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Competitive Banking: Safety Without Deposit Insurance

by David Glasner

Competitive banking has for centuries drawn criticism from those who believe it is destabilizing. The banking collapse of the Great Depression seemed to confirm that assessment, and the New Deal reforms that followed turned banking into one of the most heavily regulated industries in our economy. A modest move toward deregulation took place over the last 10 or 15 years, but a rapidly rising rate of bank failures has rekindled fears of destabilization due to competition and has evoked calls for reregulation.

Critics of competition in banking take two approaches. Some focus on the liability side of banks' balance sheets; others focus on the asset side.

Critics who take the first approach say that if not restrained, competition among banks will somehow cause them to create too many deposits. In their view, an expansion of the money supply, from whatever source, is inflationary, so if inflation is to be avoided, regulatory measures to control monetary growth must be adopted.

David Glasner, a senior research fellow at the Manhattan Institute, is completing a book on monetary reform.

In a 1985 *Policy Report* article, I explained that the payment of competitive interest on deposits eliminates any incentive for banks to create more deposits than the public is willing to hold. In that analysis, the banking system plays a purely passive role in supplying money and has no direct impact on the level of inflation, which is determined solely by the decisions of the monetary authority.

However, that analysis does not dispose of the second, and much more common, line of argument against competitive banking: that competing banks make too many risky loans and investments, thereby increasing the chances that they will suffer losses and become insolvent. Critics who take this approach believe that unfortunately, such an outcome is rarely a problem only for the insolvent banks; it often affects other banks and their depositors. And because it is costly to determine the exact financial position of a bank, depositors may begin withdrawing funds from healthy banks. Another bank's insolvency may well raise depositors' estimates of the likelihood that their bank will become insolvent. Thus, a single bank failure can trigger a chain reaction of bank failures.

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U.S. Trade Representative Clayton Yeutter talks with guests before speaking at a Cato Policy Luncheon.

Although some scholars have begun to uncover historical evidence that seems to call into question the importance of the "contagion" or "spillover" effect, it is useful to accept as a worst-case scenario the assumption that insolvent banks' failures can spread to healthy institutions. Even given that assumption, however, a case can be made for eliminating deposit insurance and deregulating the banking industry.

Bank runs used to be regarded as instances of irrational hysteria. But since it is costly to obtain accurate information about the financial condition of a bank and costly to have deposits in a bank when it becomes insolvent, withdrawing deposits after doubts are raised about a bank's solvency may be perfectly rational.

Because competing banks do not take the full social cost of becoming

(Cont. on p. 10)

Competitiveness: Productivity Is the Key

Chairman's Message

"Competitiveness" is the new buzzword in Washington. Almost everyone is for competitiveness, but there is not yet much agreement on what should be done about it. John Young, the president of Hewlett-Packard and the former chairman of the presidential commission on international competitiveness, has formed a coalition of private businesses to promote competitiveness. Sen. Max Baucus (D-Mont.) chairs a new competitiveness caucus of about 150 members of Congress. President Reagan recently forwarded a set of old and new proposals to Congress as a competitiveness package. Some of the proposals endorsed by these groups are innocuous, some are valuable, and some are dangerous. At this stage the competitiveness agenda is sufficiently fluid to provide an opportunity for considerable mischief or for desirable policy changes.

What, if anything, should be done about U.S. competitiveness?

First, let's get our facts straight. The perceived "deindustrialization of America" is a myth. The manufacturing share of total U.S. employment has declined for about 30 years, but that is due to the relatively higher growth rate of productivity in manufacturing (which other countries have experienced as well). The manufacturing share of total U.S. output, however, is now slightly *above* the postwar average. In terms of what we produce, America is not deindustrializing. The large U.S. trade deficit is a real problem. Its size, however, is due to the lowest rate of net U.S. saving (private saving minus the government deficit) in the postwar years; it is a cause, not the result, of the decline in U.S. competitiveness.

Second, let's get our thinking straight. The various competitiveness proposals from the Reagan administration and Congress should be judged by whether they make the nation more productive, not by whether they make some groups more competitive. Many of the Reagan proposals, by this standard, are probably desirable, particularly those that would improve educational standards, increase the transfer of technology, protect intellectual property rights, and revise regulation, antitrust, product liability, and export controls. There is more reason to question the substantial increase in funding proposed for displaced workers, job training, a space station, a hypersonic aircraft, and an advanced particle accelerator. Many of the proposals by both the administration and Congress, however, would help some firms compete at the expense of others. Among them are the proposals for subsidies and tax preferences for certain investments and exports, restraints on imports, and a devaluation of the dollar. There is also a danger that Congress will advance equally undesirable legislation on plant closings, corporate takeovers, or other elements of the industrial policy agenda.

The current confusion about the competitiveness issue poses both a risk and an opportunity. Many government officials have yet to recognize that it is not possible to make the United States, or any other nation, competitive in all products. The risk is that the government will approve measures that make some industries more competitive only by making the rest of us poorer. The wealth of nations, however, is dependent on their realizing their *comparative* advantage, which as a rule occurs in ways that the government cannot anticipate. The current concern about competitiveness gives us an opportunity to do something smart for a change—to reform those government policies that have restricted the spontaneous processes that increase productivity in a free economy.

—William A. Niskanen

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CATO INSTITUTE

Friedman, Hayek, Machlup Highlight New Cato Book on Monetary Policy

Milton Friedman and F. A. Hayek are among the distinguished authors whose work is included in *The Search for Stable Money*, edited by James A. Dorn and Anna J. Schwartz.

The book, being published this spring by the University of Chicago Press, contains papers from the Cato Institute's highly acclaimed conference on monetary policy. Conference participants with papers in the book include James M. Buchanan, Fritz Machlup, Karl Brunner, Roland Vaubel, Philip Cagan, and Lawrence H. White.

James A. Dorn, Anna J. Schwartz, Milton Friedman, and Karl Brunner (seated) at a recent Cato conference.

All of the papers examine policy options that might bring about a more stable, less inflationary monetary system. Among the proposals considered are a monetary price rule, a gold standard, constitutional restrictions on the monetary authorities, and private currency issuers.

In his paper, Friedman goes beyond his long-time support for a monetary price rule to argue that the best cure for a monetary crisis would be to end the Federal Reserve System's power to create money. Hayek argues that the government's monopoly on issuing money "has not only deprived us of good money but has also deprived us of the only process by which we can find out what would be good money. . . . Capitalism has never been allowed to create for itself the money it needs."

The Search for Stable Money is available in hardback from the University of Chicago Press for $30.00 and in paperback from Cato or Chicago for $13.95.

Murray Added to Summer Seminar

Once again the Cato Institute is making plans for its Summer Seminar in Political Economy. This year the week-long event will be held at historic Williams College in Williamstown, Massachusetts, from July 5 to July 12.

Each year 75 participants from around the United States and from as many as a dozen foreign countries gather for an intensive week of lectures, formal discussions, and informal conversations on philosophy, economics, history, and current affairs. The participants include college students, businesspeople, professionals, and retirees.

The speakers who will be new this year include welfare critic Charles Murray, economic historian Robert Higgs, Cato foreign policy analyst Ted Galen Carpenter, and Harvard political scientist Stephen Macedo, author of *The New Right v. the Constitution*. Speakers returning from past seminars include Roy Childs, Israel Kirzner, Leonard Liggio, Ralph Raico, Earl Ravenal, and George Smith.

