Cato Policy Report

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# Transition in the East: Democracy and Market

by Peter Bauer

In the transition in the East, the distinction between democracy and the market system is crucial. However, in current discourse on Eastern reform, political democracy and the market system are largely equated, seen as two sides of a coin. Multiparty democracy under universal suffrage (democracy for short) is regarded as a precondition or corollary of a free society and of a market system (Novak 1991).

Democracy and the market may indeed both be deemed desirable. But to equate them diverts attention from basic distinctions and acute difficulties and dilemmas facing the reformists. The practice may also inhibit the establishment and successful operation of both.

Mass democracy is plainly neither necessary nor sufficient for a market system. For instance, the freest market economy in the contemporary world is Hong Kong, which is not a democracy. Early 19th-century Britain had a market economy but extremely restricted suffrage. Nor is democracy sufficient for a free market. In the late 1940s and early 1950s, Britain was certainly a democracy, but the economy was extensively government controlled. In Chile, the elected Marxist Allende government had to be replaced by an authoritarian regime before the economy could be liberalized. Thus, democracy is neither necessary nor sufficient for a market system. Whether democracy promotes or inhibits the market depends on governmental policies.

The merits of major components of political freedom, such as universal suffrage, free expression of opinion, rule of law, and freedom of association, depend on how the political system is operated. Thus, freedom of association, much emphasized by Michael Novak, often enables people to restrict severely the opportunities of others who may be much poorer. And Prohibition in the United States, spearheaded by the Women's Christian Temperance Union (a voluntary association), was introduced under universal suffrage and under the rule of law.

James Buchanan, Allan Meltzer, Gordon Tullock, and others have shown that universal suffrage can lead to persistently increasing government. Thus, the practice of treating democracy and the market system as two sides of a coin obscures fundamental distinctions. Moreover, in current discourse primary emphasis is on democracy rather than on the market. The reverse, however, would seem more appropriate for two reasons. First, most people consider the freedom of the market—such as choice in employment, movement between places and jobs, and setting up businesses—of greater moment than the

(Cont. on p. 10)

**Peter Bauer is Emeritus Professor of Economics at the London School of Economics and Political Science and a Fellow of the British Academy. This article is a slightly amended version of comments he made at a regional meeting of the Mont Pèlerin Society in Prague, November 1991, on papers presented by Vaclav Klaus and Michael Novak.**

## In This Issue




**Czechoslovakian finance minister Vaclav Klaus, the most aggressive privatizer in Eastern Europe, discusses the importance of stable money in the establishment of a market economy at Cato's Tenth Annual Monetary Conference, "Money in Transition: From Plan to Market."**

# The State of Our Union

## Chairman's Message

There must be 100,000 men and women in our beloved country who believe that they would be better presidents than the candidates of either major party. Some of them may be wrong, but recent events only reinforce the belief. President Bush read his State of the Union address as if he did not understand that he had endorsed some of the policies he now proposes to change. Pat Buchanan makes sense on many issues, but he caters to our ugliest instincts on immigration and trade policies. And the gaggle of Democratic candidates has been trying to convince the savvy voters of New Hampshire and the South that more federal spending and regulation will increase economic growth, preserve the family, and cure warts.

Our democracy, for all its strengths, is a strange political system. We choose our political leaders on the basis of their ability to win elections, not on their ability to govern. That is equivalent, in this Olympic year, to selecting the winner of the hurdles to compete in the shotput. Those thus selected are not without merit, but it seems only incidental that they have any special capability to govern.

One reaction to this state of affairs would be to change our election system to increase the prospect of selecting more qualified political leaders. That would be a mistake. In the 1960s, the "best and brightest" led us into a strategic arms race, the Vietnam War, the Great Society, and the contemporary regulatory state. Men and women who have proved outstanding in other fields need to be on tap; they need not be on top.

A better alternative would be to reduce the scale and scope of government so it could be run satisfactorily by the somewhat-less-than-outstanding men and women our election processes select. We expect too much of our political leaders because we expect too much of government. Our political leaders get away with promising government benefits without mentioning the costs because all too many of us petition them for benefits paid by someone else, even when the cost will be borne by our children.

Our government does not do anything very well. Student performance in our public schools has declined for nearly 30 years despite a rapid increase in real expenditures per student. The real prices of medical services have escalated rapidly, primarily because of the increase in tax-financed medical insurance. Social Security is a time bomb; our politicians have been able to avoid the issue only because the biggest bills are not due for another 20 to 30 years. Many of us have been very critical of the U.S. Postal Service; on balance, however, the postal service is probably the best performing federal agency, primarily because it is monitored by almost all Americans.

Our Union has many problems, some of which merit government attention. And our Union still has an enormous reservoir of skills, creativity, and good will to address those problems. Our most important shared challenge is to reduce the scale and scope of government to a point where even inefficient government is better than the realistic alternatives. Our dilemma, however, is that extraordinary political leadership is probably necessary to restore limited constitutional government, but our election processes show no prospect of selecting such leaders.

—William A. Niskanen

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*"Market failure is government induced"*

# Energy's Ample, Let Markets Conserve It, Scholars Say

"There has always been too much oil, and the crisis of oversupply will continue," said energy economist M. A. Adelman during Cato's January 16 conference, "National Energy Policy: Markets or Mandates?" Adelman, professor emeritus at the Massachusetts Institute of Technology, was one of 22 leading energy experts who met to critique the case for federal intervention in energy markets and explore alternative strategies based on markets rather than government direction. Topics addressed included dependence on foreign oil, conservation, environmental protection, and utility regulation. The conference was organized by Jerry Taylor, Cato's director of natural resource studies.

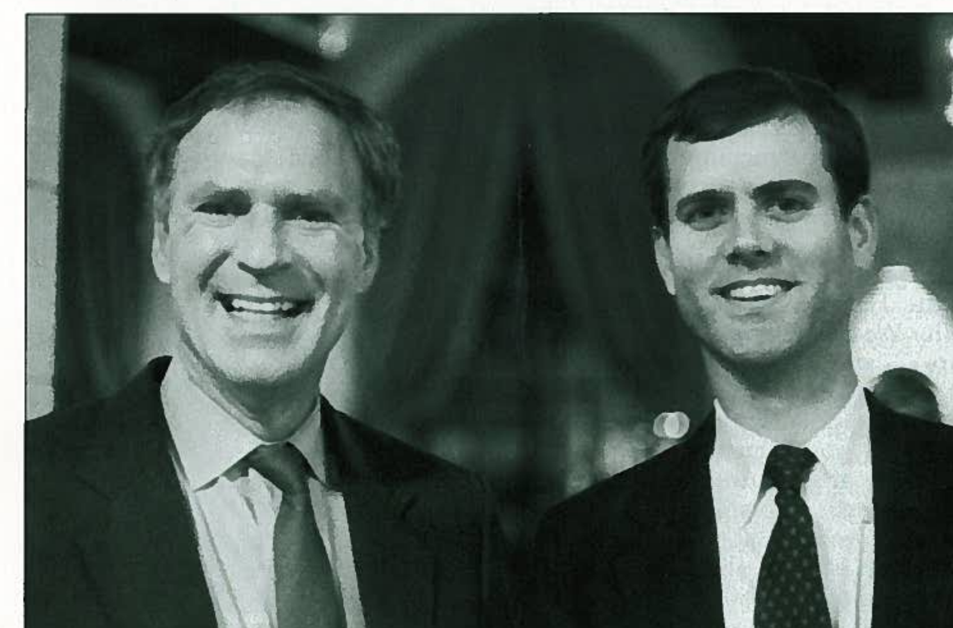
The thrust of the participants' remarks was that markets work and that the energy market is not essentially different from other markets. Taylor, for example, pointed out that the inflation-adjusted prices of gasoline and oil have declined steadily since World War II and that there is no rational standard by which to judge the American economy as wasteful of energy.

