Cato Policy Report

May/June 1989 | Volume XI Number 3

# Why Pay for the Best and the Brightest?

by Terry W. Culler

A new crisis has been discovered in Washington: the supposedly sorry state of the federal workforce. Because that crisis is unapparent to most people, it has been dubbed the "quiet crisis" by its popularizers, who include some of Washington's heaviest hitters. Their stated goal is to improve the quality of the federal workforce by raising salaries, increasing morale, getting rid of political appointees, ensuring policy stability, and making federal careers attractive to "the best and the brightest" of America's young workers. But their real goal is to perpetuate existing federal policies in the face of political change.

Government personnel policy is one of those arcane topics that cause the eyes of almost every sensible American to glaze over. Only people who are directly affected by it or have a political, ideological, or professional interest in it pay any attention to it. The sad result is that politicians and senior bureaucrats are able to use other people's money to reward themselves and their constituencies without doing what they promise to do: improve the quality of the federal workforce.

In forum after forum the advocates of "more" for the federal sector echo former Federal Reserve Board chairman Paul Volcker's assertion that "government in general, and the federal government in particular, is increasingly unable to attract, retain, and motivate the kinds of people it will need to do the essential work of the Republic in the years and decades ahead."

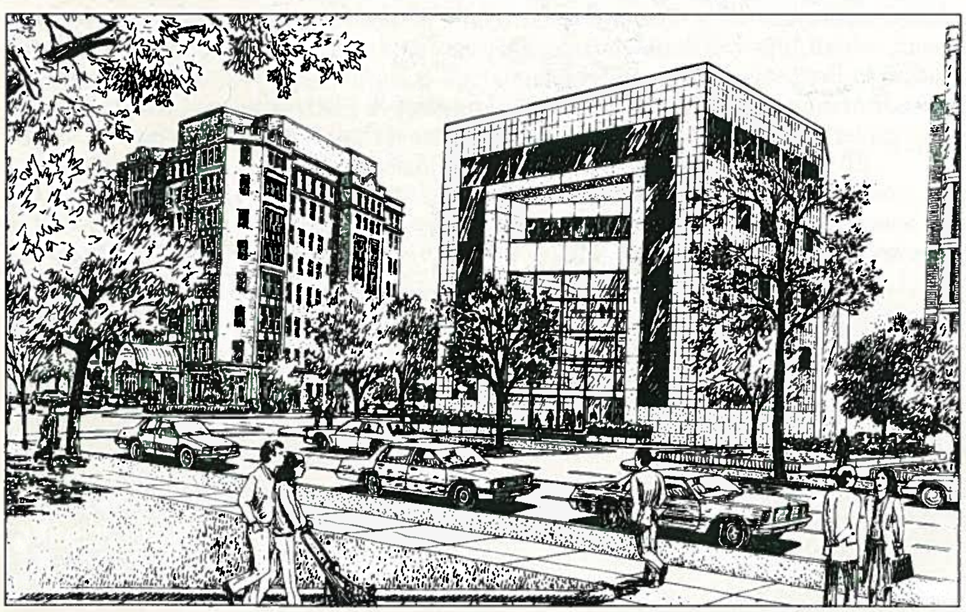
Several groups are now trying to ratchet up federal personnel costs in the name of providing the government with better employees. The most important and conspicuous group is the National Commission on the Public Service, headed by Volcker with assistance from Harvard University president Derek Bok, Elliott Richardson, and Ambassador Bruce Laingen. Others include the Center for Excellence in Government, the National Academy of Public Administration, and the National Association of Schools of Public Affairs and Administration.

Also in the "quiet crisis" camp are many other academics as well as such political luminaries as Comptroller General Charles Bowsher, former president Gerald Ford, and former vice president Walter Mondale. Congress, of course, has jumped into the fray; among its efforts is the Excellence in Government Management Act, introduced by Rep. Patricia Schroeder (D-Colo.) last year.

**Terry W. Culler, a former associate director of the U.S. Office of Personnel Management, is president of Dunhill Personnel.**

## In This Issue





**Architect's drawing of the Cato Institute's planned headquarters. For information on Project '90, Cato's building campaign, see page 3.**

### Is There a Crisis?

The argument that the federal workforce is undergoing a crisis hinges on the supposed disincentives for top-quality workers to view federal employment as a desirable career. The anti-Washington rhetoric of the Carter and Reagan administrations is generally blamed for both severely damaging the morale and performance of federal employees and causing the best entry-level workers to choose careers

(Cont. on p. 10)

# The New Spirit of May Day

## President's Message

May 1 had always been an important date in the communist world—a day of festivals and parades that purported to celebrate the bounties of socialism and the awesome military strength of the state. But by all accounts May 1, 1989, was a May Day of a different sort. The celebrations—when they were not replaced by antigovernment protests—had more to do with spring than with Marxist-Leninist ideology. The breathtaking descent of support for that ideology is probably the most significant political development of the post–World War II era.

The May Day parade in Moscow featured roadside vendors, gymnasts, and posters bearing such innocuous messages as "We're trying to renew ourselves." Gone were the traditional ostentatious (and ominous) lines of military hardware. According to the *Washington Post*, "The Soviet Union is going through such a rapid process of de-ideologization that this year's parade slogans . . . were about as class-conscious as the Michigan Wolverines fight song."

Even more impressive, tens of thousands of protesters defied a ban and marched through the capital of Armenia shouting "Down with the government!" About 100,000 supporters of Solidarity paraded through Warsaw chanting "Down with communism!"

The next day Hungarian soldiers (on government orders!) were busy cutting down the decades-old barbed-wire fence along the border between Hungary and Austria. And the Chinese government was being openly conciliatory toward the new student democratic movement, which just days earlier had mustered 150,000 demonstrators in Beijing. They demanded freedom of speech and freedom of the press—two rights with which a communist government cannot coexist.

Indeed, evidence of a loss of ideological commitment can be found everywhere in the communist world. In a celebrated *New Yorker* article published in January longtime socialist apologist Robert Heilbroner wrote, "Less than 75 years after it officially began, the contest between capitalism and socialism is over: Capitalism has won." Nobel laureate and Cato Distinguished Senior Fellow F. A. Hayek says simply, "Communism has ended."

In a very real sense, Hayek is correct. Shorn of its ideological force and its rationale, the communist movement lies exposed to the world as nothing more than a collection of oppressive dictatorships. In all but two or three of the communist countries there is now an impetus toward democratic reforms, and in many of them there is an impetus toward capitalistic reforms as well. That is heady stuff for lovers of liberty.

Nevertheless, communism is not the ultimate threat to liberty. It is only one of the purer forms of that threat, which is the state's coercive power to intervene in the voluntary activities—social and commercial—of otherwise-free individuals.

I have long believed that American conservatives focus too much attention on communist oppression abroad and too little on statism at home. When a state chooses children's textbooks, denies terminally ill patients experimental drugs, sets minimum wages and maximum rents, imposes a universal retirement tax on its citizens, and usurps 42 percent of the national income—to name just a few encroachments of Americans' liberties—the ideological banner it operates under is of little importance. Whether it is communism, fascism, democratic socialism, or a "mixed economy," statism is the enemy of freedom.

