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A Market Approach to Solving the Banking Crisis

by Catherine England

Recently, Pepsi ran a television advertisement set in a distant future with flying cars and people dressed in strange costumes. In the ad a professor and his students are visiting an archeological dig, presumed to represent home life in the late 20th century. The professor stumbles across an initially unidentifiable object and carefully brushes it off to reveal a bottle of Coca-Cola. One of the students asks, "Professor, what is it?" and the professor replies, with a puzzled look on his face, "I have no idea!" The scene closes with the bewildered students drinking their Pepsis.

In all honesty, there is little reason to be particularly concerned about the future of Coca-Cola. The firm has the incentives and, most importantly, the freedom to adapt to changing consumer tastes—even if the corporate officers don't always know when consumer tastes have changed and when they haven't.

A somewhat more realistic story line for an ad looking into the future might go like this: Envision the same cars flying overhead, the same professor and students dressed in outlandish costumes. Once again the group is visiting a recently uncovered archeological dig dating to the late 20th century. This time the professor stumbles over some sort of sign that appears to have fallen from a nearby building. As he carefully brushes away the accumulated debris, the professor uncovers the letters B-A-N-K. Again a student looks up to ask, "Professor, what's a 'bank'?" stumbling over the word a bit, perhaps. But once again, the professor is forced to admit ignorance as he responds, "I have no idea!"

> "Why the pessimism about the survival of banks? Perhaps because so many people profess to be so interested in protecting them."

Admittedly, such a scenario is a bit exaggerated. After all, an archeologist whose specialty was the late 20th century would know enough history to explain to his students the role played by banks. And surely the students would be familiar with institutions that act as depositories for individuals and corporations, that provide a convenient means of payment, and that serve as financial intermediaries. These functions are crucial to the sound operation of a healthy economy, and while the technology and forms through which such services are offered may change, the need to offer them will remain.

So why the apparent pessimism about the survival of banks as a form of financial institution? Perhaps because so many people profess to be so interested in protecting them. The fact is, any long-term solution to the types of problems we see with the savings and loans, with the "agricultural" banks, and now with the "energy" banks in Texas, Louisiana, and Oklahoma will require a fundamental rethinking of our attitudes toward banks.

Since the 1930s, especially, something of a mystique has grown up around banks. Banks are different, we are told. They cannot be subjected to the rough-and-tumble world of normal competi-

(Cont. on p. 10)

Catherine England, a senior policy analyst at the Cato Institute, directs the Institute's Financial Deregulation Project.

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Salute to Peter Bauer

Free Enterprise Key to Development

Property rights and free markets are the key to economic development in the Third World, said many of the speakers at Cato's conference "Development Economics after 40 Years," held in honor of the distinguished development economist P. T. Bauer, now Lord Bauer.

In his banquet address, "Indifference to Reality in Economics and Beyond," Bauer argued that in the social sciences—unlike, he thought, the natural sciences—people seem to hold theories in "widespread disregard of evident reality." One example he cited was the "vicious circle of poverty" theory, which holds that poor people and poor societies "are trapped in their poverty and cannot generate sufficient savings to escape from the trap."

"This notion became a cornerstone of mainstream development econom-

(Cont. on p. 4)

Flood South Africa with American Culture

A popular bumper sticker in Washington reads, "Boycott South Africa, Not Nicaragua." This seems to sum up the level of debate in town: we've decided to boycott somebody; now we're just arguing about who it should be.

In neither case is it clear exactly why we're boycotting. Presumably we want to punish someone. But the advocates of sanctions rarely stop to consider just who will be hurt by our sanctions. Sometimes they're proud of this lack of interest in results. *Washington Post* columnist Richard Cohen wrote recently, "Maybe in the short run [sanctions] will hurt poor blacks more than rich whites. But the idea, first and foremost, is to make a moral statement: to answer the question: 'Which side are you on?'"

Cohen offers a parody—or perhaps just the quintessence—of modern American liberalism, which often seems to feel that striking a moral pose is more important than achieving positive results. Welfare probably hurts the poor, but upper-middle-class Americans feel good about paying taxes for welfare. We've done something about the poor, they can tell themselves. Never mind whether the poor are better off.

Similarly, sanctions against the racist government of South Africa will make Americans feel better. Never mind whether they help the oppressed majority in South Africa.

In fact, if we really want to move South Africa into the modern world, we shouldn't boycott it—instead, we should swamp South Africa with American culture. Our culture portrays a way of life that is tremendously appealing to people in many countries, including South Africa. And one of the key aspects of the American way of life is racial integration.

Why should we want to deny South Africans, black and white, the opportunity to see a free, prosperous, and racially diverse society that works so well? Let South Africans watch "The Cosby Show," listen to Bruce Springsteen records, go to Diana Ross concerts, read American books, laugh at "Doonesbury." The message of this great mélange of cultural variety is that America is what a country should be. South Africa needs more American influence, not less.

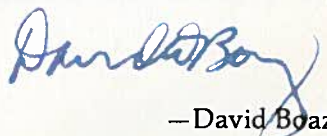
Another problem with sanctions is that they will weaken the business community, the most progressive part of South African society. The English in South Africa, who dominate the economy, are far more liberal than the Afrikaners, a rather primitive tribe suited mainly for such simple tasks as farming and government. English-speaking businessmen have pushed the limits of apartheid, admitting blacks to white restaurants before it was legal to do so, training blacks for skilled-worker jobs, and so on. By cutting off South African trade with Americans, we would weaken the position of business and tip the balance of power in society further toward the Afrikaners and the government.

And, of course, pulling American companies out of South Africa is not likely to result in a more liberal economy or society. (However, it is entirely appropriate for American companies to refuse to do business with the South African *government*, as when General Motors announced recently that it will continue to sell cars in South Africa but will stop its sales to the South African police and military. Such actions will have the beneficial effect of continuing American interaction with South African society but not strengthening the government.)

Ironically, many of the people who understand the problems with sanctions against South Africa support President Reagan's embargo against Nicaragua. Again, some of them defended it despite their understanding of those problems. Sen. Nancy Kassebaum (R-Kans.) said, "I never believed sanctions will make a lot of difference. I just felt it was important to take an action that could be legally done and would show we're not going to carry on business as usual with the Sandinistas."

Of course, the same considerations noted above apply in this case as well. The embargo, if it has any effect at all, will weaken Nicaragua's already staggering private sector. It will cut off Nicaraguans' ties with the democratic capitalist world and probably strengthen the position of the Sandinistas in Nicaraguan society. As with South Africa, surely the last thing we want to do in Nicaragua is tilt the balance of power further toward the government.

Will economic sanctions improve the lives of either South African blacks or Nicaraguan campesinos? Almost certainly not. Do the advocates of sanctions care, or are they just engaging in moral posturing?



—David Boaz

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CATO INSTITUTE

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Charles Murray Highlights Public Policy Day

Charles Murray, author of *Losing Ground: American Social Policy, 1950-1980*, delivered a moving address on the failures of the American welfare system at Cato's Ninth Annual Public Policy Dinner. Murray told the large crowd of Cato Sponsors and friends that he was not optimistic about the prospects for meaningful policy changes, but he hoped that reforms could be made "before another generation is lost."

The dinner capped a highly successful Public Policy Day at which Cato staff members and authors addressed Sponsors and corporate and foundation representatives on a wide variety of current policy issues. Among the speakers were Cato chairman William Niskanen on current economic policy, vice president David Boaz on the politics of the baby boom, adjunct scholar Peter J. Ferrara on Social Security reform, senior fellow Earl Ravenal on the costs of NATO, and senior fellow Doug Bandow on the Reagan administration. Senior policy analyst Catherine England's discussion of banking regulation is printed on page 1 of this issue of *Cato Policy Report*.

Outside speakers included Thomas Gale Moore of the Council of Economic Advisers on privatization, and Robert Crandall of the Brookings Institution on free trade.

Cato Sponsors came from as far away as California to listen to the talks, and their reaction was enthusiastic. Corporate and foundation representatives included David Arnold of the Ford Foundation, Michael Greve of the Smith Richardson Foundation, Kim Ohnemus of the John M. Olin Foundation, Mary Bennett Peterson of General Motors, and Robert H. Krieble, chairman of Loctite Corporation and vice chairman of the Heritage Foundation.