Some of the most dramatic comments came during the panel on "Oil Imports: Curse or Blessing?" Adelman noted that oil from the Organization of Oil Exporting Countries (OPEC) constitutes less than half of the world market and that non-OPEC reserves are growing. Douglas Bohi of Resources for the Future said it was a myth that the economy is very sensitive to fluctuations in the price of oil. Comparing the United States, Japan, Germany, and the United Kingdom, Bohi referred to the absence of "hard evidence . . . that energy prices can be blamed for downturns." He suggested that monetary policy was responsible for the recessions in the 1970s. Benjamin Zycher of the Milken Institute warned that any government policy on energy security will be buried in political jockeying. "Market failure," he said, "is government induced."

The panelists on conservation included Robert Crandall of the Brookings Institution, who showed the folly of the federal Corporate Average Fuel Economy standards for automobiles, and Roy Cordato of the Institute for Research on the Economics of Taxation, who argued that energy taxes in principle cannot enhance economic efficiency. The panels included proponents of government energy policy and were moderated by journalists from *Newsweek*, *Fortune*, and *Energy Daily.*

The conference concluded with a debate on President Bush's national energy strategy between John Easton, Jr., general counsel for the U.S. Department of Energy, and Robert L. Bradley, Jr., of the Institute for Energy Research. ■


**Jerry Taylor, Cato's director of natural resource studies, argues that government planners are less efficient than markets in conserving energy, as Dennis Wamsted, editor of *Energy Daily*, and Roy Cordato of the Institute for Research on the Economics of Taxation listen.**



**John Easton, Jr., general counsel of the Department of Energy, and Cato adjunct scholar Robert L. Bradley, Jr., debated the Bush administration's energy policy.**

*Health Care, Environmentalism Debated*

# Governors Weld and Engler Head Panel on State Spending

## Cato Events

**D***ecember 4:* A **"New Perspectives for the Nineties"** seminar held in Houston was keynoted by Rep. Tom DeLay (R-Tex.). Former Delaware governor Pete du Pont gave the luncheon address on "Choice, Opportunity, and Excellence in American Education." Cato president Edward H. Crane spoke on term limitation; fiscal policy director Stephen Moore described the fiscal crisis of the states; and Robert L. Bradley, Jr., president of the Institute for Energy Research, spoke about national energy strategy.

*December 11:* Rep. Frank Riggs (R-Calif.) was the guest at a Cato **Roundtable Luncheon.** The freshman congressman talked about several public policy issues, including free-market environmentalism and Cato's White Paper on defense spending, with staff members and guests.

*January 15:* A Cato conference on **"National Energy Policy: Markets or Mandates?"** featured 22 leading energy experts who examined foreign-oil dependence, conservation, environmental protection, and utility regulation from a pro-market perspective. Speakers included General Counsel John Easton, Jr., of the Department of Energy; Robert Crandall of the Brookings Institution; Robert Bradley, Jr., of the Institute for Energy Research; and Jerry Taylor, Cato's director of natural resource studies, who also organized the conference.

*January 21:* Joseph L. Bast, president of the Heartland Institute, discussed **"Why We Spend Too Much on Health Care . . . and Why It Matters"** at a Policy Forum. Bast, coauthor of a book on the topic, described how tax laws and other government interference in the medical care industry have increased costs. He said national health insurance would make things worse and called for reforms that would return power and responsibility to consumers.

*January 23:* **"Did Misguided Environmentalism Cause the *Challenger* Crash?"** was the subject of a Policy Forum. Michael J. Bennett, author of *The Asbestos Racket,* and Malcolm Ross of the U.S. Geological Survey explained that the Consumer Product Safety Commission's ban on asbestos was the result of bad science and attributed the 1986 space shuttle disaster that killed seven astronauts to the prohibition on asbestos-based putty.


**Massachusetts governor William F. Weld and Cato president Edward H. Crane listen as Michigan governor John Engler answers a question at Cato's forum, "Balancing the Budget When Times Are Tough." The two governors, whose fiscal policies were rated best in the nation in a recent Cato study, discussed how they had balanced their budgets without raising taxes.**

*January 24:* A noon Policy Forum featured a debate on **"Why the States Are Broke."** Participating were Marcia Howard, deputy director of the National Association of State Budget Officers; Neal R. Peirce, contributing editor of the *National Journal;* and Stephen Moore, Cato's director of fiscal policy studies. Howard and Moore described how the states irresponsibly overspent in the 1980s when revenues poured in but fell into trouble when the current recession reduced the tax take. Peirce defended the spending, arguing that state governments had to make up for cuts by the Reagan administration.

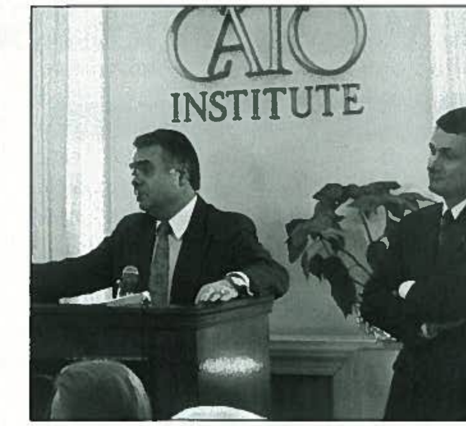

**Former Delaware governor Pete du Pont gave the luncheon address at Cato's "New Perspectives for the Nineties" seminar in Houston.**

*January 24:* Twenty young **East European interns** at the National Forum Foundation visited Cato for a reception and presentations from Cato staff members. Addressing the group were chairman William Niskanen on money and trade; fiscal policy studies director Stephen Moore on domestic issues; constitutional studies director Roger Pilon on constitutional and legal issues; and Melanie Tammen, former director of the Project on Global Economic Liberty, on foreign aid.

*January 28:* **"Social Security . . . A Ticking Time Bomb?"** was the subject of a Policy Forum featuring Dorcas R. Hardy, former commissioner of the Social Security Administration, and Aldona Robbins, vice president of Fiscal Associates. Hardy, coauthor of *Social Insecurity,* discussed the crisis the Social Security system will face when there is not enough money to pay retirement benefits. She and Robbins proposed several possible reforms and suggested ways for individuals to provide for themselves.

*February 4:* A Policy Forum examined the fiscal crisis of the states and **"Balancing the Budget When Times Are Tough."** The speakers were two of the top-scoring governors in Cato's recently published "Fiscal Policy Report Card on America's Governors," William Weld of Massachusetts and John Engler of Michigan. Weld explained how, in the wake of the Dukakis years, he balanced the budget without raising taxes and outlined his pro-growth agenda, including cuts in the capital gains and income taxes. Engler spoke about dealing with spending constituencies, his reform of Michigan's welfare system, and his plan to cut the property tax 20 percent.

*February 5:* A Policy Forum sponsored by Cato's Center for Constitutional Studies examined **"The Transition from a Command Legal System to the Rule of Law."** The speaker was U.S. Claims Court Judge Bohdan A. Futey, a Ukrainian-American who has spent much time in Ukraine advising officials on the post-communist change to a rule of law. He described his experiences and the issues involved in the unprecedented transition.




