry.

Federal Reserve Board governors gave the opening and closing talks of the conference. H. Robert Heller discussed U.S. banks' growing competition from abroad as well as the need for regulatory reform. Wayne Angell argued that payments system risk could be reduced through market-based pricing of daylight overdrafts.



Federal Reserve governor H. Robert Heller addresses Cato's banking conference.

During the first session, Ian Giddy of Drexel Burnham Lambert; P. Michael Laub of Chase, Laub; and Edward J. Kane of Ohio State University reviewed recent efforts to coordinate banking regulation internationally. Topics included the G-10's Basle agreement, which established mutual standards for capital, the U.S.-Canada free trade agreement, and the European Community's attempt to remove internal barriers to trade by 1992. Although there was some disagreement about the desirability of those efforts, it was widely acknowledged that in the future no

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Is Foreign Investment Bad for the United States?

Policy Forum

The Cato Institute regularly sponsors a Policy Forum at its Washington headquarters, where distinguished analysts present their views to an audience drawn from government, the media, and the public policy community. A recent forum featured Jim Powell, author of The Gnomes of Tokyo: Japanese Financial Power and Its Impact on Our Future *(Dodd, Mead, 1988).*

Jim Powell: In recent weeks we've had some encouraging news; outspoken economic nationalists lost key elections in Canada and the United States. But we must not become complacent. Economic nationalism is still very much with us, and it could turn the next recession—whenever that occurs—into a full-scale depression.

The world is breaking up into trading blocs that are potentially hostile to outsiders. North American trade restrictions are increasing, the European Community is maneuvering against outsiders in the course of making compromises that will lower its internal trade barriers, and a powerful East Asian yen bloc is emerging as trade between Japan and its trading partners expands at double-digit rates.

Moreover, the world is abandoning the peaceful principle that trading partners should be treated equally. In 1986 the GATT identified 93 discriminatory trade deals; the count went up to 116 in 1987 and to 135 in 1988. The United States has 51 discriminatory deals in effect, and about three-fourths of Europe's trade is discriminatory.

Those ominous trends recall a devastating critique of economic nationalism by a British businessman named Norman Angell. His book, *The Great Illusion*, was published in 1908, while millions followed the siren song of economic nationalism toward World War I, and it became an international best seller. "No one believes that war pays," Angell wrote, "but nearly everyone believes that policies which lead inevitably to war do pay. Every nation sincerely desires peace, and all nations pursue policies which if persisted in long enough must make peace impossible."

What's particularly horrifying is that few people seem to have learned very much from the Depression and the world wars, for which economic nationalism was largely responsible. Long after it had become clear that the 1930 Smoot-Hawley Tariff Act had played a key role in bringing about the Depression, Secretary of State Cordell Hull complained that special-interest groups were forever badgering him to block imports yet persuade other countries to open up their borders—the same refrain we hear today.

Jim Powell: "Economic nationalism could turn the next recession—whenever that occurs—into a full-scale depression."

The trigger for another depression could easily be the 1,000-page 1988 trade law. It's a time bomb that's likely to go off during the next recession, when American companies again become desperate to ward off international competitors. As you probably know, the trade law makes it easier than ever for American companies to qualify for all kinds of "relief." Moreover, it gives the president broad powers to block foreign investment. Yet we are already embroiled in an agricultural trade war with Europe that is costing taxpayers on both sides of the Atlantic more than $50 billion a year and sticking consumers with higher prices.

The Europeans have rejected the Reagan administration's call for phasing out agricultural subsidies. On January 1 the European Community barred shipments of U.S. hormone-fed beef, and U.S. officials retaliated by restricting trade in European hams, canned tomatoes, instant coffee, fruit juices, pet foods, and, yes, sausage casings. European Community officials have vowed to counterretaliate by restricting trade in American honey, walnuts, fibers, seed corn, beet pulp, and dried fruits. They deny having protectionist intentions, of course, but the fact is that they're already using antidumping provisions, domestic content regulations, and other measures to put the squeeze on foreign competitors.

So far those measures have primarily been directed at Japan, because the United States has not been a competitive exporter. But if, as many economists predict, the dollar continues to plunge and U.S. products become less expensive, it's a good bet that the European Community will turn the full fury of its economic nationalism on us as well.

A wider trade war could devastate services. For example, under current U.S. regulations, a Greek bank that applied to operate in both New York and Los Angeles would have its application denied. Greek officials could then cite the emerging European doctrine of reciprocity, file a complaint against the United States, and attempt to prevent American banks from establishing operations in Europe. Complaints could also be triggered by the Glass-Steagall Act, which prohibits banks in the United States from underwriting securities, even though that is permitted in Europe.

Moreover, a stepped-up trade war would likely bring about a contraction of world trade like the one in the early 1980s. But the new contraction could be worse than the Depression, because trade contributes about 18 percent of GNP today versus only about 5 percent in the 1930s.

The consequence of a wider trade war that would probably be the most ruinous, however, is financial retaliation—disrupting financial markets. That is because financial transactions dwarf trade transactions by about 20 to 1. Imagine the shock waves that would surge around the world if Japan reimposed exchange controls or imposed an export tax on capital. We are especially vulnerable to financial retaliation now that we are in a bear market.

Foreign investors are already turning away from the United States. The Japanese, for example, are deemphasizing international markets and making more new investments in domestic short-term equities; they're finding the best combination of equity, exchange-risk, and yield conditions at home. But Japanese money managers are also diversifying their international portfolios so that they will be less vulnerable to adverse trends in the United States.

Despite their megatakeovers of U.S.-based assets, European investors too are turning away from the United States; they're expanding their holdings in Spain, France, and Britain more rapidly than their holdings here. America is clearly not the only pebble on the beach, as some of the economic nationalists seem to believe. Investors can choose among many other markets, and interest-rate spreads and currency fluctuations can make other markets look very good indeed.

