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Statement by Press Secretary Fitzwater on the Adjournment of Congress
November 27, 1991

Congress has adjourned for the Thanksgiving holiday after making progress in several important areas, but much remains to be done. We still must be sensitive to the need for economic improvement in this country.

When the Congress returns next year, we will engage these issues. The American people deserve a Government that responds to the need for jobs and economic opportunities.

Text of the Thanksgiving Address to the Nation
November 27, 1991

From Camp David, Barbara and I would like to wish all Americans a joyous Thanksgiving. This holiday has always had a special meaning for the Bush family, as it does for most Americans. Thanksgiving captures our spirit as a people: Our determination, our generosity, our industry, and our faith.

Thanksgiving brings to mind the joys of plenty and the anguish of want. As Americans celebrated Thanksgiving in 1777, George Washington and his troops huddled along the banks of the Delaware River. Buffeted by the brutal cold, haunted by British troops massed over the horizon, they stopped to offer humble words of thanks and praise, and to dedicate themselves to the cause of building a land of prosperous liberty. That simple moment helped establish the American character. Our founders' faith and determination transformed this land from a patchwork of colonies into a republic of ideals.

This Thanksgiving, many of us join friends and family around the table; others share time by phoning loved ones far away; and all of us will think of others. In places of worship across the land, people contribute canned goods or turkeys or clothing. They share their blessings with people suffering through tough times. And that's as it should be. Americans always have expressed their thanks by serving others.

Many people wonder how a President understands what goes on outside Washington, especially to people struggling to make ends meet. Of course, statistics paint a sobering picture: Unemployment, tight credit, lower home values, sluggish job growth. But real life speaks far more eloquently than bare numbers. I have traveled to 48 States since becoming President: Talking, meeting people, listening, learning. I will continue traveling around our great country because that's one way a President stays in touch with people.

Recently, many Americans have written me, saying they want me to know and understand that hard times have hurt them. They don't pull any punches. One man, who lost his job in September, described how he and his wife struggle to support two children at home, pay the bills, and keep up their property while he seeks work. "Mr. President," he wrote, "now is the time to come to the aid of the American people. The American people need to know that you mean what you say." A woman, who typed beneath her signature the words, "Average Middle American," was just as blunt. Her husband recently lost his job, and she wrote that "it's pretty thorny out there."

Well, I do understand. I am concerned. And I want to help. I know that for a person out of a job, the unemployment rate is 100 percent.

As a Nation, we need to address today's problems and tomorrow's promise in a new world united in economic competition, not frozen in nuclear conflict.

Over the years we have built a strong foundation for progress in this new, revitalized world. Inflation is down. Interest rates have fallen to the lowest level in years. This year we will export billions of dollars more in goods and services than ever before, and that means good jobs for American men and women.

This doesn't mean that we ought to sit back and hope for the best. We must take strong steps to move ahead. I have asked Congress to pass an important series of initiatives to boost our economy. These include tax incentives to unleash investment, reforms to help our banks do their job, proposals to set loose a revolution in American

education, initiatives to keep health care costs down. Taken together, these proposals would let Americans do more, produce more, dream more, dare more. They would create more jobs, good jobs, for American workers.

Unfortunately, Congress did not send me a comprehensive package of economic growth measures. But we can't take "no" for an answer.

Now, I know we're about to enter an election year. And I know that both parties will spend a lot of time taking tough shots at one another. In our system of government, the opposition will attack the President aggressively. There is nothing new about this. But when people are hurting, a President cannot accept politics as usual.

Congress left town after a particularly bitter session. We now have a few weeks in which elected officials can cool off and hear from the people they serve. In this time we can build a foundation for greater prosperity. I will continue taking what independent steps I can to help the economy like fighting to create opportunities in foreign markets for American workers. I'll make sure that administration agencies do everything they can to help the people, from getting unemployment checks out to easing the credit crunch. And I will insist that we get the money in our transportation bill out right away to build roads, fix bridges, and create jobs.

When I give the State of the Union speech in January, I will ask Congress to lay aside election-year politics at least long enough to enact a commonsense series of economic growth measures. I will ask politicians to restrain their personal ambitions at least long enough to get the job done. Afterward, the normal election-year battling can resume.

Politicians should remember that hot rhetoric won't fill an empty stomach. It won't create a job. It won't get the people's business done. Americans don't care about finger pointing in Washington, and they certainly have no tolerance for politicians who use tough times for political advantage. So, I will continue to place top priority on the issues you care about: Building a growing economy, world-class schools, and what our founders called "public tranquility," a kinder, gentler Nation rid of crime and united by bonds of brotherhood and service.

Every day, as I confront the tasks ahead of us, I think of the people we serve: The family struggling to make ends meet; police risking everything to keep peace on the streets. I thank God for our teachers, who must serve as psychologists, doctors, social workers, and peacekeepers before getting a chance to teach the three R's. And I do care about the people who write me letters, especially people in trouble, people out of work.

Finally, I also remember the American people I have seen in every State and on virtually every continent: People who will not take no for an answer, people with a zest for life, people who love their country.

Americans don't ignore tough realities; we tackle them. We don't wallow in self-pity or despair. We shove obstacles aside and make life better. Optimism, opportunity, realism, determination: These are oxygen to us; they let our society live and breathe. America grew strong with the help of the greatest resource on Earth, the American people. As we look ahead, we should be as realistic about our strengths as we are about our problems. Every time I talk with Americans, I see our strength, and I feel all the more determined to do what you elected me to do: Foster growth, keep the peace, and maintain our stature as the world's greatest Nation, the standard by which all other countries measure themselves.

Two years ago, I talked to the Nation on the eve of Thanksgiving about the challenges posed by the collapse of communism. We met those challenges.

One year ago today, Barbara and I stood in the sands of Saudi Arabia, looking into the eyes of the finest men and women this country has ever known. I wondered whether I would have to send those young people into battle. We were a Nation on edge, anxious about what lay ahead in the Persian Gulf. No one knew how it would work out.

But look at what they did, what we did. We pulled together. We fought for principle. We stood up to aggression. And when our men and women returned home, remember how we felt: Proud, excited, confi-

dent, even relieved, all because we knew that we did the right thing.

Today, democracy is on the march around the globe. Nations long enslaved have begun experimenting with liberty, exploring their own promise as free people. America led the way to this new world. We met the test of world leadership.

Just as we've met every challenge in the past, we will meet those that confront us today. As we do, let us remember who we are and what we've done. Let's give thanks for our blessings, for our families, and our faith. Let's dedicate ourselves to the hard work this moment demands. Let's pledge to join hands in common purpose.

That's the Thanksgiving spirit, and it has lifted us since the Pilgrims first celebrated it more than three centuries ago. Now let's call upon that spirit today to help those in need. Let's call upon that spirit as we move toward a new year and look forward to a new century.

Thank you. May God bless all of you and our great land, the United States of America.

Note: The text of the address was issued by the Office of the Press Secretary on November 27, for release on November 28.

Points of Light Recognition Program

The President named the following individuals and institutions as exemplars of his commitment to making community service central to the life and work of every American.

November 23

South King County Multi-Service Center Literacy Program, of Federal Way, WA

November 25

Operation SHARE, of Phoenix, AZ

November 26

Williamsport Students Engaged in Real Volunteer Efforts (WillSERVE), of Williamsport, PA

November 27

Linda McKeehan, of Golden Valley, MN

November 28

Connecticut Institute for the Blind Adult Daycare Program, of Windsor, CT

November 29

Danny Davey, of Santa Ana, CA

Digest of Other White House Announcements

The following list includes the President's public schedule and other items of general interest announced by the Office of the Press Secretary and not included elsewhere in this issue.

November 24

In the afternoon, the President and Mrs. Bush returned to the White House from a weekend stay at Camp David, MD.

November 25

The President met at the White House with:

—the Vice President; John H. Sununu, Chief of Staff to the President; Brent Scowcroft, Assistant to the President for National Security Affairs; and members of the CIA briefing staff;

—Kirk Fordice, Governor-elect of Mississippi;

—Secretary of Defense Dick Cheney.

Later in the morning, the President traveled to Columbus, OH, where he visited the Ft. Hayes Metropolitan Education Center. He then went to the Veterans Memorial Auditorium where he attended a reception with Ohio education leaders.

In the afternoon, the President returned to the White House.

In a ceremony on the State Floor of the Residence, the President received diplomatic credentials from Ambassadors Luvsandorj Dawagiv (Mongolia), Abul Ahsan (Bangladesh), Pal Tar (Hungary), Alphonse Berns (Luxembourg), Ernst Jaackson (Estonia), Rudi Valentine Webster (Barbados), Yog Prasad Upadhyay (Nepal), and Abdul Rahman bin Fares Al-Khalifa (Bahrain).

NATIONAL SECURITY COUNCIL

12/17

To: Tony Snow
Dan McGroarty

From: Jim Keith (x5672)

Attached are comments on the Australia speeches, remarks, etc. Please feel free to call if there is anything I can do.

DP:

The outline for the Melbourne speech in sections II-III ought to be in the Parliament speech. The political/military/strategic aspects of Australia's international role and our commitment to the region belong in this speech.

Sections 1-4 of the attached ought to be only about a fourth of the speech; the global, regional, and bilateral sections should take up the remainder, with a light touch on past/present and a heavy dose of the things we need to do in the future.

Keeping the message palatable to those at home is good, and should call for State of the Union messages to be intertwined with the themes descibed in no. 5 on the attached.