Cato president Edward H. Crane said, "We're delighted to see how many of our friends and supporters would take a day out of their busy schedules to come to Washington and listen to discussions of public policy. I hope that Public Policy Day will become an annual event at which we can show our appreciation to our Sponsors and give them a closer look at what we're doing." ■

American Enterprise Institute economist William Haraf talks with Federal Reserve governor Martha Seger at Cato's Public Policy Dinner.

Charles Murray talks about the future of the welfare state at the Cato Institute's Ninth Annual Public Policy Dinner.

Cato sponsors enjoy lunch in the backyard during Cato's Public Policy Day.

Reform FDA to Help AIDS Victims

Victims of AIDS and other incurable diseases are denied access to potentially valuable experimental drugs by the Food and Drug Administration (FDA), says a new Cato Institute study.

Dale H. Gieringer, a writer and policy analyst affiliated with the Decisions and Ethics Center of Stanford University, examines the current system of investigatory-drug regulation and offers an "informed choice" policy alternative. He concludes that the current FDA approval process is needlessly long and expensive and denies any consideration to individual access to experimental therapies that may be of unique personal benefit. The regulation also imposes economic costs and delays that inhibit new-drug research.

Gieringer proposes "to allow unapproved investigational products to be freely used and sold along with appropriate information and precautions on risk—an 'informed choice' policy. The essential object of the policy would be to inform, but never limit, consumer choice."

"A fundamental problem with the FDA approval system is that it denies individual choice in risk," he writes. Rejecting the notion of a sole criterion for measuring drug safety, Gieringer focuses instead on individual attitudes toward risk and on medical-community uncertainty over the degree of medical risk associated with the various drugs. "Any attempt to resolve medical controversy by regulatory fiat is inevitably arbitrary. . . . To avoid uncertainty by forbidding potentially risky experiments rules out the likelihood of potential benefits."

"Compassion vs. Control: FDA Investigational-Drug Regulation" is part of the Cato Institute's Policy Analysis series and is available for $2.00. ■

Development (Cont. from p. 1)

ics," Bauer said. "Yet it is in obvious conflict with simple reality. Throughout history innumerable individuals, families, groups, societies and countries, both in the West and in the Third World, have moved from poverty to prosperity without receiving external donations. All developed countries began as underdeveloped. Indeed, if the notion of the vicious circle were valid, mankind would still be in the Old Stone Age at best."

Bauer concluded by quoting George Orwell: "Restatement of the obvious has become the first duty of intelligent men."

Happily, some of the other speakers felt that Bauer's long years of "restating the obvious," as well as his original research, had brought the state of understanding of development economics to a much higher level. Deepak Lal of the World Bank cited his own changing views as well as those of other development economists over the past 25 years or so.

Bloomsburg University economist George Ayittey, a native of Ghana, condemned the *dirigiste* development models used by post-colonial African governments and denounced African political leaders for being characterized by "megalomania, one-man rule, and kleptocracy." This kind of rule was alien to African traditions, he argued: "Freedom of speech, free trade, free markets, and freedom of movement were all part of our black African traditions." He warned, "Until economic and political freedoms are restored, no amount of aid can rescue Africa and the next drought will produce a holocaust the world has never seen before."

Alvin Rabushka found that "high and often rising tax rates applied to lower and lower thresholds of income" were strongly correlated with low or negative economic growth. Using Freedom House's ratings of political and civil liberties, he also found, "Growth, which leads to rising prosperity, is a necessary but not sufficient condition for democratic institutions and individual freedoms. Stagnation, which breeds poverty, is almost a sufficient condition for authoritarian governments, political repression, and the denial of civil liberties. A humanist view of the developing world dictates the application of low tax rate, growth-oriented economic policies."

Mancur Olson delivers the opening address at conference in honor of P. T. Bauer.

George Ayittey of Bloomsburg University condemns the economic policies of African governments at conference on development economics.

Alan Rufus Waters of Wake Forest University stressed the importance of well-defined private property rights, which "increase the flexibility with which resources can be channeled into more productive activities and to new groups within society." Julian L. Simon of the University of Maryland looked at population growth, arguing that "a more dense population does not hamper economic growth."

Mancur Olson of the University of Maryland, author of *The Rise and Decline of Nations*, discussed two key points from Bauer's work: that people in developing countries respond to incentives just the way people in advanced countries do, and that openness to imports, foreign firms, and foreign capital is very important for economic development. Jonathan Kwitny of the *Wall Street Journal*, author of *Endless Enemies*, argued that virtually no one believes in the socialist development model any longer but that the U.S. government and major banks bear some responsibility for encouraging central planning and government-controlled enterprises in Third World countries.

Other speakers at the conference included Bauer's long-time collaborator Basil S. Yamey of the London School of Economics, Keith Marsden of the World Bank, D. Gale Johnson of the University of Chicago, Karl Brunner of the University of Rochester, and Donald McCloskey, author of *The Rhetoric of Economics*.

Papers from the conference will appear in the Winter 1987 issue of the *Cato Journal*.

Alan Walters, Peter Bauer, and Basil Yamey study one of the talks at Cato's conference on development economics.

Private Savings Threatened

Keep IRAs, Ferrara Urges

The Senate Finance Committee erred in making IRA contributions nondeductible for most workers, wrote Peter Ferrara in a Cato Policy Analysis study published shortly after the Committee's vote.

Ferrara, author of *Social Security: The Inherent Contradiction*, argued that only with full IRA deductibility restored could workers receive about the same benefits in retirement from their IRAs as under current law. Ferrara challenged the results of a study by the Employee Benefits Research Institute, which had argued that because of the lower tax rates proposed in the Finance Committee tax-reform bill the nondeductible IRA would provide equal or greater value in benefits for most workers than IRAs under current law, with a deduction for IRA contributions but higher rates.

According to Ferrara, EBRI failed to account adequately for the full value of the IRA deduction at the higher tax rates under current law. It also failed to recognize that under current law most workers have lower tax rates in retirement, when their IRA withdrawals are subject to tax, than during working years, when their IRA contributions are deducted against the higher tax rates.

Ferrara argued that U.S. retirement policy is supposed to be "based on the concept of the 'three-legged stool'—Social Security, pensions, and private savings." IRAs are now the most important part of the private-savings component of retirement.

Ferrara's study, "Deductible IRAs Are Best for Workers," is part of the Cato Institute's Policy Analysis series and is available for $2.00

Studies Critique Soviet Emigration, Dangers of Imperial Presidency

Two new Cato Policy Analysis studies focus on aspects of American foreign policy. Cato foreign policy analyst Ted Galen Carpenter writes of the dangers of an imperial presidency and the importance of Congress's constitutional role in directing the nation's foreign policy. Political scientist Thomas M. Magstadt takes up the subject of Soviet emigration, calling for increased public awareness of emigration and simultaneous quiet diplomacy as the keys to encouraging an easing of Soviet restrictions.

Carpenter examines the doctrine of executive supremacy and finds it lacking: "Executive supremacy in foreign affairs was not set forth in the Constitution. That doctrine evolved from particular historical circumstances, and it is directly connected to the rise of the United States as a global interventionist power." He traces the historical evolution of the imperial presidency, noting that its ascendancy has coincided with periods of war and perceived military threats. Following such periods, there has usually been a congressional resurgence and a trimming of presidential excesses.

The current administration makes no effort to hide its opposition to any congressional role in foreign policy, charges Carpenter. "An unfettered chief executive in foreign affairs does not merely heighten the danger of unwanted and unnecessary wars; it poses a potentially lethal threat to our entire system of checks and balances, thereby jeopardizing domestic liberties. . . . Especially in matters of war and peace, the views of the American people and their elected representatives should be paramount."

Magstadt's study uses the Soviet Union as a case study of emigration policy. He asserts that "the freedom to emigrate is an essential aspect of citizenship under any political regime" and thus poses a serious moral and political dilemma for future superpower relations. The critical determinant of Soviet emigration policy, Magstadt argues, is the condition of Soviet-American relations. A strategy of quiet diplomacy, public awareness of emigration issues, and continued efforts to make the United States a positive example is the best hope for citizens of repressive regimes.

Carpenter's "Global Interventionism and a New Imperial Presidency" and Magstadt's "Emigration and Citizenship: Implications for Soviet-American Relations" are available from the Cato Institute for $2.00 each.

Bank Regulation: Legacy of 1930s

Bank regulation has been greatly influenced by a single event, the banking collapse of the Great Depression. Understanding the causes and results of the collapse is crucial to recognizing the need for deregulation of the industry today, according to financial consultant Bert Ely of Ely & Company.