New U.S. restrictions on foreign investment would undermine America's competitiveness and promote America's decline for 10 reasons:

1. New restrictions would exert strong, steady upward pressure on U.S. interest rates. Although foreign investors now hold only about 14 percent of U.S. Treasury securities, that is enough to lower borrowing costs for American consumers and companies. Foreign funds are especially important because there seems to be little hope that Congress will bring entitlement spending under control and thereby relieve the demands on capital markets.

2. New restrictions would make it more difficult for American companies to gain access to low-cost capital. Japanese interest rates are currently about half as much as the rates in the United States. As a result of currency swaps, Toyota and other Japanese companies are actually able to borrow at negative interest rates. To tap some of that low-cost capital, many U.S. companies, including American Express, Citicorp, Dow Chemical, General Motors, Pfizer, Procter & Gamble, and Sears, have gotten themselves listed on the Tokyo Stock Exchange.

3. By excluding prospective bidders, new restrictions on foreign investment would lower the value of companies, land, and other assets by as much as 50 percent. For example, Fujitsu offered the equivalent of $250 million for Fairchild Semiconductor a couple of years ago, but it was pressured to withdraw, so National Semiconductor picked up Fairchild for half as much: $122 million. The reduced valuation has made it more difficult for Fairchild to finance a turnaround. Likewise, between 1981 and 1986 U.S. farm real estate prices declined by 19 percent. Over the past decade Japanese investors' holdings of U.S. farm real estate have increased 30-fold, to about 115,000 acres. We should be delighted that foreigners have stepped in to provide liquidity and support for the value of American land.

4. New restrictions would encourage foreign investors to develop manufacturing capacity in countries other than the United States. That capacity would tend to serve regional markets and displace American exports. Japanese companies have already made more than $70 billion worth of direct investments in more than 30 countries. Lately they have been concentrating on investment in East Asia. Malaysia is now the world's largest semiconductor exporter, and Japanese investment is helping East Asia emerge as a major center of the auto industry—Mitsubishi produces cars in Thailand, Nissan in the Philippines, Toyota in Indonesia. Such successes are putting considerable pressure on East Asian nations to reduce their trade restrictions and thereby promote greater economic integration in the region.

5. Because they would reduce the availability of investment capital in the United States, new restrictions on foreign investment would cause fewer jobs to be created here and more jobs to be created elsewhere. In recent years about 750,000 U.S. jobs have been created by the so-called *maquiladora* factories south of the border, which assemble U.S.-made components and then send them back to the United States as duty-free exports. The *maquiladoras* have been widely criticized, but if we tried to strike at them by imposing investment restrictions, the entire manufacturing operation would leave the United States. Conversely, more foreign investment would mean more jobs in the United States. Foreign companies currently employ about three million Americans—and tend to pay about 20 percent more than U.S. companies.

6. New restrictions would deny U.S. companies the benefit of foreign companies' innovative management techniques. Foreign investors' management know-how has often proved to be even more valuable than their money. The most dramatic example is probably the Toyota–General Motors joint venture in Fremont, California. When GM closed its Fremont plant in 1982, it was one of the worst auto plants in the nation—absenteeism was running about 20 percent, more than 1,000 grievances were on file with the National Labor Relations Board, and the cars were lousy. But the Toyota-managed joint venture has turned that plant around.

7. New restrictions would isolate the United States from the world's fastest-growing and in many ways most prom-

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Sen. Mitch McConnell (R-Ky.) calls for an end to public financing of presidential campaigns at a Cato Policy Forum.

Investment (Cont. from p. 7)

ising region, the Pacific Basin. California owes much of its extraordinary growth to its extensive ties with that region. In recent years Los Angeles has surpassed New York to become America's largest port and manufacturing center, largely because of the tremendous influx of Asian capital and know-how. But we're not benefiting as much as we should be. Hong Kong entrepreneurs are pouring badly needed capital—and talent—into western Canada at a rate estimated to be $160 million a month. We could acquire much more capital for growth and jobs if we didn't throw restrictions in the way or threaten to impose new ones from time to time.

8. New restrictions would reduce foreign investors' stake in a sound U.S. economy. Consider the oil industry. When the United States was just another market, oil sellers didn't particularly care whether we got oil or not. But now that Saudis own American gas stations, Kuwaitis own American refineries, and Britons own U.S. exploration rights, they'd be crazy to do anything that would jeopardize their investments. They have a powerful incentive to help keep the U.S. economy healthy, and they tend to act accordingly. For instance, Arabs and other foreign investors have provided liquidity and market support during the oil glut, thus enabling the U.S. oil industry to get rid of excess capacity and achieve a restructuring. As a result, major U.S. oil companies are now positioned to make money even if oil prices head south.

9. New restrictions on foreign investment could easily trigger retaliations against U.S. investment abroad. Americans are particularly inviting targets because our international assets are worth more than $1 trillion at book value and several times as much at the current market value. Profits from Ford's European operation helped to bail out the company's U.S. operation when it was awash in red ink. IBM earns more than 50 percent of its profits overseas; Exxon has about 75 percent of its assets overseas. Major U.S. companies would clearly be devastated by a full-scale international trade war.

10. New restrictions on foreign investment in the United States would jeopardize vital alliances because our friends and allies are the biggest investors. The British have the most assets invested here (about $70 billion worth), followed by the Dutch ($50 billion), the Japanese ($30 billion), the Canadians, the West Germans, the Swiss, and the Swedish. We've had our disagreements with those countries on political issues, and we haven't always gotten the cooperation that we've sought. But it's obvious that none of them poses a military threat to us. It would be crazy for us to intervene in the trade arena and squander good will that we may need at some point, especially considering that foreign investors are benefiting Americans every day that they're in business here.