> Trade issues should include our determination to promote American interests by active involvement abroad and stress that time spent abroad is relevant to America's current concerns; NAFTA should include reference to interdependence of our economies; GATT should include commitment to an open world trade and financial system.
>
> Security issues should include explicit reference to the joint defense facilities' role in the Gulf war and the Australia Group efforts to control CBW could be linked to the global perspective that our businesses must take to succeed in the Asia Pacific region.
>
> Cultural issues should include reference to getting our own house in order and economic success based on hard work. Reference should be made to shared values of free people and free markets as well as our broad, active agenda to restore American competitiveness.

In short, our global, regional, and bilateral issues should be the context for straight talk about the link between foreign and domestic policy.

JK

Outline for Speech to Australian Parliament

1. Introductory formalities

2. We share ancient traditions, common ancestors and language, respect for the rule of law. We have a dynamic friendship today. We share a commitment to work together for peace, prosperity and security in the future.

> This building in Canberra is home to one of the few extant original copies of the Magna Carta. Washington's National Archives has one of the other copies.
>
> Anecdote about 18th century Australian-American exchange if appropriate.

3. We each developed frontier territories and became great trading and seafaring nations in the 19th century.

> Anecdote from 19th century if appropriate -- perhaps a story about Mark Twain's visit to Australia.

4. During the 20th century Australians and Americans fought side by side for freedom and democracy WWI, WWII, Korea, Vietnam, Persian Gulf.

5. Today we remain strong partners in trade, security and culture.

> Trade issues: bilateral, APEC, GATT -- including assurance that NAFTA is consistent with GATT and would be beneficial to the Pacific Rim.
>
> Security issues: Attaboys for our allies. Attaboy for Australia's good works on Cambodia, in chemical and missile tech arms control, etc. Promise to keep US engaged in Pacific security.
>
> Cultural issues: End on a high note of our common concerns for carrying on as healthy societies in the next century. There is some affinity with America 2000; for example, Australia has had educational choice for years. I'm getting Lamar ("Crocodile") Alexander's book <u>Six Months Off</u> and will look for a good closing, upbeat, forward-looking anecdote about his six months in Australia.

Throughout the speech I'll look for ways to keep the message palatable to the American audience at home. I.e. not get too deep into globaloney.

DP.

The Melbourne speech, as noted earlier, should lose the military/strategic aspects of II and III. This speech needs to address sections IV and V, but also needs as its reason for being a section that would take about fifty percent on business themes.

It should elaborate on some of the themes that were touched on in the Parliament speech as important components of our political and security agenda. This would also serve to preview the same themes that will appear in the main business-oriented speeches in Singapore, Seoul, and Tokyo.

I think IV A/B and V are the speech.

(1) IV A can be fleshed out to encompass successful completion of the Round in all of its aspects, with a chance there to tie in EEP and bilateral economic relations in the context of our shared multilateral objectives. This should include some specific points on our commercial presence in Australia directed at the audience of American and Australian executives.

(2) We could follow with V's look to the future, with an emphasis on all of the non-security relationships we have and can develop with Australia (environment, energy, education, etc.), including announcement of the APEC Education ministerial to be hosted by Secretary Alexander. The emphasis should be on the clear commercial link to these themes--American expertise in environmental engineering and the like.

(3) This would lead to competitiveness themes and steps we are taking to tie our domestic commercial goals to our foreign policy agenda, stressing again a forward-looking approach that underlines our appreciation that we can learn from each other in the region covered by APEC.

Again, the explicit link should be made between our activities in Australia and direct payoff to the American economy. The conclusion should address job creation and technology development that draws on the best of both countries.

JK

Outline for the Melbourne Business Luncheon Speech
(Smith/Aarhus)

I. Introductory Remarks:

A. Acknowledgements, humor, etc.

B. Brief trip update.

II. Recognize Australia's Growing International Role:

A. Express appreciation for the leadership role Australia has assumed in the world.

1. Australian-American military alliance.
2. Active role in working towards settlement in Cambodia.
3. Australia's contribution to the multi-national Gulf Coalition.
4. Strong efforts on proliferation issues, particularly regarding nuclear and chemical weapons.

B. Our partnership has become increasingly important, especially in the wake of the tremendous changes that have occurred in the world over the last two years.

III. U.S. Regional Role to Remain Strong:

A. The regional partnership which the U.S. has enjoyed with Australia, and other Pacific countries, has been the foundation for economic and political stability in the region.

B. Despite the changes elsewhere in the world, the U.S. will remain engaged, concerned and active in Asia and the Pacific, both in strategic and economic terms.

- continued -

IV. Stress Cooperation on Multilateral Trade Issues:

A. Both our countries have been at the forefront, pushing hard for free and open markets in the world. We must continue our joint efforts to shape an international trading system which will foster free trade, particularly through successful conclusion of the GATT Uruguay Round.

1. Stress need for greater openness in trade relations, as both our countries face economic difficulties on the homefront.
2. American export growth figures.
3. American-Australian export figures.
4. Acknowledge Australia's leadership in establishing APEC and in shaping its development as an important international economic entity.

B. Export Enhancement Program: Our use of EEP to counter agricultural subsidies of the European Community is one point of contention between our two countries.

1. EEP problem.
2. Keep pressure on the European Community.
3. POTUS commitment to further dialogue on EEP and other economic issues.

- continued -

V. Facing Challenges Ahead:

A. Environment/Energy

1. The Australian and United States governments have agreed on pursuing energy policies that will promote our energy exports while addressing environmental issues.
2. The U.S. Energy Department is working with its Australian counterpart in cooperation to develop cleaner energy techniques.

B. Australian Center for American Studies: Will expand bilateral links through programs to benefit business, education, and the universities. This new Center will provide mutual benefit for both nations.

C. General Round-up of future challenges

1. The proliferation of chemical, nuclear, and biological weapons of mass destruction remains a problem. Australia's role in achieving international safeguards to reverse the proliferation trend has been critical to this effort.
2. We share a common view that the formation of protective trading alliances must be avoided, and support for cooperative frameworks such as APEC must be vigorously continued.
3. We should do all we can to open markets and foster free trade in order to strengthen international economic cooperation, confidence and recovery.

VI. Conclusion:

A. These are real indications of the cooperative spirit that exists between our two nations as we seek to strengthen our economic, cultural, and educational ties. They are positive signs of the shape which our bilateral relationship will take over the next five decades.

B. We need to continue to work together to ensure that the future of our relationship will be as productive a partnership as it has been for the last fifty years.

# # #

UNCLASSIFIED

SUGGESTED POINTS FOR AFTER DINNER REMARKS
AT PARLIAMENTARY DINNER

Hosted by Prime Minister and Mrs. Hawke
January 2, 1991 - Canberra

-- First of all, I would personally like to thank Prime Minister Hawke, and members of the House of Representatives and Senate for the warm hospitality you have shown Barbara and me during our stay here.

-- There is a strong bond of friendship between our two countries, which I am confident will continue to strengthen and to grow in the years ahead.

-- As the world situation is evolving, so is our relationship; and it is as valuable today as it was during the darkest days of the Cold War.

-- Our relationship goes far beyond our shared political and cultural values; Australia is an important trading partner for the U.S., as the U.S. is for Australia. Australia is also an important ally in international economic fora. Our relations in the defense and security areas are solid; our joint facilities contribute importantly to our efforts to ensure a more peaceful world.

-- Our cooperation in conservation and environmental protection is expanding. There is much we can learn from each other. ~~and exchanges in the fields of~~ We can help each other in the field of education ~~are important~~ as we both seek to prepare our students ~~better~~ to live in a rapidly ~~and vastly~~ changing high-tech world. -- We need productive citizens to make our societies competitive. We must expand our economic engagement abroad to ensure stability and prosperity for our peoples.

-- I have come to appreciate the regional and cultural diversity of Australia, both from my visit here in 1982 and in my few days here. ~~Being someone who calls Texas home, I feel very much at home here.~~

-- ~~I especially want to~~ Let me close with a special expression of my appreciation to Prime Minister Hawke and the Australian Government for all the arrangements that went into my visit here. I also want to thank PM Hawke for hosting ~~this wonderful~~ tonight's dinner. Thank you, my friends...

Like another Texan who came here in 1966, I feel like I never left home at all, as LBJ

felt at home when he saw your plains, your hills, your bush country, and your cattle.

-- Like ~~that~~ President Johnson I have come to realize the real similarities are far more meaningful. The real equation is human -- we have the same openness, the

cont. ->
~~OVER~~

UNCLASSIFIED

SUGGEST POINTS FOR [illegible]
AT PARLIAMENTARY [illegible]

Hosted by Prime Minister [illegible]
January [illegible]

Same self confidence, and the same generosity of spirit. LBJ visited when

-- There is a new hope today that was only glimpsed in 1966. We can focus our energies now on making a decent life possible for our people and share a vision of freedom. Freedom from foreign domination, freedom from tyranny. Free people and free markets are on the increase all over the world.

Let us continue to work together to build on our shared values here in the United States, in the Asian Pacific region, and beyond.

POINTS TO BE MADE WITH THE AUSTRALIA-UNITED STATES CORAL SEA COMMEMORATIVE COUNCIL

-- I am pleased to have the opportunity this morning to thank all of you personally for your participation in the Australia - U.S. Coral Sea Commemorative Council.

-- The programs and activities you coordinate or sponsor will ensure that events which shaped the beginnings of our bilateral alliance -- especially the 50th anniversary of the Battle of the Coral Sea -- receive the attention they deserve in 1992.

-- I also want to convey to this Council and to all Australians who are developing commemorative programs this year the appreciation of the over one million American men and women who served in Australia during World War II.

-- The participation of so many prominent Australians on this Council is evidence that the defense of freedom here and in the South Pacific during World War II by Australians and Americans has not been forgotten by succeeding generations.