**Judge Bohdan Futey discusses the transition to the rule of law in his native Ukraine as Cato senior fellow Roger Pilon listens.**

*February 6–9:* Cato held its annual **Benefactor Summit** at the Ritz-Carlton in Naples, Florida. The featured speakers were political humorist P. J. O'Rourke, ACLU president Nadine Strossen, and former Soviet dissident Vladimir Bukovsky. In addition, Harry E. Teasley of Coca-Cola Nestle Refreshments spoke on product packaging and the environment, and Patrick Rooney, CEO of the Golden Rule Insurance Co., discussed tax-free medical savings accounts. The program, attended by Cato's major contributors, also included talks on policy issues by Cato staff members. Chairman William A. Niskanen spoke on President Bush's record on regulation; executive vice president David Boaz on education; Jerry Taylor, director of natural resource studies, on energy policy; Ted Galen Carpenter, director of foreign policy studies, on America's outmoded alliances; Roger Pilon, director of the Center for Constitutional Studies, on natural rights and the Clarence Thomas nomination; Stephen Moore, director of fiscal policy studies, on federal and state fiscal performance; and Sheldon Richman, senior editor, on free trade. President Edward H. Crane gave an address on the State of the Institute. ■

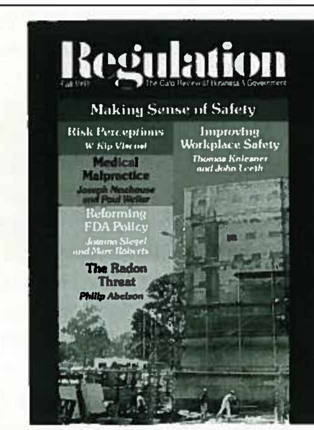


# Radon Scare, FDA Barriers to Drugs Show Flaws in Safety Regulation

**T**he Environmental Protection Agency and some members of Congress have embarked on a questionable radon program that would cost hundreds of billions of dollars and produce trivial benefits, according to Philip H. Abelson in an article in the latest issue of *Regulation* (Fall 1991).

Abelson, science adviser to the American Association for the Advancement of Science, reports that the EPA used a shaky scientific basis to set goals for acceptable radon levels. The EPA's claim that 16,000 to 43,200 annual lung cancer deaths are attributable to radon is not supported by epidemiological studies; it is based on limited data derived from the experience of uranium miners.

Although the EPA has no solid evidence that low levels of radon cause lung cancer, especially in nonsmokers, the agency has been taking strong measures to brainwash and alarm the public. As a result, Congress legislated a virtually impossible goal for the EPA: reduce the amount of radon inside residences to that found in outside air. The cost of reaching that goal has been estimated at about a trillion dollars. Abelson charges that the EPA's typical approach "entails developing worst-case scenarios and giving credence to sloppy data if they indicate a greater risk. Experiments that later show no risk exists are disregarded."




In another article, "Reforming FDA Policy: Lessons from the AIDS Experience," Joanna E. Siegel and Marc J. Roberts write that AIDS has revealed the true cost of the Food and Drug Administration's high standard of proof of efficacy in the approval of new drugs. "For many years we have been content to live with a high level of errors of omission to minimize errors of commission. . . . AIDS has emphasized the cost of this form of caution," they write. The authors call for easing the standard of proof to facilitate access to new drugs for those with life-threatening illnesses.

Other articles in the issue address the costs of Occupational Safety and Health Administration, Consumer Product Safety Commission, and Environmental Protection Agency regulations and ways to reform medical malpractice and insurance. *Regulation* is edited by William A. Niskanen. ■

# Will the Social Security System Survive till 2001?

## 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 Dorcas R. Hardy, U.S. Commissioner of Social Security from 1986 to 1989 and author (with C. Colburn Hardy) of* Social Insecurity: The Crisis in America's Social Security System and How You Can Plan Now for Your Own Financial Future. *Commenting on her remarks was Aldona Robbins, vice president of Fiscal Associates, Inc., and a former senior economist with the Department of the Treasury.*

**Dorcas Hardy:** I appreciate the opportunity to talk about *Social Insecurity.* In it we warn that America's Social Security system will face a crisis; we explain why and suggest ways individuals can provide for themselves. The Social Security crisis will affect all of us, and the American public has got to figure out how to deal with it.

Approximately 35 percent of our current federal budget is being spent on 12 percent of our population. And those figures are going to escalate as more of us, especially the baby boomers, reach retirement age. Unfortunately, the problems of Social Security are the third rail of American politics; touch it and you're dead. So the solutions are not going to come from Washington. They will have to come from the American public. But as a society we are woefully ignorant about the way Social Security—the entitlement program for which we pay the most taxes and that puts tremendous pressure on workers—really operates.

Seventy percent of America's families are paying more in Social Security taxes than they are in income taxes. I say that over and over around the country, and the commentators and the interviewers say, "No, you can't be right." However, the commentators and the interviewers generally make a lot more money than does the average person or the average family in the United States.

During the last decade, the Social Security tax rate, as well as the base, has increased considerably. Supposedly no increase in the Social Security tax rate is imminent, but the base will continue to ratchet up, and that obviously presents a problem for all of us.

Most of us have gone along with the Social Security tax increases. We heard no howls of protest when the tax increased from 7.5 to approximately 7.65 percent in 1990. And we didn't hear many complaints in the 1980s when we were told that if we just paid a little more, mom and dad and grandma and grandpa would be fine. In 1979 the top amount paid was $965, under $1,000. Today that amount is almost $5,000, including Medicare. That 400 percent increase over the last decade has affected all of us.

**Dorcas R. Hardy: "Social Security is not a pension fund. There are no trust funds, just a bunch of IOUs."**

Any increase in net income that the cuts in the income tax might have generated in the early 1980s were eaten up almost entirely by increases in the Social Security payroll tax. And remember that although Social Security benefits are progressive, the payroll tax is regressive. At 7.65 percent it's going to make a bigger difference to somebody earning $13,000 or $15,000 or $20,000 a year than to somebody who is earning more. Will we continue to not begrudge the money we pay into the system for our parents and grandparents?

I doubt it. We're getting to the point where, given the state of the economy, we're going to look at what it costs to support our families and educate our children—and we're going to look at unemployment—and ask what our money is going for. People are beginning to realize that Social Security is not a pension fund. It is a pay-as-you-go system. There are no trust funds, just a bunch of IOUs. That realization comes as a shock.

Most people still think that there is a savings account with their name and number on it. They believe that the money is stored some place in Baltimore, and when you are ready, you just go and take out your shoe box. When I talk about IOUs, people say either, "No, that's not possible," or, "Well that's what I thought. I won't get it anyway." A 30-year-old can say that resignedly today, but 25, 30, 35 years from now, today's 30-year-old is going to look at his older neighbor and say, "You got it; why didn't I?"

There are a lot of current retirees, particularly the notch babies, whom you can't convince that the money they are receiving is the money we are putting in now, not what they contributed back when. The money that goes into FICA is not a contribution; it's a tax. And trying to educate people has been an uphill struggle. The title of the act, the Federal Insurance Contribution Act, makes it hard to convince people that they have no shoe boxes, that what they pay into the system is not a contribution but a tax that is spent as soon as it's paid. But I think we're making a little bit of progress. And I hope that *Social Insecurity* will start some kind of national dialogue that will lead to changes in the system that will ensure that it becomes a *basic* Social Security program for all of us.

The national dialogue will need to cover a number of options. The solution to the present and future problems will be found in a combination of remedies. Obviously, the first would be to balance the budget. With a balanced budget, we could talk about real trust funds, we could talk about pension funds, we could talk about investing them not just in government bonds but also in part of the private sector. That is unlikely to occur. I don't think we can hold our breath while we wait for a balanced budget. We could get closer, but I don't see even that happening soon.



Raising the Social Security retirement age to 70 is not a new idea. Haeworth Robertson and others have written about it, and I think the time has come to act on it. If you tell me now that I'll have to work until I'm 70 in order to receive a Social Security benefit, that's fair. If you tell me three years before I plan to retire, that's not fair. Right now the "normal" retirement age is scheduled to slowly increase for everyone born after 1939. Some people will get the full "benefit" at 65; others will have to wait until they are 66 or 67. For some reason, the change occurs one month at a time after the turn of the century. (That's a typical congressional, and in some ways staff, action. You don't want to do anything too precipitously.) Why not just say to the world, listen, it's the luck of the draw; you were born in 1946, the first year of the baby boom, congratulations. You won't be eligible for Social Security benefits until age 66. End of discussion. Born in 1947, you can retire at 67—and so on until we reach 70. The other way to do it would be to say, you were born in 1946 or later; you'll work till you are 70, period. I think that would help. I haven't done all the math to determine exactly where we would come out, but obviously there would be less strain on the system. We would have people eligible for benefits later, and therefore we would have to pay out less in the future. But we're still going to have to face the problems of having IOUs not cash. The government is going to have to get cash someplace to redeem its IOUs for the baby boomers. What will the government do? raise taxes? decrease benefits? try a combination of the two? restructure the system?