What must we do to prevent a full-scale economic war that could quite conceivably turn the next recession into a depression? First, we must do a better job of educating people about the dynamics of prosperity. Nations prosper through the free movement of talent, goods, and capital, and individuals prosper through the freedom to take advantage of the best that the world has to offer.

The case for open markets does not depend on the condition that others exhibit fairness or on the existence of perfect competition, nor does it depend on our getting so-called concessions through endless multilateral negotiations. Rather, we will prosper to the extent that we are open to the world—and we will suffer to the extent that we are isolated from the world, just as Japan and China suffered when xenophobic rulers cut them off for more than 200 years. We will benefit from opening our markets and thereby acquiring true freedom of choice even if other nations continue to deny their citizens freedom of choice.

Freedom of choice would provide U.S. businesses with a vital safety valve. If funds were not available at sufficiently attractive rates and terms in the United States, an American company could shop the world for rates and terms that would enable it to be competitive. Of course, the same principle applies to goods. If American companies were free to shop the world for steel, they wouldn't be dragged down in the event that the U.S. steel industry had problems and couldn't deliver for 12 months or get the quality of its products up to competitive standards.

Second, we must do a better job of exposing the damage done by U.S. trade, investment, and immigration restrictions. For example, we should point out specific companies—including John Deere, Caterpillar, Lone Star Steel, and Sun Microsystems—that have been badly hurt because import restrictions make it too difficult and expensive for them to acquire the components they need. Most trade cases do not involve consumer goods; they involve electronic components, steel bars, timber, and other goods that American manufacturers need.

Third, we must do a better job of getting Americans to recognize the truth of Henry George's most powerful insight: that economic nationalism is a policy wherein we do to ourselves in peacetime what our enemies seek to do to us in wartime, namely, block trade and investment.

Fourth, we must do a better job of pointing out that U.S. trade, investment, and immigration restrictions are unjust; they almost always help a small group of people at the expense of a large group of people with lower incomes. For example, there are about 30 times more American workers in the steel-using industries than in the steel-producing industry. But the steel-using industries' workers make about 40 percent less than the steel-producing industry's workers, who benefit from import restrictions. Likewise, the 12,000 American workers in the semiconductor-producing industry benefit from import restrictions that hurt the 400,000 American workers in such semiconductor-using industries as computer manufacturing.

In addition to pointing out those inequities, we must stress that the government cannot create fairness by affording some people privileged access to other people's pockets. If we do our job right, more Americans will come to recognize the evils of economic nationalism and support a unilateral repeal of trade, investment, and immigration restrictions. Such reforms would make America more prosperous, strong, and just and give us better control over our destiny. They would also help secure international peace. ■

Buchanan Keynotes London Event

Cato-IEA Conference Speakers Assess Reagan's Impact

Cato chairman William A. Niskanen addresses 160 participants at Cato-IEA conference.

During a London conference cosponsored by the Cato Institute and the Institute of Economic Affairs, some of the world's leading economists and political analysts discussed the domestic and international impact of President Reagan's economic policies.

The conference, "Reaganomics and Beyond," featured presentations by James M. Buchanan, a Nobel laureate and Cato Distinguished Senior Fellow; Sir Alan Walters, a personal economic adviser to Prime Minister Margaret Thatcher; Cato chairman William A. Niskanen; Cato president Edward H. Crane; Sir Alan Peacock of the Institute of Economic Affairs; Donald Devine, former director of the U.S. Office of Personnel Management; and Paul Craig Roberts, a Cato adjunct scholar and former assistant U.S. treasury secretary for economic policy.

In the keynote address, Buchanan argued that any success at limiting the growth of government achieved since 1980 should be attributed to President Reagan's political effectiveness. He observed that no new institutional constraints on government growth were imposed during the Reagan administration. As a result, he warned, the proliferation of government powers is almost certain to resume in the post-Reagan years.

Niskanen, a member of the Council of Economic Advisers during Reagan's first term, observed that although the administration had its share of successes, "there was no Reagan revolution." Niskanen gave the administration substantial credit for its accomplishments in the areas of taxation and deregulation as well as for slowing the pace of inflation. But he concurred with Buchanan in finding that the Reagan years saw no fundamental change in the 20th-century pattern of government growth. In his view, Reagan squandered an opportunity for monumental achievement, leaving decidedly uncertain prospects for limited government.

Crane argued that the administration's policy failures stemmed from the president's leadership style—Reagan was long on rhetoric, short on substance, and startlingly inattentive to a number of important matters, including cabinet appointments. Moreover, Crane said, the president vested extraordinary power in people whose beliefs were fundamentally opposed to his antigovernment world view. "People, as they say, are policy," Crane noted. "And because very often the right people weren't there, the policy very often was at odds with Reagan's mandate."

Papers from the conference will be published by the Cato Institute and the Institute of Economic Affairs later this year. ■

Cato president Edward H. Crane talks with Graham Mather, general director of the Institute of Economic Affairs.

Call for Papers

The Cato Institute seeks papers on public policy issues for the *Cato Journal*, *Cato Policy Report*, and the Policy Analysis series. Send papers or proposals to Editor, Cato Institute, 224 Second Street S.E., Washington, D.C. 20003.

Interns Needed

The Cato Institute seeks interns for spring, summer, and fall 1989. Please contact Gordon Anderson at Cato for more information.

Privatization (Cont. from p. 1)

explicit policy of political support.

The average American, steeped in public-sector mythology, may well be surprised to learn, for example, that four-lane highways and freeway interchanges have been financed and built by businesses and private landowners in Houston. Other examples: Laredo, Texas, has allowed private parties to buy all of its streets except major thoroughfares in order to finance the resurfacing and upkeep of the streets remaining in its inventory; Wichita has abolished its municipal garbage department and turned the entire service over to private providers; and Texas has begun to contract with private firms for the construction and operation of prisons.