-- I share your hope that many of our veterans will return to Australia with their families in 1992 to take part in the activities that are being planned. I know they will receive the same open, warmhearted Aussie welcome that I have received.

-- I am sure that the actions of this Council will strengthen and sustain an alliance that has matured and is as relevant today as it ever was.

-- My best wishes to you throughout this commemorative year.

-- Dramatic changes are taking place throughout the world. It will be up to our daughters and sons to not only remember the individuals who participated in important historical events such as the Battle of the Coral Sea, not only remember the events that shaped our lives, but also carry with them as they face the challenges of a new era in the decades ahead the spirit of freedom and democracy that energized our patriots of fifty years ago.

UNCLASSIFIED

SUGGESTED POINTS FOR TOAST AT THE STATE DINNER

Hosted by the Governor General and Mrs. Hayden
January 1, 1992 - Canberra

Before proposing a toast to the Queen, I would like to make a few brief remarks.

First and foremost, I can't express strongly enough how pleased Barbara and I are to be here with you, Mr. Governor General, your gracious wife, Dallas, and the other distinguished guests.

Barbara and I recall fondly the warmth we felt during our 1982 visit during Coral Sea Week. We are feeling that warmth again on this visit. [~~Other than Kennebunkport, I can't think of another place we would rather be to see in this new year.~~]

Our shared values, history, culture, and struggles through war and peace together have created a bond between our two peoples that is close and lasting.

We shared the burdens of the Cold War together. Now ~~let's~~ we look ~~together~~ to the next fifty years. Let's seek ways to expand the bonds of friendship for the next generation of young Americans and Australians, ~~to~~ Let's help them face the challenges of their time, building on the peace, conserving the environment, educating their children, and sharing the benefit of God's bounty with all.

Ladies and gentlemen, a toast to Her Majesty the Queen.

On this New Year's day it is appropriate that we look back at what we have accomplished together and look forward to the challenges ahead.

UNCLASSIFIED

(Duggan/Aarhus)
December 12, 1991
Draft One
Maritime

PRESIDENTIAL REMARKS: NATIONAL MARITIME MUSEUM
SYDNEY, AUSTRALIA
[date]
[time]

[Acknowledgments]

I am delighted to take part in dedicating this gift from the people of the United States to the people of Australia -- the USA Gallery of the Australian National Maritime Museum. President Reagan announced the gift in 1988, to celebrate the bicentennial of Australia's settlement by Captain James Cook. This year, it happens, marks the two hundredth anniversary of the arrival of the first foreign trading ship in Sydney -- an American vessel called the Philadelphia.

Never was a ship more aptly named. Brothers we are, and brotherly love has linked the Australian and American people now for two centuries. Our common ancestors endowed us with language and culture, the rule of law, a spirit of enterprise and a passion for freedom that we still share today.

Australians and Americans have been together for many a maritime adventure -- in peace and in war, in commerce and in sporting competition. Visitors to this gallery may see historical displays on the three Americans who were among the crew of Captain Cook's Endeavour ~~Crew~~ on its voyage to Australia in 1770. Interactive audio-visual displays allow visitors a unique glimpse into life aboard a 19th century trading ship.

Other displays commemorate the common courage Australian and American naval forces showed half a century ago in the fateful battles of Midway and the Coral Sea.

Fraternal ties of culture and commerce between our nations have never been stronger than now. *Let us dedicate ourselves today to build on these ties, to expand economic opportunity, growth, and stability in the Asia Pacific region.* In this spirit, and in this anniversary year, I am honored to take part in opening the USA Gallery of Australia's National Maritime Museum.

# # #

Aarhus
December 11, 1991
A:AUSCONGR
Draft One

PRESIDENTIAL TALKING POINTS: CONSULATE STAFF GREETINGS
JANUARY 1, 1992
2:10 PM

o Thank you. [Consul General Phil Lincoln, and other acknowledgements]. Happy new year to all!

o Barbara and I are pleased to be here, "fair dinkum", and we'd like to thank you for the hard work you've done to make this visit a success. We feel very much at home here, ~~and~~ it may have something to do with the fact that Australia ~~is known as "bush country". Seriously,~~ the same raw beauty, vitality and vigorous commerce as my home state Texas. We truly appreciate your dedication, especially when our visit was rescheduled for the holiday season.

o The ties that bind Australians and Americans stem from our shared values, forged by shared experiences in war and peace. During this visit, we will focus on our goals for the future. You and your work will help us define and build that future.

o The United States is fortunate to have representatives like you in our embassies, consulates, and defense facilities all over the world. Both the American staff and National staff exhibit a professionalism and devotion that is unrivaled.

o Thank you very much and keep up the good work.

# # #

Policy Analysis

No. 163 October 28, 1991

Routing

REPLACING THE RUBLE IN LITHUANIA: REAL CHANGE VERSUS PSEUDOREFORM

by Kurt Schuler, George Selgin, and Joseph Sinkey, Jr.

In early August 1991 we visited Lithuania at the invitation of Prime Minister Gediminas Vagnorius. George Selgin and Kurt Schuler had previously visited Lithuania in October 1990 at the invitation of the Lithuanian Bank of Industry and Construction. They met with the president and prime minister and suggested ideas for monetary reform in a memorandum to the Lithuanian government that has since been translated into Lithuanian.[1]

This paper extends those ideas in light of what we observed on our recent visit and what has happened since the failed Soviet coup. Lithuania has achieved independence but remains linked to the Soviet economy and to the Soviet ruble. The ruble is becoming less and less acceptable in trade, and as a result, parts of the Soviet economy have reverted to barter. The need for a stable, convertible currency in Lithuania is more urgent than ever. However, the actions the Bank of Lithuania and the Lithuanian government have taken so far will not produce such a currency. This paper explains how Lithuania can successfully establish a sound currency to replace the ruble.

Hyperinflation: A Desperate Situation

The Soviet ruble is at the heart of Lithuania's present monetary problems. The Soviet government is printing more rubles every month than it had originally planned to print

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during the entire year. In consequence, and despite extensive price controls, inflation is in triple digits. Soviet officials apparently do not understand that they are causing hyperinflation. In the simplest terms, the present hyperinflation is due to a rapidly increasing supply of rubles chasing a shrinking supply of goods. The only way to stop hyperinflation is to stop printing so many rubles. Because Soviet officials do not acknowledge that fact, no effective upper limit to the supply of rubles exists. Since the failed coup, inflation has accelerated, and the ruble is heading for total collapse.

A price system can be only as good as the currency in which prices are expressed. Other countries that have experienced hyperinflation, such as Argentina and Brazil, have found that it so distorts price relations as to make price calculations in domestic currency of little use for guiding economic activity. If the hyperinflating ruble remains the sole legal currency, price reform will continue to be unpopular in both Lithuania and the Soviet Union, for it will only replace one inefficient price system with another. But price reform is crucial for establishing a market economy.

As unsound as the ruble is, it has the advantage of being a common currency. Until recently it was acceptable throughout the Soviet Union and linked the Soviet republics into a common trade area in which goods could move somewhat freely. That enabled the Soviet Union to achieve economies of scale in production that present policies are endangering. Just when Western Europe is developing an integrated market to promote economic growth, the Soviet republics and the Baltic nations are moving in the opposite direction. The tariffs and quotas that they are imposing will destroy important economies of scale that now exist in production. If in addition the Soviet republics and Baltic nations replace the ruble with separate inconvertible currencies, they will destroy the existing division of labor and make trade among themselves collapse, as it has among the members of the former Council for Mutual Economic Assistance. The results will be massive unemployment and a further fall in output.

The solution to those problems is free trade and convertible currencies. Since our focus is on currency, we shall say no more about free trade here, except to note that large-scale trade can revive only if the Soviet republics and the Baltic states do not erect barriers to it. Price reform will be more popular if it is linked to a currency reform that introduces a stable currency, which can be the basis of a reliable price system. In addition to promoting economic development within the former Soviet Union, con-

vertible currencies will also integrate the newly autonomous republics into world markets. If the new currencies that emerge are not convertible, outsiders will not accept them, and trade with the rest of the world will be limited to barter, just as it is now under the ruble.

It would be best for Lithuania if the Soviet republics would quickly establish convertible currencies, or better yet a common convertible currency. At the moment that seems unlikely. Lithuania will have to establish a convertible currency by itself or perhaps at the same time as Estonia and Latvia. Lithuania's extensive economic links with the Soviet Union mean that if the Soviet republics follow unwise policies, Lithuania's economy will inevitably suffer. Only a convertible currency can offset the dislocations that will follow. Only with a convertible currency can Lithuania reorient its trade toward the West and encourage large-scale foreign investment. A convertible currency will also be vital for keeping Lithuania supplied with oil, coal, and natural gas, which it receives from the Soviet Union. Lithuania now has a trade surplus with the Soviet Union because it buys energy at prices far below world market prices. When the Soviet Union starts charging world market prices, Lithuania's balance of trade with the Soviet Union will shift to a deficit. If Lithuania's currency is convertible, Lithuania can attract foreign investment to offset its trade deficit, just as Hong Kong--a currency board economy with no natural resources--did for many decades. If its currency is not convertible, Lithuania will be reduced to trying to make inefficient barter deals for energy, as other East European nations do.

Coupon Money: Symbol without Substance

In early August 1991 the Lithuanian government introduced ration coupons as a way of laying the groundwork for a separate Lithuanian currency and avoiding price hikes on goods sold in state stores. Prime Minister Vagnorius hatched the coupon scheme quite suddenly in response to public discontent with inflation. He apparently did not consult with specialists, many of whom severely criticized the scheme in conversation with us. The scheme even took other members of the cabinet by surprise. But such are Vagnorius's energy and force of personality that he persuaded the Lithuanian parliament to approve the scheme.