We might also privatize a portion of the Social Security tax (Rep. John Porter has introduced a bill to do just that). We could reduce the tax (but not raise it later, as Sen. Pat Moynihan would like) and put the money into a separate IRA that would be managed either by the government, like the Fed Thrift plan, or by some kind of board representing all the investors in the country. That would certainly fuel the economy.

We could possibly reconfigure the system on the British plan. As a private economist, Michael Boskin talked about that, but for the past few years, as chairman of the Council of Economic Advisers, he's been amazingly quiet. Boskin used to talk about a two-tiered system under which everybody would get at least x, $100, $200, $1,000—whatever we could afford at any given time. After that, the less income you had, the more you would get, and vice versa.

I think the most important issue to address is private savings, and that is what the second part of *Social Insecurity* is about.

The big policy issue is the restoration of the tax-deductible IRA. Tax-deductible IRAs would be new savings, not old savings moved to a new place. Young people, and older people too, are saying, "Give me an incentive to save." The government really has not gotten its act together, to say the least.

**Aldona Robbins: "We are looking at long-term deficits in Social Security that will require a 5 to 13 percentage point increase in payroll tax rates."**

Many people who call in on radio shows say, "I save, I'm good, and I don't expect Social Security to be there when I retire. You're penalizing me. I get taxed higher, and I have no way out." We have no national retirement policy. We have the Department of Labor that denies us true pension portability, and we have no incentives for savings. The government is sending all sorts of mixed messages, and the American consumer is thinking, "I can't put my money in a CD; so where do I go? I want to get some kind of return, but I'm not willing to gamble a whole lot."

In *Social Insecurity* we address some of these concerns. For example, zero-coupon bonds are safe vehicles. We've also made some suggestions about pooled income funds and other instruments that can really help you build a base for your retirement. We estimate that if you're 25 or 30 years old, you'll need $300,000 to $500,000 in today's dollars for tomorrow. So you've got to save, and policymakers really need to push the American public to save and give us some incentives to do so. If we can't provide for ourselves now, we're going to have to figure out how to move in that direction.

We have also suggested that people try to participate in 401-K plans and, if self-employed, Keogh plans. That will do a lot for you in the future (the magic of compounding, you know) and make Social Security a very small part of your base. Then you really would be responsible for a large part—90 or 70 percent—of your retirement income. Fifty percent of today's retirees rely on Social Security for 50 percent or more of their income, and that is just too much. The structure's going to fall apart. So, we have to come up with a solution. I am still an optimist. I think, working together, we can.

**Aldona Robbins:** I was first introduced to Social Security in 1975 when I was working at the Labor Department. The world has certainly changed since then—the Reagan Revolution of the 1980s and the collapse of communism in the Soviet Union and Eastern Europe—but little has changed with respect to Social Security. We continue to talk about the same problems we were talking about in 1975. The difference is that the long run is now closer. What I would like to do today is look at a couple of solutions to the long-run problem of Social Security.

Of course, some people believe that there really isn't any problem. That is the official government position, the one taken by the trustees of the Old-Age Survivors and Disability Insurance Trust Funds. Their 1991 annual report, the latest one available, tells us that those funds, from which cash benefits are paid out, are sufficient to "insure timely payment of benefits for the next 50 years." I read that and I am supposed to think that the trust funds will take care of me since 50 years is a long time. They also tell us that the trust funds will not have a problem until

(Cont. on p. 8)

## Social Security (Cont. from p. 7)

2041 when they "exhaust"—all of the government bonds that make up the trust funds will be gone; there will be no "assets" to draw on.

I believe the funds will run out before 2041. Under the trustees' intermediate economic assumptions, current revenues to the system, which are for the most part payroll taxes, will fall short of the benefits that have to be paid out around 2017. If we add in Part A of Medicare, which also has a trust fund, the date moves up to around 2009.

Under the trustees' more pessimistic assumptions, payroll taxes will fall short of benefits in 2010; if we include Part A of Medicare, they will do so in 1995, which is not long run but short run. Then there is the question of whether the trustees' economic assumptions are realistic. If our pathetic economic performance continues, the problem could arise even sooner.

When payroll taxes fall short of benefits, the government will have to sell off or redeem the bonds that are in the trust funds. That means that the government will have to come up with money from somewhere else. Suppose Social Security had to redeem $20 billion in government bonds. What would we do? We might raise the personal income tax, which is, after all, the primary source of general revenues.

It is possible that a 25-, 30-, or 40-year-old paying into the trust funds today will face a shortage of funds by the time she reaches 65. Income taxes will have to be raised. Those in retirement will be paying income taxes, and they will see a significant reduction in their Social Security benefits because of the higher income taxes they will be paying to retire the accumulated debt.

I think there will have to be major reforms in the way benefits are calculated. Right now, we are looking at long-term deficits in the Social Security cash program that will require a 5 to 13 percentage point increase in the payroll tax rates if we are going to continue to pay out benefits at the current rate. The problem today is that replacement rates are too high. (Replacement rates are the benefits that a worker receives at age 65 divided by the earnings she received during her last year of work.) Until 1970 the replacement rate for the hypothetical average-wage worker was in the range of 30 to 35 percent. In other words, that worker could get benefits equal to 30 to 35 percent of her last year's earnings. Congress can and did make ad hoc adjustments to the benefit formula. In 1972, however, Congress legislated automatic increases in benefits, and a "minor boo-boo" was introduced. That error caused replacement rates to escalate more quickly than anyone had intended. The high rates of inflation in the 1970s made things even worse. We went from paying the average retired worker 30 to 35 percent in 1970 to paying 55 percent in 1981. The problem was recognized in 1973–74. Several commissions studied the problem and decided that the benefit formula had to be readjusted.

The formula was changed, but the replacement rate for the average worker was set at 42 percent. The 1977 amendments raised real benefits by almost a third, even though it was known that there would be a baby-boom problem followed by a baby-bust problem, which would cause long-term financing difficulties.

If we could reduce the replacement rate to between 38 and 40 percent for the average worker, we would eliminate the long-run OASDI problem and reduce the Medicare Part A problem. The replacement rates can be adjusted by using the price index instead of the wage index in the benefit formula. Prices usually increase more slowly than wages. The advantage of that change is that it would take place very gradually. It would have no effect on someone who was about to retire. The further a person was from retirement, the more slowly her benefits would be reduced. That should not create a problem, because people will have plenty of notice and time to make other preparations for retirement. The problem with raising the retirement age, which Dorcas suggested, is the age-62 retirement penalty. When Congress raised the retirement age in the 1983 amendments, it did not reduce the penalty for early retirement at age 62 as much as it reduced the penalty for retirement at 65 or 67. Waiting until 70 to retire is probably not a problem for a white-collar worker, but it might well be a problem for a coal miner or an assembly-line worker. Congress is rather sensitive about that point.

Another set of solutions would encourage private saving for retirement. I would like to see something like the Bentsen-Roth bill, which was proposed last year, that would expand individual retirement accounts. My research shows that about 80 percent of the money in the new IRAs would be new savings, which would reduce the cost of capital in the United States by 3 to 4 percent and increase the capital stock by 3 to 4 percent. That increase in capital stock would bring more jobs and more economic growth.

I would also get rid of the income tax on Social Security benefits. The way that tax is phased in, a person in the 15 percent bracket is really facing a 22.5 percent tax rate, and a person in the 28 percent bracket faces a 42 percent tax rate. The tax not only affects today's elderly; it also poisons the savings incentives of future retirees. The tax discourages savings because people will face higher taxes after retirement. The tax brings in very little revenue—at this point, only $6 billion a year. Doing away with it would help reduce, rather than increase, the federal deficit.