During the Reagan years many of Cato's friends in the conservative camp who generally recognize the virtues of limited government seemed to be obsessed with increasing the bloated U.S. military budget, funding the Nicaraguan contras, and otherwise engaging in military geopolitics. But what has brought the communists to their knees is not military might (in fact, they still have more missiles than we do, as conservatives often point out) but free enterprise. The gaping economic disparity between East and West—and the recognition of its magnitude by hapless denizens of the Soviet bloc, made possible through Western telecommunications technology—is the source of the new spirit of May Day.

Conservatives took far too little advantage of the unprecedented opportunity that the Reagan presidency afforded advocates of limited government. Today, with perestroika and glasnost taking the steam out of anticommunism, they hold meetings to complain about the lack of purpose in the Bush administration. Physician, heal thyself.

Too many hard-line anticommunists have become indifferent and ineffective champions of a free society. As the great libertarian social commentator F. A. Harper wrote in 1951, "One who would serve the freedom of man is bound by his honor to do everything within his power to re-establish liberty and justice at home before concerning himself with its demise elsewhere." Let us applaud the new spirit of May Day and denounce any departures from it abroad, but let us also redouble our efforts to reclaim the lost liberties that are our rightful heritage as Americans.

Ed Crane

—Edward H. Crane



*Project '90 Under Way*

# Cato Unveils Plans for New Five-Story Headquarters; Building to Be Located in Downtown Washington

In a move designed to assure the Cato Institute of a prominent role in the Washington policy debate during the 1990s and beyond, the Institute's board of directors has approved a plan to construct a 40,000-square-foot headquarters at 1000 Massachusetts Avenue, N.W., in the heart of the nation's capital.

"The new building is vital to Cato's future," said Institute president Edward H. Crane in announcing the board's decision. "Our current headquarters, the Watterston House, has served us well since we moved to Washington in 1981, but we've quite outgrown our limited space here and are already leasing nearby offices for four employees. We made a thorough search of the District for a building of the appropriate size and were unable to find any—most of the available buildings were either very large office complexes downtown or small townhouses on Capitol Hill."

Crane said that the decision to construct a headquarters will spare the Institute both the possibility of future rent increases and the relative anonymity of not having its name on the building it occupies. Another benefit, he said, is the opportunity to design the building to meet the precise requirements of a public policy research institute—for example, Cato's new headquarters will feature an auditorium with a raised stage, audio-visual capabilities, and comfortable seating for 170 people.

The Cato Building is the centerpiece of Project '90, the most ambitious capital campaign in the Institute's history.

Conference room

Terrace for receptions

The campaign's goal is to raise $10 million by the end of 1990. Most of the funds ($7.4 million) would be applied to developing the land and the building; the remainder would be dedicated to modestly endowing some of Cato's programs. The board of directors chose not to make Project '90 public, according to Cato chairman William A. Niskanen, until at least one-quarter of the funds had been raised. "We wanted to make sure we had an achievable goal before we asked the majority of our friends and supporters to make a special contribution to the campaign," said Niskanen.

As of April 1989 the project's assets consisted of $1.9 million worth of contributions and pledges and an estimated $1.4 million worth of equity in the Watterston House, for a total of $3.3 million. During the next 18 months Crane and Niskanen will both be spending much of their time visiting the Institute's major supporters across the nation. "We are depending very much on individual contributions of five and six figures to make the campaign a success," said Crane, who noted that corporate contributions account for only 10 percent of the Institute's annual operating budget.

The Cato Building will be five stories high. The Institute will lease out three of the floors, then gradually take over that space; it plans to occupy the entire building within a decade. Among the features of Cato's new headquarters will be a library of classical liberal books and research materials, a large conference room on the top floor, which will open onto a terrace (allowing Cato to continue its tradition of holding receptions outdoors), staff meeting rooms, and office space for visiting scholars.

"The most important feature, however, is the auditorium," said Crane. "It will allow us to triple the number of attendees at Cato Policy Forums and seminars. The auditorium will also make it much easier for the electronic media to cover our events and for us to

(Cont. on p. 4)

Published by the Cato Institute, *Cato Policy Report* is a bimonthly review. It is indexed in *PAIS Bulletin*.

Correspondence should be addressed to: *Cato Policy Report*, 224 Second Street S.E., Washington, D.C. 20003. *Cato Policy Report* is sent to all contributors to the Cato Institute. Single issues are $2.00 a copy. ISSN: 0743-605X 

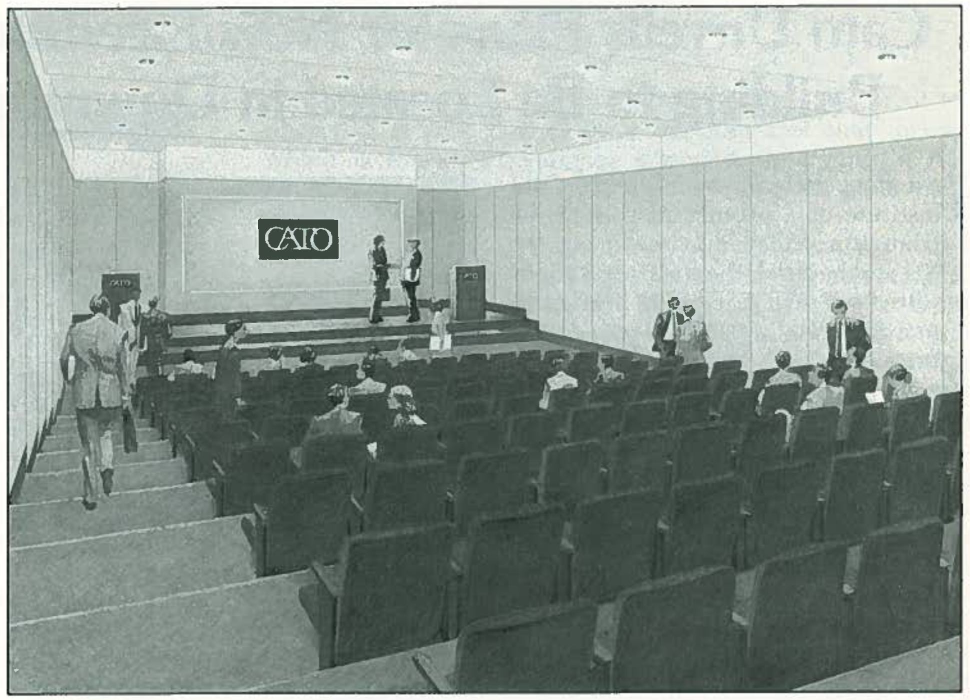
## Project '90 (Cont. from p. 3)

attract important speakers and influential audiences."

Because 1000 Massachusetts Avenue, N.W., is roughly halfway between Capitol Hill and the White House, it will be a convenient location for executive-branch personnel as well as members of Congress. The Cato Building will be situated at the corner of Massachusetts Avenue and 10th Street, directly across the street from the prestigious Henley Park Hotel and a block and a half from the Washington Convention Center. It will be one of the few freestanding office buildings in the District of Columbia.