Admittance to the seminar, which past participants have called "the most intellectually stimulating week of my life" and "the best 'vacation' I ever took," is competitive, based on the Cato Institute's review of applications. Applications are available from Sandra McCluskey at Cato.

James M. Buchanan

Buchanan, Koch to Speak at Cato Dinner May 21

James M. Buchanan, 1986 Nobel laureate in economics and distinguished senior fellow of the Cato Institute, will be the featured speaker at the Institute's Tenth Anniversary Dinner. The event will be held on Thursday, May 21, at the historic Willard Hotel near the White House, newly restored to its original 19th-century elegance.

Buchanan's topic will be "Democracy and Constitutional Order." Also addressing the audience will be Charles G. Koch, chairman of Koch Industries and a member of Cato's board of directors since its founding in 1977.

The following day Cato Sponsors will be invited to attend the Institute's second annual Public Policy Day, a series of lectures on current policy issues delivered by Cato staff members and associates. Speakers will include William Niskanan, Charles Murray, Earl Ravenal, Ted Galen Carpenter, Catherine England, and Peter Ferrara.

The events will celebrate Cato's growth over the past 10 years and honor the Cato Sponsors, who have helped make it possible. Those interested in further information on these events should contact Sandra McCluskey, director of public affairs, at the Institute.

Meiselman, Manne, Roberts, 12 Others Become Cato Adjunct Scholars

Fifteen distinguished scholars have recently been added to Cato's list of Adjunct Scholars. They join such eminent thinkers as Nobel laureates F. A. Hayek and James M. Buchanan, legal scholar Richard Epstein, historian Arthur Ekirch, and economist Sam Peltzman in being formally associated with Cato.

The new Adjunct Scholars are economists Peter Aranson, Marilyn Flowers, James Gwartney, Robert Higgs, David Meiselman, Morgan Reynolds, Richard Rahn, Paul Craig Roberts, Norman Ture, and Roland Vaubel; Henry G. Manne, director of the Law and Economics Center; philosopher Ellen Frankel Paul; energy analyst Robert L. Bradley, Jr.; foreign policy analyst Christopher Layne; and political scientist Stephen Macedo.

Many of the new Adjunct Scholars have already worked extensively with Cato. Papers from two conferences organized by Gwartney through the Policy Sciences Program at Florida State University have been collected in issues of the *Cato Journal*, and papers from a conference this spring will appear in a future issue. Cato published Macedo's book *The New Right v. the Constitution* last year and will publish books by Bradley, Reynolds, and Roberts over the next two years. Several of the other scholars have spoken at Cato conferences or Policy Forums.

In accepting Cato's invitation to become Adjunct Scholars, many of the scholars were generous in their praise of the Institute's work. Gwartney wrote, "The battle for freedom is a battle of ideas. I have long admired both the strength and consistency of Cato's stand." And Higgs wrote, "I can think of no organization with whose principles I am in greater sympathy."

Cato president Edward H. Crane said, "We are very pleased to have such outstanding scholars and policy analysts associated with Cato, and we look forward to working closely with them to expand and broaden our program."

Adjunct Scholars often publish their research findings in the Policy Analysis series, *Cato Policy Report*, the *Cato Journal*, and Cato monographs; write essays on current policy issues that Cato distributes to newspapers; and participate in Cato's Policy Forums and conferences. The Adjunct Scholars are also asked to evaluate works in progress, ress, recommend new policy studies, and aid in locating other scholars interested in public policy research. ■

Marilyn Flowers

Robert Higgs

Henry Manne

David Meiselman

Richard Rahn

Paul Craig Roberts

F. A. Hayek
Nobel Laureate in Economics
Distinguished Senior Fellow

James M. Buchanan
Nobel Laureate in Economics
Distinguished Senior Fellow

Earl C. Ravenal
Senior Fellow

Doug Bandow
Senior Fellow

Adjunct Scholars

Terry L. Anderson
Political Economy Research Center

Peter Aranson
Emory University

D. T. Armentano
University of Hartford

John Baden
Southern Methodist University

Charles Baird
California State University-Hayward

Randy E. Barnett
Kent College of Law

Walter Block
Fraser Institute

Robert L. Bradley, Jr.
Enron Corp.

Thomas J. DiLorenzo
George Mason University

Lloyd J. Dumas
University of Texas-Dallas

Arthur Ekirch
SUNY-Albany

Richard Epstein
University of Chicago Law School

Peter J. Ferrara
Attorney

Marilyn Flowers
University of Oklahoma

Roger Garrison
Auburn University

Walter Grinder
Institute for Humane Studies

James Gwartney
Florida State University

Steve H. Hanke
Johns Hopkins University

Robert Higgs
Lafayette College

Jack High
Center for the Study of Market Processes

Joseph P. Kalt
Harvard University

Don Lavoie
George Mason University

Christopher Layne
Attorney

Stephen Macedo
Harvard University

Henry G. Manne
George Mason University Law School

Richard B. McKenzie
Clemson University

David I. Meiselman
Virginia Polytechnic Institute

Thomas Gale Moore
Council of Economic Advisers

Gerald P. O'Driscoll, Jr.
Federal Reserve Bank of Dallas

Ellen Frankel Paul
Bowling Green State University

Steve Pejovich
Texas A&M University

Sam Peltzman
University of Chicago

William Poole
Brown University

Alvin Rabushka
Stanford University

Richard W. Rahn
U.S. Chamber of Commerce

Morgan O. Reynolds
Texas A&M University

Mario J. Rizzo
New York University

Jennifer Roback
Center for Study of Public Choice

Paul Craig Roberts
Center for Strategic and International Studies

Henry N. Sanborn
Towson State University

Julian L. Simon
University of Maryland

Vernon L. Smith
University of Arizona

John W. Sommer
University of Texas-Dallas

Richard Stroup
Montana State University

Thomas Szasz
SUNY Upstate Medical Center

Richard Timberlake
University of Georgia

Norman Ture
Institute for Research on the Economics of Taxation

Roland Vaubel
University of Mannheim

Karen Vaughn
George Mason University

Lawrence H. White
New York University

Walter Williams
George Mason University

Leland B. Yeager
Auburn University

Liberty Fund Conference

Social Security Examined

Cato senior policy analyst Catherine England recently directed a Liberty Fund conference titled "Liberty and Security: The Privatization of Social Welfare."

Carolyn Weaver, editor of *Regulation* magazine and author of *The Crisis in Social Security: Economic and Political Origins*, launched the conference with a discussion of two historical topics: pensions before Social Security and the passage of the Social Security Act.

Allan Carlson and Robert Rogowsky presented a paper titled "The Effects of Dependence on the State for Old Age Security," and Peter Ferrara discussed the theory of privatization.

Other participants in the conference included Martha Derthick of the University of Virginia, former Social Security chief actuary A. Haeworth Robertson, Stuart Butler of the Heritage Foundation, Marilyn Flowers of the University of Oklahoma, James Swenson of Prudential Insurance, and Colin Campbell of Dartmouth College. Paul Heyne of the University of Washington served as moderator.