Finally, I would like to see a pro-growth tax strategy adopted. After reforming benefits, the thing that will help the Social Security system the most would be to raise the long-term economic growth rate in the United States. My associate and I did some work for the U.S. Chamber of Commerce and the National Center for Policy Analysis on reforming depreciation allowances and the capital gains tax, as well as other ways to boost the capital stock. We included a reduction in the Social Security payroll tax. As Dorcas mentioned, many workers pay more in Social Security taxes than they pay in income taxes, and the payroll tax increases have overtaken the decreases in income taxes. We have estimated that a 2 percent reduction in the payroll tax rate, proposed last year in the Moynihan-Kasten bill, would increase the number of jobs by 650,000. To reduce the deficit, we will have to couple a payroll tax cut with other measures that will stimulate capital investment. The growth effects of a payroll tax reduction alone would offset only 25 to 30 percent of static revenue losses. A pro-growth strategy and the reform of benefits will do a lot to solve our long-term Social Security problem. ■

## In Memoriam

F. A. Hayek, one of the greatest social thinkers of the 20th century and a Distinguished Senior Fellow of the Cato Institute, died March 23 in Freiburg, Germany, at 92. Hayek won the Nobel prize for economics in 1974 and received the Presidential Medal of Freedom last year. He was the dean of the Austrian school of economics, which emphasizes the purposeful individual in a world of change and imperfect knowledge. Among Hayek's many accomplishments in economics and social philosophy are his elaboration of the case against government economic planning, his analysis of the market as an open-ended process for discovering and communicating information, his study of how institutions arise without design, and his moral justification of capitalism. In 1944, during dark days for advocates of individual liberty, Hayek broke through to a popular audience with *The Road to Serfdom* in which he argued that government planning, consistently applied, would lead to totalitarianism. He subsequently helped found the Mont Pèlerin Society, an organization of market liberals that paved the way for a full-fledged movement of free-market thinkers and activists.



# CATO INSTITUTE CALENDAR

**Bitter Medicine: Insurance and the Regulation of Medical Care**
*Third Annual* Regulation *Conference*
**J. W. Marriott Hotel • Washington • April 30–May 1, 1992**
Speakers will include Rep. Bill Gradison, George R. Fisher, Gail Wilensky, Gerald L. Musgrave, Deborah Haas-Wilson, Robert Moffit, John Holohan, Susan Feigenbaum, Steven Hyde, and John C. Goodman.

**Liberty in the Americas: Free Trade and Beyond**
Cosponsored with Centro de Investigaciones Sobre la Libre Empresa
**Camino Real • Mexico City • May 19–22, 1992**
Speakers will include Milton Friedman, Jaime Serra Puche, Pedro Aspe, Hernan Buchi, Enrique Ghersi, Teresa Infante, Norman Macrae, Michael Novak, and Luis Pazos.

## Transition (Cont. from p. 1)

extent of suffrage and freedom of political speech. Second, historical experience suggests, though the evidence is not conclusive, that democracy is more likely to grow out of the market than the market out of democracy.

There are some major benefits of democracy. First, it reduces dependence on a single ruler or party. Second, it serves as a safety valve because discontent, even strongly felt discontent, can be registered by voting without recourse to physical force. Third, in the modern world, it confers legitimacy on the government. Election by some kind of popular, and not obviously rigged, vote is often seen both within a country and abroad as giving a government legitimacy, which enhances its effectiveness.

### Limiting Government

It is generally agreed that a market system is required both for personal freedom and for economic improvement, especially improvement of general living standards. The market system, in turn, requires a government that performs certain necessary tasks but refrains from direct control of economic life beyond the taxation required for its basic tasks. The list of those tasks is familiar if not universally agreed on: public security, which means protection of life and property, including the definition and enforcement of property rights; maintenance of the value of money; management of external relations in the interests of the population; provision or supervision of basic education, public health, and transport; and assistance to those in need (perhaps by income support schemes) who cannot help themselves and are not helped by others. Effective performance of those tasks would stretch the human and financial resources of Eastern governments. It is notable that those functions do not normally imply direct control over people's lives and activities. They, therefore, do not set up the tensions and conflicts often engendered by such control.

What matters for a market system, and therefore for personal freedom and economic advance, is not how a government originates but what it does. What matters in this context is not elected government but limited government. Whatever its origins, a government is most likely to promote personal freedom and economic advance when it effectively performs a specific range of tasks without directly controlling economic life. It is a paradox that many modern governments cannot or will not perform those basic tasks, including public security, while simultaneously they intervene, or try to intervene, extensively, in economic life. They are often bloated without being firm.

In the East, limited government, notably absence of extensive state economic intervention, implies substantial depoliticization of life. The establishment of limited and stable post-communist government requires drastic measures, as proposed by Vaclav Klaus (1991, p. 4).

> "Democracy is more likely to grow out of the market than the market out of democracy."

There are major obstacles, however, in the way of far-reaching reform. They derive from two sources: extremely powerful hostile interests and widespread apprehension about the effects of reform, closely linked with unfamiliarity with the market.

The reformists have to rely on existing personnel in the public services, including the military, the police, the civil service, the public utilities, and the state enterprises, most of whom oppose dismantling the command economy. They try to stir up popular discontent and fear and to deny supplies to the private sector or to activities controlled by the reformists. As U.S. Sen. Strom Thurmond (R-S.C.) has said, "You cannot get a hog to butcher itself."

In the East, many people fear the results of reforms, such as steep rises in prices and rents, the withdrawal or reduction of health services, and unemployment following closure of inviable enterprises. Various other legacies of communist rule add to the difficulties of the reformists. Under the command economy, people did not look for jobs but were directed into them. Production was divorced from the value of output, which was measured by the cost of inputs, which was unrelated to economic cost. Many people, therefore, find it difficult to face the opportunities, risks, and rewards of the market.

Communist rule has given a new lease on life to the ancient misconception that the incomes of relatively prosperous people, especially foreigners or members of distinct groups, have been extracted from others, notably the poor, rather than produced by themselves or with their resources. Under the command economy, the incomes of the prosperous were indeed all too often extracted from others. And many of the beneficiaries are still well placed to remain or become prosperous. Such ideas and circumstances add to the difficulties of the reformists.

The drastic measures required to dismantle a comprehensive command economy are unpopular and difficult. The government may need some sort of popular mandate before it can proceed with them. Even if such measures are introduced by presidential or ministerial decree, a government can claim a mandate if it was elected through reasonably extensive suffrage. In that sense, democracy may be helpful or necessary for dismantling the command economy.

### Democracy May Inhibit the Market

On the other hand, effective ongoing functioning of the market is often inhibited by certain widely prevalent tendencies in mass democracies. Forces are at work that promote extensive government intervention through taxation, government spending, lax monetary and fiscal policies, and also intervention to placate special interest groups in both the public and the private sector.

Buchanan and Tullock have shown, in truly seminal writings, how the operation of special interest groups and coalitions (including coalitions between bureaucrats and legislators) brings about such results. Allan Meltzer has cogently argued that redistributive taxation and state spending to benefit the majority of the electorate—that is, recipients of the median income or less—persistently increase the role of government.

The factors analyzed by Buchanan, Tullock, and Meltzer are not mutually exclusive. They tend to reinforce each other. They are likely to lead to an ever-increasing role of government in mass democracies unless held in check by strong tradition against government intervention or by special constitutional provisions, designed to tame democracy (to borrow from Hayek). They may also be checked if their consequences patently damage the majority of the electorate, represented in this context by the median income recipient.

In the East, those factors are likely to operate forcibly. Ethnic and cultural diversity, which extends into small regions, multiplies special groups and coalitions. The market system and its institutions are less developed or deep-rooted than in the West. Although there is currently much revulsion against a totalitarian system, state intervention in economic life is traditionally more readily accepted than in Britain or the United States. Again, the ancient misconception that the incomes of relatively prosperous people have been taken from others is widespread and firmly held.