At the neighborhood level, self-help associations have received contracts to maintain parks in Baltimore, carry out health and safety code inspections in Kansas City, construct sidewalks in Louisville, and manage social service centers in Florida. Self-sufficient community groups in St. Louis and elsewhere have provided housing for the poor by using abandoned, condemned property for income-producing real estate ventures.

Neighborhood Associations

The trend in privatization that is perhaps the most significant also happens to be the least recognized and understood. In the past decade the number of community associations nationwide has more than tripled, increasing from 25,000 to over 90,000. Many provide such basic services as street maintenance, garbage pickup, security patrols, and even water and sewage treatment. Such "shadow governments," whose deed covenants serve as miniconstitutions, have a corporate character yet resemble traditional governments in many respects.

Shadow governments have already begun to exercise enough political clout to declare independence from traditional governments by steps and degrees. Lobbying by community associations that provide their own municipal-type services has pressured local governments in four areas of the nation into rebating taxes to their members. Pennsbury Village, a 503-unit townhouse community south of Pittsburgh, became the nation's first association to declare itself an independent corporate municipality. After a nearby local government called in state regulators in an attempt to force the association to abandon its sewage treatment plant and hook into an inferior municipal system, the Pennsbury Village residents went to court and won their independence.

The only practical difference between such shadow governments and traditional governments is the residents' power to choose their own form of governance. By contracting to live under an association's guidelines, members acquire a voice in the administration of its affairs through votes based on ownership. Such direct participation has rarely, if ever, been a feature of traditional governments.

> "Why must consumers tolerate government monopolies over the provision of services?"

Cities that have allowed, if not encouraged, the formation of self-assessing associations in order to relieve their budgetary strain are often reluctant to reveal the scope of that trend. For example, at least 400 home-owner associations have emerged in Houston; many of them have taken advantage of a program, unveiled a few years ago, in which tax rebates are given to deed-based self-assessing associations that collect their own garbage. Houston has also raised up to $4.5 million a year by selling streets to resident associations and making them responsible for maintenance—a program that city officials refused to discuss with this writer, apparently out of fear that the associations would be encouraged to demand more tax-rebate concessions.

Similar tax-rebate programs have taken root in Kansas City, which has nearly 50 self-assessing neighborhood associations, in Alexandria, Virginia, where a rebate for garbage pickup is provided, and in Montgomery County, Maryland, which rebates a portion of the taxes intended for roads to associations that conduct their own road and street maintenance.

St. Louis too has transferred the ownership of certain streets to property owners who have established self-assessing associations with deed covenants. At least 1,000 streets in St. Louis and the adjoining community of University City have been privatized through a program that began in the late 19th century. According to studies by urban planners, the private streets have up to 60 percent less crime and 25 percent higher property values than comparable nearby public streets.

By encouraging the proliferation of community associations, perhaps to double or triple their current number, we can extend the privatization revolution in practice and expand the political support for further changes in the taxation and service-production roles of government. It is recognition of the ways in which exercising more control over life-support services benefits the individual that will endow such associations with both wider popularity and the political will to use their power.

Lower Costs and Fairness

The two rationales for privatization that have the greatest populist appeal—lowering taxpayer costs and instituting fairness—must be aggressively advanced in the public arena rather than allowed to remain the plaything of public policy experts. Contracting out already has a track record that can be applied to every service performed by governments at all levels—federal, state, and local.

Public officials with the courage to break old habits have already achieved extraordinary taxpayer savings.

- Newark, under Mayor Kenneth Gibson, began contracting out for solid waste collection, street sweeping and resurfacing, sewer reconstruction, and snow plowing. Its total spending has since been reduced by 18 percent.
- Lafayette in northern California and Rancho Palos Verdes in southern California have contracted out the functions of their entire public works departments. By eliminating their public works staffs, they have realized savings of 25 percent.
- Westchester County, New York, has contracted out the management of its airport and turned a deficit into a profit of $1 million a year. The county has also contracted for bus service and saved nearly $8 million a year.
- Bay County, Florida, has saved nearly $1 million a year and brought its antiquated correctional facilities into compliance with state law by having a private firm operate its jail.
- Miami Beach has saved $600,000 a year since it turned its public golf courses over to private management.
- Newton, Massachusetts, has achieved annual savings of $500,000 by contracting with a private firm for ambulance service.
- Navarro County, a rural area south of Dallas, needed a new $20 million hospital facility in order to keep the hospital's accreditation. Instead of building such a facility, the county sold the rights to build and operate one to a for-profit hospital chain for $1.1 million. The new $27 million private hospital, whose owner also created a fund to care for the indigent, now provides the county with $300,000 a year in tax revenue, about the same amount that taxpayers were losing when their hospital was operated by the government.

The fairness issue will emerge as another potent argument for privatization if we pose such questions as the following: Why must consumers tolerate government monopolies over the provision of services, particularly in the case of mass transit, when the monopolies that periodically evolve in the private sector are forced to face competition in order to lower costs and enhance efficiency? Why must our laws prevent entrepreneurial Americans from doing a better job of delivering letters than the U.S. Postal Service? Why must taxpayers in eastern states be forced to subsidize electricity for consumers in northwestern states by power marketing administrations? Why must the poor be forced to support, through their taxes, public golf courses, marinas, and other recreational facilities used mostly by Americans wealthy enough to pay for such amenities?