Under the scheme, each Lithuanian receives coupons equal to 20 percent of his ruble salary, up to a maximum of 200 rubles in coupons. People with incomes of 80 rubles a month or less may receive coupons for more than 20 percent

of their incomes. To buy consumer goods other than food in state shops, people need to pay one ruble in coupons for each ruble in currency. So if a coat costs 300 rubles, the purchaser pays 300 rubles in currency plus 300 rubles in coupons. The Bank of Lithuania also has a limited stock of coupons. At first the bank announced that it would make even exchanges of coupons for rubles or rubles for coupons while supplies lasted. Before the coupon scheme took effect, though, the bank announced that the rate would be two rubles in currency to one ruble in coupons.

The coupon scheme is a way of rationing goods without raising ruble prices in state shops. Initially, coupons also served as a symbol of defiance of the Soviet government, a purpose that has become superfluous since Lithuania achieved independence. The coupon scheme may have been politically expedient, but it did nothing to correct the underlying causes of the shortage of goods at official prices. In addition, it has other defects, which Elena Leontjeva, an economics professor at the University of Vilnius, has explained in a series of articles in a Lithuanian newspaper. One defect is that people who wish to buy refrigerators and other expensive consumer goods will now need to save a considerable amount in coupons as well as rubles. There may be temporary surpluses of such goods in state shops--an unusual phenomenon under socialism--because people lack enough coupons to buy the goods, even though they have enough rubles. That will have effects all along the chain of production and distribution, requiring the Lithuanian government to counteract the coupon scheme's effects by issuing additional instructions to state-owned enterprises. The coupon scheme thus requires more government involvement in the economy at precisely the time when Lithuania is trying to move away from socialism.

Another defect of the coupon scheme is that it cannot prevent hyperinflation of the ruble, because the coupons are not really an independent currency. Rather, coupons are a supplementary currency with a fixed exchange rate for rubles. Coupons are a way of trying to prevent Lithuanians from spending 80 percent of their ruble incomes. Like water behind a dam, the unspent rubles will continue to accumulate, leading to inflation in the prices of goods that are not purchased with coupons (for instance, goods on the black market) and to a black market for coupons.

The Ukraine tried a coupon scheme similar to Lithuania's last year and was unsuccessful. (It has since reintroduced coupons.) Last summer the Estonian parliament considered a coupon scheme but rejected it on the grounds that it might complicate introducing an independent cur-

rency. The coupon scheme will not solve the problems it addresses.

The Bank of Lithuania: A Lithuanian Gosbank?

The Lithuanian government has also established the Bank of Lithuania, whose ultimate goal is to issue an independent currency. The bank combines central banking and commercial banking functions. Originally, it was nothing more than the Lithuanian branch of the USSR State Bank (Gosbank), charged with supervising other state-owned banks. Its origins as an independent bank date from the autumn of 1989. Under perestroika the Baltic republics were entertaining ideas of greater economic independence. Zilevicius, the local head of the Gosbank, a member of the Lithuanian parliament, and, naturally, a Communist, drafted a bill elevating the Gosbank branch into the quasi-independent Bank of Lithuania. He expected to become its first president. The bill passed, but Zilevicius was disappointed because in February 1990, before the bill took effect, Lithuanians elected a new non-communist parliament in their first free elections in half a century.

The new parliament faced the problem of whether to revoke or confirm the old parliament's last acts. Vilius Baldisis, a professor of economics at the University of Vilnius and a member of the new parliament, cleverly pushed a near-copy of the old Bank of Lithuania bill through parliament when the most prominent opponents of the bill were out of town. Baldisis subsequently was appointed the bank's president. Stasys Uosis, also a professor of economics at the University of Vilnius, is commonly regarded as Baldisis's idea man. He has written many newspaper articles supporting the bank's policies and is one of its directors.

At the time of our first visit, the Bank of Lithuania had no real power. It was vainly trying to assert its authority over the state-owned banks. It was embroiled in a contest with the Gosbank's Lithuanian branch, which remained open because Moscow did not recognize the new Lithuanian parliament's actions as legitimate. As the Lithuanian independence movement gained strength, so did the Bank of Lithuania. To give the bank some real power, the parliament, at Baldisis's urging, allowed it to take over the Lithuanian Bank of Industry and Construction and the Bank for Social Development, which had recently become independent from their Moscow parent banks. The Bank of Industry's top managers fought the takeover; after losing, most left in January 1991 to form a private commercial bank, Litimpex Bank.

The Bank of Lithuania now also controls the local assets of the Savings Bank, which under the Soviet system was the only bank that accepted consumer deposits. The Bank of Lithuania does not let the Savings Bank lend to other banks. Some 7 billion rubles of the Savings Bank's deposits are immobilized at its former Moscow parent bank, but there is some prospect that the Lithuanian Savings Bank will get the money back. (By the time it does, the money may not be worth much.) Another state-owned bank, the Agricultural Bank, is trying to convert itself into something like a private commercial bank, with some independence from the Bank of Lithuania.

The remaining bank left over from the Soviet system, the USSR Bank for Foreign Economic Relations, successfully evaded the Bank of Lithuania's control since almost all of its assets were in Moscow. The Bank of Lithuania was able to monopolize the foreign currency transactions of enterprises owned by the Lithuanian government, but not those owned by Moscow, and of other parties within Lithuania. During our visit, the Lithuanian government was considering making Lithuanian government-owned enterprises and private firms pay up to 30 percent of their hard currency earnings into a fund managed by the Bank of Lithuania.

The Bank of Lithuania is by far the dominant commercial bank in the country. As the central bank, it also has extensive regulatory powers, though it does not yet issue currency. Indeed, its regulatory powers far exceed those of any Western central bank. The Bank of Lithuania has powers similar to those of the Gosbank, which is surely not a good model to emulate. At the time of our visit, the bank was regulating the banking system by simply translating into Lithuanian the decrees the Gosbank had issued in Russian.

Among the Bank of Lithuania's regulatory powers, as set forth in the law establishing it, are the powers to deny licenses to other commercial banks, to set minimum capital requirements for them, to set maximum and minimum interest rates, and to control foreign exchange transactions. The bank has been active on all those fronts. It has dragged its feet about granting licenses to commercial banks that meet the requirements for going into business--it took three months to grant Litimpex Bank's license. The Bank of Lithuania can also prohibit other commercial banks from opening branches that would compete with its own branches. Because the bank has imposed a maximum rate of 25 percent on commercial bank loans, banks cannot afford to pay more than 25 percent minus a margin to cover their costs. (Deposits in the Savings Bank, however, are somewhat indexed against inflation.) Inflation is 300 percent, according to the

Lithuanian Free Market Institute's estimate. Consequently, loans greatly subsidize the enterprises that receive them, and private commercial bank depositors have no hope of keeping even with inflation. Originally, the Bank of Lithuania set the minimum capital requirement for commercial banks at 30 million rubles, which would have prevented any privately owned banks from forming. It later reduced the requirement to 10 million rubles. Unlike the Bank of Estonia, which was trying to introduce a free-market element into foreign exchange dealings by holding auctions of hard currency for rubles, the Bank of Lithuania during our visit was enforcing the regulations of the Gosbank.

In its current form, the Bank of Lithuania has grave defects. The most important is that it has announced no definite plan for establishing and maintaining the value of the proposed Lithuanian currency, the litas. The Bank of Lithuania has all the important powers that the Gosbank has. Among them is the power to inflate the litas just as the Gosbank is now inflating the ruble. The law establishing the Bank of Lithuania authorizes the bank to purchase Lithuanian government debt "not exceeding the parliament's set limits," but the parliament can change those limits at any time. There are no limits to the bank's power to lend to commercial banks, including its own commercial banking operations. Therefore, the law imposes no effective limits on the bank's powers to create money. Bank officials have not announced how they plan to keep the litas's value stable. Other aspects of their behavior also inspire little confidence. Lithuania has been cut off from the outside world for so long that the knowledge of how to read a balance sheet, let alone manage a central bank, is almost nonexistent. We were unable to get bank officials to meet with us during our recent visit, though we had met with Baldisis in October 1990.

A previous Bank of Lithuania, which existed during Lithuania's period of independence between the world wars, issued a litas convertible into gold at a fixed rate. The present litas will not be convertible into anything. The experience of other newly independent nations indicates that pressures for financing government deficits will probably be too great for the bank to be able to adhere to any rule that purports to limit the quantity of money (such as a rule limiting the growth of currency plus deposits to 8 percent per year). Lithuania runs the danger of replacing the inconvertible ruble with the inconvertible litas.

Another defect of the Bank of Lithuania is the conflict of interest between its roles as a commercial bank and as the regulator of other commercial banks. Western central

banks that once had commercial banking functions, such as the Bank of England and the Bank of France, gradually abandoned them because it came to be recognized that the possibility for abuse of power was great.[2] Policymakers in the West came to realize that when a central bank competes directly with commercial banks, it may use its regulatory powers to suppress them. During our visit many businessmen expressed opposition to the bank's inordinate powers but said that they were afraid to speak out against it for fear that it would deny them loans and access to foreign exchange. (Politicians have also been reluctant to criticize the Bank of Lithuania, for fear of being accused of lacking patriotism. Last year a prominent bank official publicly declared that to be opposed to the bank was to be opposed to Lithuania itself.)

