FREEDOM TO TRADE

EAST ASIA READY TO REMOVE TRAINING WHEELS

by Brink Lindsey

***Brink Lindsey** is director of the Cato Institute's Center for Trade Policy Studies.*

Will the economic crisis in East Asia have a silver lining? That depends on whether the blame is ultimately placed on unregulated capitalism run amok or on the failure of interventionist policies. The current mess can act as a prod for beneficial reforms, but only if free market advocates place the blame where it belongs.

First, let's be clear that the "Asian miracle" was not a mirage–it really happened. Over the course of a single generation, per capita income has multiplied many times over, life expectancy has soared, and poverty levels have dropped sharply. Although times are rough now, the historic transformation has not been reversed. It stands as a continuing testament to the creative power of relative economic freedom: low taxes, decent respect for property rights, and openness to the world economy.

Still, as the saying goes, mistakes were made. The details differ for each country, but as a general matter, the Asian economic mess is attributable to three different kinds of policy (not market) failure: (1) mismanaged exchange rates; (2) backward and closed financial systems; and (3) moral hazard created by the IMF safety net. Admittedly, there is probably also a herd instinct during boom times that leads investors to overrate the quality of investment opportunities. But that human foible alone could not have produced the present calamity; the herd was driven over the cliff by egregious policy errors.

The countries that have experienced currency collapses–Thailand, Indonesia, Malaysia, and Korea most prominently–all tried to maintain independent monetary policies while at the same time pegging their exchange rates. Like Mexico before them, they have learned a cruel lesson: you can't do both indefinitely. Over the long term, you must either give up monetary policy and adopt a currency board (à la Hong Kong and Argentina), or you must give up the peg and let your currency float.

By maintaining untenable exchange rates, those countries encouraged banks to borrow short term in foreign currency and lend long term at home. From the banks' perspective, taking advantage of the big spread between foreign currency and local currency interest rates was like printing money–as long as the exchange rate held. When it didn't, the debt levels became crushing and the rest is history.

At a deeper level, East Asian countries are suffering from dysfunctional financial sectors. The economic crisis is fundamentally one of malinvestment: those wonderful Asian savings rates have been squandered on unneeded factories and office buildings. And the malinvestment comes from overreliance on politicized and uncompetitive banks. Banks have been shielded from foreign competitors, as well as competition for capital from securities markets, and then used as slush funds for the powerful (though not necessarily the creditworthy). In hindsight, it's a wonder Asia's financial crackup didn't happen earlier. Glittering growth rates blinded us to the increasing rot in the system.

Fickle foreign money eventually exposed this rot. Foreign investors were attracted by those fat spreads in interest rates, and the existence of moral hazard allowed them to ignore the risks. I don't know if anyone actually explicitly counted on an IMF bailout if loans went sour; I am sure, though, that investors would have been much more cautious had they been forced to pay for their mistakes in Mexico.

Critics of free markets argue that unregulated international capital flows produce excessive volatility and therefore new capital controls are in order. While it is true that foreign money catalyzed the present crisis, inhibiting investment flows is no answer. Such a move may mask countries' bad policies, but it won't cure them.

If East Asia is to resume its miracle, its only option is to move further in the direction of free markets. The region must abandon manipulation of exchange rates; it must allow competition to sweep through and transform its financial sectors. The carnage of recent months makes clear that liberalization in the global economy is like riding a bicycle: if you don't keep going forward, you fall down.

ADVISORY OPINION

REPUBLICANS FIXING TO NATIONALIZE GAMBLING ISSUE

by Timothy Lynch

***Timothy Lynch** is associate director of the Cato Institute's Center for Constitutional Studies.*

One of the few areas of American life that the federal government has largely left alone is gambling. But a quiet effort is underway for broad based federal intervention. In a few years, there may be a whole new regulatory agency that will oversee gambling operations across America.

By way of background, gambling regulation has been considered the province of state and local government. Historically, gambling has been frowned upon and such activity has been generally prohibited. The state of Nevada, of course, distinguished itself as being the exception to the general rule. Over the last twenty years, however, many states have liberalized their rules on gambling. First, Atlantic City in New Jersey allowed it. Next, state lotteries became popular. In recent years, states in the Midwest allowed riverboat gambling. The public has responded in droves.

The Religious Right would like to see a government crackdown. Dr. James Dobson, the founder and president of Focus on the Family, has argued that legalized gambling leads to addiction, bankruptcy, family breakdown, and homelessness. Ralph Reed, the former executive director of the Christian Coalition, concurs. Thus, powerful groups on the Religious Right have joined with the National Council of Churches to open a fully staffed lobbying operation in Washington to fight against the "scourge" of legalized gambling.