The premier event associated with Project '90 was Cato's first annual Benefactor Summit, held at the Hyatt Regency Hotel on Grand Cayman Island. At the summit individuals who had pledged or contributed $10,000 or more to Project '90 formed a Finance Committee, which currently consists of K. Tucker Andersen, Wayne and Shula Beyer, James U. Blanchard III, Frederick and Celeste Brunner, Ray and Carol Cunningham, Jay and Ethelmae C. Humphreys, Herrick Jackson, Charles G. Koch, David H. Koch, Eric S. O'Keefe, David H. Padden, John Arthur Pope, Lewis and Martha Randall, Scott Rasmussen, Paul Raynault, Howard and Andrea Rich, Sheldon Rose, Richard and Debbie Sears, and Joe Stilwell.

Anyone interested in assisting with Project '90 or becoming a member of the Finance Committee should contact Cathi Smith, Cato's vice president for development and public affairs. ■



**The new auditorium will seat 170 people.**


**Library**

# Pilon Essay Receives Award

Roger Pilon, a senior fellow of the Cato Institute and director of its Center for Constitutional Studies, has received the 1988 Benjamin Franklin Award for excellence in writing about the U.S. Constitution. The award, sponsored by the National Press Foundation and the Commission on the Bicentennial of the United States Constitution, was presented to Pilon and the other winners by former chief justice Warren E. Burger during a luncheon held at the National Press Club.

Pilon's essay, "On the Foundations of Economic Liberty," appeared in the September 1988 issue of the *Freeman*. ■


**Judge George Revercomb and Lynne Cheney, chairman of the National Endowment for the Humanities, present the Benjamin Franklin Award to Cato senior fellow Roger Pilon (right).**



# Savings and Loans, Social Security, NATO Discussed

## Cato Events

*February 22:* **"The Texas Thrift Situation: Implications for the Texas Financial Industry."** Economist Genie D. Short of the Dallas Federal Reserve Bank discussed her recent study, which argues that the partial deregulation of depository institutions was undertaken without addressing the moral hazard problems introduced by federal deposit insurance and other aspects of the federal safety net. James R. Barth of the Federal Home Loan Bank Board commented on her talk.

*February 23–24:* **"Alternatives to Government Fiat Money."** The Cato Institute's Seventh Annual Monetary Conference focused on private-sector alternatives to central banking and government currency issue. Speakers included Sen. Phil Gramm, Nobel laureate James M. Buchanan, Lawrence H. White, Richard N. Cooper, Leland B. Yeager, Richard Rahn, Jerry L. Jordan, and Allan H. Meltzer.

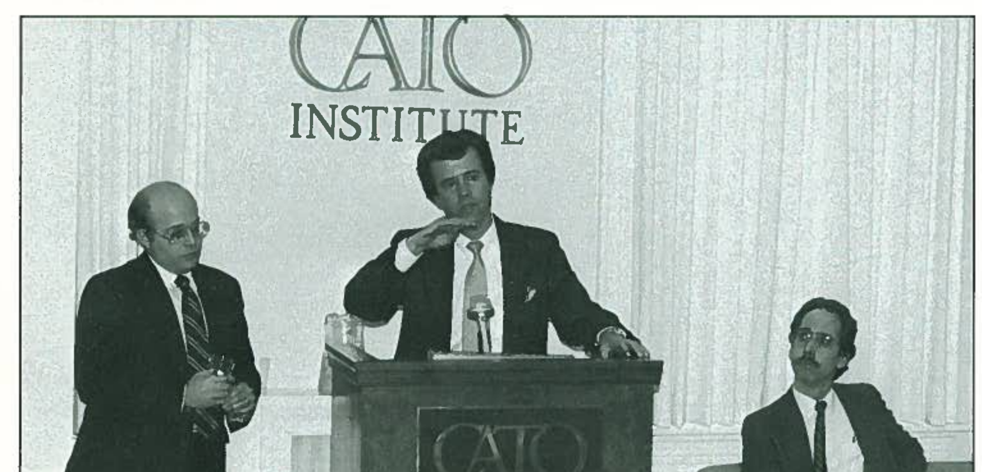
*March 9:* **"The Myth of the Social Security Surplus."** Paul W. Boltz, vice president and financial economist at T. Rowe Price Associates, argued that no real surplus in social security trust funds is imminent and that the money in those funds should not be used to reduce the budget deficit. Cato senior fellow Peter J. Ferrara commented.

**Peter Trapp of the Kiel Institute discusses the European Community's 1992 plans.**

*March 15:* **"The Elderly: The People the Supply-Side Revolution Forgot."** John C. Goodman, president of the National Center for Policy Analysis, discussed his recent study, which finds that disproportionately high marginal tax rates—sometimes in excess of 100 percent—have been imposed on the elderly. William J. Lessard, director of research at the National Committee to Preserve Social Security and Medicare, commented.

*March 22:* **"1992 European Single Market Initiative."** A policy luncheon featured Peter Trapp of the Kiel Institute of World Economics, who discussed the prospects for a true common market in Europe after 1992.


**Genie D. Short of the Federal Reserve Bank of Dallas is interviewed after her talk on the savings and loan crisis.**



**Economist John C. Goodman discusses confiscatory tax rates imposed on the elderly as Peter J. Ferrara and William J. Lessard (right) listen.**

*March 22:* Book party for ***Collective Defense or Strategic Independence?***, edited by Ted Galen Carpenter, Cato's director of foreign policy studies. The book criticizes the longstanding doctrines of containment and collective defense and offers proposals for reform. Authors in attendance included Earl C. Ravenal of Georgetown University and Alan Tonelson of the Twentieth Century Fund.

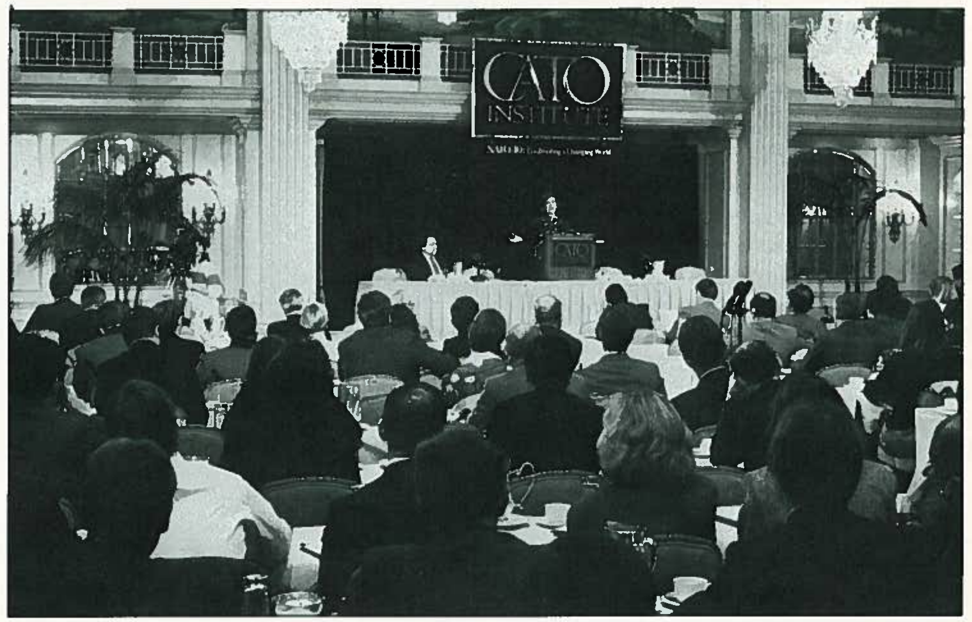
*April 3–4:* **"NATO at 40: Confronting a Changing World."** Speakers at this conference included Rep. Patricia Schroeder, Irving Kristol, Cato adjunct scholars Christopher Layne and Earl C. Ravenal, David P. Calleo, Josef Joffe, Robert Hunter, Jeffrey Record, Melvyn Krauss, and Karsten Voigt of West Germany's Bundestag. ■