The Bank of Lithuania's control extends far beyond banking to all spheres of economic activity. As monopolist of the foreign exchanges, it has the final say on all foreign trade. As the dominant commercial bank, it has the power to dictate which enterprises shall prosper and which shall not, independent of what competitive market conditions may determine. As the regulator of interest rates, it can rob depositors of their savings and create shortages of funds for lending at below-market rates, which will perpetuate the system of political favoritism that the Soviet banking system now uses to allocate credit. The bank is potentially more powerful than the Lithuanian government.

The Bank of Lithuania is nominally answerable to the Lithuanian parliament, but given the long terms of office of the bank's president (seven years) and directors and the relative lack of economic knowledge of persons in the government who might monitor the bank, the parliament is unlikely to impose effective checks on the bank's behavior. The bank is neither politically accountable nor subject to the market test of competition; nor does Lithuania have a reassuring recent tradition of fairly competent central banking. All those things make it extremely unlikely that the Bank of Lithuania will be capable of issuing a stable, convertible currency.

Private Commercial Banks: Cause for Hope?

Recently, a number of "private" commercial banks have sprung up in Vilnius and Kaunas. At the time of our visit, eight such banks were operating. The largest has capital of 18 million rubles. Some have separate foreign currency accounts abroad, which they keep distinct from their Lithuanian business because of foreign exchange regulations.

Those banks are not privately owned in the Western sense; their major stockholders are state-owned enterprises, and in one case also the Ministry of Finance. However, they are independent of the Bank of Lithuania and of the Lithuanian government. The bank managers own shares, and their voting power is important because some banks do not allow all shares equal voting rights.

Despite their independence, the private commercial banks are under the Bank of Lithuania's thumb because their legal status is uncertain. At present, they operate under the law on joint stock companies, although a provision of that law states that it does not apply to banks. The Bank of Lithuania has broad powers over them; in addition to setting reserve and other requirements, it can prevent them from opening branches and can revoke their licenses at will. The parliament is scheduled to debate a law on private commercial banks this autumn. The Bank of Lithuania has proposed one draft version of the law, and the Lithuanian Free Market Institute has proposed another. The Free Market Institute's version is less restrictive and would more effectively promote competition in banking. We recommend that the parliament enact it rather than the Bank of Lithuania's version of the law.

As is the case with the managers of the Bank of Lithuania, lack of contact with the outside world has left a void in the education of private commercial bankers. They and other Lithuanian businessmen need to become familiar with Western bookkeeping and accounting practices and with the principles of financial management of banks. American and Canadian bankers and accountants of Lithuanian descent could do a great service by sharing their expertise with their Lithuanian counterparts, as some already are doing.

Reforming the Banking System

Lithuania's present banking system is largely a continuation of the Soviet system. Unless Lithuania changes the powers of the Bank of Lithuania and gives commercial banks a more independent legal basis than they now have, its banking system will never be any better than the Soviet system.

In our previous memorandum we argued that licensing requirements, if any, should be liberal; that foreign banks should have the same freedoms as Lithuanian banks; that banks should be allowed to establish branches wherever they wish; that banks should be allowed to undertake any other lines of business they wish, such as insurance and stock underwriting; and that there should be no reserve, interest

rate, or foreign exchange controls. We argued against deposit insurance, which shifts responsibility for bank managers' mistakes onto taxpayers at large. We also recommended that banks in Lithuania publish accurate financial statements frequently. The financial disclosure requirements should be modeled after American and British practice, not after German and Swiss practice that allows banks to keep "hidden" reserves off balance sheets. Stringent disclosure requirements plus the ordinary penalties on fraud should keep embezzlement at an acceptably low level. We reiterate those recommendations here.

We recommend that private commercial banks be licensed by the Ministry of Finance, not the Bank of Lithuania. Licenses should be granted automatically to all banks that meet the disclosure requirements. Private commercial banks should not need the Bank of Lithuania's permission to establish branches. The statutory reserve requirements that the bank imposes are an unnecessary and inefficient tax on banks. Interest rates should be decontrolled to end the present artificial shortage of credit at below-market rates. Foreign exchange should also be decontrolled; now that Lithuania is no longer part of the Soviet Union there is no reason for it to prop up the Soviet ruble. Finally, the Bank of Lithuania's commercial banking functions should eventually be privatized. It may be possible to make many of those changes by inserting clauses in the law on private commercial banks that the parliament is considering this autumn. If not, the government should amend the law that established the Bank of Lithuania appropriately.

Right now, state-owned enterprises are the major depositors and borrowers as well as the major shareholders of private commercial banks. They deal with private commercial banks because they do not want to depend entirely on the Bank of Lithuania. The private commercial banks would like to lend to private businesses and to individuals but have difficulty doing so because property rights are poorly defined and no real bankruptcy law exists. There is as yet very little private property in Lithuania, though the government has begun privatization. The parliament is scheduled to debate a bankruptcy law this autumn.

Clear property rights and private property ownership are vital to a well-functioning free-market banking system. To enable individuals to borrow at reasonable rates, it is particularly important that, as part of Lithuania's privatization scheme, they receive unrestricted title to their apartments or agricultural land. Their apartment or the land they till will be the most valuable thing most people own. We recommend that people have complete freedom to

rent, sell, or mortgage the property they receive through privatization schemes. That will enable persons who want to start small businesses, for instance, to pledge their apartments as collateral against bank loans and will thus encourage economic growth. It makes no sense to prohibit people from selling their property until several years after receiving it, as one privatization scheme proposes doing.

The Currency Board Alternative

Long-term credit, unlike short-term credit, can only be encouraged by the introduction of a sound currency. At present, the private commercial banks limit themselves to short-term loans because of the hyperinflation of the ruble and uncertainty about the future shape of the Lithuanian monetary system.

The ruble is a bad currency that is getting worse every day. However, the litas is not likely to be any better if it is issued by the bank of Lithuania. The bank has no plan for achieving a stable, convertible currency and no competence in central banking. Lithuania does not need a central bank to issue or regulate a new currency. Instead, we propose that it establish a "currency board" to accomplish those goals while avoiding the dangers inherent in central banking. In our previous memorandum we explained how to establish a currency board, and a forthcoming monograph discusses at length how a currency board works and how to establish and operate one.[3] Rather than repeat ourselves, we shall just sketch our ideas to make the basic points clear to readers who are unfamiliar with currency boards.

A currency board is not a bank at all, nor does it regulate commercial banks. Its only purpose is to issue notes (paper currency) and coins convertible on demand into a foreign asset at a fixed rate of exchange. The foreign asset can be a foreign currency, gold or some other commodity, or a currency or commodity basket. A currency board does not grant loans (except perhaps in serving as a clearinghouse for bank checks) or accept deposits. As reserves it holds high-quality, interest-bearing securities denominated in the foreign asset. Its reserves must be a fixed proportion (at least 100 percent) of its notes and coins in circulation. A currency board makes profits from the difference between the interest on the securities that it holds and the expense of maintaining its notes and coins in circulation. It remits to the government all profits beyond what it needs to pay its expenses and to maintain its reserves at the level set by law.

More than 60 countries have had currency boards during this century. Most have been British colonies or former colonies. In 1918 and 1919, during the civil war, a Russian currency board existed in the northern region occupied by the British and other Allies. It issued a ruble currency with a fixed exchange rate to the British pound.[4] All currency boards maintained convertibility except when their countries were actually overrun by enemy armies. Even then the boards' assets were safe from seizure, because they were held abroad. Despite the success of currency boards, they exist today in only a few places, most notably Hong Kong. Other countries that once had currency boards replaced them with central banks, chiefly because central banking enabled governments to manipulate the money supply for political and fiscal purposes.

The currency board system works like the gold standard or the gold exchange standard. Market forces determine the amount of notes and coins that a currency board supplies as well as the amount of deposits and other forms of credit. The supply of reserves is determined by the actions of the supplier of the reserve asset--the foreign central bank to which the currency board currency is linked, or commodity producers if the reserve asset is a commodity. Competition among commercial banks determines the distribution of (demand for) the reserves, including how much becomes the foreign currency reserve of the currency board country. The currency board has no role in determining the supply of reserves, because its 100 percent reserves make it merely a sort of warehouse for reserves. The only way to acquire new reserves, obviously, is to obtain assets from the reserve currency country, which in its simplest form requires running a trade surplus. Changes in the balance of trade tend to change the domestic money supply in the same direction. The need to acquire reserves from abroad limits credit expansion in the banking system, since commercial banks must have reserves to make interbank payments and to meet customers' occasional demands for cash. The need to acquire reserves from abroad also keeps inflation roughly in line with inflation in the reserve currency country.

Some economists have criticized the currency board system for its allegedly restrictive monetary policy, which they have claimed hinders economic growth.[5] That view rests on a misunderstanding of how the currency board system works. In an economy in which capital flows can occur (which is to say, any economy with a convertible currency that has few barriers to foreign investment), the balance of trade does not impose any strict limits on a currency board system's ability to expand the money supply. Instead, a more complex but still completely market-based form of limi-

tation, based on people's estimates of profitability, applies.[6] (Even under floating rates a somewhat similar process is at work. A central bank operating a floating-rate currency has little or no power to stimulate the economy in an economically beneficial manner, though it can cause a temporary boom, to be paid for later with a depression.) Hong Kong and Singapore experienced trade deficits for decades under their currency board systems, yet their money supplies expanded all the while.

The currency board system is particularly well suited to overcome the problems of establishing confidence that a new currency faces. The currency board system guarantees that government's ability to manipulate the supply of currency will be extremely limited. A central bank, even one that is allegedly independent of the government, carries no such guarantee. Experience shows that all central banks bow to political pressure. Even the German Bundesbank has done so several times in the last few years. Also, central banks have a direct incentive to create high inflation so as to maximize their own profit from money creation, even if they do not finance the government debt. The people proposing a Lithuanian currency issued by a central bank seem to be unaware of those problems. We doubt that a new currency issued by a Lithuanian central bank would gain confidence at home or abroad.