To advance the fairness issue, we must imprint a fundamental economic principle on the public's consciousness. Although most Americans intuitively recognize that the private sector is more efficient than government bureaucracies, many believe that government should be able to provide services more cheaply than private firms because it doesn't have to make a profit. We need to acquaint such people with the Public Choice school of economics, which asserts that political rather than economic considerations dictate the way government bureaucracies function and predispose them to fail. As Peter Drucker, the dean of the nation's management analysts, has argued, "Forces which impede innovation in a public service institution are inherent in it, integral to it, and inseparable from it."

Studies by groups as diverse as the National Science Foundation, the International City Management Association, and the Urban Institute have found that private firms have provided community life-support services at costs significantly lower than governments' and at levels of quality as high or higher.

> "Privatization is a means of resolving the conflict between service needs and taxation limits."

A study conducted for the Department of Housing and Urban Development examined the provision of eight public services, comparing 10 municipalities that used public employees to provide those services with 10 that contracted with private firms. The disparities in costs were staggering. For instance, asphalt paving cost 95 percent more when performed by government, and janitorial service cost 73 percent more. Differences between government and private salaries did not account for the cost disparities in the eight services analyzed; the contractors actually paid their workers an average of $106 a month more in salary and benefits than the municipal agencies paid theirs. Rather, structural differences between public and private management accounted for the stark contrast.

Freeing Public-Sector Employees

In making the case for private-sector superiority, one must never impugn the competence or commitment of public-sector employees. Many Americans have relatives or friends who work for federal, state, or local agencies, and government employee unions make quick and creative use of any implied slanders. We should point out that their difficulties in competing with the private sector spring from straitjackets imposed by the institutional environment. The structural incentives that distinguish the private sector from government induce people to behave differently. In governments, management policy is constrained by politics and unable to create the pressures for efficiency produced by competition and the profit motive. Inefficiency and high costs are thus natural consequences of governments' monopoly over the provision of services.

There are abundant examples of frustrated government employees and officials who have turned to privatization to release themselves from the constraints of government service provision. A judge in Arizona started a system of private courts for dispute resolution that serves as an alternative to overcrowded public courts. A federal prison warden in Pennsylvania formed a private prison company to escape the bureaucracy that had stifled his attempts at innovation. Three public-school teachers in Minnesota resigned to found a company that would sell fifth-grade teaching services to public schools. Employees of a public bus line in a Nevada city established their own bus company to contract with the city for local bus service.

Privatization will gain the most acceptance if it is perceived as a budget remedy that transcends party and ideology. That too can be accomplished if the proponents of privatization reach beyond the traditional, predictable free-market advocacy groups for ideas and ammunition, and they have begun to do so. At the Hubert Humphrey Institute of Public Affairs in Minnesota, for instance, theorists associated with the Public Services Redesign Project have formulated a proposal to divest government of its role as a producer of

(Cont. on p. 12)

Privatization (Cont. from p. 11)

services and enable it to become instead a skillful buyer, shopping around in the private sector for service providers that would accomplish its policy goals at the least possible cost. Their strategy is simply to do more with less by using private enterprise.

At the activist level, privatization has attracted numerous converts from the political left. Larry Silverman, formerly Ralph Nader's chief antipollution lobbyist, now promotes the privatization of wastewater treatment and purification plants. Silverman has learned from personal experience that the private sector not only can build and operate such plants more cheaply and efficiently than government but also can be held more accountable to the public. Lupe Anguiano, a labor organizer for Cesar Chavez's United Farm Workers union, created a private-sector group to rescue mothers from welfare, having realized that a private organization that accepts no government money is an effective and less costly means of training welfare recipients for employment.

There is a danger that contracting out and other forms of privatization could be manipulated by advocates of increased social welfare spending to expand the clientele for their political agenda. In a study conducted for the National Conference on Social Welfare, Marc Bendick, an economist, reasoned that by mobilizing private-sector service providers into political coalitions for higher spending similar to those of defense contractors, the momentum toward privatization could be co-opted. "A flourishing and politically secure social welfare system" that would "constitute a distinctly American welfare state" could then evolve, Bendick wrote. He therefore urged welfare statists to become "fervent and creative advocates for implementing privatization throughout the social service delivery system."

To thwart such strategies, tax limits and program spending ceilings could be imposed at the federal, state, and local levels. Beyond that, the simple act of load shedding would sever any evolving symbiotic relationships between private firms and government bureaucracies.

Governments at all levels have at their disposal numerous incentives with which to lure the private sector to assume the delivery of services that they currently provide. The incentives include tax rebates, tax credits, deregulation, and the ownership or use of the equipment or assets involved in the provision of the services. When critics protest that such incentives constitute hidden costs to taxpayers, we should point out that any such costs would be more than compensated for by the benefits to the public.

When Wichita phased out its garbage-collection department, at least 70 companies emerged to compete for residential garbage-hauling contracts. Lower costs and better service resulted for consumers, who also benefited as taxpayers by having one less city department to support.

The Pension Time Bomb

Finally, and perhaps most important, one argument for privatization deserves wider mention. In making bids, private contractors must figure in employee retirement costs, whereas government agencies rarely have to. More than 6,000 state and local retirement programs cover about 12 million public-sector employees. Most contributions to such plans are made by taxpayers, with today's government employees being promised that future generations of taxpayers will finance their retirement. The current unfunded liability for public-sector pensions has been estimated to be $10,000 for every man, woman, and child in the United States. Some police, firefighter, and teacher pension funds already face insolvency. We will eventually be forced to raise taxes just to cover the mounting unfunded liabilities if we do not begin to whittle down the size of the public-sector workforce through attrition by privatizing many of the functions it now performs. Given the dimensions of the problem and the fact that it comes on top of other budgetary woes, surely the wiser choice for taxpayers will become obvious if privatization advocates properly shape the context of the debate.