*Broadcast Live on C-SPAN*

# Schroeder, Kristol Give NATO Left-Right Punch

The historic Willard Hotel in Washington, D.C., was the setting of a Cato Institute conference marking the 40th anniversary of the North Atlantic Treaty Organization. Nearly 200 people attended the conference, "NATO at 40: Confronting a Changing World."

Keynote speaker Rep. Patricia Schroeder (D-Colo.) opened the conference on a lively note, calling NATO "one of the biggest sacred cows grazing in the federal budget" and noting that it consumes more than $160 billion a year. Schroeder also decried the political shortcomings of current U.S. policy, saying, "While Gorbachev is modernizing global strategy, all we're doing is modernizing weapons."




Nearly 200 people listen as Rep. Patricia Schroeder calls NATO a budgetary "sacred cow."

Irving Kristol says the U.S. nuclear guarantee to Europe has lost credibility.

During the first session Hoover Institution fellow Melvyn Krauss argued that by taking responsibility for Western Europe's security, the United States has turned increasingly prosperous and capable allies into resentful dependents. Josef Joffe, foreign editor of Munich's *Suddeutsche Zeitung*, disagreed, contending that only the U.S. military presence is preventing the emergence of an accommodationist or Finlandized Europe and the revival of nationalistic quarrels on the continent.

Ronald Steel, author of *The End of Alliance: America and the Future of Europe*, noted that although NATO has frequently been beset by economic, military, and political problems, its current disarray is far more serious. In light of Mikhail Gorbachev's more conciliatory policies, most Europeans no longer view the Soviet Union as a military threat. Steel urged the United States to use its remaining influence in the alliance to secure a Soviet withdrawal from Eastern Europe and the transformation of NATO into a purely European defense arrangement. Otherwise, he warned, the alliance will unravel, leaving the West's security in jeopardy without conferring any corresponding benefits.

During the second session, which focused on the military aspects of NATO, Hudson Institute senior fellow Jeffrey Record argued that America's commitment to Western Europe has never entailed a specific troop level. Given that the Soviet threat has receded, reductions in the U.S. military presence on the continent may be both strategically and politically permissible, Record concluded. Defense analyst Stanley Kober supported Record's contention that the Soviet threat is rapidly dissipating; he urged the United States to encourage Soviet reforms because their success would further diminish any danger to the West.


Robert Hunter, David P. Calleo, and Tom Bethell listen to Cato senior fellow Earl C. Ravenal's argument that strategic disengagement is inevitable.



During the third session former National Security Council staff member Robert Hunter insisted that NATO has functioned reasonably well and should not be jettisoned casually. The need for Western vigilance, however, does not mean that every aspect of the status quo, including the current level of U.S. troops in Europe, should be preserved, Hunter conceded. Cato senior fellow Earl C. Ravenal countered that merely tinkering with the status quo would be insufficient. Because America's political and economic systems will no longer bear the enormous costs and risks of Washington's NATO commitments, he argued, a gradual strategic disengagement is unavoidable.

Cato adjunct scholar Christopher Layne described how Europe's 1992 free-trade area could affect NATO and contended that an economically integrated Western Europe would be an embryonic superpower that could pose difficulties for both the United States and the Soviet Union. Layne urged U.S. policymakers to seek a mutual U.S.-Soviet military disengagement from central Europe.

Other speakers at the conference included University of Wisconsin-Milwaukee professor David Garnham, Yale University professor Paul Bracken, Johns Hopkins University professor David P. Calleo, and William Lind of the Free Congress Foundation.

The luncheon speakers were neoconservative author Irving Kristol and Karsten Voigt, a prominent West German legislator who serves in the Bundestag. Kristol observed that Washington's nuclear guarantee to Western Europe has lost credibility now that the Soviet Union has achieved strategic parity. He urged American leaders to eliminate that guarantee and transform the alliance into a loose arrangement between a European NATO and the United States. Voigt advocated deemphasizing NATO's military role and argued that a more self-reliant Western Europe could foster greater political pluralism in Eastern Europe.

Conference participants line up to question speakers.


Conference director Ted Galen Carpenter offers closing remarks.

West German parliamentarian Karsten Voigt discussed Western Europe's relations with Eastern Europe.


Christopher Layne urged the Bush administration to seize the diplomatic initiative in Europe.

In his closing remarks, Ted Galen Carpenter, Cato's director of foreign policy studies, noted that the conference participants were virtually unanimous in concluding that the status quo was becoming increasingly untenable. "Profound changes in the alliance are certain—and not merely in the mists of the distant future but in the next few years," he stated. "Moreover, the direction of those changes is reasonably predictable—toward a less extensive, less dominant role for the United States. Only the extent and the pace of U.S. devolution remain to be determined."

The conference received extensive media coverage; it was broadcast live on C-SPAN and attended by correspondents of numerous American and European publications. It was also attended by embassy officials representing nearly all the NATO and Warsaw Pact countries. A book of conference proceedings will be published in late 1989 or early 1990. ■

*Fun in the Sun*

# Grand Cayman Site of Cato's First Benefactor Summit

In late March 75 supporters of the Cato Institute gathered at the Hyatt Regency Hotel on Grand Cayman Island for the Institute's first Benefactor Summit. The purpose of the summit was to allow the participants to learn more about the Institute's work and the goals of Project '90, described elsewhere in this issue of *Cato Policy Report*, as well as to offer their advice on Cato's future efforts.

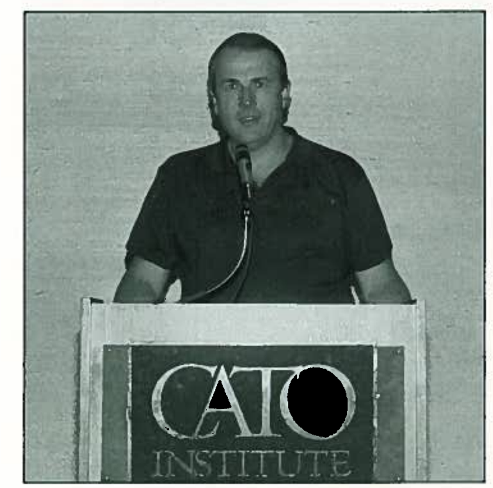
Speakers at the three-day event included former federal budget director James C. Miller III; Charles Murray, author of *Losing Ground* and *In Pursuit;* syndicated columnist Warren Brookes; and Richard Rahn, vice president and chief economist of the U.S. Chamber of Commerce. Cato Institute staff members Edward H. Crane, William A. Niskanen, David Boaz, James A. Dorn, Catherine England, and Peter J. Ferrara discussed current public policy issues and the Cato activities designed to address them.