Establishing the Currency Board

As the experience of more than a dozen past currency boards indicates, it is simple to replace a central bank with a currency board. The way to do so is to separate the Bank of Lithuania's currency issue, bank regulation, and commercial banking functions. The currency board would take over the currency issue functions; the Finance Ministry would take over the regulatory functions; and the commercial banking functions would become a commercial bank like any other, eventually to be privatized.

Lithuania is regaining gold that the old Bank of Lithuania owned abroad before the Soviet invasion of 1940. Depending on the arrangements that the foreign central banks holding the gold make with Lithuania, the value of the gold or compensation paid in its place will be $50 million to $100 million. The gold can provide Lithuania with the reserves necessary to establish a convertible currency. If used to establish a currency board, it will be the basis of a lastingly stable currency. If given to the Bank of Lithuania, it is likely to be frittered away, leaving Lithuania without hard currency reserves or a convertible currency.

In our memorandum we suggested that the most satisfactory reserve asset for a Lithuanian currency board is probably the German mark. The European Currency Unit (ecu) is also worth considering, because it offers the advantages of a somewhat diversified currency basket. If the ruble continues to be inconvertible, Western Europe will be Lithuania's main source of hard currency export earnings and investment, so it is desirable that its reserves be linked to the West European currency system. If Lithuania adopts the mark or ecu as its reserve asset, it should sell its gold and invest the proceeds in high-quality mark-denominated or ecu-denominated bonds, as the case may be. Although there is no actual ecu currency, there is a large and active market in ecu bonds. Until Lithuania sells its gold, it can earn interest on the gold by lending it in the London gold loan market, whose interest rates are published daily in the Financial Times.

The Lithuanian currency board will exchange its notes and coins on demand at a fixed rate into or from marks or ecus. It need not actually accept or pay hard foreign currency notes and coins; it could instead accept and pay out hard foreign currency-denominated bonds. It could establish a minimum amount for transactions, such as DM20,000 or 10,000 ecus, to cut its handling costs and restrict dealings to large blocks of foreign exchange. People who wish to transact smaller amounts will still be able to do so through banks, of course.

Judging from the experience of past currency boards, the annual cost of running the Lithuanian currency board should be less than 1 percent of the board's total assets. The board will make profits from the difference between its interest earnings and its expenses. All profits should go to building up unborrowed reserves until unborrowed reserves are at least 100 percent of the board's notes and coins in circulation. The board might accumulate an "equity reserve" equal to another 5 percent of notes and coins in circulation, as the Hong Kong currency board has, to provide it with extra funds in case its reserve assets should decline in value. Profits beyond that will go to the government.

We suggest that the currency board have its legal seat in Switzerland. That will prevent a Soviet takeover from jeopardizing the board's assets, as happened to the old Bank of Lithuania. The board will have its headquarters and its actual operations in Lithuania. To insulate the currency board as much as possible from politics, its directors should serve staggered terms, so not all can be replaced at the same time. A majority of directors could be required to be foreign nationals, chosen by institutions in their home

countries. Furthermore, the law establishing the currency board should make clear that the board's assets belong not to the Lithuanian government but to the board itself. The board should be required to publish regular, detailed financial statements. In our previous memorandum we included a model authorizing statute for a Lithuanian currency board.

Issuing the Litas

In our previous memorandum we also suggested a method by which Lithuania could convert rubles into litas. Here we shall suggest an alternative method for introducing the litas: circulating it as a parallel currency. A possible advantage of introducing the litas as a parallel currency is that doing so may be administratively simpler than converting rubles into litas. The Lithuanian government could also use some combination of methods, as the German government did during monetary unification. The Lithuanian government could convert some rubles into litas and distribute other litas by the method we suggest here. Indeed, any politically acceptable method of introducing a currency board-issued litas would work.

If the currency board has DM165 million ($100 million at current exchange rates), it can issue up to that amount in notes and coins. It should declare that one litas equals one mark (or one ecu, if the ecu is the reserve asset). That will be a sign that the government intends to make the litas as good as the mark rather than as bad as the ruble. It will also take fullest advantage of the savings in international transactions costs that can be realized by having a linked currency.

The currency board can distribute the litas to the public according to some simple plan; for instance, it can give every citizen of Lithuania approximately 40 litas (DM40). The public will spend some of the litas its receives, hold some, and deposit some at banks in new litas accounts. Banks will begin to make loans in litas. The litas and the ruble will at first exist side by side as parallel currencies, with a freely fluctuating exchange rate determined by market conditions. Ruble bank deposits can be converted into litas deposits at the market rate of exchange, if both bank and depositor wish. Ruble interest rates will have been freed to reach market levels. After adjusting for inflation, they should be no lower than litas rates, so that not everyone may want to convert ruble deposits into litas deposits. Prices may be expressed in litas or rubles depending on the wishes of sellers. Wages should be converted into litas at workers' request. People who do

not have litas can acquire them by exchanging their rubles for litas at the freely fluctuating market rate at banks or other dealers in foreign exchange.

Taxes should be payable only in litas. Ruble income should be taxed at its current equivalent in litas at market exchange rates. Ruble subsidies to consumers and enterprises could be continued. As the ruble continues to depreciate, ruble subsidies will eventually be self-eliminating if they are not increased. Litas prices should not be controlled. If the government follows that advice, there will be a growing litas sector with unregulated prices and a shrinking ruble sector with controlled prices. The end of the controlled sector will be gentler and perhaps less politically unpopular than if all prices were decontrolled at once.

The currency board litas will be a better currency than the ruble and should quickly drive the ruble out of circulation in many uses. That will be a spontaneous market process; there will be no need to force people to use the litas. The litas should be, so to speak, democratically chosen by the Lithuanian people. Furthermore, allowing the ruble to circulate as a parallel currency will facilitate trade with the Soviet Union.

Distributing free litas to the public would be extremely simple. Litas notes have already been printed. Under this proposal, they could be distributed to the public, and Lithuania could have its own stable, fully convertible currency within a few days of establishing a currency board. It is not necessary to wait years or possibly forever for a convertible currency, as plans for a central bank-issued litas envision.

With a stable currency in existence, the Lithuanian government could undertake price reform by freeing prices to rise to market levels. As part of the price reform, the government should abolish ruble coupon money.

The Ultimate Goal: Free Markets in Currency and Banking

Both theory and evidence strongly indicate that financial institutions and markets work best and contribute most to economic growth where they are freest.[7] Western nations are gradually relearning the advantages of freedom for financial markets. Lithuania would do well to avoid slavishly imitating Western financial regulations, which have often hindered growth without producing any general benefits.

Instead, it should proceed directly to the goal that Western nations have not yet fully achieved: complete freedom for financial institutions to compete with each other as Western companies in other types of business do.

As well as the particular freedoms for banks that we advocate above, we wish to stress again that Lithuania should not erect barriers to foreign financial institutions that wish to do business in Lithuania, even to own Lithuanian banks. It is common for public opinion in newly independent nations to oppose so-called foreign economic domination. For Lithuania to succumb to such ideas would be unwise and costly. Much of the property in Lithuania that before independence was owned by the government in Moscow was forcibly seized. In contrast, since sales of property by Lithuanian citizens to foreigners will be voluntary, with no element of coercion, there is no reason for the Lithuanian government to interfere with those transactions.

If foreigners wish to invest in Lithuania, Lithuanians should be glad, because it means that foreigners think Lithuania has good economic prospects. For more than a century after independence, British investment in the United States was so large that some Americans feared British economic domination. Nothing of the sort happened; in fact, British investment sped America's rise as the world's greatest industrial nation. Lithuania preserved its culture during half a century of occupation by a foreign army. Surely it has nothing to fear from the peaceful activities of a few business people whose intent is to make deals that both they and their Lithuanians counterparts find beneficial.

We also wish to stress that Lithuania needs no law to prevent people from using the ruble or other foreign currencies if they prefer once the litas is introduced. (Fratianni, Davidson, and von Hagen, on the other hand, wish to prevent people from using other currencies.)[8] If the ruble continues to be a bad currency, it will die a natural death in competition with the superior currency board-issued litas. As it is in other aspects of economic life, competition in currency is the best guarantee of consumers' interests. Competition in currency should extend even so far as allowing commercial banks to issue their own bank notes, convertible into the currency board litas or directly into the mark or some other foreign currency. That could result in lower and smoother interest rates by keeping as much base money as possible in bank reserves. Such competitive currency issue systems have worked well in dozens of cases in the past.[9]

Conclusion

The ruble is rapidly losing value. The Bank of Lithuania has no definite plan for producing a stable, convertible currency. The experience of many newly independent countries indicates that probably no form of central bank can produce a stable, convertible currency.

As an alternative monetary institution, we propose that Lithuania establish a currency board. The currency board system, as used in Hong Kong and elsewhere, is a simple and proven vehicle for promoting economic growth.

To summarize, we recommend that Lithuania take the following steps.

* Establish clear property rights, which will allow individual people and enterprises to offer their property as collateral for bank loans. Allow people to sell, rent, and mortgage privatized state property immediately.

* Pass a bankruptcy law, as the parliament is scheduled to do.

* Pass the version of the private commercial banking law proposed by the Lithuanian Free Market Institute rather than the version proposed by the Bank of Lithuania.

* Remove restrictions on interest rates for loans and deposits.

* Allow free trading in all foreign currencies.

* Abolish most of the Bank of Lithuania's regulatory powers over private commercial banks. Transfer the remainder, if any, to the Ministry of Finance.