In a Cato Policy Forum entitled "Banking Regulation: Legacy of the Great Depression," Ely analyzed the structure of the economy and banking industry of the 1920s, the collapse of the early 1930s, and the resulting government policies. The 1920s, he argued, laid the groundwork for the collapse. Particularly important factors undermining banks were the lack of deposit insurance in all but eight states and laws prohibiting branch banking and interstate banking, which made it impossible for banks to spread their losses. Other contributing factors included the counterproductive Federal Reserve money-supply policy, the absence of a lender of last resort, and rampant price deflation.

The restrictive economic policies adopted in the wake of the collapse were generally counterproductive. Regulation Q (which regulated the amount of interest banks could pay on consumer savings), continuing limits on geographical expansion, and the separation of commercial banking from investment banking made the structure of the industry more inflexible.

Commenter Robert Litan of the Brookings Institution noted that although branch banking did not exist in the 1920s, chain banking—different banks owned by one person—did exist. Also, holding companies enabled some banks to avoid interstate banking bans. Both practices did give banks some flexibility, Litan said.

A Skeptical Feminist Looks at Comparable Worth

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 Jennifer Roback, a professor of economics at George Mason University and author of A Matter of Choice: A Critique of Comparable Worth by a Skeptical Feminist *(Twentieth Century Fund, 1986). Commenting on Roback's remarks was Donna Lenhoff, associate director for legal policy and programs of the Women's Legal Defense Fund.*

Jennifer Roback: Comparable worth, far from being a help to women, will in fact seriously hinder some of the most important goals that women have established for themselves in the late 20th century.

First of all, what is "comparable worth," or "pay equity," as it's sometimes called, and what motivates it? The term refers to an attempt to pay comparable wages for jobs of "comparable worth." The reason we observe comparable worth on the political scene today is that women are still earning less than men. Probably all of you have seen the "59 cents" button around, which refers to the fact that a woman earns 59 cents for every dollar earned by a man, in spite of the fact that we have had the Equal Pay Act of 1963 and Title VII of the Civil Rights Act of 1964 on the books for over 20 years. Now, the significance of these laws is quite simply that discrimination has been illegal for some time, that is, it is already illegal to pay different wages for the same job. Current law also forbids job segregation.

So comparable worth is an attempt to deal with those wage differentials that still exist even with legislation that addresses the most proximate causes of those wage differences, namely, unequal pay for the same jobs and keeping women out of certain occupations. Comparable worth goes beyond current legislation in that it requires that an employer pay comparable wages for *dissimilar* jobs. In this scheme, job comparisons have to be made in order to decide which jobs are in some sense comparable in the wages that should be assigned to them.

The reason we observe this effort now is that there continues to be an earnings gap between men and women. The earnings gap has narrowed over the years—it's not 59 cents anymore; as of 1983, it was 64 cents. Still, it's not 100 cents. If we continue to observe these differences in earnings, the argument goes, it must be because women are not getting into better jobs. The jobs of women are somehow different from the jobs of men, and the only way we will ever correct the wage disparity is to deal with the fact that women are still segregated in certain types of jobs. Since job segregation is itself forbidden by law, it must be that women are systematically shunted into their lower-paying jobs, through societal pressure or some other means. Thus, the only way to get wage parity is to bring the wages of *those* jobs up. We also see the argument that "women's jobs" are systematically undervalued because they are women's jobs.

Jennifer Roback: "Comparable worth tends to focus your attention on constraints rather than possibilities. It portrays women as victims, rather than as achievers."

Policy Forum

One of the earliest relevant cases was the *Gunther* case, in which the Supreme Court held that the County of Washington had discriminated against its women employees and was therefore required to provide back pay. This was not really a comparable-worth case, however. The Court's decision in favor of the plaintiffs was based upon a determination that the county had intentionally discriminated. The evidence was that the county devised a job-evaluation survey as a means of setting pay but that it paid the women less—because they were women—than the survey recommended. The Supreme Court ruled, "Respondents' claim is not based on the controversial concept of 'comparable worth,' under which plaintiffs might claim increased compensation on the basis of a comparison of the intrinsic worth or difficulty of their jobs with that of other jobs in the same organization or community. Rather, respondents seek to prove, by direct evidence, that their wages were depressed because of intentional sex discrimination, consisting of setting the wage scale for female guards, but not for male guards, at a level lower than its own survey of outside markets and the worth of the job warranted."

Most courts have shared the view that Title VII does not require the comparable-worth standard, that it just requires equal pay for equal work. The one exception was Judge Tanner's decision in *AFSCME* v. *State of Washington*, a comparable-worth ruling that was recently overturned. What's the difference? In the *AFSCME* case, the job survey was not done by the organization itself, and the organization was not using it to set wages. Rather, a job survey had been done at the request of the state legislature but had never been implemented. Last September the Circuit Court held that Title VII does not require an employer to implement a job-evaluation scheme and to pay according to it.

Now let me discuss briefly the politics of comparable worth and, in particular, two of the main groups that have been instrumental in promoting the comparable-worth concept. The first major group is the public-employee unions. In a way this is odd because over the years the union movement, to put it mildly, didn't perceive women as one of its big constituencies. Recently, unions have become more active in recruiting women—primarily because union membership has been declining

steadily over the last 10 or 15 years. The only exception to this trend is the public-employee unions, which have actually been growing because government is the big growth industry. The public-employee area is an important one for unionization and for comparable worth in particular, for one very important reason: the public sector doesn't face any competition. They're not going to go out of business if they pay higher than competitive wages. Thus there is a certain amount of protection for union demands. Comparable worth is just another line of argument that will support wage gains.

The second major promoter of comparable worth has, of course, been the women's movement, and in particular the National Organization for Women (NOW). The women's movement is in need of some new issues that have widespread appeal to women. A lot of very important issues have been won for women, although we continue to have to fight for them. An interesting thing about the women's movement's involvement in comparable worth is that the issue is one that has the potential to appeal to working-class women, a group usually ignored by the women's movement. The idea of opening up different kinds of jobs to women never held much appeal for working-class women. It's not easy for them to imagine themselves doing the kinds of jobs that the men in their lives do. It's easy for a middle-class or professional woman to imagine being an attorney or an accountant—doing the kinds of jobs that the men in *her* life do. So comparable worth is an appeal to working-class women in that it is trying to obtain higher wages for jobs that these women are already doing.

Now let me turn to the economics of comparable worth. Comparable worth will be one step forward and two steps backward for women. Comparable worth would establish a minimum wage for women; it argues that the market-clearing wage for women is somehow inappropriate because of discrimination, job segregation, social pressure, or whatever it is that "forces" women to enter the traditionally female jobs.

Essentially, a minimum-wage law sets a wage that is higher than market-clearing and says you cannot pay less. Now anybody with any knowledge of economics knows that the minimum wage has strikingly mixed effects. Its beneficial effects are obvious—some people have higher paychecks—but the other side is that some people who would have been employable at a lower wage are not now employable.

Jennifer Roback talks with Freddie Hill Lucas of General Motors after the Cato Policy Forum.

Comparable worth would create the same kind of problem, except that it would be targeted exclusively to women's jobs. It would increase the incentive for women to go into traditional jobs and conversely decrease the incentive to go into nontraditional jobs. That means greater competition for the "female" jobs, more women wanting those higher-priced jobs. And when you have an excess supply of people willing to do a job, employers tend to select people with the best credentials, and they tend to discriminate on grounds other than the person's ability to do the job. In the minimum-wage case, that has resulted in higher teenage unemployment for blacks relative to whites. In the case of women, I suspect that the women who would tend to get those jobs would be those with the better credentials, who have been to college; those less likely to get those jobs would be women who have raised a family, who are returning to the labor force—the very women that the women's movement presumably wants to help.

A second effect of legislated above-market-clearing wages for women would be a decrease in the number of jobs available. Employers are less interested in hiring higher-priced workers than lower-priced workers. They would likely substitute capital for labor, get word processors and answering machines instead of secretaries. That would also aggravate the labor surplus I mentioned earlier. And, again, it would tend to favor highly credentialed women at the expense of the less credentialed.

If we go forward with comparable worth, we are selling out on some of the most important goals of the early women's movement: first, the idea that women should be doing all kinds of jobs and not just staying in "women's" jobs; and second, that there should be more opportunities, not fewer, for displaced homemakers, women who have been out of the labor force and want to return to work. Comparable worth does absolutely nothing to address either of these problems. One of the ideas motivating comparable worth is that of job segregation, but comparable worth will aggravate job segregation.