Crane described Project '90, the Institute's major fundraising campaign, in detail and invited contributors to join the Finance Committee for the project.

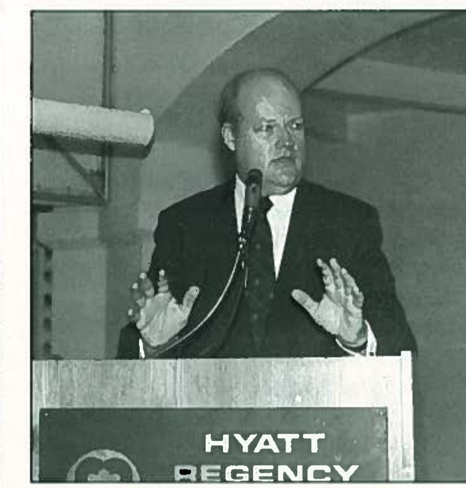
Any event held on a Caribbean island, of course, is not likely to be all business. Participants in the Benefactor Summit enjoyed beautiful beaches, great snorkeling, and excellent weather. Chicago's famous Second City comedy revue—now featuring Rob Kolson, who performed at Cato's 10th Anniversary Banquet—provided opening-night entertainment.

Crane expressed satisfaction with the Benefactor Summit and declared his intention to make it an annual event. ■

**About 75 Cato supporters gathered on Grand Cayman Island to discuss Project '90 and Cato's future.**




**Cato president Edward H. Crane welcomes participants to the Benefactor Summit.**




**Former budget director James C. Miller III discusses upcoming policy issues.**

**Chamber of Commerce vice president Richard Rahn discusses budget policy.**

**Eric O'Keefe and Frank Buchta of Wisconsin and David Padden of Chicago discuss the pleasant weather in the Caribbean.**

## Federal Pay (Cont. from p. 1)

in business, academia, and state and local government, leaving workers who are not as bright, ambitious, or competent to be the federal bureaucrats of the future.

Charles Levine of the Congressional Research Service is one of those who warn that "human resource erosion" is undermining the federal government. Yet in a 1987 paper, "The Quiet Crisis of the Civil Service: The Federal Personnel System at the Crossroads," Levine admits that "building a case for the proposition that such erosion is taking place is no easy task. *Systematic evidence to confirm or deny the proposition simply does not exist*" (emphasis added).

Instead of presenting hard data that indicate a general decline in the quality of federal employees, the "quiet crisis" camp treats us to anecdotes, quotations from John F. Kennedy and Franklin D. Roosevelt, and the results of opinion surveys of federal employees conducted by interested groups. Punctuating the mass of speculation and supposition are statistics showing recruitment and retention problems within specific occupations and occupational categories. Those problems are then attributed to the workforce as a whole.

Most of the concern expressed by the "quiet crisis" camp seems to focus not on federal employees in general but on high-level careerists in Washington, who are supposedly underpaid, underappreciated, and not consulted often enough or listened to intently enough by those appointed by the president to carry out his policies. That elitist outlook prevails because the organizations in the "quiet crisis" contingent are often staffed by people who were high-level bureaucrats, people who hope to be high-level bureaucrats, high-level workers in the private sector who view high-level bureaucrats as their counterparts, and academics who enjoy associating with high-level bureaucrats.

Because the "quiet crisis" camp knows that one can't get very far, even in Washington, by voicing concern over people whose incomes place them in the top 0.5 percent of the American workforce (as witnessed by the recent brouhaha over a congressional pay raise), its members sometimes attempt to extend the "crisis" to include the worker bees down below. That is where they run into trouble. One cannot make a compelling case that more than a minuscule number of federal employees are underpaid in relation to their private-sector counterparts. In fact, the empirical evidence suggests just the opposite.

Levine seems bemused by the discovery that the quit rate is 10.9 percent in the private sector but only 5.2 percent in the federal government. Even in the case of occupations for which there are significant disparities between private-sector and federal salary levels, the differences in the rates at which employees vote with their feet are insignificant. The largest pay gap is that of chemists and engineers in the federal government and their private-sector counterparts, but the federal group's quit rates are very low (2.3 percent for chemists and 3.3 percent for engineers). Given that government chemists and engineers have skills that can readily be transferred to the private sector, there must be something about federal employment that makes it attractive to them.

> **"The best and the brightest can do more good for America by creating wealth than by managing government programs."**

Indeed, federal employment seems to be an attractive option for many people. The demand for federal jobs, in fact, casts doubt on a central assumption of the "quiet crisis" camp. If federal and private-sector wages were comparable, there would be an adequate supply of qualified workers waiting to fill federal jobs. If federal wages exceeded private-sector wages, there would be queues of qualified workers waiting to fill federal jobs. And if federal wages were lower than private-sector wages, there would be a shortage of qualified applicants for federal jobs—which we are told is the case.

A few years ago Steven Venti of Dartmouth College took a hard look at federal and private-sector salaries and found just the opposite of what the "quiet crisis" camp would have us believe. First, there are queues of people waiting to fill federal jobs, and most of those people are qualified. Second, the demand is due to a federal wage *advantage* of 4 percent for men and 22 percent for women. Third, the only way to eliminate the queues—and thereby establish the federal government as a cost-minimizing employer—would be to lower men's wages by 16 percent and women's wages by 42 percent. Fourth, such wage cuts would have little impact on workforce quality; they would reduce men's average education level by one-tenth of a year and women's by three-tenths of a year. Venti used 1982 figures in his study, but nothing that has happened in subsequent years would appear to significantly affect his findings.

Given that the federal government has lower quit rates than the private sector and pays salaries high enough to attract a substantial pool of qualified applicants, we must ask, Is the "quiet crisis" camp trying to fix something that isn't broken? The answer to that question is yes. There is no empirical evidence of a staffing crisis to justify radical increases in federal employees' pay and benefits.

### Let the Best and the Brightest Produce Wealth

Even if the best and brightest young Americans were choosing to enter the private sector, would that really bode ill for the future of the Republic, as Volcker claims? Chances are that the country would be a lot better off in the long run.

Government does not produce wealth. True, the findings of government laboratories and programs lead to the development of products that are exploited by the private sector to produce wealth. Likewise, the government facilitates wealth production by providing an infrastructure supportive of property rights and private enterprise. In addition, government purchases of goods and services lead to the creation of wealth (though at the price of taxing away money that would have been spent on goods and services in the private sector). But it is profit-seeking groups and individuals that produce wealth, and they do so by maximizing their revenues and minimizing their costs. Even in the rare instances that government attempts to do those things, it doesn't do them very well.

A nation needs both wealth and government to prosper. Without government a nation will be constantly at the mercy of its enemies and unable to resolve conflicts among its people and institutions. But without wealth a nation will be unable to provide the limited amount of government necessary to sustain its basic functions. Under normal circumstances, therefore, wealth must take precedence over government.