Weaver's paper "Pensions Before Social Security" will appear in the *Cato Journal*. ■

Paul Heyne, Carolyn Weaver, Jim Swenson, Haeworth Robertson, Peter Young, and Catherine England discuss the government's role in providing retirement security at a Liberty Fund conference organized by Cato.

Cathi Smith Named Cato VP

Catherine S. Smith has joined the Cato Institute as vice president for development and public affairs. She will be in charge of fundraising and will help to coordinate Cato's public affairs program.

Most recently Smith was associate publisher of the *Fed Fortnightly*, a magazine covering the Federal Reserve System. She had previously served for five years as director of communications for the American Business Conference, a coalition of chief executives of fast-growing companies. In that capacity she helped to make ABC, then headed by Jack Albertine, one of the nation's four leading business organizations.

"I'm delighted that Cathi Smith has accepted this position," said Cato president Edward H. Crane in announcing the appointment. "She joins us at a time when the growth of Cato's programs necessitates a rapid increase in our funding base. The enthusiasm and professionalism she brings to the task will be a great asset to the Institute." ■

Displaced Workers: Do They Need a Federal Agency?

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 Malcolm Lovell, Distinguished Visiting Professor of Government and Business at George Washington University and chairman of Secretary of Labor William Brock's Task Force on Economic Adjustment and Worker Dislocation, and Richard B. McKenzie, professor of economics at Clemson University and a member of the task force, and a Cato adjunct scholar.

Malcolm Lovell: The main problem that the task force was formed to address is this: how can American business be more successful in the increasingly competitive world economy, and how can employment policy play a constructive role?

There are two ways that we can survive in this competitive economy—maybe three. The most desirable way is to commit ourselves as a nation to producing goods and services of better quality and better prices than other nations. You can always be competitive by selling lower-quality goods at lower prices and lowering your standard of living as a society. But we don't think that's one of our options. We think we have to do the tough, hard things to remain competitive. That means we have to allow industries that can't make it to disappear. We have to adopt new technologies that can create products of better quality at better cost. Management has to follow tough operating policies to get rid of unnecessary costs and burdens. Intelligent and vigorous marketing efforts have to be made so that products can be sold in a competitive fashion.

Short of protectionism, which in the short run maintains jobs—but in the long run costs jobs—all of the actions taken to make businesses more competitive are threatening to some people because they cause short-term or long-term displacement of workers. So the task force has been asked to address this question: how should we as a society deal with the casualties of economic warfare: displaced workers?

Our task force of 21 people included labor leaders, business leaders, academics, and public officials. And after a year's deliberation, we came up with a consensus of 20 of those people. Dick McKenzie distinguished himself by not joining that consensus. He maintained his position with vigor and defended it intelligently, but we didn't end up agreeing with him.

Richard McKenzie: "The task force effectively treats all displaced workers as victims of markets that have failed. It is unwilling to acknowledge that some of them have contributed to their own displacement, and it identifies shopworn federal programs and taxes as a solution."

The task force had four subcommittees. The first subcommittee concentrated on the nature and magnitude of the problem, because although the task force recognized that some dislocation was taking place, we didn't know whether the problem was large enough to attract the public's attention, to warrant the public's concern. The subcommittee concluded that the problem was large enough to warrant public policy priority but not so large that nothing could be done about it.

From 1948 to 1985 imports rose from 4 percent to 13 percent of GNP. Fifty percent of the people who became unemployed during the 1981–82 recession were permanently displaced, compared to 37 percent during previous recessions. There's been a lot of concern that the new industry mix means that the jobs being created today pay less well. The evidence there was mixed: though we are moving people from the traditionally higher-paying industries to the traditionally lower-paying industries, the salaries for jobs within each of those groups are moving up.

Anyway, the subcommittee decided that the displacement of workers was a serious problem; we're talking about a million people a year. Not all of them need help. We assumed that roughly half of them do.

The second subcommittee looked at the private-sector response. It found that companies that really addressed themselves to helping people permanently laid off were often able to accomplish a lot. Now, the question of whether companies should be required to give advance notice of plant closings to their employees is one of the reasons the task force was formed in the first place.

Naturally, given the composition of our task force, the members of the subcommittee could not agree on whether advance notice should be mandatory. But they did agree that advance notice was tremendously helpful in the readjustment process and that not enough private employers were giving advance notice.

The third subcommittee studied what other countries had done about displaced workers. With the exception of the Canadian experience, which was generally recognized as being very successful, we didn't find very good models for the United States.

The fourth subcommittee examined the public sector's response to the problem. Of course, one of the questions was, does anything work? Probably the most successful public manpower program we've ever had is the GI Bill. But we know that some of the private efforts have worked, and we have learned a lot from the failures. We have learned that programs work only if they are well designed and conceptually sound. Trade adjustment assistance, for example, was not conceptually sound because it was not a program designed to help people move to new jobs but an income support program that in effect kept people from moving out of their industries.

A lot of government programs don't work simply because they aren't managed properly. CETA failed not because it didn't have any sound aspects but because the government flooded it with public-service employment money, which totally depreciated its other aspects—training, counseling, and so on.

The government could do several things that would be helpful; it could provide labor market information and job-related training, for example. The kind of training that has been the least successful is vocational training that is not related to a specific job. So we stress training conducted by employers to prepare people for specific jobs and basic education to allow people to compete for the increasing number of jobs that require solid educational skills.

Another very important concept is that the government should limit its manpower programs to displaced workers. One of the major failings of public manpower programs is that everybody has gotten into them. We have defined the target group as permanently displaced people who have worked for three years or more in covered employment. Over time we think we will be able to prove that providing certain kinds of labor market information, employee training, and job-development programs through the public sector can in fact be worthwhile.

If we are not able to do it, we can stop the programs. We stopped CETA; we scrapped most of the programs that came under the Economic Opportunity Act. But you know, our military establishment doesn't make every bit of defense equipment work the first time either. We've got to decide whether it's worthwhile to try to produce a solution that meets the needs of society—and we're talking about economic warfare here. Meeting our competitive challenge is so important today that we must not be faint of heart. We must do everything we can to make sure we have a trained, competent workforce that is on the right job in the right industry at the right time.

Richard McKenzie: When I think of the task force's work over the past year, I'm reminded of what Hugh Macaulay, my colleague at Clemson University, always tells me when we're talking about public policy issues. He says, "If you have a problem and somebody from the government comes to you and says, 'I'm here to help you,' then you have two problems." What the task force is saying is, "We're here to help you." And I'm here to tell you that the task force's report is your second problem.

The task force has two goals. One is to resurrect, in subtle and tempered ways, the national industrial policy myth that Americans can no longer compete and adapt to change without government aid. The other is to resurrect virtually all of the national industrial policy agenda that was advocated several years ago, except this time the members of the task force will present it under the banner of national labor policy. They found out that steel mills and sewing machines do not buy votes, but they think that maybe jobs will.

Malcolm Lovell: "The government should limit its manpower programs to displaced workers. One of the major failings of public manpower programs is that everybody has gotten into them. We have defined the target group as permanently displaced people."

Now, let me outline exactly what they are recommending in this report. They are recommending a new federal agency called the Displaced Worker Unit. Of course, this agency will "be staffed by a cadre of professional employees uniquely qualified for the work at hand through having extensive knowledge and personal experience." We can always depend on people in this town having the necessary experience to solve all of the problems that they've been working on for some time.