It is often the case that a policy that creates economic problems will in turn create a set of social problems. Much of the argument surrounding comparable worth has to do with women feeling forced into traditional jobs, but that is really much more applicable to older women than to younger women. It is not very credible to say that women who came of age in the last 10 or 15 years seriously believe that the only thing they can do is become secretaries. Older women might have felt that. A great deal of the feminization of poverty centers on older women because they often find themselves divorced in

(Cont. on p. 8)

Comparable Worth (Cont. from p. 7)

middle age with small children to take care of. Lenore Weitzman's *The Divorce Revolution* shows that women's standard of living falls dramatically after divorce, while men's standard of living goes up. The cause of that problem is that those women made a contract with their spouses, and with society, and that contract was reneged on. The contract was that the husband would take care of the family financially, and the wife would take care of the home and the children. In the middle of their lives the rug was pulled out from under these women. Today, however, a young woman knows that she will have to take care of herself, and she makes different plans based on that. But comparable worth is not a program for older women; it's a program for all women, and it will encourage younger women not to acquire the skills they may need someday.

But the primary social problem with comparable worth is that it would contribute to sex stereotyping. The rhetoric is about women's jobs—women don't get science degrees, they get English degrees, and so on. Statistically speaking, these things are true, but I don't think we should revel in it. Some of us spent a lot of effort trying to overcome the idea that there was such a thing as "women's jobs." We argued that women could do a lot of jobs that have been thought of as men's jobs. The policy of comparable worth and the argument that surrounds it contribute to the idea that some jobs are women's jobs. A policy like comparable worth tends to focus your attention on the constraints, rather than on the possibilities. It portrays women as victims, rather than as achievers. That's not something I want to encourage. It does a serious disservice to women, and particularly to younger women who are trying to decide what to do with their lives. We owe it to younger women to say to them that many, many things are possible.

Comparable worth would be a serious mistake for women. It gives up on some of the major goals of the feminist movement, among them the idea of women participating fully in all sectors of the economy, the idea that there aren't such things as "women's jobs."

Donna Lenhoff: Ms. Roback sets up a lot of straw men—straw persons?—and knocks them down. But the danger of doing that is that she ignores the thrust of the arguments in favor of comparable worth. For example, she asserts—correctly—that the fact that women earn 60 percent of what men earn does not "prove" that there is sex discrimination in wages. But it *is* a shorthand reference to a lot of data that raises the inference that women's wages are determined in part by their sex.

One of the basic feminist insights is that women and, by extension, women's work are valued less in our society than men and men's work; and that women's and men's spheres are separate and unequal. One of the consequences of the idea of separate spheres is that the "women's sphere" is undervalued.

This basic feminist insight is supported by an awful lot of evidence. First, there is the entrenched nature of the discrimination; the rate of 60 percent, as in the "59 cents" buttons, rings with historical significance. Leviticus provides that the wages for a day's work for a man shall be 50 shekels; for a woman, 30 shekels. In the U.S. Constitution, each slave was counted as three-fifths of a person. There is a historical something going on here that makes you wonder.

In the anthropological data, Margaret Mead's studies show that in societies where women weave and men fish, fishing is valued—but in societies where women fish and men weave, weaving is valued. There is the cross-cultural data: lawyers and doctors in the USSR and Eastern Europe are predominantly women, but they are not paid or valued there in the way they are in our society, where doctors and lawyers are predominantly men.

There is also the historical data: teaching, clerical work, and bank telling in the United States and Britain were all, at the beginning of this century, men's work and were paid very well. A clerical job was often the entry level into management in a company; when clerical work was taken over by women, the wages for it relative to the rest of the wages in society went down. Another example is the lack of any apparent logic in the wage scales that are set for job classifications. For example, for a long time a technical-drafting job in the Bell system was almost everywhere exclusively a man's job, paid on a high-level crafts scale. But at Michigan Bell, that job was always done predominantly by women—and there it's considered a clerical job and is paid on the clerical wage scale. Why is that, if not because of sex discrimination?

Finally, there is the overt evidence. I hear it every day. People call our office and say that someone in their company told them, when they complained about their salary, "you can't expect to be paid as much as so-and-so; you're a woman and he's a man." Indeed, one of my clients sued when she was told exactly that; she settled for the entire difference between her salary and that of her male counterpart.

In short, at least part of the wage differential between men and women is due to sex discrimination. Not all of it, granted: the market probably explains a lot of it, choice explains a lot, the human-capital theory explains some. But once you accept that wage differentials *may* be due to sex discrimination, then you have to accept that the usual means in our society for investigating discrimination should be used. And that is precisely what pay-equity advocates are asking for.

Contrary to the picture given by the straw men that have been set up for you, we do not advocate that uniform job evaluations be applied on a national scale to all firms. Nor are we asking to expand the existing definition of discrimination. Title VII of the Civil Rights Act and the Equal Pay Act are quite flexible and broadly apply to various manifestations of discrimination. What we ask for is application of those laws to wage discrimination, in whatever form it occurs.

Indeed, that is the point of the 1982 *Gunther* case, which Ms. Roback mentioned. In that case, the Supreme Court authorized the plaintiffs to try to prove that the difference in wages between or among different jobs was due to the gender of the people who held the jobs; if they could prove that, of course, it would be unlawful sex discrimination under Title VII. The Court held that a plaintiff's case does not get thrown out of court solely because she is comparing *different* jobs, as the employer there had argued. However, the Supreme Court left to the lower courts the all-important question of what proof is required to show that the wage differential is due to sex discrimination.

And, contrary to Ms. Roback's assertion, that is a question about which there has been a great deal of litigation since the *Gunther* decision. *AFSCME v. State of Washington* is one example; in that case the Ninth Circuit Court of Appeals found that the evidence did *not* prove sex discrimination in wages. On the other hand, recently the Ninth Circuit upheld a finding that sex-based discrimination, not the market, was the reason for wage differentials in another case. There, the market study on which the employer claimed it relied was done two years after the complaint was filed, the employer was well known in the area for paying more than the market rate, and there was evidence that the employer regularly departed from the market.

In addition to litigation under Title VII and other civil-rights laws, another now traditional avenue used by pay-equity advocates for attacking wage discrimination is to put pressure on employers—in particular, public employers because they are the most responsive to public pressure—to do studies to find out whether their wage systems are discriminatory, whether they are in fact following the market, whether the wage scales they set by purportedly neutral criteria are in fact sex-neutral and race-neutral. That is the other major arm of the pay-equity movement.

I would like to respond last to Ms. Roback's view that stereotyping of women will be promoted by investigating whether wages for traditional women's work are in fact set because of discrimination. She ignores two things in saying that. First, she ignores the possibility that the lower wages may well be the result of discrimination. If they are, they are just as invidious and illegal as the more familiar kinds of discrimination. Second, she ignores the rest of the women's movement and its programs. She doesn't discuss the many programs around the country for training women for nontraditional jobs, for affirmative action, for parental leave, for pension reform, for child care, for child-support enforcement reform, or for enforcement of existing EEO laws.

Indeed, there have always been two different sides to feminist goals. One is to ensure that women's traditional roles are valued. If housework, secretarial work, and caring for children are undervalued, it is part of the advancement of women to make sure that society corrects that imbalance; and the pay-equity movement serves that goal. At the same time, women need to be able to get into nontraditional roles as

Donna Lenhoff: "One of the basic feminist insights is that women and, by extension, women's work are valued less in our society than men's work and men."

well, and men should be able to get into the traditional nurturing jobs. As a whole, we are talking about bringing down the old divisions between women's work and men's work in a lot of different ways. One of those ways would be to make sure that if women's work is comparable in value, it can be paid comparably.

Jennifer Roback: First, I don't deny that the women's movement is involved in all the areas mentioned; my point is that comparable worth is counterproductive to achieving many of the goals the movement has set in these areas.

Second, how are women's jobs valued? What is the relationship of one's earnings to the value placed on jobs? Something that is second nature for an economist but perhaps a bit more difficult for a non-economist is the idea of "subjective value." The dollars attached to a job don't necessarily tell you how you *value* that job. Most people have a lot of respect for the clergy, and yet most clergymen don't make much money. We value child rearing and mothering, but we don't pay money for it. Money is not the only form in which people express their valuations. Furthermore, one of the things that confuses people about labor markets is that sometimes people do exchange money for things that they value. In particular, if you value a job that has certain working conditions associated with it, you might very well be willing to accept a lower wage for it. You might be willing to accept a lower wage for a job that gives you certain kinds of opportunities, certain kinds of flexibility. Clerical jobs not only were taken more by females and became less well paying, they also provided more flexibility. Similarly, teachers used to have enormous responsibilities within the community. The men and the unmarried women who were teachers did nothing but take care of the children. As more women entered the profession, the nature of the profession changed so that it could accommodate other things that women valued—like having more time for their families.