At every opportunity we should be repeating, like a mantra, the words of New York governor Mario Cuomo: "It is not government's obligation to provide services but to see that they're provided." ■

Banking (Cont. from p. 5)

country, least of all the United States, is likely to enjoy the luxury of pursuing its financial policy in isolation.

The second session dealt with the feasibility of isolating banks within holding companies. James L. Pierce of the University of California at Berkeley pointed out that limiting a bank's ability to aid its nonbank affiliates in times of trouble would limit their ability to aid the bank. Walker F. Todd of the Federal Reserve Bank of Cleveland raised a more basic question: Would the Federal Reserve Board and Congress have the political courage to refrain from extending the safety net beyond a bank in order to rescue other members of a holding company? Todd and Gerald P. O'Driscoll, Jr., of the Federal Reserve Bank of Dallas argued that in the long run only harm would result from such bailouts, whether they were conducted by the Federal Reserve Board or another arm of the government.

Federal Reserve governor Wayne Angell discusses payments system risk.

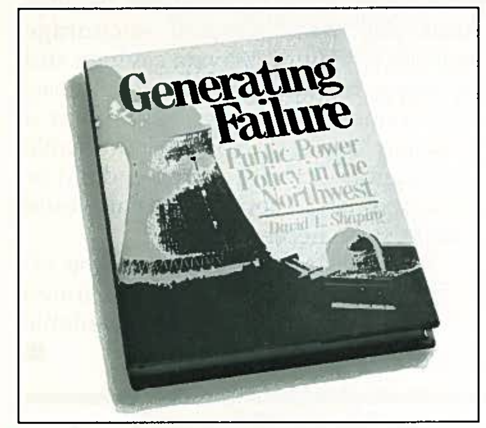
The final session addressed payments system risk. Robert T. Clair of the Federal Reserve Bank of Dallas explained how the U.S. payments system works, and Angela Redish of the University of British Columbia compared it with its Canadian counterpart. Gerard F. Milano of the California Bankers Clearing House Association noted that as long as daylight overdrafts, which are perceived to involve a significant risk, are tolerated, the Federal Reserve Board will have a rationale to continue its close regulation of large banking organizations.

The proceedings of the conference will be published later this year. ■

How the Feds Created WPPSS

Federal power provision in the Pacific Northwest has cost taxpayers billions of dollars, charges a new book from the Cato Institute.

In *Generating Failure: Public Power*



Policy in the Northwest former Department of Energy official David L. Shapiro exposes the policy disasters caused by the public power system. He maintains that the Washington Public Power Supply System's default on $2.25 billion worth of municipal bonds—the largest such default in America's history—was due to reckless mismanagement by WPPSS's federal parent, the Bonneville Power Administration. He also warns that political maneuvering continues to jeopardize the stability of the power industry.

According to Shapiro, the 1933 establishment of the Tennessee Valley Authority ushered in a new era for American energy policy in which the federal government supplanted private industry as the primary generator of power for much of the nation. In 1937 BPA was established in the Northwest to transmit and market power from the Bonneville Dam on the Columbia River. Eventually BPA became responsible for all federal power facilities in the Northwest.

As Cato Institute chairman William A. Niskanen points out in the foreword, the case for federal power programs was based on the claim that public utilities could provide power at a lower cost than the private utilities, which allegedly charged monopolistic rates. But the public utilities' performance in what Niskanen calls a "massive experiment in social engineering" disproved that claim. "As it turned out," Niskanen writes, "few of the hopes and most of the fears about this experiment were realized."

Shapiro concludes that the problems are systemic; BPA is a prime example of a federal agency that has grossly exceeded its initial charter and pursued an independent course at the expense of taxpayers and the constituents it was intended to serve. His solution is to privatize the agency and restore the responsibility of energy provision in the Northwest—and throughout the nation—to the private sector.

A clothbound edition of *Generating Failure: Public Power Policy in the Northwest* is available from the Cato Institute for $17.50. ■

Repeal the Medicare Tax

Peter J. Ferrara

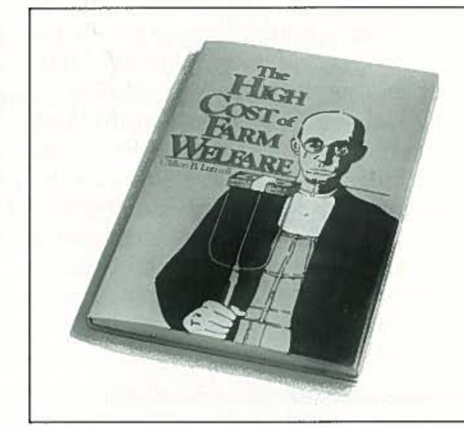
The income-tax surcharge imposed on the elderly as part of the 1988 catastrophic health care plan should be repealed, argues a new Cato Institute study.

Cato senior fellow Peter J. Ferrara, an associate professor of law at George Mason University, writes that repealing the new surcharge would give the elderly a $17 billion tax refund and the same marginal tax rates that apply to other citizens. He also proposes to readjust the Medicare benefits structure

(Cont. on p. 14)

Farm Subsidies Help the Rich

Few people have been helped by the massive farm subsidy programs that have developed over the past 50 years, according to a new book from the Cato Institute.



In *The High Cost of Farm Welfare* agricultural economist Clifton B. Luttrell examines the subsidy programs and concludes that their enormous costs far outweigh their benefits, which are generally confined to a small number of politically well-connected landowners.

Luttrell traces the history of government intervention in the agricultural sector from the early price support schemes to the massive expansion of farm programs during the New Deal and the postwar period, then provides a comprehensive analysis of modern programs. He describes three phases of aid: supply management, export subsidies, and direct payments. After discussing food stamps, subsidized credit, the dairy and sugar programs, and payments in kind, Luttrell charges that such programs "tax the poor to enrich the wealthy."