That lobbying effort has already paid off. In 1995, the Republican-controlled Congress created the National Gambling Impact and Policy Commission. The Commission is presently touring the country to study the impact that gambling is having on communities. In June 1999 the Commission will complete its work and issue a report to the President and Congress.

It is not difficult to see how all of this is going to play out. The fact-finding Commission will generate a fair amount of media coverage over the next eighteen months on the "negative" effects of gambling. Such news stories will lay the groundwork for a legislative "solution" to the various problems. The Commission's final report will doubtless recommend "comprehensive" federal regulation so that there will be "uniform" rules throughout the United States. After the media fanfare that will accompany the issuance of that report, antigambling politicians will seize the moment and try to ram a federal bill through Congress.

Federal intervention should be resisted for several reasons. First and foremost, the Constitution does not authorize the federal government to involve itself in gambling. In the landmark case of *Marbury v. Madison*, Chief Justice John Marshall observed that the powers of Congress "are defined and limited." The powers of Congress are spelled out explicitly in Article I, section 8. The Tenth Amendment was later appended to the Constitution to make it clear that the powers not delegated to the federal government were to be "reserved to the States."

Second, citizens in a free society should be able to spend their money on whatever peaceful pursuits fit their fancy. Thomas Jefferson defended state lotteries as a means of raising revenue because lotteries, unlike taxes, involve only willing participants. Jefferson thought everyone had a "natural right" to pursue whatever type of human industry that seemed most likely to furnish subsistence. Some citizens, to be sure, may be profligate spenders; others may be miserly; most, of course, fall somewhere in between. By what right does the government (even the state or local government) declare those individuals who wish to spend their money in a casino to be criminals? Why is money spent in a casino any different than money spent in a tavern, on jewelry, or at a political fundraiser? And why should those who gamble "responsibly" be punished simply because some choose to gamble "irresponsibly"?

It is, of course, sad to see someone foolishly risking essential income on a game of chance, but it is also sad to see people pouring money into the coffers of politicians, or eccentric hobbies, or handing their essential income over to cults and shady televangelists. The government of a free society should trust the people to learn from their mistakes. Excessive gambling is an ethical problem that should be dealt with in the open. Criminal prohibition is not (and never was) the answer.

Federal gambling regulation would be the antitheses of a respect for the Tenth Amendment and individual liberty. Will the Republican congressional leadership see the waywardness of their plan? The odds are about even.

PROMETHEUS BOUND

THE CASE FOR ENERGY USE

by Fred L. Smith Jr.

Fred L. Smith Jr. *is president of the Competitive Enterprise Institute in Washington, D.C.*

> [Environmentalists seek] to block the increase in one source of man-made power after another . . . thereby undoing the Industrial Revolution and returning the world to the Economic Dark Ages."
>
> George Reisman, *The Toxicity of Environmentalism.*

An extreme statement? Not when one observes what environmentalists already have wrought. Energy use, once viewed as man's hope for a brighter future, today is caricatured as an addictive drug, a threat to the very existence of our planet. But the ability to utilize energy is for man what flying is to birds, an essential means of survival. Those who make conservation an end in itself would clip man's wings.

America's intellectual elite call for coercive controls on energy demand. Yet the initial rationale for intervention the Malthusian argument that fossil fuel reserves are "running out" has been completely discredited. Today, proven reserves of oil and natural gas are at all time highs. And when we eventually do shift to nonfossil energy sources in future centuries, vast quantities of fossil fuels almost certainly will remain unused in the ground.

Man's advance from caves to wealthy, technological and, yes, cleaner societies owes much to increasing, albeit more efficient, energy use. Prehistoric men commanded little energy; only enough to cook food and heat shelters. And they used that energy inefficiently. When humanity was limited to animal power and renewable fuels (wood, brush, dung) the environmental impacts were substantial. Indoor air pollution was significant and serious. Moreover, wood use required vast tracts of land and dung use depleted the soil of useful nutrients. Too often the result was hillsides and forests stripped of plant life, with bare soils vulnerable to erosion. Further, "exhaust" from horse-drawn carriages was far worse than that from sport utility vehicles (SUVs).

Gains in agricultural productivity made possible by abundant fossil fuel reduced environmental stress, freeing thousands of acres of pasturage for woodlands and wildlife habitat. Shifting to fossil fuels and increasing energy use in the Third World could produce similar benefits.