In addition, they're recommending the centralization of labor policy, because the Displaced Worker Unit in the Labor Department would have clones in the states—whose policies and budgets, of course, would be controlled by Washington. They're also recommending close to $900 million in additional expenditures for training, outplacement service, job placement, psychotherapy, and whatever else displaced workers think they need. They tell us in their report that $330 million of it would be taken from programs such as JPTA and TAA. I suspect they don't have the foggiest idea whether that is going to happen. They're recommending tripartite advisory committees—which reminds me of what John Naisbitt said: "Any idea that is agreed to by business, labor, and government is very likely to be a lousy idea."

They stop short of advocating mandatory advance notice. But they get the camel's nose under the tent by saying that once a firm announces a plant closing, it should be required to give notice to the local government, state officials, and the federal government. That would be a requirement.

The task force has an assortment of outplacement services to recommend, and it wants to make them a national entitlement for "*all* displaced workers"—including those who caused their own displacement and those who can handle their problems themselves. They also recommend a study on the effects of workers buying out their own plants.

Now, those findings would be understandable if the report had been developed in 1964. My opinion of it is extraordinarily harsh. I view it as unrepresentative, unbalanced, deceptive, paternalistic, dishonest, gutless, and destructive.

I think I can back up every one of those charges. The report is unrepresentative in that only one business member of the task force represented a business that employs fewer than 1,000 workers. Most of the other businesses represented on the task force employ more than 100,000 workers, and all of the others have been closing

(Cont. on p. 8)

Workers (Cont. from p. 7)

plants. The task force had six union representatives but not one representative of the 83 percent of the workforce that is nonunion. The union people on the task force were said to represent the entire workforce.

The report is unbalanced in that all the task force had was a parade of people who talked about displaced workers and plant closings and distress. Only one critic came before the task force, and he complained about the inefficiency of the federal employment service. Not one person criticized the GAO, the BLS, or any of the other agencies from which we received statistics. There is no admission that some workers are responsible for their own displacement. There is no recognition of the value of contracts and property rights or the need for tradeoffs. The report tells us that workers are going to get all kinds of benefits, but it doesn't mention that their wages and other fringe benefits may be lowered as a consequence.

The report is deceptive. It alludes to various data that seem to demonstrate that the pace of change is accelerating. It doesn't talk about developments that have enabled workers to adjust to change with greater ease. It doesn't allude to data that indicate that the pace of change is *not* accelerating.

The report is paternalistic in that it places a lot of emphasis on what the government can do but little or no emphasis on what employees should do for themselves. It is dishonest. It makes assertions for which the task force had evidence to the contrary.

It is gutless. The December 11 draft of the report presented a Christmas tree of benefits to be provided. Mac Lovell and others recommended that we have a payroll tax of $570 million, three-fourths to be covered by employers, one-fourth by employees. The task force members responded by saying, in effect, "I like these benefits, but I'm not so sure that my constituency is going to go for this payroll tax." Mac said, "It takes courage to say that there is a real problem here. And it takes even more courage to say how we're going to finance it." But in the final version of the report, the financing recommendation is "Draw it from general revenues"—that means the general deficit—"or find alternative methods of financing." The task force refused to admit where we would have to go to find the money.

Richard McKenzie expands on his criticism of the report by the task force on displaced workers after his talk at the Cato Policy Forum.

The report is destructive. The policy it advocates would create more incentives to be unemployed and would create regressive redistributions of income because it would deny benefits to displaced workers who had less than three years of tenure and were therefore likely to need help the most. And the report proposes to take money out of programs for low-income people and give it to people that qualify as displaced.

In short, the task force's report on economic adjustment and worker dislocation is potentially dangerous. It focuses on a social problem—worker displacement—whose existence no one denies. Under the guise of seeking a more humane society, however, the task force effectively treats all displaced workers as victims of markets that have failed. It is unwilling to acknowledge that some of them have contributed to their own displacement and therefore should not be entitled to governmental largess or that individuals and communities ought to solve their own problems, and it identifies shopworn Washington-based programs and taxes as a solution.

I hope that the business community, the Reagan White House, and even workers will see the report for what it is: a misguided and counterproductive policy statement that should be dismissed. ■

Roberts Writing on USSR Economy

Paul Craig Roberts, one of the nation's most distinguished analysts of Marxism and socialist economies, has undertaken a major study for the Cato Institute on Soviet-style economies and Western misperceptions of them.

Roberts, a Cato adjunct scholar, will examine the inability of the Soviet and Eastern European economies to innovate and progress. He will also study the early Soviet claims of economic success and the Western intellectuals who believed them and often ridiculed such economists as Ludwig von Mises, who understood the Soviet system from the beginning.

The socialist and communist governments in such countries as China, Hungary, and India are now joining the Soviet government in acknowledging the failures of their economies and moving toward market-oriented reforms, and Roberts will consider the success of their efforts as well.

The book will likely be published by Cato and a major publishing house in 1989. ■

South Africa Needs Capitalism Along with Political Rights

Deregulating South Africa's economy would help blacks and ease the transition to majority rule, says a new study from the Cato Institute.

University of Virginia law student Peter Spiro, who has lived and worked in South Africa, writes, "The South African economy has been hobbled for decades by a maze of interventionist measures that have subjugated the black majority in economic and social as well as political terms, while reducing overall economic growth. Further loosening of this regulatory framework would certainly promote the betterment of everyday life for the average black South African, including an improvement in black economic standing relative to that of whites."

Along with putting an end to the current "emergency" measures immediately, Spiro calls for scrapping the Group Areas Act, which mandates residential segregation; deregulating the underground economy and small business, where arbitrary licensing and regulation have a disproportionate impact on blacks; privatizing state-monopoly industries; and abolishing agricultural marketing boards and "industrial decentralization" agencies designed to keep black businesses out of white areas.

Spiro says that "despite protestations to the contrary, the present South African state is essentially a socialist one, especially with regard to its treatment of non-whites. . . . South Africa's troubles are the result of government intervention on a scale presently known only in the Eastern Bloc."

South Africa's "ludicrous" claim of being a capitalist country has unfortunately led many blacks to associate capitalism with apartheid. Allowing blacks economic freedom and private property rights would help to end both apartheid and the belief that capitalism and apartheid are somehow related.

Economic reforms will create a prosperous middle class among South African blacks, increasing the likelihood of democratic capitalism under majority rule and removing the bureaucratic weapons now available to any South African regime.

Spiro's paper, "Better Now Than Never: Economic and Social Reforms in South Africa," is part of the Cato Institute's Policy Analysis series. ■

Syndicated columnist and "Byline" commentator Donald Lambro autographed copies of his recent book, *Land of Opportunity*, at a Cato reception.

Japanese Firms Buy from U.S., Cato Study Finds

Charges that Japanese automakers in the United States discriminate against American auto parts manufacturers are a form of "Japan bashing," according to a Cato Institute study.

Economist Thomas J. DiLorenzo, a Cato adjunct scholar, writes, "Japanese automakers do *not* discriminate against American parts suppliers per se—only against the ones that offer inferior or uncompetitive products. Japanese manufacturers do business with hundreds of American parts suppliers."