One of the most interesting things I see happening in the late 20th century is that the corporation is changing because women are starting to participate in it. Women's greater participation benefits small companies at the expense of big ones. Big companies are not willing to be flexible about child care and maternity leave and home emergencies. Small businesses can handle things like that, and, in particular, your own business can handle it. We are starting to observe a strengthening of the smaller firm as opposed to the larger firm *because* the small firm can accommodate the other needs that women have in their lives. Many women are unwilling to give all of their time and loyalty to the corporation, which is what the corporation seems to demand sometimes; women have other concerns as well. Many men are likewise unwilling to give all their loyalty to the company, and you don't find those men in Fortune 500 companies.

So when you observe money wages for a job, you are not necessarily observing the value that somebody places on that job. You are observing a whole bundle of things: flexibility, opportunities, time off, and other personal benefits. Our focus should be, does a job allow you to achieve your own life goals? If you're willing to give up money to do some of the things you want to do, then the dollars are not a problem. ■

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tion because they would be unlikely to survive, and the failure of a local bank is clearly more costly to the community than the failure of the local grocery store.

On the other hand, bankers apparently exercise such extraordinary power over their customers that banking activities must be strictly limited. Bankers are presumed to be capable of forcing consumers to invest in stocks they don't want, to pay for insurance they don't need, and to purchase furniture they can't use.

Thus, federal regulators are kept very busy. On the one hand, they must work to keep everyone else out of the business of banking and, at the same time, they must keep banks out of everyone else's business. Unfortunately, there is growing evidence that such efforts are doomed to failure and that the institutions ostensibly promoted and protected thereby may also be doomed unless our attitudes change in the near future.

Let us consider the implications of both sides of our schizophrenic attitude toward banking—first, that banks are too frail to survive competition, and second, that bankers are all-powerful when it comes to controlling the financial lives of depositors.

The Issue of Competition

Suppose the NCAA instituted a policy whereby this year's basketball champions received an automatic invitation to next year's tournament. Suppose further that Coach Denny Crum of Louisville, upon hearing about his automatic berth in the tournament, chose to rest his team during the regular season. For fear of injuries, for example, he might minimize the number of games the team played during the year; and to build the team's confidence, Coach Crum might choose to schedule all its games with less-skilled opponents.

Now, what chance would this give the Louisville team to repeat its earlier success? A very slim one, certainly. After all, in sporting events, as in business, it is widely accepted that it takes competition to make one ready for competition. Successful coaches make a conscious effort to expose their teams to tough opponents to prepare them for tournament play. And while not guaranteeing success, at least to some extent the strategy works.

According to the NCAA, the five teams with the toughest schedules in 1985-86 were Georgia Tech, Louisville, Maryland, Kansas, and North Carolina State. While Maryland had a disappointing year, the other four teams made it to the regional semi-finals, three were in the final eight, and two were in the final four. Coach Crum of Louisville, by the way, believes so strongly

> "Many bankers are currently unable to identify the true financial needs of their customers. They are at a loss when it comes to devising products that appeal to a broad base of consumers."

in competition as a key to excellence that he schedules games with some of the nation's best teams early—for November and December—because doing so is likely to uncover weaknesses before they become an integral part of the game plan.

Compare this attitude with that of many bankers who want Congress and state legislatures to protect them from anyone—other financial services firms, commercial firms, even banks—that might encroach on their turf. The result is predictable. Decades of focusing on Congress and the regulators rather than on their customer bases have, in many locales, created a generation of bankers who are ill prepared to function in a more competitive environment. Removing interest rate ceilings has created a great deal of uncertainty, and many mistakes are being made by bankers who don't know how to price their products, for example.

These bankers often don't know how to control costs because they have never had to worry about which services were cost-justified and which were not. Many have little idea about what it costs to operate an additional branch or to process a check. How can they decide, then, which services should be expanded and which curtailed?

Perhaps most important, many bankers are currently unable to identify the true financial needs of their customers. They are at a loss when it comes to devising products—matching maturity with returns, trading off fees against extended services—that appeal to a broad base of consumers. Many bankers have little understanding of the demographics of their markets, the potential for exploiting a particular market segment, or how to communicate with potential customers (how to sell banking services).

None of this should be surprising. For a long time a bank was a bank was a bank. The products and role played by banks were defined by regulation, and most depositors chose their banks primarily on the basis of location. But soaring inflation in the 1970s and early 1980s, combined with the clamoring of a wide range of firms for customers, has increased the level of financial sophistication among consumers. Many old-world bankers, i.e., those who believe the situation can be made to revert to the pre-1980 status quo, are stunned by the notion that depositors will no longer come to them, that they must go out and sell services to depositors.

Independent bankers would not be so concerned about new competition—whether from "big city" banks or from new entrants into the industry—if they truly believed they were meeting the needs of their customers. It is not only the widespread name recognition that banks fear when Sears talks about going into banking, it is Sears's experience and success in identifying and responding to consumer needs and the firm's demonstrated ability to market its products and services.

Most importantly, it is no longer a matter of *if* all banks will be forced to compete. It is a matter of when and from what direction competition will come. The days of isolated communities are gone. Increasingly widespread computer use will remove all remaining geographic barriers to shopping—whether for new clothes or for banking services.

Newly chartered depositories are rethinking the traditional ways of doing business. Consider but one example, New England Federal Savings Bank. New England Federal opened in January 1986 in an upstairs Boston office. Officials there expect to operate almost entirely through the mails and by telephone. They argue that the absence of a physical branch network will allow the institution to offer customers more attractive interest rates on deposits and secure better returns for stockholders. Realistically, there is no banking market into which such an institution cannot eventually reach. In fact, banking services are particularly subject to increased competition through new technologies. The bulk of the money supply is, after all, made up of so many electronic blips.

Since it is increasingly impossible to imagine effective protection for banking markets, the best way to preserve community banks is to force them, through competitive pressures, to turn their attention away from Washington and the state capitals and back to the needs of their customers. Many institutions will fail because their managers will prove unable to adapt to a rapidly changing world, but those who can adapt will have a renewed chance of long-term survival.

The Issues of Place and Powers

If new competition should be allowed into the banking markets, should not the regulations limiting the activities in which bankers can engage be reexamined? The answer is clearly yes. The current situation is something akin to staging a swim meet in which the local favorite has his feet shackled.

Suppose the Department of Health and Human Services, after careful study, determined that the diet of the average American was simply atrocious: children were not receiving the nutrients needed to grow into strong young citizens, and adults could be more productive—and generate more tax revenues—if only their diets were more balanced.

To reduce the social costs imposed on the nation by bad eating habits, HHS might propose a regulation that dictated the mix and types of foods grocery stores could sell. Regional specialties would be disregarded, as would the preferences and particular needs of individuals. At checkout, each customer's basket would be carefully inspected to ensure it contained what had been defined as the "proper diet"—in this case, specified proportions of poultry, fish, meat, green and yellow vegetables, fruits, dairy products, and bread. And, of course, grocery stores would be strictly regulated concerning the range of food products they could sell. No more fried chicken or salad bars in the deli section. No more deli section. After all, other establishments provide those services already.

> "The best way to preserve community banks is to force them to turn their attention away from Washington and back to the needs of their customers."

Ludicrous? Perhaps. But it does describe a situation similar to that which has long faced banks. For decades, the products and services banks could offer were narrowly circumscribed by regulation and statute. Depositors—particularly small depositors—were long told, in effect, what financial services they should have. They didn't need a return of more than 5 percent on their savings. When individuals turned to the Treasury market for relief, the minimum size of T-bills was increased. It took a virtual depositor revolution in the late 1970s before Congress was forced to make an effort to allow small savers to obtain market returns on their funds.

But what about other services? Individuals with limited financial assets are probably most familiar with the local bank. But can they turn to their banker for life or car insurance? for a real estate loan? for advice about how to invest a nest egg if they manage to accumulate one? Probably not. Can these small savers count on having access to their funds should an emergency arise while they are vacationing at Disneyland? The chances are slim.