* Separate the Bank of Lithuania's commercial banking functions from its other functions, and privatize its commercial banking functions.

* Establish a Lithuanian currency board to issue the litas. The litas should equal one German mark or one ecu.

* Sell Lithuania's prewar gold reserves for mark- or ecu-denominated assets.

* Distribute litas notes and coins to the public.

* Abolish the coupon scheme.

Notes

1. Kurt Schuler and George Selgin, "A Proposal for Reforming Lithuania's Monetary System" (Unpublished paper, November 1990).

2. Charles Goodhart, The Evolution of Central Banks (Cambridge, Mass.: MIT Press, 1988), pp. 45-46.

3. Steve H. Hanke and Kurt Schuler, Currency Boards for Eastern Europe (Washington: Heritage Foundation, forthcoming).

4. Steve H. Hanke and Kurt Schuler, "Ruble Reform: A Lesson from Keynes," Cato Journal 10, no. 3 (Winter 1991): 655-66.

5. Michele Fratianni, Lawrence S. Davidson, and Jurgen von Hagen, "Currency Reform in the Baltic Republics" (Hudson Institute, Indianapolis, Ind., September 13, 1991, Mimeographed), p. 20.

6. Hanke and Schuler, Currency Boards, appendix B.

7. See Rondo Cameron et al., Banking in the Early Stages of Industrialization: A Study in Comparative Economic History (New York: Oxford University Press, 1967); Rondo Cameron, ed., Banking and Economic Development: Some Lessons of History (New York: Oxford University Press, 1972); Kevin Dowd, The Experience of Free Banking (London: Routledge, forthcoming); Maxwell Fry, Money, Interest, and Banking in Economic Development (Baltimore: Johns Hopkins University Press, 1988); Ronald McKinnon, Money and Capital in Economic Development (Washington: Brookings Institution, 1973).

8. Fratianni, Davidson, and von Hagen, p. 34.

9. Dowd.

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Policy Analysis

No. 162 October 17, 1991

Routing

FALSE DREAMS AND BROKEN PROMISES: THE WASTEFUL FEDERAL INVESTMENT IN URBAN MASS TRANSIT

by Jean Love and Wendell Cox

Over the past quarter century, U.S. taxpayers have pumped more than $100 billion in subsidies into the nation's urban mass transit systems. That massive taxpayer investment has paid for urban public transportation systems that fewer and fewer Americans are using. Incredibly, mass transit ridership is lower today--not only as a percentage of commuter trips taken but also in absolute numbers of riders--than it was in the early 1960s. Despite the low and declining use of bus and rail systems, federal grants for urban transit now appear to be as popular as ever: bills before both houses of Congress would provide increases of up to 20 percent in public aid for municipal bus and rail systems.

The considerable support within Congress for expanded transit aid is not surprising. Since the federal government created the Urban Mass Transportation Administration during Lyndon Johnson's administration, public transit has been a fertile field of dreams and promises. Tax-supported transit lobbyists[1] supply Congress and state houses with visions of magic carpets that whisk commuters around gleaming cities.

The alleged virtues of public transit are by now familiar. For weary motorists, public transit systems promise less automobile-generated traffic congestion; for environmentalists, less air pollution; for city planners, a first step toward urban revitalization; for the poor, inexpensive access to efficient transportation; for conservationists, less wasteful use of energy; and for the business community, a way to lure suburbanites back to central business districts.

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Regrettably, more than two decades of experience with publicly supported bus and rail systems have exposed each of those dreams as a costly illusion. Public transit systems have failed to deliver any of the promised benefits.

* Transit subsidies are not increasing ridership. Transit ridership is lower today than it was 30 years ago--before the billion-dollar subsidies began. People, including transit executives[2] and elected officials, tend to ride public transit only when they have no other reasonable choice.

* Transit subsidies have not reduced road congestion. The shiny new multi-billion-dollar rail systems have not diverted meaningful numbers of drivers from their cars; most new patronage has been of less expensive, more flexible bus lines and energy-efficient car and van pools.[3]

* Transit subsidies do not reduce air pollution. Because public transit has not increased ridership, transit has had no discernible impact on air quality in cities. Mass transit patronage is so low that even doubling it would have a negligible effect on air quality.

* Public transit is not energy efficient. The average public transit vehicle in the United States operates with more than 80 percent of its seats empty.[4] Because of the low average number of passengers per bus, energy consumption per passenger mile for public transit buses now is greater than that for private automobiles and far exceeds that for car and van pools.[5]

* Transit subsidies have not helped revitalize cities. Cities, such as Buffalo, with new multi-billion-dollar rail systems have not reduced flight from their central business districts. Even with ever-greater subsidies for public transit, the exodus of businesses and residents from downtown areas is accelerating.[6]

* Urban transit does not benefit the poor. Ridership studies show that the poor are not heavy users of federally subsidized transit systems. Transit provides only 7 percent of trips made by low-income people.[7]

The cold, hard lesson of the last 25 years is that instead of promoting increased efficiency in bus and rail service, higher taxpayer subsidies have paid higher-than-inflationary transit costs. Subsidies have financed excessive compensation for transit employees, declines in transit

productivity, and swollen bureaucracies--not increased services. If public transit costs had risen only at the same rate as private bus industry costs, service levels now could be more than double the 1989 level.[8]

Worst of all, taxpayer subsidies, particularly federal grants, have actually impeded the development of efficient and cost-effective urban transit programs in U.S. cities. The experience of other industrialized nations and some selected systems in the United States demonstrates that by tearing down the significant regulatory barriers, which prevent private, unsubsidized transit systems from developing, and by encouraging competitive contracting by private providers for subsidized systems, the mobility needs of urban residents can be met at lower cost and greater convenience to customers. Conversely, if Congress approves further large increases in transit subsidies, they will fuel further increases in transit costs. Those funding increases will ill-serve the interests of urban commuters, and they will certainly ill-serve the interests of American taxpayers.

The Destructive Federal Role in Urban Mass Transit

Before 1960 most transit systems in the United States were privately owned and operated. That situation was reversed when Congress created the Urban Mass Transportation Administration (UMTA) in 1964.[9] Indeed, during the mid and late 1960s, public aid was used to help finance the conversion of transit from private to public monopoly. From an initial $435 million over three years,[10] UMTA's funding level grew over the next 20 years to $3 billion per year by 1989.

As a result of the poor performance and waste of many of the transit systems receiving federal support, the Reagan administration, under David Stockman and James C. Miller III at the Office of Management and Budget, succeeded in cutting transit grants by roughly 25 percent in the mid and late 1980s. In 1985 former senator William Proxmire (D-Wis.) presented his celebrated Golden Fleece Award for wasteful use of tax money to UMTA. Proxmire said that UMTA had "played Santa Claus to the nation's cities," and that the results of the program were "a spectacular flop, the Edsel of federal programs. Taxpayers were taken for a ride." Ralph Stanley, at that time the administrator of UMTA, accepted the award in person stating, "I embrace Senator Proxmire's Golden Fleece Award and totally agree with his criticism."[11]

Despite the obvious problems of mass transit, higher levels of federal subsidies have been proposed. This year funding for mass transit may rise by as much as 20 percent to nearly $4 billion annually.[12]

The Myth and Reality of Public Transit Systems

The conventional wisdom in Washington is that the manifold social benefits of efficient public transit systems justify high taxpayer subsidies. A massive commitment of taxpayers' money to public transit is purportedly essential to solving a variety of national problems--including urban decay, traffic congestion, U.S. dependence on foreign oil, and the transportation problems of the poor. For those and other reasons, strong special interest groups support increasing subsidies to bus and rail systems.[13] Yet upon closer inspection, the evidence convincingly demonstrates that each supposed benefit of transit is more myth than reality.

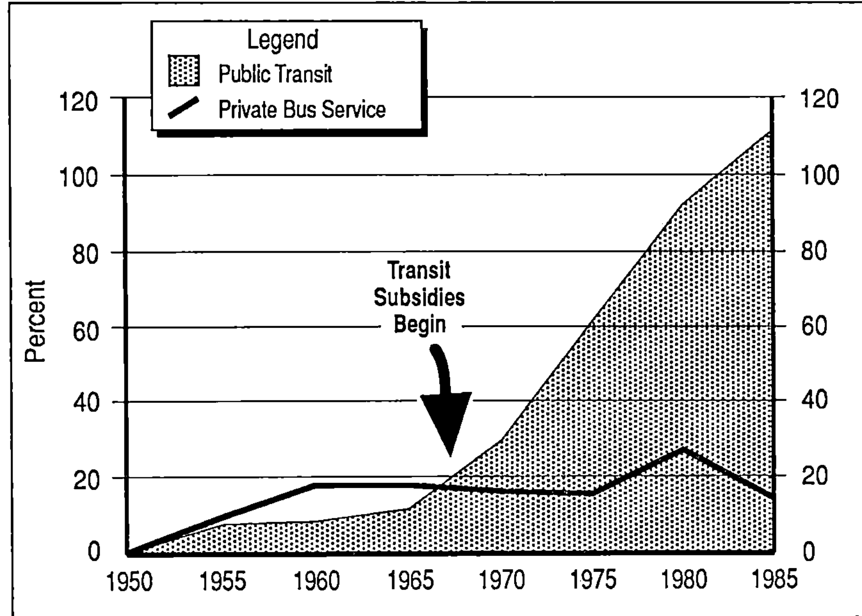
Myth no. 1: Federal Transit Subsidies Have Improved Transit Service