Protectionist policies, which some parts manufacturers and their unions have demanded, would raise prices, harm American auto manufacturers, and reduce the number of jobs in the United States.

In fact, DiLorenzo writes, "the Japanese market is more 'open' to American auto parts suppliers than the American market is to Japanese suppliers. There are no import duties on auto parts imported into Japan, as there are on Japanese imports to the United States . . . . Japanese imports of auto parts have doubled in the past four years."

There are several reasons that Japanese automakers in the United States sometimes purchase parts from Japanese suppliers: Many Japanese parts suppliers are in effect divisions of automakers. Japanese firms prefer the "just in time" production method, which American firms are just beginning to use. And many Japanese firms consider the quality control on American parts inadequate.

DiLorenzo's study, "Foreign Manufacturers in the United States: Should They Be Told to Buy American?", is part of the Cato Institute's Policy Analysis series and is available from Cato. The study received front-page coverage in *Sankei Shinbun*, a six-million-circulation daily business newspaper in Japan. The study is available from Cato for $2.00. ■

Banking (Cont. from p. 1)

insolvent into account, the argument against competition goes, they must be made safer than they might choose to be. Heeding this argument after the financial collapse that ushered in the Great Depression, the architects of the New Deal chose to make banks safer through a combination of regulation and deposit insurance.

Regulation was supposed to give banks a captive market and thus enable them to earn generous and safe returns. Banks were expected to be less eager to take risks in that cozy atmosphere than they were when exposed to the harsh winds of competition. More important, deposit insurance was expected to eliminate depositors' incentive to withdraw their funds from a bank if they feared it would default. However, the deposit insurance agency worked diligently to preclude insolvencies by arranging for failing banks to be taken over by sound ones.

Whatever may be true of a purely competitive banking system, banks with deposit insurance undoubtedly have an incentive to take excessive risks. Regulation to reduce such risks is therefore a necessary accompaniment of deposit insurance.

Many astute observers have criticized the notion of deregulating banks before reforming deposit insurance, because unregulated banks have free rein in exploiting the deposit insurance subsidy for risk taking. That incentive, perversely, is strongest for banks that are already in a precarious financial condition, since their stockholders, protected by limited liability, have already taken all the losses they can. All the downside risk is shifted to the insurance agencies.

The savings and loan crises in Maryland and Ohio and a nationwide bank failure rate more than 10 times the rate between 1940 and 1980 have alerted the public to the precarious condition of our depository institutions. Because the situation is so serious, reforming deposit insurance may finally become a legislative priority. At least two proposals to bail out the Federal Savings and Loan Insurance Corporation, whose reserve fund is now less than $2 billion, are before Congress. Nor is the Federal Deposit Insurance Corporation in much better shape. Its reserve fund is about $18 billion, but that is a small fraction of what the marketplace thinks the commitments of the deposit insurance agencies are actually worth.

In his disturbing recent book, *The Gathering Crisis in Deposit Insurance*, Edward Kane estimates that the deposit insurance agencies' explicit and implicit guarantees have raised the market value of depository institutions by between $100 billion and $150 billion. Indeed, the assets in the portfolios of many insured institutions are worth less than their liabilities, yet

> **"Since the deposit insurance agencies are government monopolies, their pricing decisions are not made on economic criteria alone."**

their stock continues to sell at positive prices because investors place a high value on the deposit insurance agencies' guarantees. The effective value of those guarantees dwarfs the combined FDIC and FSLIC reserve fund of perhaps $20 billion.

Reforming Deposit Insurance

Students of deposit insurance have put forward several proposals for reform. One is to restore the increasingly blurred distinction between insured and uninsured deposits and to begin reducing the $100,000 limit on insured deposits to the $40,000 limit that prevailed before 1980. Because the insurance agencies have always preferred arranging a takeover of a failing institution to compensating insured depositors, uninsured depositors have enjoyed de facto insurance coverage. Another proposal is to introduce insurance premiums that would vary with the riskiness of a bank.

Unfortunately, both proposals would cause serious problems. Restoring the distinction between insured and uninsured deposits would reduce banks' incentives to take risks but would also undercut the fundamental rationale of deposit insurance. As the Continental Illinois case showed, uninsured large depositors can start a run on a bank. If withdrawing funds is the rational response of depositors who consider themselves at risk as a result of new information, then the possibility that uninsured depositors would start a chain reaction of bank runs and failures cannot be casually dismissed.

But the whole point of having deposit insurance is to eliminate just that possibility. Furthermore, the government regularly provides de facto 100 percent insurance to depositors whose accounts exceed $100,000. On the face of it, nothing in the proposal to lower the federal insurance agencies' explicit coverage to $40,000 per account suggests that it would lead the government to behave differently and begin to restrict the actual guarantee to the first $40,000 of each account.

Variable insurance premiums, on the other hand, could eliminate the threat of runs by uninsured depositors. We could retain virtually complete deposit insurance but discourage excessive risk taking by raising the premiums of banks that adopted risky loan and investment strategies and had low ratios of net worth to assets. Yet there are serious practical and political obstacles to such a reform.

One problem involves its execution. How could the insurance agencies acquire accurate information about banks' riskiness before it was too late? When the riskiness of a bank's past strategy becomes evident, the bank is more likely to require financial assistance to keep it from failing than a higher insurance premium to reflect that riskiness. Nor are the criteria that ought to be used to gauge the riskiness of banks self-evident. Whatever criteria are applied, there will always be a lag between the risks that institutions are beginning to exploit and the risks that the insurers have identified.

Another problem is that the deposit insurance agencies are government monopolies. It is therefore unrealistic to assume that their pricing decisions would be governed by economic criteria alone. No government agency bases its prices for the goods or services it provides solely, or even primarily, on economic criteria. If the insurance agencies had discretion over setting premiums, political considerations would inevitably influence their pricing decisions.

Would congressmen and senators from Texas resign themselves to the notion that banks in Texas, having lent heavily to energy producers and thus contributed selflessly to the national goal of energy independence, should be penalized for their patriotism by being charged higher premiums than banks elsewhere in the United States? The question, of course, answers itself. There is excellent political, if not economic, logic behind the long-standing insistence by Congress that deposit insurance premiums be uniform for all banks and all thrifts.

To circumvent the difficulties of reforming the present federal deposit insurance system, some observers have proposed replacing it with a system of private deposit insurance. Private deposit insurance could compensate the depositors of a single bank that failed, but it could not protect us from a systemwide financial collapse. If bank failures became contagious, private deposit insurers would fail along with the banks they were insuring, once the public lost faith in both.

Moving Beyond Deposit Insurance

So we are back in our original quandary. Would a competitive banking system without deposit insurance carry an excessive risk of producing contagious bank runs and bank failures that could lead to the kind of financial collapse that triggered the Great Depression? Until a few years ago it was difficult to make a really strong case that the risk would not be excessive. But a recent development has demonstrated, perhaps for the first time, how a truly safe and competitive system could exist without any need for deposit insurance to prevent contagious bank runs and bank failures.