And it's not just small depositors who are hurt by these regulatory restrictions. It is the banks themselves. Banking markets have changed dramatically over the past 30 years. In the mid-1950s, the most important business of the larger banks consisted of making short-term, self-liquidating loans to large corporations. That is now called the "commercial paper market" and, by law, banks are excluded from it.

The primary importance of "junk bonds," more neutrally known as "non-investment-grade bonds," is that they have the potential to do for mid-sized regional companies what commercial paper did for large corporations, i.e., provide a ready source of relatively inexpensive funds. Again, banks cannot compete. They are not allowed to.

U.S. banks are losing market share at home and in the international arena. Even when banks are willing to compete, they frequently cannot because regulations do not allow them to match the innovations of their less-regulated competitors. Banks are forbidden to take advantage of many of the technological and economic innovations that have occurred during the past decade and that continue to occur, creating opportunities for the individuals and institutions capable of using them.

So, one might say, the consumer market will be left for banks, and perhaps that is where they should concentrate their efforts. Not so fast. There is increasing activity among "captive" finance companies (e.g., GMAC) and consumer financial corporations to "securitize," i.e., to package for resale, car loans and other consumer loans. The ability of these nonbank firms to rapidly recover their money through secondary markets should substantially reduce the risk, and hence the costs, to them of making consumer loans. Will this market be lost to banks as well?

Now let us turn to the more widely recognized problems with savings and loans, "energy" banks, and "agricultural" banks. The most often repeated dictum in finance classes is "The proper diversification of financial assets reduces the overall risk of the portfolio." Yet the law does everything possible to prevent depository institutions—those firms that rhetoric argues cannot be allowed to fail—from diversifying their portfolios.

Savings and loans were, moreover,

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required to fund portfolios composed of local long-term, fixed-rate assets with short-term liabilities—thereby breaking the second great finance-class dictum about matching the maturities of assets and liabilities. No wonder there was trouble! Recent regulatory changes have helped somewhat, but they haven't addressed the underlying problem. And why must we have specialized mortgage lenders? Because banks are limited by law in the number of real estate loans they can make.

Geographic restrictions are, perhaps, the most damaging restraint on good financial planning and adequate risk management by bankers. Banks forced to concentrate their loan portfolios in a particular state or county are, not surprisingly, dependent on the economic health of that limited geographic area. The situation is made even worse when, as is often the case, the whole economy of a particular area is dependent on one industry.

When farmers in Iowa experience financial difficulty, so do Iowa feed stores, farm-equipment dealerships, and, eventually, clothing and grocery stores. Similarly, tumbling energy prices affect not only Texas oil drillers and refiners but also Texas machine-tool manufacturers. And an unemployed oil-field worker is less likely to make his next car payment.

Conclusion

So how can the banking crisis be resolved? We must reassess our attitudes toward those institutions that call themselves banks. It is no longer a matter of deciding whether competition will be good or bad for the local bank. Competition is here. Regardless of how hard Congress tries to close loopholes, the private sector will find new "statutory opportunities" through which to move into lucrative markets.

The real question is whether public policy will allow banks the flexibility necessary to adapt to a rapidly changing world, to survive in increasingly integrated domestic and worldwide financial markets. If it does not, banks will disappear—except perhaps as an oddity preserved in places like Williamsburg or Philadelphia where we take the children to teach them about how things used to be. But the services provided by banks will survive. Tomorrow's entrepreneurs will simply offer them through organizations with such names as "Fidelity General Financial Services Store" or "Citicorp," rather than "Fidelity Bank" or "Citibank."

But let us end on a more positive note. Banks will not disappear, though not because of any logical decision of the federal government. In fact, the best thing for the banking industry may well be, rather ironically, a continuation of the existing deadlock in Congress between Rep. Fernand St Germain, chairman of the House Banking Committee, and Sen. Jake Garn, chairman of the Senate Banking Committee. The action at present has shifted to the state legislatures, which seem to be much more forward-looking in what they will *do* than Congress is in what it will *discuss*. Thus, interstate banking, for example, is rapidly becoming a reality through state initiative.

> "The real question is whether public policy will allow banks the flexibility necessary to adapt to a rapidly changing world. If it does not, banks will disappear, but the services provided by banks will survive."

Furthermore, the courts and the regulators are being forced by market realities to recognize attempts by bankers to reinterpret statutes in the absence of congressional action. Nonbank banks, bank-like institutions that generally simply choose not to make commercial loans, are an outgrowth of congressional inaction. In addition, some observers believe that the Federal Reserve Board may respond positively late this year to a request by Citicorp to open a subsidiary that would, as a "minor" part of its business, underwrite securities. The board has apparently delayed its decision to give Congress an opportunity to act first.

Meanwhile, what could one expect if Congress did act? Senator Garn says he will not allow any mere "loophole closing" bills out of committee, that any legislation considered by the Senate must be of a "comprehensive" nature. Representative St Germain, however, is inclined toward more regulation and prefers "simple" one-issue bills dealing with loopholes and/or incorporating some response to the consumer lobby, e.g., requiring "lifeline" banking or imposing limits on credit card interest rates.

Thus, any bill likely to become law would almost certainly include some additional regulation along with any deregulatory steps taken. The most likely "reregulation" would involve nonbank banks, and, while often portrayed as innocuous, current proposals to close the nonbank-bank loophole, regardless of the grandfather date chosen, would be a step toward further balkanization of the banking industry. Existing proposals would place serious restrictions on the parent company of any nonbank bank: in the future, such firms would be limited to expanding only in areas "closely related to banking." The practical impact of such a requirement would be, first, to force many diversified companies to divest themselves of their nonbank banks and, second, by appearing to address current inconsistencies in the legal structure, to reduce the likelihood that the powers of banks would be expanded significantly in the foreseeable future.

This last observation completes the circle, for it conjures up a scenario that could involve an American economy without banks. Let's hope there are enough people in Congress who understand the consequences of that eventuality well enough to foreclose it. ■

Interns Needed

The Cato Institute seeks interns for fall 1986 and spring 1987. Contact David Boaz for more information.

New Right v. Constitution

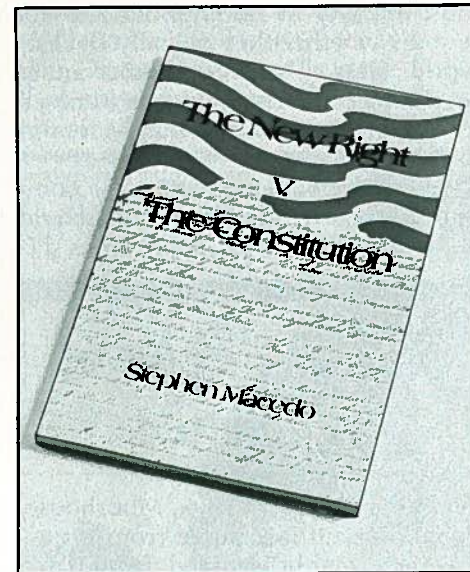
Reagan Judges Tilt Toward Government, Narrow Rights

Judge Robert Bork and other Reagan appointees to the federal courts have a commitment to "construing government powers and the powers of majorities broadly and individual rights narrowly," charges Harvard political scientist Stephen Macedo in a new book from the Cato Institute.

In *The New Right v. the Constitution*, Macedo warns that the New Right's "Jurisprudence of Original Intent" seems to put untrammeled majoritarianism in place of constitutionally guaranteed liberties. "What is striking," he writes, "is how far the New Right has departed from the ideas of the Founders, the majestic phrases of the Constitution, and what is best in the American political tradition."

In his foreword to the book, Richard A. Epstein of the University of Chicago writes, "Because the Constitution was drafted in the natural-rights, limited-government tradition, modern commentators in that tradition will be among those best able to explicate the principles that make the document so great and enduring a human achievement. Macedo's excellent essay is an important contribution to putting constitutional interpretation back on a sound basis, one capable of sustaining the liberties that are the singular virtue of our republic."

Macedo accuses Bork of "moral skepticism" for claiming that "every clash between a minority claiming freedom and a majority claiming power to regulate involves a choice between the gratifications of two groups." Macedo argues that this "conception of morality is so counterintuitive that hardly anyone would accept it and so implausible that no one should. . . . The truth is that we can and do distinguish between mere gratifications and genuine moral claims all the time."