People use energy to improve their lives. Glance around your room or out of your window and you are immediately aware of the machines, appliances, medical services—all the items of our bountiful society made possible by the efficient employment of energy. Moreover, those benefits accrue to all segments of modern society—the wealthy have always enjoyed mobility and comfortable homes; consumer-friendly energy policies have democratized those privileges. Other nations penalize their citizenry; the Japanese do use less energy per capita, but also have smaller homes and cars, less mobility, living space, and other amenities.

Mobility, a driving force since the days of Icarus, is made possible by the private automobile and affordable gasoline, freeing Americans from the need to work, live, and raise children in the same locale. Multi-passenger vehicles, including the dreaded SUV, bring families together and improve the mobility of the handicapped, for whom mass transit is rarely convenient.

Restricting energy use can be deadly. Energy efficiency standards and other environmental rules, for example, have made home air conditioning more expensive. A recent *New England Journal of Medicine* study concluded that over half of the seven hundred deaths in the Chicago heat wave could have been avoided had air conditioning been more affordable. The insulation craze of the 1970s contributed to lower indoor air quality and increases in asthma. And federal automobile fuel economy standards continue to kill and maim thousands of Americans by forcing them into smaller, less safe, vehicles. Proponents of such programs sometimes argue that energy conservation is a major source of energy which suggests that diets are a major source of food. If so, then the peoples of the developed world are well fed indeed!

In decades and centuries in the future, humanity will consume vast amounts of energy, as poorer countries develop and as mankind begins energy-intensive efforts to mine the asteroid belt, or colonize and terraform the other planets. We should expand not curtail the availability of energy throughout the world. Only economic growth, fueled by energy, will make it possible to address the world's economic and ecological concerns. The alternative is immoral: A world starved of energy will be a world of starving people.

Belly of the Beast

Friends In Low Places

by Frank N. Wilner

***Frank N. Wilner** is former chief of staff to Vice Chairman Gus A. Owen, Surface Transportation Board.*

The socialist world may have digested the bitter lesson that well-meaning bureaucrats produce substantially inferior decisions than does Adam Smith's invisible hand, but U.S. policymakers are finding that it is as hard to get rid of their bad habits as it is to get rid of soft chewing gum from the sole of a shoe.

Consider the Interstate Commerce Commission. In 1995, Congress reduced the ICC's size and recast it as the equally powerful Surface Transportation Board. Repeatedly since the early 1980s, the ICC and the STB have permitted railroads to abrogate existing contracts with their labor unions merely upon showing that the action was "necessary" to further the cost-cutting intent of the merger. Further, such abrogations have occurred a decade after the merger transaction was consummated. The "Surf Board," as it is called, based those decisions on its statutory authority—upheld by the courts—to insulate merging railroads from all local, state, and federal laws.

Curiously, many supposed free market advocates have defended that behavior as appropriate "punishment" for the liberal left. But what if the railroads instead had sought to renege on contracts with banks or with oil companies? What if the railroads sought to shred with impunity agreements with Chase, Exxon, and General Motors in the name of cost-cutting?

One reason for the troubling assault on contracts is that the ICC/STB has increasingly been used as currency to repay political debts. Recent and current members might mean well, but their ends-justifies-the-means approach to policy follows in part from the truly disturbing fact that most of them are unqualified for their jobs.

You may not like regulators, but at least in the past many had an idea of what they were doing. There was a time when respected legal minds and academic economists earned appointments to the ICC. The agency's first chairman was Thomas M. Cooley, an eminent constitutional scholar who later became chief justice of the Michigan Supreme Court. John Harlan, son of the Supreme Court justice and himself a clerk to Chief Justice Melville Fuller, served, as did scores of others eminently qualified by education, training, and experience. Those appointees' decisions have rarely been overturned by the courts due to an institutional bias that the ICC was the most expert agency on such issues.

But beginning in the 1980s, White House nominees to the ICC/STB—all confirmed by the Senate—were chosen almost entirely for political reasons. One was a twenty-nine year-old wife of a congressman whose vote Ronald Reagan considered crucial to his military budget expansion. Another pick—this one at the insistence of Barry Goldwater—was a self-described former truck driver and one-time Goldwater fundraiser who said he slept in his automobile while awaiting Senate confirmation because he could not afford a hotel room. Two other Senate-confirmed nominations were those of an oil-patch buddy of the Bush family and a young woman that Senate Republicans rewarded for her loyalty as a committee staffer.

Bill Clinton's nominations to the STB also have been politically motivated. Chairman Linda Morgan, although well-educated and well-meaning, has spent her professional career as a attorney mostly on Capitol Hill. Clinton elevated her to the chairmanship on the insistence of her former boss, powerful Senate Commerce Committee member Fritz Hollings, (D-S.C.).