The innovation that could make this possible is a runproof monetary asset, the money-market mutual fund. Why is it runproof? Because an MMMF shareholder does not have a fixed nominal claim on the fund as a depositor has on a bank. Instead, he is a part owner of the fund's portfolio of assets, and as such, he has no incentive to join in a run on the fund. What would he gain by doing so? A depositor may want to cash in his fixed claim on a bank if he finds out that its asset portfolio has depreciated and he believes that there is an increased probability that it will default on its liabilities. But the owner of shares in an MMMF portfolio absorbs a reduction in the value of the fund's portfolio as soon as it occurs. Since he cannot save what he has already lost, he has no incentive to cash in his shares. Even if he tries, in order to invest in a better-

> **"The money-market mutual fund could make possible a safe banking system without deposit insurance."**

managed fund, for example, he will not endanger the fund's solvency because all he can withdraw is his share of the fund's portfolio.

But the very characteristic that eliminates the possibility of a run on an MMMF—the absence of a fixed nominal claim—involves a different kind of risk, one that bank depositors do not bear. A depositor always knows the exact worth of his claim. An MMMF shareholder bears no default risk, but he cannot know exactly what his shares are worth until he redeems them.

In a competitive environment, both deposits and mutual fund shares would be offered. But since MMMFs can minimize fluctuations in the value of their portfolios by holding only liquid, short-term assets, banks would have a hard time competing with them if deposits were not guaranteed against the risk of default.

At present, banks do not have to provide that guarantee because deposits are insured by the federal government. That subsidy gives banks a competitive advantage over mutual funds, but the advantage is hardly absolute. When many MMMFs were generating yields of more than 10 percent and banks were prohibited from paying more than 5½ percent interest on NOW accounts, deposit insurance could not offset MMMFs' relatively high rates of return. A difference of 5 percent in expected returns was more than enough to induce the public to forsake insured deposits for MMMF shares in droves. From 1978 to 1982 the assets of MMMFs grew from $10 billion to over $240 billion. Only when depository institutions were allowed to offer insured Super NOW accounts and money-market savings accounts with competitive interest rates did the massive shift from deposits to MMMF shares end.

It is disturbing that deposit insurance subsidizes a potentially unstable form of money based on debt at the expense of an inherently more stable form of money based on equity. In the absence of the deposit insurance subsidy and the laws that prohibit MMMFs from offering complete checking services, either banks would develop their own equity accounts (though the Glass-Steagall Act currently prohibits them from doing so) or they would have to find some other way of guaranteeing deposits against default risk.

How could they provide such a guarantee? The same way other debtors do—by building up enough capital to eliminate the risk of default or by pledging enough collateral to secure the redemption of deposits. To be acceptable to depositors, the collateral would have to be a highly liquid security with an active secondary market, such as Treasury bills. Banks are already doing something like this when they sell repurchase agreements. Banks would not necessarily have to designate a specific security to back each deposit, however. They could simply maintain a securities fund earmarked for the repayment of depositors in case of default and undertake to keep its market value at least as great as the total of outstanding deposits. Such an undertaking could be continually monitored by an independent agency, either private or public. Banks would in effect be providing shares in a fund of liquid securities together with a

(Cont. on p. 12)

Banking (Cont. from p. 11)

guarantee of a specific interest rate. That guarantee would presumably allow them to offer somewhat lower interest than the average yield on MMMF shares.

As financial markets continued to develop, the class of assets that were acceptable as collateral would be likely to expand as well. Here is another instance in which financial innovation has the potential to increase the safety of the banking system.

It is impossible to tell how banks would respond to the challenge of competing with MMMFs on equal terms. In some cases, banks would have a choice between increasing their capitalization and collateralizing their deposits. Raising additional capital would not be in the interest of their stockholders. Collateralization might reduce the amount of additional capital that would be required, but banks would have to exchange some of their illiquid assets for liquid assets eligible to serve as collateral. Removing the prohibition against the direct trading of bank loans in a secondary market would be helpful in that regard. The resulting market would make it easier for banks to restructure their portfolios and thereby reduce the amount of additional collateralization they needed to reassure depositors.

A secondary market in bank loans would also accomplish another important objective. It would disseminate information about the actual value of those loans—information about which deposit insurance agencies and bank regulators apparently prefer to keep themselves and the public in the dark.

Would Competition Be Stable?

Would competition from MMMFs force banks without deposit insurance to make their deposits so safe that the public would not demand to redeem them in the event of a perceived banking crisis? Would the competitive system described above be susceptible to the bank runs and panics that deposit insurance was designed to eliminate?

As explained earlier, mutual funds and equity accounts, no matter what financial institution creates them, are immune to runs. Based on the popularity of MMMFs, even with their limited check-writing privileges, it can be assumed that in a competitive environment, a large fraction of the money balances created by financial institutions would be equity shares. The remainder would be traditional deposits. Could runs on depository institutions still occur? And if they did occur and became contagious, could the nightmare of a banking collapse still come to pass?

The answer to both questions would seem to be no. If depositors were not protected by federal insurance and if they could hold shares in equity accounts providing a full array of payment services, they would keep their funds only in banks that either collateralized deposits or were sufficiently capitalized to provide a virtual guarantee against insolvency. Given such security, depositors would have no incentive to redeem their funds from banks that suffered losses. The losses would be absorbed by the banks' shareholders and would not endanger deposits.

> "Deposit insurance subsidizes a potentially unstable form of money based on debt at the expense of a more stable form of money based on equity."

What if a bank's management was so inept or irresponsible that it dissipated a large part of shareholders' capital? Since shareholders absorb such losses, presumably they would replace the bank's management before customers began to redeem deposits. But suppose a streak of bad luck caused the bank's losses to persist. Might not customers finally begin to get nervous and withdraw their deposits? Not if those deposits were collateralized. In that case, customers would bear no risk of losing their deposits and would have no incentive to redeem them in anticipation of the bank's insolvency.

But what if banks chose not to collateralize, even though that would reduce both their capital requirements and the chances that nervous depositors would join in bank runs? If a large share of the monetary assets produced by the financial system was in equity accounts, the system would be immune from the destabilizing effect of contagious runs.

Suppose that despite a high initial capitalization, a bank failed. Even that should not threaten the banking system in general, since customers would convert their deposits not into currency but into deposits in other highly capitalized banks.

Moreover, bank depositors would have the alternative of holding MMMF shares that carried no default risk, so if they lost confidence in the banking system, they could exercise that option. No massive shift to currency would be required. The public's desire to convert deposits into currency is what generates the violent deflation associated with banking panics. Switching from deposits to MMMF shares would not generate deflationary pressure.

Because of its broad equity base, this competitive financial system of the future would be immune from the instability that seems to have been a problem in the past. More important, it would be immune from the difficulties that the current deposit insurance system threatens to bring about in its role as a solution to past problems.

That our current deposit insurance system is unsustainable is becoming painfully clear. Yet our 50-year experience with banking stability under a federal deposit insurance system and our mindfulness of the financial collapse that preceded it have created an understandable intellectual and political attachment to the current system. However, a new era of financial innovation has opened up an unprecedented opportunity for us to enjoy the benefits of competition without having to bear an unacceptable risk of financial instability. The task before us now is not to reform the deposit insurance system but to devise an orderly program for liquidating that system and letting financial institutions finally stand on their own. ■

Courts Distort Age Rights Law, Study Argues

The little-known Age Discrimination in Employment Act has given rise to a number of recent court decisions that distort its intentions by mandating reverse discrimination on behalf of older workers, according to a new Cato study.