Conservatives say they want to limit the judiciary's power. But, says Macedo, what this amounts to is an unwarranted acquiescence to abuses of power by the legislative and executive branches. He calls for a principled judicial activism that interprets the Constitution as a charter of liberties protecting both economic and personal freedom.

Responding to the New Right's call for political enforcement of "the community's morality," Macedo writes, "Respecting the whole range of human rights, including property rights, is the best way for a pluralistic society such as ours to express a public morality." He points out, "Community ends with coercion; it doesn't begin there. And a community cannot be a moral community unless it is also a free community."

Macedo's essay has drawn praise from Sotirios Barber, professor of government at the University of Notre Dame and author of *On What the Constitution Means*, who writes, "In this powerful essay Professor Macedo shows that New Right constitutional theory is rooted in a moral skepticism that is alien to the morality of most Americans and actually degrades the value of their constitutional tradition. Professor Macedo writes from a traditionally conservative understanding of that tradition. He is therefore one critic the New Right should not be permitted to ignore. The wider this book's readership, the better."

Walter F. Murphy, McCormick Professor of Jurisprudence at Princeton University, calls the book "a thoughtful analysis and sharp criticism of the constitutional jurisprudence of 'new' conservatives. Macedo strips away the rhetoric from the New Right's claims to show that its basic argument bears only a faint resemblance to the political theories underlying the original constitutional document or to the development of American constitutional history."

The New Right v. the Constitution is available from the Cato Institute for $7.95 in paperback. ■

Free Trade in Ideas Urged

It is essential to the health of our democratic society that political ideas be allowed to flow freely across the U.S. border, argued Morton Halperin of the American Civil Liberties Union at a recent Cato Policy Forum. Calling for "free trade in ideas," he pointed to the McCarran-Walter Act of 1952, which denies entry to anarchists, communists, and fascists, and the Passport Control Act of 1926, which denies passports to Americans wishing to give speeches in particular foreign countries, as "fundamentally inconsistent with the principles of the First Amendment."

Halperin cited specific instances of government restrictions on the free flow of ideas: the barring of former Italian general Nino Pasti, who wished to speak against Cruise missile deployment; the prohibitions against Cubans visiting the United States, Americans traveling to Cuba without U.S. government consent, and Americans receiving Cuban publications without a license; and government-imposed boycotts of foreign nations, which are used to deny U.S. citizens the right to travel to those nations.

William S. Miller, chief counsel for the Senate Subcommittee on Criminal Law, commented on Halperin's remarks. He asserted that the First Amendment as interpreted by the ACLU puts the nation at risk. Claiming that there must be some recognition of the goals and principles of the nation, which he labeled a "cohering force," Miller concluded that the citizens of a democratic society must have the right to ban certain ideas. ■

Books Take New Look at Monopoly, Utility Regulation

Direct Electric Utility Competition: The Natural Monopoly Myth, *by Walter J. Primeaux, Jr. (New York: Praeger Publishers, 1986), 297 pp., $37.95.*

Electric Power: Deregulation and the Public Interest, *ed. John C. Moorhouse (San Francisco: Pacific Institute, 1986), c. 450 pp., $34.95/$14.95.*

Unnatural Monopolies: The Case for Deregulating Public Utilities, *ed. Robert W. Poole (Lexington, Mass.: D.C. Heath & Co., 1985), 224 pp., $25.00.*

The current renaissance of market thinking challenges the entire range of government controls. At one end of the spectrum are those restrictions that require only passing reflection to see that they are unwise, such as minimum-wage laws and taxi-cab licensing. At the other end are government controls that actually offer coherent economic arguments in their defense. Notable among the latter is public utility regulation, which relies on the longstanding and well-respected theory of natural monopoly.

Natural monopoly is said to exist in an industry when a single supplier can serve a market at lower unit cost than can two or more smaller suppliers. Diminishing average cost, economies of scale, and increasing returns to scale are common expressions of this idea. In an unregulated struggle, the argument goes, suppliers will compete until only one remains. In the end, the losers have wastefully duplicated production facilities.

More significantly, the victorious firm can exercise monopoly power, i.e., restrict supply and raise prices, because its only worry is that new firms may enter the market. Since the industry can sustain only one firm and the monopolist can shift back to a more competitive performance, potential entrants are reluctant to challenge the monopolist's control.

In markets where natural monopolies exist, therefore, the government should grant monopoly privileges to a firm to avoid wasteful competition and then regulate its activities to keep it from abusing its position. This policy is commonly followed with the firms called "public utilities."

The natural-monopoly argument indeed has a certain logic. The critic must uncover its assumptions and determine whether they actually fit real-world cases. The three books under review do precisely that, constituting a fierce barrage against natural-monopoly theory.

While the books advance the common message that public utilities should be decontrolled, their approaches differ. In the order Primeaux, Moorhouse, Poole, the authors move from a narrow and highly detailed focus to a broader and more theoretical one. The first two books are written for the specialist; the third, for anyone economically literate.

Policy Report Reviews

University of Illinois business professor Walter Primeaux's *Direct Electric Utility Competition: The Natural Monopoly Myth* is concerned with only the most central element of the natural-monopoly argument, as applied to public electric utilities: the claim that competition in the industry will inexorably lead to a single supplier and that the competition is socially wasteful.

Primeaux's preliminary contribution is to point out that direct electricity competition *does* exist in numerous American cities. He compares 49 duopolistic electricity markets of the late 1960s, most of which involved one municipal and one private electricity company, with monopolistic electricity markets. According to the natural-monopoly argument, a duopolistic electricity market should result in greater unit cost than its monopolistic counterpart. But the competitive firms had, on average, lower unit costs and lower prices. The theory also holds that competition in a scale-economies industry will be transitory, yet in many electricity markets competition is ongoing. Electricity competition has existed for 40 years in Sikeston, Missouri, for example, and for 50 years in Poplar Bluff, Missouri.

Primeaux explains that the natural-monopoly argument assumes that firms will perform equally efficiently regardless of the economic environment. That assumption is unrealistic, however, because competition spurs greater efficiency. Primeaux found that "competitive effects on costs were even stronger than the gains from economies of scale from prohibiting competition."

Primeaux's exhaustive analysis—comprising a wealth of case studies and statistical data—makes for a definitive defense of electricity competition, but the narrow scope leaves many interesting questions unaddressed: How did electricity regulation develop? How do the regulatory commissions perform? To what extent do electric utilities face *indirect* competition from other energy sources? What political role do electric monopolies play?

These and many other questions are taken up in *Electric Power: Deregulation and the Public Interest*, edited by Wake Forest University economist John C. Moorhouse, which covers every aspect of electric utilities.

An important theme of the collection is the invalidity of the so-called nirvana approach to regulation. This approach, UCLA economist Harold Demsetz explains in the foreword, assumes that government regulation is perfectly effective; if the market is somehow less than perfect, corrections by the government must be made. But the real choice, says Demsetz, is between various institutional arrangements, none of which corresponds to the blackboard ideal of the nirvana economists.

Several essays in *Electric Power* indicate that there are insurmountable real-world obstacles to the perfect regulation envisioned in the nirvana approach. Claire Hammond's overview of regulation, for example, points out some of the problems involved in rate-of-return regulation. A utility can manipulate its financial basis, accounting, and production techniques over time to receive inflated approved rates from the regulatory commission. Furthermore, under rate-of-return regulation a firm has no incentive to produce efficiently because rates must cover costs. As Hammond explains, "Commissioners operating within the constraints of limited information and budgets and aware of their lack of expertise are uniformly reluctant to overturn utility management decisions on cost levels."

The theory of natural monopoly has been applied to much more than electric utilities, and for that reason the general reader will find the broader *Unnatural Monopolies: The Case for Deregulating Public Utilities*, edited by Robert W. Poole of the Reason Foundation, the most useful of the three books under review. The essays collected here cover the evolution of natural-monopoly theory, rate-of-return regulation, antitrust, the deregulation of utilities, and private contracting for utility services. Industry-specific pieces investigate cable television, the Bell breakup, and electric utilities. Comments follow six of the pieces.