Redistributive taxation and large-scale government spending in post-communist countries are likely to be encouraged by the influence of statists and dirigistes on official contacts between the West and the post-communist governments, especially on the administration and allocation of the official subsidies known as aid (including technical assistance, soft loans, and guaranteed bank lending). International organizations such as the European Commission, the World Bank, and the European Bank for Reconstruction and Development (which in reality are political institutions and not banks) are in the forefront of the advocacy and administration of those subsidies. Much of their personnel is indifferent or outright hostile to the market system and to voluntary decisions generally, though they may pay lip service to both. The influence of the personnel, especially over the long term, is likely to favor more official spending and redistributive taxation, and generally government economic intervention.

Thus, the extensive and lasting depoliticization of economic life required for a successful market system is likely to be difficult in the East under mass democracy. Yet failure to achieve it will prove even more harmful than in the West. Extensive state economic control engenders tension and conflict, especially in the heterogeneous societies of the East. Resources, energy, and attention are diverted from productive economic activity to concern with the outcome of political struggles and administrative decisions. Such politicization of economic life is damaging to economic performance, and at times it provokes civil strife.

The wide ethnic and cultural diversity in the East means that economic controls can lead to extensive and costly fragmentation of those economies. Centrifugal forces can be set up, at least until opposition is suppressed. Unless reined in, those forces under mass democracy will impede the operation of the market and thereby improvement in living standards.

> "What matters for a market system is not elected government but limited government."

### Traditional Societies

I should like now to turn briefly to two subsidiary matters. Novak (1991, p. 8) made a comparison between the traditional and the free societies. Is the comparison helpful? It is rather like classifying a pack of cards into red suits and kings. Traditional societies are often free societies. People may freely accept a hierarchical and differentiated society. Governments of traditional societies are often limited. And neither the government nor the nobility needs to have the power in traditional societies to coerce people or to reduce them to dependency, let alone to serfdom. Novak refers to the Austro-Hungarian Empire (the Dual Monarchy) and mentions that dukes, counts, knights, and petty officials were people to whom the population was subject. But neither the monarchs nor the nobility had absolute powers. In Britain (and elsewhere) there also are dukes, earls, and knights. People are occasionally referred to as Her Majesty's subjects. But that does not mean that Britain is less free than the United States. In many ways people in the Dual Monarchy were freer than they are in the United States. When Novak's forebears migrated from Slovakia to the United States, they did not need passports. People could move freely between places and jobs, were free to set up businesses, to come and go, to drink, and to take money in and out of the country. And petty officials with coercive power are ubiquitous in today's democracies.

Following Mises and Hayek, Klaus (1991, p. 2) writes that the indicators of success under economic planning were irrational. His statement is true if the aim of planning is to improve economic welfare, especially general living standards. But the process and its success indicators can be quite rational if the purpose is to keep the rulers in power, whether the Communist party or African despots. Then, the policies make sense. So do the success indicators, because they impress supporters and sycophants abroad, and may impress or terrorize people at home. The policies and the rulers may eventually collapse. But such policies have kept African despots in power for decades, and the Communist party of the Soviet Union ruled the country for more than 70 years. It is thus somewhat misleading to call central planning irrational. The policies usually suit the purposes of the rulers. The term irrational also suggests that outside observers, especially academics, are better qualified than are seasoned politicians to assess what best serves the interests of the rulers.

### Depoliticizing Economic Life

The West can influence developments in the East. The preceding discussion suggests that such influence should be targeted primarily to the promotion of the market. For instance, official aid—that is, subsidies in cash or kind, including technical assistance, soft loans, and government-guaranteed bank credits—if provided at all, should go to the governments that are politically committed to the market system. If the governments change their course, the subsidies should be withdrawn. Aid should be administered and allocated by people who are themselves market ori-

(Cont. on p. 15)

*Case for Nonintervention Outlined*

# Rating of Governors Draws Return Fire from Targets

Recent Cato studies rated the fiscal performance of the nation's governors, offered a strategy for dealing with a possible North Korean nuclear threat, and called for ending Cold War era military alliances.

### Governors' Report Card

A new study by Stephen Moore, Cato's director of fiscal policy studies, ranks the nation's governors on frugality and profligacy. Predictably, it has drawn fire from the governors who got failing grades. "A Fiscal Policy Report Card on America's Governors" (Policy Analysis no. 167) establishes the first fiscal restraint index for determining which governors have raised taxes and spending the most and which the least or not at all. The paper analyzes each governor's performance in detail and gives each an overall fiscal policy score and grade. The study attracted much attention from the media immediately after its release.

Two governors received A's: William Weld of Massachusetts and Michael Sullivan of Wyoming. Six governors got F's: Gaston Caperton of West Virginia, James Florio of New Jersey, Bob Miller of Nevada, John Waihee of Hawaii, Lowell P. Weicker of Connecticut, and Pete Wilson of California. Moore illustrates the dramatic divergences in the governors' fiscal policies by pointing out that Weld cut taxes by $1,316 per family for 1992, while Weicker proposed an income tax that would raise taxes by $1,400 per family.

Moore's latest Cato study continues his record of generating more official responses than any other Cato scholar. His study "The Profligate President: A Midterm Review of Bush's Fiscal Policy" (Policy Analysis no. 147) sent the Office of Management and Budget scrambling to respond, and the findings in "State Spending Splurge: The *Real* Story behind the Fiscal Crisis in State Government" (Policy Analysis no. 152) were widely reported in news stories and op-ed commentaries. Governor Wilson reacted to Moore's latest study by issuing a statement defending his spending policies and erroneously claiming that the Cato study did not take into account California's large and growing population. Florio denounced Cato. New York governor Mario Cuomo boasted about his rating on radio shows, and his administration issued a statement proclaiming that Cuomo had the highest rating in the "Tri-state Area"—that is, his C was a good deal better than Weicker's and Florio's F's.

### North Korea and the Bomb

The United States should use a diplomatic "carrot-and-stick" approach to induce North Korea to abandon its nuclear program, according to Cato senior fellow Doug Bandow in "Defusing the Korean Bomb" (Foreign Policy Briefing no. 14). Bandow argues that North Korea's apparent desire to join the larger world community strongly suggests that it might accept the "carrot"—full diplomatic ties with other nations, meaningful participation in international forums, expanded trade, and increased foreign investment.

He writes that the "stick" would be the threat that Japan and South Korea would go nuclear if North Korea pursued any nuclear ambitions. That disincentive, Bandow writes, is preferable to keeping America's nuclear umbrella over the region.

### Decentralization Is Better

Regional governance is not the answer to America's urban problems, writes Sam Staley, president of the Urban Policy Research Institute, in "Bigger Is Not Better: The Virtues of Decentralized Local Government" (Policy Analysis no. 166). Staley presents evidence that large regional governments are inefficient and may destroy the competitive political foundation on which democratic society depends.

The further government is removed from the citizens, the less control voters have over budgetary and policy decisions, Staley writes. Large governments are more likely to have higher spending levels and tax rates than are small governments. Diseconomies of scale often result from increased administrative costs. Smaller units of government and the private sector can more efficiently and effectively meet urban needs such as those for public transportation, law enforcement, and low-income housing.

Staley concludes that, instead of trying to erect a public-sector monopoly, policymakers should direct their efforts to creating efficient political markets that rely on the private sector to provide needed public services.

### Free Trade with Eastern Europe

Free access to American markets would be the greatest "aid" the Bush administration could give to the ex-communist countries of Eastern Europe, according to "Washington's Iron Curtain against East European Exports" (Foreign Policy Briefing no. 15) by Cato associate policy analyst James Bovard. He argues that the Bush administration's policy of providing billions in aid to East European countries while maintaining pervasive trade barriers against products from those countries is hypocritical and unnecessary.