Another Clinton nominee, California real-estate developer Gus Owen—also committed to doing good—possesses no prior knowledge of transportation, economics, or the law. Owen, however, is a founder of one of the nation's richest Republican fund-raising machines and his wife won high praise for Democratic fund-raising activities that helped Clinton carry California in the 1992 election. So the unlikely duo of Bob Dole and Clinton championed Owen's nomination in 1994.

The most recent Clinton nominee is a thirty-one year-old nephew of Democratic South Carolina Congressman James Clyburn. Young Clyburn is rumored to have delivered crucial rural black votes to Fritz Hollings' reelection campaigns.

Perhaps the lesson is that regulatory power, like sharp objects, can poke holes in the Constitution. It should be kept out of the hands of those who do not have the credentials to use it competently but do have friends in high places. It is those very friends who create the regulations to begin with.

THE LAUGH'S ON U.S.

CLOSE THE GATES

by Sheldon Richman

***Sheldon Richman** is the editor of* The Freeman *published by the Foundation for Economic Education.*

Thank goodness Microsoft caved in to the government's demands. The dispute had gotten nasty. The U.S. Justice Department thought Microsoft was in contempt, which shows you how smart the Antitrust Division lawyers are. President Clinton's chocolate Labrador puppy could figure out that contempt is exactly what Bill Gates is feeling these days toward the government. As a public service, I present the following guide to this complex case.

The Justice Department avers that Microsoft abuses its dominant market position by giving away its Internet Explorer web browser with Windows 95, the user interface installed on almost every computer bought. If Gates bundles Internet Explorer with Windows, so goes the argument, few people will consider buying a competing browser such as Netscape Navigator, thus driving Microsoft's rivals from the marketplace.

The government wanted the company to separate Internet Explorer from Windows, but Microsoft said the two programs were integrated. The government replied, quoting from its brief, "Bull feathers!" (Ok, it's not a verbatim quote; I cleaned it up for this family magazine while managing to retain the quality of the argument.) Later, Microsoft agreed to separate the two programs, setting a benign precedent: the Justice Department will protect us from the over-integration of computer programs.

Microsoft wouldn't be in this mess if it hadn't so ruthlessly saturated the market with Windows and the underlying MS-DOS operating system. A long, long time ago, personal computers had no Windows. They had other operating systems, for example, CP/M from Digital Research. Computers were not nearly as much fun in those days.

One day, IBM, the leader in big computers, decided that the personal computer was not such a dumb idea after all and asked Digital Research to write a new version of CP/M for the Intel microprocessor that would be installed in the IBM PC. The head of Digital Research was busy that weekend and declined. So IBM went to Bill Gates, who started his climb to multibillionaire status by licensing MS-DOS to IBM. Microsoft and Intel soon became kings of the PC hill.

So far this story sounds like a simple case of merit prevailing, but there's more to it. Many computer users, refusing to get lost in Microsoft-Intel-IBM cyberspace, vowed to stick with computers that ran CP/M or the operating systems made by Apple and Tandy Radio Shack. But Bill Gates had his eye on world domination and would have none of that.

Not many people know how he has come so close to achieving his dream. I can now reveal the details from classified government documents. At first, Gates hoped to dispatch legions of agents to disable every computer with a competing operating system. Ruling that out as impractical, he did something more ingenious. He used mass hypnosis to sour people on the computers with which they had been perfectly satisfied just the day before.

I speak from personal experience. In 1983 I had a Kaypro II running CP/M and WordStar. It had a whopping 64 kilobytes of RAM, two floppy disk drives, and a speed of 2 megahertz–all for just $2,500 (with ten character-per-second printer thrown in). I thought nothing could be better.

Yet, shortly after Gates got started, I–like millions of others–came to despise my computer as clunky and obsolete. In what must have been an unprecedented campaign of psychic manipulation, Gates compelled people to junk perfectly good Kaypros, Apple IIs, and TRS-80s and buy any computer that ran DOS. It only half-worked on me. I junked the Kaypro but bought an Apple Macintosh rather than a computer possessed by Gates's spirit. A few others also managed to escape Microsoft.

Bent on world domination, Gates pursues us relentlessly. He tempted us with Windows, which mimics the Mac. But that was not entirely successful. So he has gone even further to achieve his monopoly. He subjects us–well, me anyway–to ubiquitous subliminal messages. I can't even walk through an airport without being targeted by his campaign. Wherever I look, I see his subtle signs: Gates 1-12, Gates 13-25, Gates 25-35. I am trying to hold out. But it gets more difficult all the time.

Janet Reno, please make him leave me alone.