In light of increasingly sophisticated technology and significant overseas competition, the production of goods and services requires the highest level of skill available. The best and the brightest can do more good for America by running companies, developing and marketing products, and creating enough wealth to "raise the level of all the boats" than by managing government programs. Encouraging them to enter government service will not lead to a better society.

Suppose that the government attempted to attract more Wharton MBAs, Harvard law graduates, and other graduates of the best schools in the country by increasing salary levels significantly. It would then be spending more tax dollars to raise the salaries of not only the best and the brightest but the other newly hired workers, who were happy to take jobs at lower rates. The government could not pay applicant Smith more to analyze projects than it paid applicant Jones just because Smith was an honors graduate of Yale and Jones was a middling graduate of Great Plains State.

Moreover, because fairly hefty salary increases would be required to attract more Smiths, more Joneses would be attracted as well. Remember, there is already a large pool of qualified workers waiting to fill government jobs. If the government raised salaries high enough to attract superior workers, it would be overwhelmed with applicants.



Of course, the private sector would continue to value the Smiths of the world, and it would raise its salaries to compete for them. The government would then raise salaries again in an effort to keep attracting the Smiths.

Thus, such an attempt to attract top-quality workers to federal careers would serve to increase the already-long applicant queues and raise the cost of doing government. Furthermore, better benefits packages and more-frequent pay raises would be provided in order to retain top-quality workers. Federal pay and benefits totaled $84 billion in 1984, or $28,730 per work year. The cost increases would thus be significant, and they would continue indefinitely. The private sector would be taxed in order to fund better retirement benefits as well.

> **"At stake in the battle over federal pay is whether an administration committed to reducing the size and power of the federal government can succeed."**

Such an attempt to attract the best and the brightest to federal careers would also serve to deprive the U.S. economy of its driving force: the skill and knowledge that result in the production of wealth. The cost of that loss cannot be estimated. If the best and brightest Americans were employed by the government, the breakthroughs that result in new products, processes, and markets would surely come from firms in other countries.

### The Politics of Federal Pay

Also important to the "quiet crisis" case is the myth that political appointees hold too large a percentage of the jobs in the federal government. In fact, political appointees constitute only about 0.12 percent of the federal workforce. When the "quiet crisis" groups complain that there are too many political appointees, they generally mean that there are too many conservative Republican appointees. It is no accident that the political figures they usually cite as good stewards of government are Franklin D. Roosevelt, John F. Kennedy, and Lyndon B. Johnson—presidents who expanded the role of federal employees. Obviously, any attempt to reduce that role would lower federal employees' morale, but such a decision should be made by the voters, not by bureaucrats. The issue that underlies much of the "quiet crisis" crusade is not federal employees' morale or efficiency but power—who is to wield it and thereby shape government policy.

The permanent government now sees its influence waning, and it is fighting back on many fronts. At stake in the battle over pay, benefits, and recognition is whether an administration committed to reducing the size and role of the federal government can succeed. Such a task will always be difficult, but implementing the "quiet crisis" camp's recommendations would make it more so. In his first annual message to Congress, Andrew Jackson wrote, "The duties of all public offices are, or at least admit of being made, so plain and simple that men of intelligence may readily qualify themselves for their performance." President Jackson's observation did not apply to every federal position then, nor does it now. Nevertheless, we must not allow talk of a "quiet crisis" to obscure the basic truth of that observation.

We deserve the best government we need, but we should not be railroaded into paying higher wages—and higher taxes—than are necessary to achieve it. Doing so would produce not more-efficient government but merely more government. ■

*Don't Restrict Them*

# Leveraged Buyouts Are Just Another Corporate Structure

Leveraged buyouts create just one of the many forms that a corporation may take, and it would be a mistake for the government to restrict them, according to a new study from the Cato Institute.

George Mason University law professors Barry E. Adler and Larry E. Ribstein argue that "opponents of LBOs are misguided in their proposals to discourage such transactions. . . . The public interest is best served if the government's policy toward LBOs is one of neutrality."

Adler and Ribstein note that investors in public corporations seek to ensure that management will act in their interest by employing a number of tools: incentive pay for managers, outside directors and auditors, and, perhaps most important, the market for corporate control.

According to Adler and Ribstein, "the only way to ensure corporate efficiency is to eliminate perverse tax incentives." The double taxation of corporate dividends gives firms an incentive to load up on debt even if a high debt/equity ratio is inappropriate for them. The best way to reduce that incentive is to integrate the corporate and personal income taxes so that corporate earnings are taxed only once; a second-best way is to make corporate dividends tax-deductible.

"The mix between debt and equity contracts in a corporation varies according to the corporation's needs and the investors' interests," Adler and Ribstein write. "Because each corporation will have a different optimal mix of contract terms, leverage and the LBOs that create leverage produce benefits and costs that must be balanced for each corporation, not for the economy generally."

A high debt/equity ratio is appropriate for some firms because it places most of the equity in the hands of a small, coherent group; if that group includes management, which is often the case, it eliminates conflicts of interest between managers and stockholders; and it reduces the opportunities for managerial inefficiency.

The authors cite increased regulation as one reason that such high fees are paid to investment bankers, lawyers, and other parties involved in an LBO. When regulation is increased, so are compliance costs and the risk that a deal will go sour.

Adler and Ribstein's paper, "Debt, Leveraged Buyouts, and Corporate Governance," is no. 120 in the Cato Institute's Policy Analysis series and is available from the Institute for $2.00. ■

# Sequestration Beats a Tax Hike

Should Congress fail to endorse a pro-growth deficit reduction package, "President Bush should not hesitate to use the sequester," according to a new study from the Cato Institute.

Daniel J. Mitchell, a budget analyst for Sen. Bob Packwood (R-Ore.), argues that economic growth requires deficit reduction without a tax increase. The Gramm-Rudman-Hollings Act, Mitchell notes, gives the president the power to reduce the deficit without a tax increase; he need only make it clear to Congress that he is willing to invoke the sequester. If he "notifies Congress that failure to produce a budget acceptable to the White House will result in a sequester, lawmakers will have no choice but to comply or allow sequestration to occur."

Mitchell points out that the funds generated by a tax increase would not be used for deficit reduction—"The Gramm-Rudman law virtually guarantees that every dollar of additional tax revenue will result in another dollar of federal spending."

The study criticizes Congress for not using the definition of a spending cut understood by the American people—spending less than was spent in the previous year—and instead defining a cut as "spending less than you would have spent if all spending programs were simply left on automatic pilot." The use of the congressional definition has become so common in Washington that the *Washington Post* recently commented on the Bush administration's "startling new method of accounting. In the Bush budget, a program is deemed to be cut only if its spending falls below the prior year figure."

Mitchell's paper, "Sequestration: Gramm-Rudman's Potent Weapon for Spending Restraint," is no. 119 in the Cato Institute's Policy Analysis series and is available from the Institute for $2.00. ■

**Budget analyst Dan Mitchell shows how a spending freeze would work.**



# Covert Action Has Long-Term Costs

Covert action is an overrated tactic that has frequently damaged America's long-term interests, concludes a new study from the Cato Institute.