Textile, steel, and agricultural products are among the most tightly restricted imports, and some products cannot be imported at all. East European nations are not allowed to sell butter, dry milk, or ice cream to American customers.

### Time to End the Alliances

Significant reductions in military spending are unlikely until the United States adopts a defense strategy that redefines America's vital security interests in the post–Cold War world, writes Ted Galen Carpenter, Cato's director of foreign policy studies, in "The Case for U.S. Strategic Independence" (Foreign Policy Briefing no. 16). Carpenter argues that maintaining expensive and outdated Cold War–era military alliances, such as NATO and those with South Korea and Japan, will cause the United States to continue spending nearly seven times as much on the military as does any other member of the Group of 7 industrial nations.

Carpenter offers a new defense strategy of "strategic independence" that redefines America's vital security interests as having a direct, immediate, and substantial connection to America's physical survival, political independence, and domestic liberty. His policy of strategic independence calls for a five-year period of "burden shedding" that would reduce the military budget from the current $291 billion a year to $125 billion.

### Monetary Reform for the Late Soviet Union

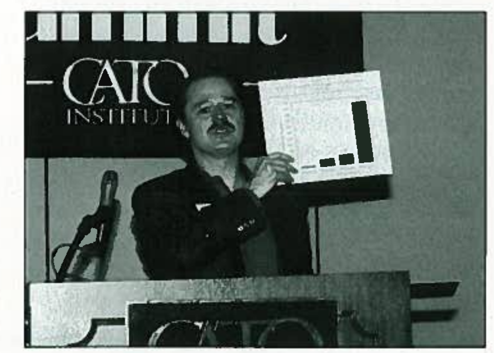
The nations of the Commonwealth of Independent States need stable, convertible currencies, not foreign aid, to move from socialist to capitalist economies, write economists Steven H. Hanke and Kurt Schuler in "Currency Convertibility: A Self-Help Blueprint for the Commonwealth of Independent States" (Foreign Policy Briefing no. 17). Hanke and Schuler argue that the way to create such currencies is to establish currency boards. They propose three steps for doing so: Fix an exchange rate with a reserve asset and issue currency equal to the board's reserves; remove all restrictions on foreign exchange; and distribute the new currency according to a predetermined formula. This study continues Cato's ten years of work on monetary reform and its involvement in transforming socialist economies. ■





# More than 100 Gather in Florida For Fourth Annual Benefactor Summit

Cato senior fellow Roger Pilon and president Edward H. Crane talk with Benefactors Arthur Cinader of New York and James Waters of Framingham, Mass., at a reception before P. J. O'Rourke's dinner speech at Cato's Fourth Annual Benefactor Summit, held February 6–9 at the Ritz-Carlton in Naples, Florida.



Cato executive vice president David Boaz points out the growth in non-teaching personnel in public schools at a talk during the Benefactor Summit.

ACLU president Nadine Strossen discusses why groups that defend individual rights—such as Cato and the ACLU—are sometimes perceived as far from the American mainstream.

Vladimir Bukovsky, who spoke at the final dinner of the Summit, here questions Nadine Strossen about the ACLU's position in the case of Walter Polovchak, a 15-year-old Ukrainian boy who resisted returning to Ukraine with his parents.

*Bring the Troops Home*

# Commitment to Korea Is Costly and Outdated, Book Says; Wealthy South Korea Can Defend Itself against North

America's multibillion-dollar commitment to defend South Korea is a waste of money, according to several authors in a new book published by the Cato Institute. *The U.S.–South Korean Alliance: Time for a Change* (Transaction Publishers), edited by Doug Bandow, Cato senior fellow, and Ted Galen Carpenter, Cato's director of foreign policy studies, provides evidence for the view that the alliance is expensive, unnecessary, and self-defeating. The book is based on papers delivered at Cato's 1990 conference on the U.S.–South Korean alliance.

Bandow argues that the conditions under which the alliance was formed more than 40 years ago have changed radically. He points out that South Korea is no longer poor and helpless and that China and the former Soviet Union are no longer prosecuting the Cold War. He writes that with a per capita income at least four times and a population twice that of the North, South Korea is capable of defending itself. "South Korea is far more technologically advanced and has become one of the world's most important trading nations with wide access to international credit and foreign markets," writes Bandow. "The Democratic People's Republic of Korea, in contrast, faces economic stagnation, manufacturing shortages, and even, apparently, famine." He adds that the North's quantitative military edge would vanish if the South made a more serious defense effort. Bandow concludes that the United States should phase out its troop presence over five years.

Carpenter argues that South Korea does not represent a vital interest of the United States. Economically, he writes, a disruption of trade with South Korea, while unpleasant, would be of small consequence for the United States. Strategically, South Korea has little value because the Cold War strategy of containment is outmoded, he adds.

In another chapter, Selig S. Harrison, a senior associate of the Carnegie Endowment for International Peace, writes that the alliance has given rise to growing South Korean resentment

**Colorado senator Tim Wirth speaks at Cato's conference on U.S.–Korea relations.**

of the United States and that U.S. intransigence toward North Korea has strengthened the position of the hardliners there against those who favor liberalization. He calls on the United States to negotiate arms reduction agreements with the North. Dae-Sook Suh, director of the Center for Korean Studies at the University of Hawaii at Monoa, argues that significant changes in North Korea make an American withdrawal feasible. Removing U.S. troops would help relax tensions on the peninsula, he adds.

Sen. Tim Wirth (D-Colo.), in an afterword, writes that he expects the continuing political pressure for military spending cuts to lead to a reduction in overseas forces. He proposes using American troop cuts as leverage to improve the relationship between the two Koreas.

Other contributors include Stephen D. Goose, legislative assistant for foreign and military affairs to Rep. Robert J. Mrazek (D-N.Y.); Changsu Kim, senior researcher at the Korea Institute for Defense Analyses; and Edward A. Olsen, professor of national security affairs and Asian studies at the U.S. Naval Postgraduate School.

Three analysts who oppose a U.S. withdrawal from South Korea also contributed chapters: William J. Taylor, Jr., of the Center for Strategic and International Studies; Daryl M. Plunk, a visiting fellow with the Heritage Foundation's Asian Studies Center; and A. James Gregor of the Pacific Basin Project at the Institute of International Studies.

*The U.S.–South Korean Alliance: Time for a Change* is available from the Cato Institute for $19.95 in paperback. ■

# National Health Care Hasn't Worked, *Cato Journal* Authors Find in Study

Government involvement in health care around the world has not improved infant mortality or controlled health care spending, according to three economists writing in the latest issue of the *Cato Journal* (vol. 11, no. 1). Their study of the countries of the Organization for Economic Cooperation and Development raised "serious doubts about the desirability of a national health care program in the United States," write Rexford E. Santerre, Stephen G. Grubaugh, and Andrew J. Stollar of Bentley College in "Government Intervention in Health Care Markets and Health Care Outcomes: Some International Evidence." They point out that infant mortality is related to standards of living and the relative abundance of medical care; thus, they write, the government could better improve conditions by avoiding policies that impede economic growth or discourage the provision of medical services.