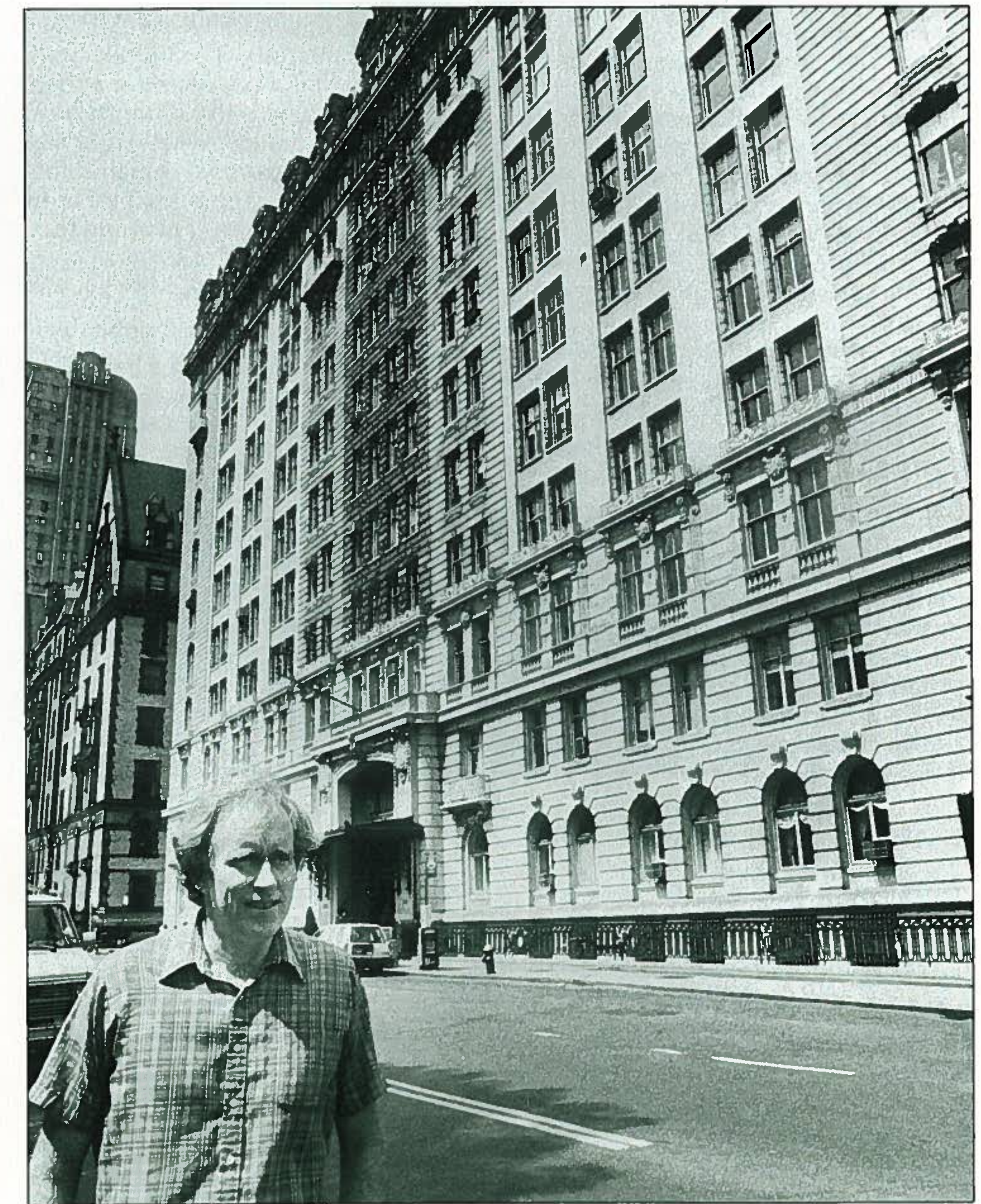
Among the most insightful essays is one by Thomas Hazlett on private contracting. In contrast to the other works under review, which deal primarily with the inapplicability of the natural-monopoly model to the real world, Hazlett's piece discusses the relevance of the one *analytic* criticism of the model, presented by Harold Demsetz in 1968.

Demsetz pointed out that economies of scale in no way imply the existence of an uncompetitive market. Rather than wastefully duplicating facilities by competing *in* the electricity market, firms can compete *for* the market through precontracting. Without generating a single watt, firms can submit competitive bids of price-quantity-and-quality packages to private parties or to a political body running a community auction. As long as the bidding firms have a good idea of the costs and demands for their products, the bids will be forced toward competitive performance. The winning bid has the market to itself, but by precontracting it is obliged to perform in accordance with its bid. Efficiency has been achieved without regulation.

Hazlett presents examples of cable-television franchise auctions, the most successful of which was Co-op City, a privately owned apartment complex of 15,000 units in the Bronx. Co-op City issued a detailed request for proposals to the cable industry. Eight bidders responded, and the winning bidder now provides Co-op City with television services far superior to what is routinely available through regulated cable services: a 104-channel capability, a free closed-circuit security channel, and lower prices. Hazlett's study shows that Demsetz's scheme is more viable than many had believed and that the principal obstacles to it are political, not economic.

A final word on natural monopoly and innovation: The three books under review cover a lot of the same ground, and the unit cost of each publisher is certainly decreasing. But could a single one of them have been produced if the activity were governed by a regulatory commission following the natural-monopoly theory?

—*Daniel Klein*
New York University



Author William Tucker stands in front of a luxurious Central Park apartment building, where Mia Farrow pays $1,870.31 a month for a 10-room apartment that might rent for $12,000 if it weren't rent-controlled. Tucker has been collecting stories of such "good deals" to illustrate his contention that rent control doesn't benefit the poor. He is writing a book on rent control for the Cato Institute and the Manhattan Institute.

"To be governed..."

The *Journal* doesn't even care if the trains run on time

In its espousal of the . . . Packwood "tax reform" plan . . . , *The Wall Street Journal* has advanced a theory that must be making Alexander Hamilton . . . turn over in his grave.

It says that . . . "a country is more likely to benefit in terms of the crucially important levels of income and employment if decisions about economic allocation are made primarily by individual citizens, rather than by their governments."

That's populism verging on libertarianism. . . .

The *Journal* would have the U.S. government simply serve as a kind of tax refund bureau, with most decision-making done by individuals. Certainly, individuals want to make decisions, but they also expect the elected government to establish national economic policy.

—Columnist Anthony Harrigan, June 2, 1986

How dare they expect to keep 73 percent of what they earn!

There are legitimate public policy issues to be resolved. One is the question both [Minnesota Sen. David] Durenberger and [Maine Sen. George] Mitchell have raised about the equity of a maximum 27 percent rate for the wealthiest people in America.

—David Broder in the *Washington Post*, May 11, 1986

Might want to consider a shelter for some taxpayers, if you get my drift

The Reagan administration, which five years ago proposed massive evacuations from cities in the event of a nuclear attack, is considering a revised plan that would shelter state and local officials while encouraging the rest of the population to rely on "self-help."

—*Washington Post*, May 10, 1986

We're afraid you're right

The fine print of the Senate [tax reform] proposal contains plenty of help for special interests. The bill illustrates once again that it pays to have a friend on the Senate Finance Committee. . . .

"It helps if you've been a big supporter of the senator," explains John Chapoton, former top tax expert at the Treasury Department. "I'm afraid that's democracy."

—*Wall Street Journal*, May 16, 1986

Big Brother's got your number, pal

Anaheim is considering a ban on fast food—including microwave products and prepared food—at gas outlets that carry beer and wine.

Some city council members feel the combination of gas, beer and food encourages drunk driving.

The rationale: Customers who buy fast food might want to wash it down with a cold beer. If the food's hot, the patron will rush to eat it in his car before the food gets cold.

—*U.S. Oil Week/C-Store Digest*, June 2, 1986

Fair to everybody—except the taxpayer?

Since the Justice Department made a grant to a coalition of women's shelters last summer, Phyllis Schlafly says, she has been upset about "giving government money to a feminist group to pursue feminist goals."

Now Schlafly . . . has evened the score. She helped persuade senior Justice Department officials to award $622,905 to a group of her associates to study the problem of family violence.

"I thought fair play required equal treatment of traditional women," she said.

—*Washington Post*, June 4, 1986

Catch-22

When John and Sue Hoven decided that their son, Niels, needed special reading, math and science classes, they asked the Montgomery County school board for permission to transfer him to a magnet program at East Silver Spring Elementary School.

But the Hovens soon found there was a problem. Because Niels' father is white and his mother is Asian, Niels was considered a minority student, and there were already too many minorities at East Silver Spring.

Yet being "white" would not have helped, the Hovens learned. That would have prevented Niels from transferring out of his current school . . . because there are too few white students there.

—*Washington Post*, May 27, 1986

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