Foreign policy analyst David Isenberg argues that "despite all the resources lavished on them, covert actions haven't had much of a payoff" during the cold war. Even operations that were initially hailed as great successes, such as the mission that restored the shah of Iran to power in 1953, "only fostered hostilities that caused the United States great difficulty later."

Moreover, Isenberg notes, covert operations have often been used to implement policies that lacked congressional and public support. He charges that such a "secretive, elitist foreign policy agenda is contrary to America's commitment to representative democracy."

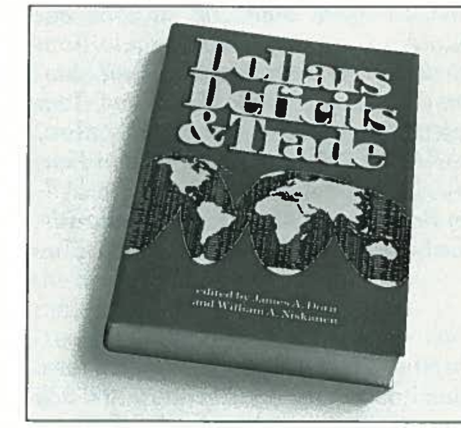
Isenberg advocates such major reforms as stripping the Central Intelligence Agency of the authority to conduct paramilitary operations and transferring that function to the Pentagon's Special Operations Command; banning interference in other countries' election processes, the overthrow of democratically elected governments, assassinations, and economic destabilization measures; and adopting effective congressional oversight procedures.

The characterization of the CIA as a "rogue elephant" is generally invalid, according to Isenberg. The responsibility for failures should rest with policymakers in the executive branch.

Isenberg's study, "The Pitfalls of U.S. Covert Operations," is no. 118 in the Cato Institute's Policy Analysis series and is available from the Institute for $2.00. ■

*Dollars, Deficits, and Trade*

# Constitutional Perspective Needed For Stable World Economic Order




Few policy issues are as perplexing or as critical as the role of the dollar in the world economy, the future of the international monetary system, the significance of America's twin deficits, and the proliferation of nontariff barriers to trade. Those issues and others are considered in *Dollars, Deficits, and Trade*, edited by *Cato Journal* editor James A. Dorn and Cato Institute chairman William A. Niskanen.

Many of the contributors to the volume argue that the lack of long-term rules designed to promote sound money, fiscal integrity, and open markets is the fundamental flaw of modern democratic thought and that a constitutional approach is needed to ensure a stable world economic order. Although they disagree on which rules should be adopted, they tend to agree that the call for international policy coordination is misguided.

State Department economists William Dewald and Michael Ulan dismiss the charge that the United States has become a debtor nation. Those who make that charge, Dewald and Ulan note, generally base their calculations on historical values and do not consider market values or inflation. Refuting the misleading Commerce Department estimate that the United States was a net debtor to the tune of $334 billion in 1987, the authors demonstrate that the nation was actually a net lender of between $83 billion and $194 billion.

In other essays Richard N. Cooper, Lawrence H. White, and Paul Craig Roberts discuss the feasibility of an international currency; Leland B. Yeager points out that domestic fiat currencies preclude exchange-rate stability; Michael D. Bordo and Anna J. Schwartz defend floating exchange rates; Gottfried Haberler observes that floating rates are better than the "pseudo-fixed" rates that are now the alternative; William A. Niskanen explores the "uneasy relation" between the budget and trade deficits; and Paul Heyne argues that trade deficits are meaningless.

*Dollars, Deficits, and Trade* has already received widespread praise. According to Michael Boskin, chairman of the Council of Economic Advisers, the authors "do an admirable job of sorting out the key issues and debating the various reform proposals. Their views will help shape the policy debate during the coming decade." Jerry L. Jordan of First Interstate Bancorp says, "This collection of essays will be enormously helpful to anyone trying to peer into the 1990s and think about the emerging global economic order."

A paperback edition of *Dollars, Deficits, and Trade*, published for the Cato Institute by Kluwer Academic Publishers, is available from the Institute for $19.95. ■

## Interns Needed

The Cato Institute seeks interns for fall 1989. Please contact Morris Barrett at Cato for more information.

## Call for Papers

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

# Cato's "Byline" Heard on More Than 200 Radio Stations

*The Cato Institute's daily public affairs radio program, "Byline," is heard on more than 200 stations nationwide. Commentators include Tom Bethell, David Boaz, Julian Bond, Stephen Chapman, Edward H. Crane, Tom Hazlett, Nat Hentoff, Donald Lambro, Earl Ravenal, Jeff Riggenbach, Joan Kennedy Taylor, and former senator William Proxmire, who presents his monthly Golden Fleece Award on "Byline."*

## The Thrift Crisis

In the year just ended the Federal Home Loan Bank Board committed $38 billion of your money—that is, if you're a taxpayer—to close down 217 insolvent thrift institutions. Another way to put it is that some of your neighbors made bad investments, and the government is forcing you to make them good.

To make matters worse, the big spenders in Congress are blaming deregulation for the fiscal crisis. But deregulation is not the problem. It was heavy-handed regulations that got the savings and loan industry into trouble in the first place. Congress passed laws forcing S&Ls to lend long-term and borrow short-term, so when interest rates rose sharply in the seventies, expenses went way up while their income stayed pretty much the same. Congress forced the S&Ls to limit the bulk of their investments geographically, so when the oil-patch economy went in the tank, many institutions became insolvent.

In the early eighties Congress deregulated the industry, but only partially—and partial deregulation always leads to more problems. In this instance, deposit insurance wasn't privatized; investments remained federally insured. Without the discipline that would have been imposed by free-market deposit insurance rates, many S&Ls began speculating in risky loans in order to get higher returns—after all, Uncle Sam would pick up the tab if the loans turned sour. Investors didn't (and still don't) care how irresponsible S&L management might be. Because of federal deposit insurance, they're even taking money out of sound S&Ls and putting it into higher-return insolvent thrifts—a trick only Congress would be dumb enough to pull off.

In Washington, this is Ed Crane for Byline.

## Foreign Aid

That was quite a headline in the *Washington Post* the other day—"Foreign Aid Largely a Failure, U.S. Report Says." The Agency for International Development, after spending tens of billions of your dollars in 25 years of trying to help Third World nations escape poverty, has concluded that the program has largely failed.

Most pointedly, AID found that only a handful of countries receiving U.S. aid have graduated from dependent status. After all these years it has finally occurred to the foreign aid bureaucrats that poverty is reduced by economic growth, and growth is created by free-market policies. Aid to governments with market-oriented policies is unnecessary; aid to socialist or bureaucratic governments is useless.

The AID report notes that Europe and the United States became wealthy—and virtually eliminated poverty—by slow and steady economic growth created by private enterprise, with governments mostly staying out of the way. The recent success of Japan and Korea demonstrates that the same results can be obtained in non-Western countries.

Does this report signal an outbreak of common sense in Washington? Not quite. After detailing 25 years of failure, the report concludes by proposing not to abolish foreign aid but to "reshape" it. And the Bush administration's new budget seeks to increase foreign aid spending, which is already over $15 billion.