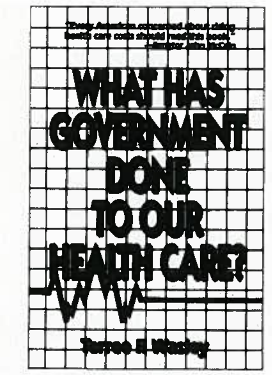
Other articles in the journal include "The Dismal Fate of Soviet-Type Economies: Mises Was Right" by Gertrude E. Schroeder, "The First and Second Reich: The Taming of an Industrial-Policy Advocate" by Richard B. McKenzie, and "Government v. Coase: The Case of Smoking" by Dwight Lee. The *Cato Journal* is edited by James A. Dorn, vice president for academic affairs. ■

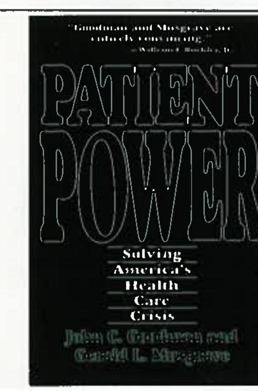


*Conference, Two Books Planned*

# Cato Launches Project on Market-Oriented Health Care

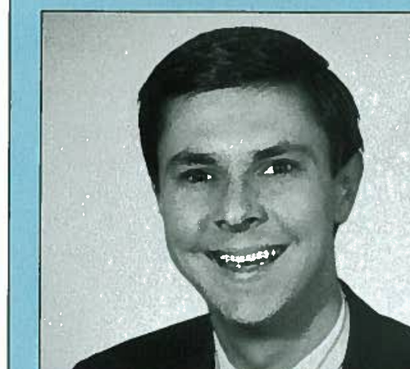
The Cato Institute has launched a project to promote market-oriented reform of America's health care system. Health care reform is a major issue, but so far the most publicized proposals call for greater government involvement, including national health insurance. Cato's project will demonstrate that government intervention in the medical marketplace has caused the problems everyone now recognizes. For example, the federal Medicare and Medicaid programs dominate the health care industry in the United States, and the tax laws encourage most people to shift responsibility for health insurance to their employers. To help establish a free market in health care, the Cato project will focus on tax-free medical savings accounts; individual, rather than employer, tax deductions for health insurance; and the privatization of Medicare. Those measures would restore the consumer of medical services to a position of responsibility in the marketplace, which in turn would restore cost consciousness and reverse the spiral of health care costs. The project will also target medical licensing and restrictions on medical schools and hospitals, all of which limit competition and innovation and raise prices.



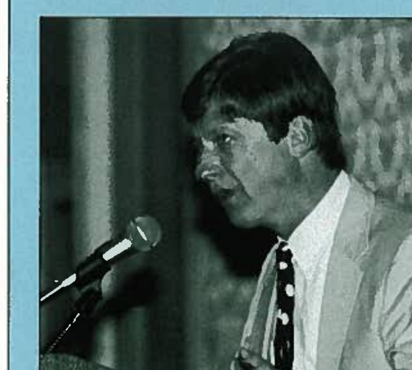




As part of Cato's multi-front project, the annual *Regulation* conference, April 30 and May 1, will be devoted to health care reform. Experts on the health care industry will gather in Washington to analyze the problem, examine the claim that Canada and Great Britain have systems worth emulating, and demonstrate how free markets hold the key to true reform.

Cato will also publish two books this year. *Patient Power: Solving America's Health Care Crisis* by John C. Goodman and Gerald Musgrave is a comprehensive exposition of the perverse effects of government involvement in health care and a detailed plan for free-market reform. *What Has Government Done to Our Health Care?* by Terree Wasley is a shorter, highly accessible monograph that traces the history of the American health care system, examines systems in other countries, and elaborates the principles of market-oriented health care reform. Cato will continue to publish papers in the Policy Analysis series and hold Policy Forums on health care issues. ■



**Brink Lindsey has joined the Cato Institute as director of regulatory studies and senior editor of *Regulation* magazine. A graduate of Princeton University and Harvard Law School, he has practiced law in Washington for five years, specializing in international trade regulation. His articles on regulation and trade have appeared in the *Wall Street Journal*, *Reason*, and other publications.**



**P. J. O'Rourke has been named Cato's Mencken Research Fellow. The author of such books as *Holidays in Hell* and *Parliament of Whores*, he is now working on a book about apocalyptic predictions. Here, he discusses how government really works at Cato's Fourth Annual Benefactor Summit in Naples, Florida.**

## Transition (Cont. from p. 11)

ented. In reality, all too many people in charge of those programs are indifferent or antipathetic to the market, even though they pay lip service to it.

Finally, reduction of Western trade barriers would do far more to promote the market in the East than would official subsidies. Getting rid of such obstacles, however, requires the depoliticization of economic life—something that democratic politicians who respond to special interest pressures and those in charge of international organizations have little incentive to do. The problem, then, is to place constitutional limits on democratic rule in order to cultivate a private market system in which individuals are free to pursue their own interests and at the same time to revitalize national economies. ■

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Klaus, Vaclav. "Dismantling Socialism." Paper presented at the Mont Pèlerin Society regional meeting, Prague, 1991.

Novak, Michael. "A Philosophy for the Transition: The Moral/Cultural Dimension of Liberty." Paper presented at the Mont Pèlerin Society regional meeting, Prague, 1991.

# "To be governed..."

**On the bright side, it could have been a declaration of war on Mexico**

California's 2nd District Court of Appeal has upheld a voter-approved measure mistakenly placed on the ballot by Los Angeles Mayor Tom Bradley. The measure, which Bradley said he signed accidentally, allows the City Council to veto decisions by his commissioners.

—*Washington Post*, Jan. 18, 1992

**An ugly ordinance if we've ever seen one**

The [Santa Cruz, Calif.] City Council voted 5 to 2 to tentatively approve an ordinance that would ban discrimination in employment or housing based on how someone looks. . . .

Cooper Hazen . . . said he had been fired . . . because of the post in his pierced tongue, which apparently proved to be too much for his boss on top of the purple hair, five earrings and nose ring. Or, to put it Hazen's way: "Thith ith wha gah me thierd." . . .

Had the ordinance been in effect, Hazen's job might have been saved. . . .

In addition to prohibiting discrimination based on long-recognized factors such as age, race, color and religion, the ordinance also protects according to "sex, gender, sexual orientation, height, weight or personal appearance."

—*Los Angeles Times*, Jan. 24, 1992

**A shoemaker makes something useful?**

[Former governor Jerry Brown] listens to the ideas of . . . Jacques Barzhagi, . . . whom Brown met at a dinner party in 1972 and brought to Sacramento as a special assistant. Barzhagi . . . used to open cabinet meetings with questions such as: "How is the governor different from a shoemaker?"

—*Washington Post*, Dec. 18, 1991

**We would have recommended the public school system**

The [Maryland] Senate voted 32 to 12 today to make the long-gone sauropod the state's official dinosaur.

—*Washington Post*, Feb. 1. 1992

**They also said your illiterate**

"Japan said your lazy—no to Japanese imports."

—Protest sign outside a Toyota dealership in Detroit, pictured in the *New York Times*, Jan. 26, 1992

**Honesty in government**

Before dawn recently, about 40 tanks and armored vehicles rumbled out of Lima's Rimac barracks and moved downtown. While they took position a couple of blocks from the presidential palace, about 350 soldiers cordoned off the area.

Another Latin American coup? No, just [Peruvian IRS director] Manuel Estela out to collect taxes from vendors in the Polvos Azules market.

—*Wall Street Journal*, Jan. 8, 1992

**Also, it would be good if the Diet arranged for Chrysler to get 15 percent of the Japanese market**

Establishing an independent dealer network in Japan would be prohibitive. . . . That is why the Chrysler Corp. has made the point that we need access to volume distribution through the established dealer points of the Japanese manufacturers. . . .

By the way, we will begin to sell right-hand-drive Cherokees next fall, following shortly thereafter with a diesel version, at a cost to Chrysler of $35 million—just to ensure that we have tried everything.

—Alisa Learner Maher, Chrysler Corp., letter to the editor, *Washington Post*, Feb. 7, 1992

**The council also reaffirmed its concern about homelessness**

A sharply divided Montgomery County [Maryland] Council enacted a tax yesterday that will add thousands of dollars to the cost of new houses.

—*Washington Post*, Dec. 4, 1991

**And as the biggest spender since FDR, I should know**

President Bush formally opened his reelection campaign today with a conservative manifesto against big government. . . .

"I believe government is too big and it costs too much," Bush said.

—*Washington Post*, Feb. 13, 1992

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