Civil rights attorney Clint Bolick writes, "In only two decades, the ADEA has been distorted to such an extent that as presently interpreted, it poses a grave threat to the ability of employers to make rational employment decisions."

When it was passed in 1967, the ADEA was intended to forbid the firing of or refusal to hire workers over 40 because of "assumptions about the effect of age on their ability to do a job *when there is in fact no basis for those assumptions.*" The sponsors of the act made it clear that it was not intended to affect employment decisions based on such age-related factors as seniority, benefits, or actual ability to perform.

Today, however, courts are often equating cost-based decisions that have a disproportionate impact on older workers with age discrimination. Even "underrepresentation" of older workers is often seen as evidence of discrimination. As in race and sex discrimination cases, such decisions may force companies into proportional representation of older workers.

Bolick's study, "The Age Discrimination in Employment Act: Equal Opportunity or Reverse Discrimination?", is no. 82 of the Cato Institute's Policy Analysis series. ■

Mark your calendar:

May 21
Tenth Anniversary Dinner
May 22
Public Policy Day
July 5-12
Summer Seminar in Political Economy

Mark Frazier, president of the Services Group, discussed enterprise zones around the world at a Cato Policy Forum.

Book: *The Best of Byline 1986*

Commentaries from "Byline," the Cato Institute's daily public affairs radio program, have been collected in *The Best of Byline 1986.* The book serves as an entertaining review of the social and political events of the year.

Included in the book are commentaries by Earl Ravenal on the Reykjavik minisummit, Michael Kinsley on the farm crisis, Jeff Riggenbach on Kurt Waldheim, Donald Lambro on the trillion-dollar budget, Nat Hentoff on the Supreme Court's sodomy decision, Joan Kennedy Taylor on the Statue of Liberty celebration, William Niskanen on tax reform, and almost 200 more.

In other "Byline" news, Cato is pleased to announce that Stephen Chapman has returned to the program. Chapman is a nationally syndicated columnist based at the *Chicago Tribune.*

"Byline" is a series of 90-second commentaries carried daily on nearly 200 stations coast to coast. It is available to independent stations and as a feature from both Associated Press Radio and National Public Radio.

The Best of Byline 1986 will be sent to all Cato Sponsors. Copies are available for $2.00 each. ■

Cato chairman William A. Niskanen (left) and president Edward H. Crane (right) recently met with Virgilio Floriani, president of the Centro Ricerche Economiche Applicate, a free-market foundation in Italy.

Capitalism, Freedom, and Apartheid

Policy Report Reviews

After Apartheid: The Solution for South Africa, *by Frances Kendall and Leon Louw (San Francisco: ICS Press, 1987), 200 pp., $17.95.*

Capitalism and Apartheid: South Africa, 1910–1984, *by Merle Lipton (Totowa, N.J.: Rowman and Littlefield, 1985), 462 pp., $19.95.*

The secret to success in Africa is not—despite all the talk of the continent's deep-rooted problems and the need for complex solutions—difficult to spell out.

Put simply, the more a postindependence black African country has encouraged foreign investment, accommodated skilled workers, and pursued market-oriented policies, the more it has flourished. And the more a country has nationalized industry, controlled prices, and uprooted its people in villagization schemes, the more it has suffered.

How good a country looks on paper—whether it is rich in minerals or poor, landlocked or blessed with natural ports—has remarkably little to do with its prosperity. A survey of side-by-side success stories and failures bears this out—Kenya vs. Tanzania, Ivory Coast vs. Guinea, Swaziland vs. Mozambique.

In that light, the simultaneous success and failure of South Africa is easily understood. Basically, whites have enjoyed the fruits of a capitalistic society, blacks the bitter harvest of socialism.

"If apartheid did no more than separate blacks and whites," write Kendall and Louw, "Soweto would be a flourishing city with . . . high-rise buildings, banks, department stores, supermarkets, prosperous business people and numerous entrepreneurs. But it is not. The reason for this is that blacks live in a socialist world—a world in which almost everything is owned and controlled by the state. . . . There is no genuine private ownership of land or free exchange of land rights in black areas. Government controls the trade unions and the distribution, allocation and movement of labour. Virtually every aspect of life is provided or controlled by government, from houses, hospitals and creches [preschool nurseries] to schools and transport."

During this century various governments threw blacks off the land and designated 87 percent of the land for whites; raised taxes for blacks, forcing them to seek work under whites; made it illegal for blacks to quit their jobs; and created a nearly impregnable maze of red tape to prevent the emergence of a substantial black business class.

The Nationalists have filled the bureaucracy with their supporters—*baantjies vir boeties*, or jobs for pals, it's called. Lipton, in her thoughtful, exhaustively researched book, notes that upon coming to power, the Nationalist regime shifted government accounts to Afrikaans banks; steered government contracts to Afrikaans companies; used parastatal industries such as the Iron and Steel Corporation as a training ground for Afrikaner workers; and grandly subsidized white farmers and ensured them a supply of dispossessed, disenfranchised workers.

Wanton shootings by the police, forced removals, restrictions on property ownership and on who could marry whom and live where—South Africans, especially those of the wrong color or political stripe, have suffered from nonstop government folly. And yet capitalism, not state power, gets blamed.

What is the solution? Both books argue that South Africa needs the basic freedoms associated with capitalism. Lipton says a multiracial or nonracial capitalist system could be achieved with less violence and coercion than could socialism or the perpetuation of apartheid and is the only option "compatible with the revival of the remnants of liberty and democracy." But she says the main aim of her book is not so much to argue for that goal as to explain—and it does, thoroughly—the long-simmering conflict between capitalism and apartheid.

Kendall and Louw, on the other hand, have a specific prescription for the country. The solution to which the title of their book refers is a Swisslike system in which South Africa would be divided into some 300 semiautonomous cantons under a common bill of rights. Even the most cynical reader should find their case for the system compelling. Nonracial, it is not a disguised attempt to perpetuate white rule, as are most Nationalist dispensations. The franchise would be universal, and most cantons would, due to demographics, have black rule.

Perhaps more important than Kendall and Louw's proposal for a canton system is their reasoned demand for a constitution and bill of rights that would curb government excess. Indeed, an understandable concern of many South African whites is that majority rule would simply lead to the replacement of white tyranny with black. That could be avoided through the guarantees of an independent judiciary administering a comprehensive constitution—Kendall and Louw's call for freedom of movement, property rights, freedom of association and disassociation, civil liberties, due process, and freedom from intimidation.

The bottom line: a government of any hue—even with the support of the majority—should not have the right to expropriate land, lock up innocent people, and impoverish and enslave segments of its population.

Kendall and Louw recognize that it would take time to adopt a canton system or any other political dispensation, so they offer a series of sensible deregulatory steps the present government should take to propel the country toward equality and prosperity and thus set a more suitable stage for a negotiated settlement.

Both *After Apartheid* and *Capitalism and Apartheid* ought be read by those who would like to see postapartheid South Africa resemble a robust Western democracy rather than another pathetic African people's republic.