In Washington—where we do learn from our mistakes; we just don't change anything—this is David Boaz for Byline. ■





# South Korea Has Grown Up; Bring the Troops Home

by Doug Bandow

As it surmounts each new political crisis, South Korea is demonstrating that democracy has firmly taken root. Indeed, the Republic of Korea is proving to be a dramatic success for U.S. policy. South Korea, a ravaged, helpless land at the end of the war 36 years ago, is today one of the strongmen of East Asia. Yet as Seoul grows more assertive, strains are increasing between the United States and South Korea. Now, therefore, would be a good time to update the alliance for a changed world by withdrawing American troops from the Korean peninsula.

When the United States initiated the defense treaty that now binds Washington to Korea, the South lay in ruins. If Seoul was to be defended, America had to play the lead role. Today, however, the Korean balance has shifted dramatically. South Korea competes globally in the computer, auto, and construction markets, and its economy is nearly five times the size of that of North Korea. South Korea has twice the population of the North, and Pyongyang is on its own militarily; in fact, North Korea's erstwhile ally China is now pushing for a peaceful settlement of the peninsula's conflicts. Thus, American troops are no longer needed to defend the South.

Of course, an immediate withdrawal of all U.S. forces would leave Seoul vulnerable. The North has been investing disproportionately in its armed forces for years, though South Korea currently has a number of compensating advantages—a qualitatively superior air force, newer weapons, a defensive posture in rugged terrain, and better-trained soldiers—and even now could probably thwart an invasion from the North. In any case, it will not be long before Seoul achieves clear parity with Pyongyang.

And it will be almost impossible for the North, which suffers from severe economic problems that have caused it to default on $800 million in foreign loans, to keep up in the future. A 1985 RAND Corp. study estimates that in the years ahead North Korea would have to devote 36–42 percent of its gross national product to defense, roughly twice the current share, just to match Seoul's present expenditure of 6–7 percent.

The South is also gaining ground internationally. The presence of virtually every communist nation at the Olympics, an event boycotted by Pyongyang, shows the limits of the North's influence even among its putative friends. In fact, South Korea is a bigger trading partner of Beijing than is the North, has been developing warmer relations with the Soviet Union, and recently established official diplomatic relations with Hungary. This contrasts sharply with the Korean War, when the Soviet Union equipped North Korea's forces and China intervened directly.

Another important change in the East Asian military dynamic is the growing influence of Japan, which has surpassed the Soviet Union as the world's second-ranking economic power. Japan is increasingly able not only to defend its own territory and surrounding seas but also to directly support future South Korean defense efforts, with financial aid if nothing else.

With a new administration in Washington, this is an excellent time to reassess America's defense guarantee. The United States should provide South Korea with, say, five years in which to build up its own forces, after which the defense shield would be eliminated. Washington could sell South Korea, which is running a multibillion-dollar annual trade surplus, any conventional weapons that it wanted; the State Department could also work to smooth relations between Seoul and Tokyo, which are still tainted by Korean resentment over Japan's colonial rule during the first half of this century.

One benefit of a troop pullout would be to dismantle a tripwire that threatens to involve the United States in a conflict unrelated to its basic security. Disengagement would also save money, as long as the troops were demobilized, reducing the disproportionate global military burden borne by the United States. Finally, removing American troops from Korea would help insulate Washington from Seoul's fractious political struggles.

Of course, disengagement would not be risk-free. But no foreign policy is without cost. Today the United States pays a very high price to defend populous, prosperous nations around the globe as part of a containment strategy developed in a different era. Withdrawing troops from Korea would begin the much-needed process of updating U.S. foreign policy for the 1990s and beyond. ■

**Doug Bandow, a senior fellow at the Cato Institute, is writing a book on U.S. policy toward Korea. This article appeared in the *Los Angeles Times*.**

# "To be governed..."

**How can we be competitive if no one buys our stuff?**

A joint industry-labor advisory committee to [trade representative Carla] Hills' agency suggested last month that . . . the government should "insist" that Japan buy an agreed amount of specified U.S. products "to properly reflect the international competitiveness of U.S. suppliers."

—*Washington Post*, Mar. 2, 1989

**Chutzpah**

Officials from the U.S. League of Savings Institutions, the largest lobby group for S&Ls . . . were criticized by members of the Senate Banking Committee who said the league contributed to the problem.

—*Washington Post*, Mar. 8, 1989

**Stop me before I legislate again**

Starting today, "potty parity" is the rule in Virginia, thanks to precedent-setting regulations by Del. John A. (Jack) Rollison III (R-Woodbridge) designed to eliminate long lines at women's restrooms. . . .

Beginning today a toilet will be required in new churches for every 75 women, compared with 150 men. . . . For museums or theaters, there must be a fixture for every 125 men, compared with one for every 65 women.

—*Washington Post*, Mar. 1, 1989

**Not to worry, Senator**

Senator Howard M. Metzenbaum, Democrat of Ohio, recalled for [drug czar William J.] Bennett that in 1986, after Congress and the President agreed that the Education Secretary should spend $200 million to $250 million to combat drugs in schools, "You came up to Capitol Hill and said you only wanted to spend less than half that amount."

He added, "I hope we're not going to see more of that."

—*New York Times*, Mar. 3, 1989

**Sweet land of liberty**

Rep. Harley O. Staggers Jr. (D-W. Va.) said he will introduce legislation next week to ban all foreign production of U.S. flags.

—*Washington Post*, Feb. 16, 1989

**We just heard about it**

A group has threatened to blow up a monument to Dante Alighieri because the medieval poet's "Divine Comedy" places the prophet Mohammed in hell.

—*Washington Post*, Mar. 6, 1989

**Spreading free enterprise**

The March 19 victory of the right-wing Nationalist Republican Alliance (Arena), some diplomats . . . fear, could also mark the beginning of the end of efforts at social and economic modernization [in El Salvador]—efforts that the U.S. administration has supported throughout most of the country's almost nine years of civil war.

A sweeping program launched in 1980 by President Jose Napoleon Duarte's Christian Democratic Party nationalized the banks and declared a state monopoly on exports, including coffee, the nation's leading cash crop. The moves were aimed at . . . undercutting the appeal of Marxist-led rebels.

—*Washington Post*, Mar. 27, 1989

**Or others would, to put it more precisely**

The U.S. Supreme Court will decide whether cities awarding public contracts can legally give preferred treatment to minority-owned firms. . . .

AGS Inc. submitted a proposal for the engineering work on a sea wall along the Pacific Coast Highway. Although AGS was rated second, based on a combination of price and other criteria, it won the $250,000 contract, thanks to a city law giving preference to firms owned by minority groups or women. . . .

Today, AGS has grown to 25 employees, and business is thriving. But if the Supreme Court rules against minority preference, [owner Robert] Wong fears, "it would be very hard to stay in business. We wouldn't have a chance to compete."

—*Wall Street Journal*, Dec. 28, 1988

CATO POLICY REPORT
224 Second Street, SE
Washington, D.C. 20003

Nonprofit Organization
U.S. Postage Paid
Washington, D.C.
Permit No. 3571

ADDRESS CORRECTION REQUESTED

CATO INSTITUTE