According to Luttrell, the situation has been growing worse because internal mechanisms in the farm programs exacerbate their negative effects. "Accumulating problems and snowballing costs," he writes, are "the unmistakable legacy of more than 50 years of government manipulation of American agriculture."

Luttrell argues that dismantling nearly all of the farm programs would provide major savings for American con-

(Cont. on p. 14)

Farm Welfare (Cont. from p. 13)

sumers and taxpayers, increase the economic viability of the nation's farming sector, and reduce the federal budget deficit by as much as $25 billion.

"Farm subsidies are the biggest scandal in a federal budget filled with excesses," said former budget director David Stockman. "*The High Cost of Farm Welfare* should be required reading for Congress before the next farm bill or budget resolution is written." Former Delaware governor Pete du Pont concurred, saying that Luttrell's analysis will "offer policymakers a way out of the tangled web of government intervention in agriculture that is depressing farmer and consumer incomes alike."

The High Cost of Farm Welfare is available from the Cato Institute, in cloth for $19.95 and in paper for $9.95. ■

Medicare Tax (Cont. from p. 13)

and eliminate the increasingly burdensome monthly premium in order to provide financial relief to elderly people of modest means.

Ferrara notes that the costs of Medicare are escalating rapidly for the elderly. The monthly premium has increased by 78 percent since 1987 and is projected to increase to about $50, or about $1,200 a year for an elderly couple, by 1993. The Medicare surcharge for taxpayers over age 65 is currently 15 percent and is scheduled to increase to 28 percent by 1993.

Medicare itself has contributed to the rising cost and declining quality of health care, Ferrara contends. Because the federal government "pays the bills through Medicare, both patient and doctor lose incentives to keep costs down. As a result, unnecessary... services, tests, and treatments are pursued."

Ferrara warns that Medicare will face dramatic financial difficulties. According to government projections, simply paying all promised benefits to those in the workforce today when they retire will require a 130 percent increase in the Medicare payroll tax rate by the early years of the next century. He proposes to establish Health Care Savings Accounts, which would encourage workers to rely on private savings and insurance to cover their medical costs in retirement. He views HCSAs as a means to "avoid the soaring, untenable tax increases on both young and old or the draconian benefits cuts that would otherwise be necessary."

"Abolish Medicare Taxes on the Elderly" is no. 115 in the Cato Institute's Policy Analysis series. It is available for $2.00. ■

Cato Cosponsors Publication of Hayek's Collected Works

The Cato Institute is to be a cosponsor of a 22-volume collection of the works of F. A. Hayek, a Nobel laureate and Cato Distinguished Senior Fellow who ranks as one of the most important figures in 20th-century intellectual history. The series is being coordinated by the Hoover Institution and edited by Hoover senior fellow W. W. Bartley III.

The first volume in the series, *The Fatal Conceit: The Errors of Socialism* (Routledge, 1988), has just been released. The book, presumed to be Hayek's final one, is most notable for offering a restatement and extension of his classic critique of central economic planning.

Cato president Edward H. Crane welcomes F. A. Hayek to Cato.

All of Hayek's works, including his seminal books *The Road to Serfdom* and *The Constitution of Liberty*, will be included in the series. The collection will highlight the impressive range of the subjects that Hayek has addressed during his 50-year career, from his exhaustive economics treatise *The Pure Theory of Capital* to a collection entitled *The Sensory Order and Other Essays on Psychology* to his account of the marriage of John Stuart Mill and Harriet Taylor. Hayek's letters, including his long correspondence with Karl Popper, will also appear, as will transcriptions of his conversations, lectures, and debates.

"Throughout his brilliant and distinguished career, F. A. Hayek has been one of the truly great champions of freedom, leading the intellectual charge against the forces of collectivism and tyranny," Cato president Edward H. Crane said. "The publication of his collected works is a historic and momentous event, and the Cato Institute is honored to be associated with it."

In other news, Cato chairman William A. Niskanen's *Reaganomics: An Insider's Account of the Policies and the People* was selected by *Business Week* as one of the 10 best business books of 1988. "The book explains how a program that promised to balance the budget within three years instead produced crippling deficits," *Business Week* observed. "Other political memoirs may be juicier, but Niskanen's is marked by trenchant analysis." A cloth edition of *Reaganomics*, published by Oxford University Press, is available from the Cato Institute for $22.95. ■

The Washington Post THURSDAY, JANUARY 12, 1989

In Government, Is Smaller Better?

Cato Institute Favors Drastic Downsizing to Solve Problems

By Spencer Rich
Washington Post Staff Writer

The Cato Institute is a little place with big ideas.

Today it will issue a new book aimed at policymakers in the Bush administration and elsewhere calling for the most radical reduction of U.S. government activities at home and abroad yet suggested by any serious policy organization.

Cato urges a drastic downsizing of the government: in its view, President Reagan did not go far enough in reducing domestic programs, and the institute supports cutting the defense budget by half over a 10-year period.

The institute's organizing concept, said Edward H. Crane, a 44-year-old former business investment adviser who founded Cato in San Francisco in 1977 and moved it here in 1981, is that "we are skeptical of the efficacy of government intervention" in a wide range of activities.

"Our view doesn't fit in with the current left-right spectrum," said Crane, a libertarian in his personal views.

The government, he said, in undertaking an activist role to solve domestic problems frequently makes things far worse than if the matter were left to the private activities of individuals and nongovernment entities. And the United States, in seeking to play the role of "world policeman," expends huge amounts of money and does a worse job of providing security than the prosperous nations of Europe and some other areas would do for themselves if deprived of U.S. support.

Cato's new book—"An American Vision: Policies for the '90s"—offers a variety of proposals on reducing the government.