—*Don Caldwell*
Manzini, Swaziland

Discovery and the Capitalist Process, *by Israel M. Kirzner (Chicago: University of Chicago Press, 1985), 182 pp., $22.50.*

Israel Kirzner, a foremost proponent of the Austrian school of economics in America, continues his pathbreaking work on the entrepreneur in the seven essays collected in *Discovery and the Capitalist Process*, which investigate the effects of various institutional arrangements upon entrepreneurship. The essays, six of which have been published previously, discuss entrepreneurship in relation to various tax, regulatory, and economic systems and consider the prospects for capitalism in the future, among other topics.

Kirzner's entrepreneur is a discoverer of profit opportunities—a new product, a more efficient method of production, a superior marketing strategy, or simple arbitrage opportunities (a gap between buyers and sellers that the entrepreneur can fill). The entrepreneur generates a perpetual improvement in the range of available choices.

Kirzner argues that people have "the propensity to discover information that will be useful to them." In a controlled economy, however, there are far fewer opportunities, compared with a market economy, to which this information can be applied. Thus the citizens of a controlled economy tend to keep their entrepreneurial antennas "switched off."

Economic controllers are, like everyone, capable of entrepreneurship. However, their alertness to opportunities on behalf of society is no substitute for the alertness of individuals acting in a free market. Even assuming benevolent and energetic officials, central directors simply cannot collect and process enough information, and the information they do collect and process will be of only limited value to individuals.

As Kirzner observes, "Two individuals walk through the same city block teeming with hundreds of people in a variety of garbs, with shops of different kinds, advertising signs for many goods, buildings of different architectural styles. Each of these individuals will notice a different set of items out of these countless impressions. . . . The difference will not merely be one of chance. . . . Each tends to notice what is of interest *to him.*"

Discovery and the Capitalist Process is an excellent volume, building on the insights in Kirzner's 1973 *Competition and Entrepreneurship* and 1979 *Perception, Opportunity, and Profit.* Highly recommended. ■

Governed . . . (Cont. from p. 16)

They're too busy taking bus trips

Over 50 complaints about Britain's newly deregulated bus companies have already been received by the Office of Fair Trading. . . .

Most complaints, citing predatory pricing, have been made by rival bus companies. . . .

"We have had quite a lot of complaints, although none have been received from individual passengers," the OFT official told BNA.

—*Antitrust & Trade Regulation Report*, Dec. 4, 1986

The budget can't be cut any more

The federal government is suing a contractor who tried to save it money by refusing a $16,143 contract to replace window screens worth $200 at a U.S. Marine Corps base.

W. G. Burnette . . . said he made the $16,143 bid without visiting the base.

When Burnette and another company official visited Quantico, . . . he told the contracting officer he could do the job for $200 and sent the contract back unsigned. . . .

The next month, he said, he received another contract for the same work, this time for $22,320. He sent it back unsigned, too.

Last month the Justice Department sued in federal court for $215.89 in extra costs the government apparently incurred when it hired another contractor to do the job, plus $1,000 in liquidated damages.

—*Washington Post*, Dec. 16, 1986

Really, it's been cut to the bone

The Tennessee-Tombigbee Waterway . . . is the most ambitious project ever undertaken by the Army Corps of Engineers. It took 15 years and $2 billion to turn the shallow, snag-ridden Tombigbee into a sleek barge canal and to blast away 39 miles of rocky ridge that separated it from the Tennessee. . . .

The waterway's supporters, mostly powerful southern politicians, envisioned it as an important commercial artery. . . . The Tenn-Tom would become a second Mississippi River. . . .

In 1976, . . . the Corps predicted that the Tenn-Tom would move 27.3 million tons of cargo in its first year of operation. . . .

In 20 months of operation, the canal has carried just 4.8 million tons of cargo. . . .

Instead of a busy barge canal lined with bustling ports, the Tenn-Tom has become a haven for pleasure boaters, water-skiers and bass fishermen.

—*Washington Post*, Dec. 26, 1986

Decisions, decisions

The Reagan administration is about to announce a plan that will provide hundreds of millions of dollars in short-term military debt relief for its key allies around the world. . . .

The plan . . . would allow 38 countries collectively owing the United States $15 billion to $16 billion . . . to choose between paying off their debt now or refinancing it at a much lower rate.

—*Washington Post*, Dec. 16, 1986

And cynics thought tax reform was a trick!

House Speaker James C. Wright Jr. (D-Tex.) yesterday renewed his suggestion that Congress block the tax cuts promised high-income people in last year's tax bill.

—*Washington Post*, Jan. 10, 1987

"To be governed..."

At least they won't have to learn on the job

Three of the 10 mayoral hopefuls in East St. Louis have been convicted of felonies. . . .

State Rep. Wyvetter H. Younge, D-East St. Louis, said she saw nothing wrong with felons running for mayor.

—*St. Louis Post-Dispatch*, Jan. 28, 1987

Illegal until proven legal

Although the practice of surrogate motherhood has grown dramatically in the past few years, it is still so new that no states have yet enacted regulations making it legal.

—*Newsweek*, Jan. 19, 1987

Plot to undermine Japanese economy foiled

U.S. trade officials yesterday accused the Japanese government of reneging on its commitment to allow American lawyers to set up practices in Japan.

—*Washington Post*, Dec. 23, 1986

Extra! Extra!

"The Polish government continues to violate the human rights of its citizens," the Lawyers Committee for Human Rights charged this week.

—*Washington Post*, Dec. 13, 1986

Couldn't have said it better ourselves

Three dozen of the nation's wealthiest Democratic fund-raisers . . . gathered here on a sort of kingmakers' holiday. . . .

What moves such people to spend such long hours raising money? . . .

"It's being able to pick up the phone and talk to the President of the United States," said Duane Garrett, a San Francisco lawyer. . . .

Garrett, who is chairing Bruce Babbitt's presidential campaign, paused to search for a crisper analogy. "They are sort of like the noble class was in 17th-century France. The sort of people who served Richelieu, or Louis XIV."

—*Washington Post*, Jan. 12, 1987

While we at the Committee for the Free World are in the business of making just such fine distinctions

Mr. Jefferson Morley, associate editor of the *New Republic* . . . can see no moral distinction between an alcohol high and a marijuana high.

—*Contentions*, January 1987

In which direction?

Despite the first trillion-dollar-plus budget that the White House unveiled last week, . . . the President may have finally turned the corner on spending.

—*Human Events*, Jan. 17, 1987

Reagan administration urged to emulate disastrous Hoover administration

In the laissez-faire atmosphere toward antitrust considerations of the Reagan administration, [few] obstacles [were] raised by the government toward the acquisition [of RCA by General Electric]. . . .

In 1929, the Hoover Justice Department filed an antitrust suit against RCA and, in 1933, as part of the settlement, GE divested itself of its interests in the company. They then became competitors. What the disastrous Hoover administration would not allow, the Reagan administration blinked an eye at.

—Judy Mann in the *Washington Post*, Dec. 19, 1986

The President still doesn't recognize him

The [Iran-contra] crisis has affected [White House] policies and actions. . . .

To be sure, many agencies report that their dealings with the White House have continued pretty much as usual. Deborah Dean, Housing and Urban Development Secretary Samuel Pierce's liaison with the White House, says, "They've been as responsive as ever. . . . I haven't noticed a change at all."

—*Wall Street Journal*, Jan. 16, 1987

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