Under institute proposals, the defense budget would be chopped in half over 10 years, from $291 billion today to $150 billion (in 1989 dollars) by 1998, and U.S. alliance commitments in Europe, Asia, the Mideast and elsewhere would be annulled.

When costs are tabulated, Crane said, the United States spends $120 billion a year on military outlays basically used to defend Europe and $20 billion on similar outlays to defend South Korea. "We're being played for a sucker," he said.

Cato proposals also tackle domestic problems head on:

The sale of drugs such as cocaine, heroin and marijuana would be allowed in the same fashion as sale of alcoholic beverages. Cato thinks the current legal prohibitions have created massive public disorder and criminality that make the drug-abuse problem worse rather than better.

Welfare for working-age people would be abolished and minimum-wage requirements repealed. Cato thinks this would break a mentality of dependency by pushing people into work and making available new jobs where the wage would not by law exceed the worth of the labor.

At the same time, the Cato proposals would stop tax increases, freeze federal spending, impose a means test on entitlement programs, "immediately halt all forms of aid to the Nicaraguan contras," and pledge to "refrain from interfering in the affairs of its [Latin American] neighbors if they refrain from establishing certain kinds of ties with governments deemed unfriendly to the United States."

By Washington standards, Cato is not a giant. Its budget, $2.4 million a year, and staff, 25 paid full-time persons, are far smaller than that of the Urban Institute ($12 million), Brookings Institution ($15 million), Heritage Foundation ($14 million) or American Enterprise Institute (about $8.5 million).

David Boaz, vice president and coeditor with Crane of the new book, said the name Cato was chosen to reflect admiration and unity with some 18th-century English pamphleteers who were anti-statist and libertarian in their views. They grouped under the name of Cato, after Cato the Younger, "regarded as the last republican who stood against the onslaught of the Roman Empire," Boaz said.

People associated with Cato include William Niskanen, former member of the Council of Economic Advisers early in the Reagan administration and now Cato chairman; Earl C. Ravenal, professor of international affairs at Georgetown University; Nobel economists F.A. Hayek and James Buchanan; Federal Express chairman Frederick Smith, former Delaware governor Pete du Pont, and author George Gilder.

Crane said the institute receives funding from numerous businesses, foundations and individuals, with Sears, Roebuck a major contributor.

While the proposals in the new book "would result in much smaller government and much less intrusion into people's lives," Crane said the aim isn't simply to reduce government but to turn over responsibilities to the private sector in the strong conviction that it can do a better job.

"We don't regard this book as a blueprint for paring the government down as much as a blueprint for solving problems."

"To be governed..."

Aimed right at the citizens

Bush has accused Dukakis of being for unilateral disarmament. Yet Bush has disarmed himself by promising no new taxes. Taxes are one of the most important economic weapons a government has.

—John Chancellor on "NBC Nightly News," Nov. 2, 1988

Hey, it got votes, didn't it?

Ronald Reagan promised to balance the budget, Lyndon B. Johnson warned against sending "American boys to do the fighting of Asian boys" in Vietnam and Franklin D. Roosevelt vowed to get government off the back of business.

—*Philadelphia Inquirer*, Oct. 28, 1988

Oh, well; no problem, then

Former president Chun Doo Hwan, beset by charges of corruption during his rule, is willing to make a public apology.

—*Washington Post*, Nov. 5, 1988

Which may be extended due to the threat of spring

President Daniel Ortega, citing the threat of Hurricane Joan 220 miles off Nicaragua's Caribbean coast, declared a 30-day nationwide state of emergency today, allowing him to suspend press and other freedoms.

—*Washington Post*, Oct. 21, 1988

And so was born the Flea and Tick Drought Relief Act of 1989

The sizzling drought that shriveled crops around the country last summer also shriveled much of the U.S.'s flea population. . . . Now that's good news . . . for just about everybody. Except, that is, companies in the flea- and tick-control business.

—*Wall Street Journal*, Dec. 5, 1988

And let's see—oh yes, no tax increase

President-elect George Bush sought today to build a post-election mandate for several domestic initiatives, including a deficit-cutting drive to start his first day in office, a sharp increase in federal prison construction, a child-care grant program and environmental proposals to reduce acid rain and maintain the nation's wetlands.

—*Washington Post*, Nov. 23, 1988

The mayor who bombed them got reelected

Ernest A. Edwards Jr., the developer convicted of stealing more than $137,000 in his failed attempt to rebuild the 61 houses destroyed in the May 1985 MOVE fire, was sentenced yesterday to seven to 14 years in state prison and ordered to repay the money.

—*Philadelphia Inquirer*, Oct. 28, 1988

I said I'd preserve and protect it, not read it

Gov. William Donald Schaefer, Maryland's leading advocate of the state's handgun control law, made a "confession" today that he owns a handgun. . . .

Agreeing with gun advocates in his own parlance, Schaefer said, "Under the Constitution, I have a right to—what?—something, I don't know, whatever it is, to bear arms or something."

—*Washington Post*, Nov. 10, 1988

Values in the schools

The IRS will be accepting from 93-year-old songwriter and lyricist Irving Caesar the copyrights to two of his songs for children and plans to use the songs in its public relations materials. Caesar . . . is offering the IRS "Tommy Tax" and "The Red, White and Blue Can't Live on I.O.U." . . .

The Tax Reform Act of 1986 required children with earned and unearned income over $500 to file a return and the IRS is now sending out notices to the children . . . about the taxes they owe.

[The first song features such lyrics as] "Poor Tommy Tax, poor Tommy Tax, His bills are oh so many, So ev'ryone should pay a tax, For he needs ev'ry penny; And who pays all our Teachers, For teaching us these facts? Who? You! And little Tommy Tax!"

—*Tax Notes*, Oct. 17, 1988

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