Federal dollars for urban transit have not bought improvements in service levels for commuters; rather, they have generated rapid inflation of costs in the industry. Between 1970 and 1985 public transit operating costs per vehicle mile increased an incredible 393 percent (Figure 1), or roughly twice the rate of general inflation during the same time period and roughly 2.5 times the operating cost increase for similar service in the private bus industry.[14] Public transit costs have increased at a faster rate than costs in any other sector of the economy--even health care (Figure 2). From 1970 to 1989 public transit costs per vehicle mile increased approximately 20 percent more than health care costs.[15]

The cost inflation in the public transit industry has corresponded almost precisely with mushrooming levels of federal assistance. Annual subsidies rose from less than $300 million in 1970 to more than $12 billion in 1989[16]--a 10-fold increase after adjusting for inflation. Those subsidies represented 14 percent of transit revenues in 1970 and nearly two-thirds of transit revenues in 1989 (Figure 3). Public transit has consumed more than $100 billion in public aid in the last two decades. Although federal funding for public transit declined in the 1980s, state and local assistance has more than made up for the loss so that

Figure 1

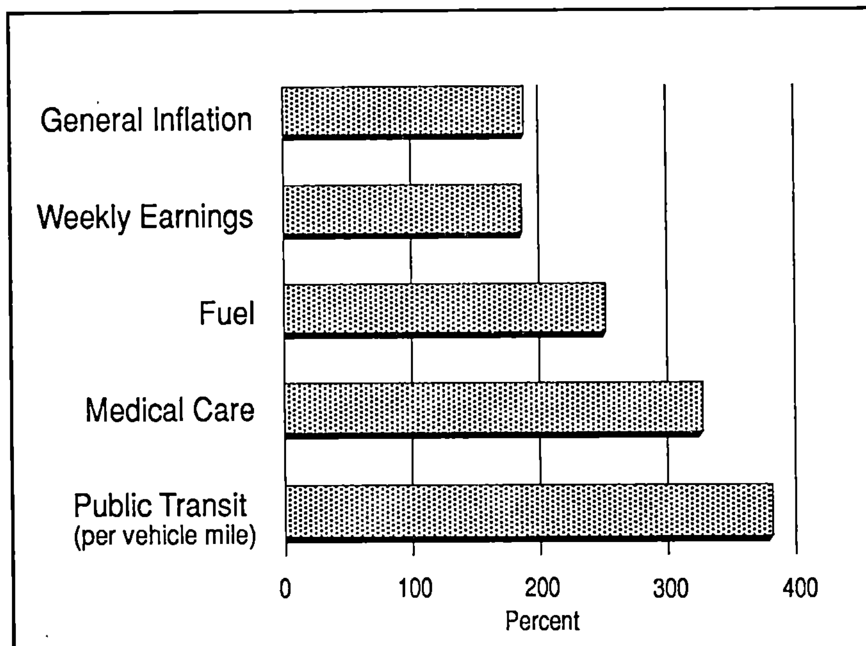
Change in Inflation-Adjusted Costs per Mile for Transit and Private Bus Service, 1950-85



Source: APTA Annual Reports and UMTA Section 15 Annual Reports.

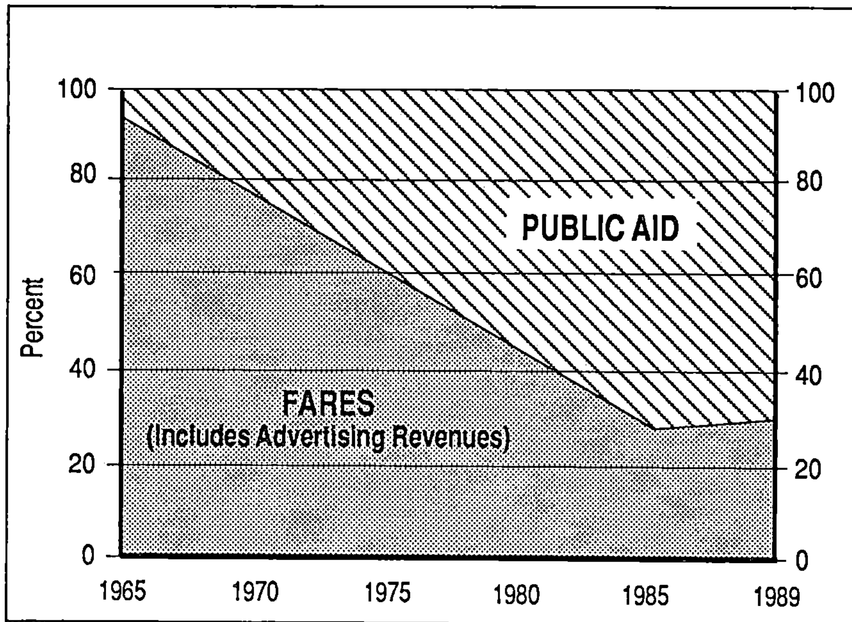
Figure 2

Inflation in Transit Costs versus Costs of Other Goods and Services 1970-89



Based on APTA annual reports; UMTA Section 15 annual reports; and U.S. Department of Labor, Bureau of Labor Statistics, various annual reports.

Figure 3
Fares as Percentage of Operating Expenses



Based on data from the APTA annual reports and UMTA section 15 annual reports.

aid to public transit continues to grow faster than inflation.[17]

Regrettably, service has improved little in response to the increased federal commitment to local transit. For each new inflation-adjusted dollar of revenue, transit has produced less than 25 cents of new service--75 cents of each dollar has financed cost increases that exceed the rate of inflation. A 1986 study by UMTA found that of the $8 billion spent by the federal government on operating subsidies, $2 billion went for higher real wages, $1.5 billion went for lower employee productivity, and $1 billion went to reduce real fares. Only $1 billion went to extend or improve transit service.[18] As a result, today it costs an estimated $4.20 to generate a dollar's worth of new transit service.[19]

In sum, federal subsidies to urban transit have not purchased additional or improved levels of service. The funds have contributed to a largely inefficient and overcompensated industry that is failing consumers.

Myth no. 2: Increasing Federal Subsidies Will Attract More Transit Riders

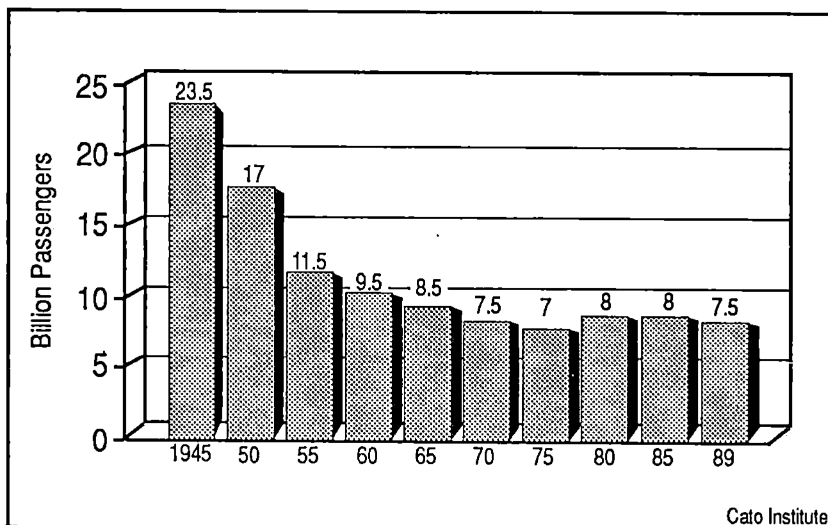
Gross public transit ridership has been consistently falling since World War II. In 1945 ridership was 23.5 billion passengers, whereas in 1989 it was 7.5 billion--or less than one-third the 1945 level and less than half the 1950 level (Figure 4). The drop in ridership occurred despite huge increases in the number of urban commuters between 1945 and 1989.

Since 1970 urban ridership has risen by roughly 5 percent, which could be taken as a sign that public transit is on the rebound. Unfortunately, even the small reported increase in ridership is probably vastly exaggerated as a result of the way trips on public transit are counted. Each segment of a public transit journey is counted separately, so a passenger transferring from one bus to another or from a bus to a rail car is counted as two passenger trips. Studies have shown that up to two-thirds of new rail ridership represents transfers from buses. Hence, many bus riders are double-counted because they must use both a bus and a rail line or two buses to make a trip that they previously made on a single bus.

Because the population has increased 25 percent and the labor force has increased 50 percent since 1970, the minuscule increase (if it exists at all) in ridership claimed by

Figure 4

Transit Ridership, 1945-89



Based on data from APTA and UMTA.

the transit industry translates into a shrinking market share captured by public transit. Transit's share of trips to and from work--transit's biggest market--declined by nearly 30 percent during the 1970s in large metropolitan areas. Total public transit rides per capita plunged an additional 15 percent from 1980 to 1989 in metropolitan areas with populations of more than 1 million.[20] In 1980 public transit's urban market share[21] (6.4 percent of work trips) just exceeded the market share for walking to work; car and van pools, which do not receive any direct federal subsidies, provided nearly three times the number of trips to work that public transit did. Nationwide, only 2.2 percent of all personal trips were made by transit, and just over 5 percent of work trips were provided by transit.[22]

Even the development of expensive new rail systems did not reverse the trend in ridership loss; per capita transit ridership dropped in all urban areas that opened or expanded rail systems in the 1980s: Atlanta, Baltimore, Buffalo, Miami, Portland, Sacramento, San Diego, San Francisco, and Washington, D.C. Consider these examples:

* Portland's light rail line, which opened in 1987, attracted only one-third of its riders from the automobile;[23] most other riders were diverted from buses.

* Buffalo spent more than $600 million, most of which was federal money, to construct a rail line, but combined bus and rail ridership in 1989 was 20 percent below the bus-only ridership figure for 1980.[24]

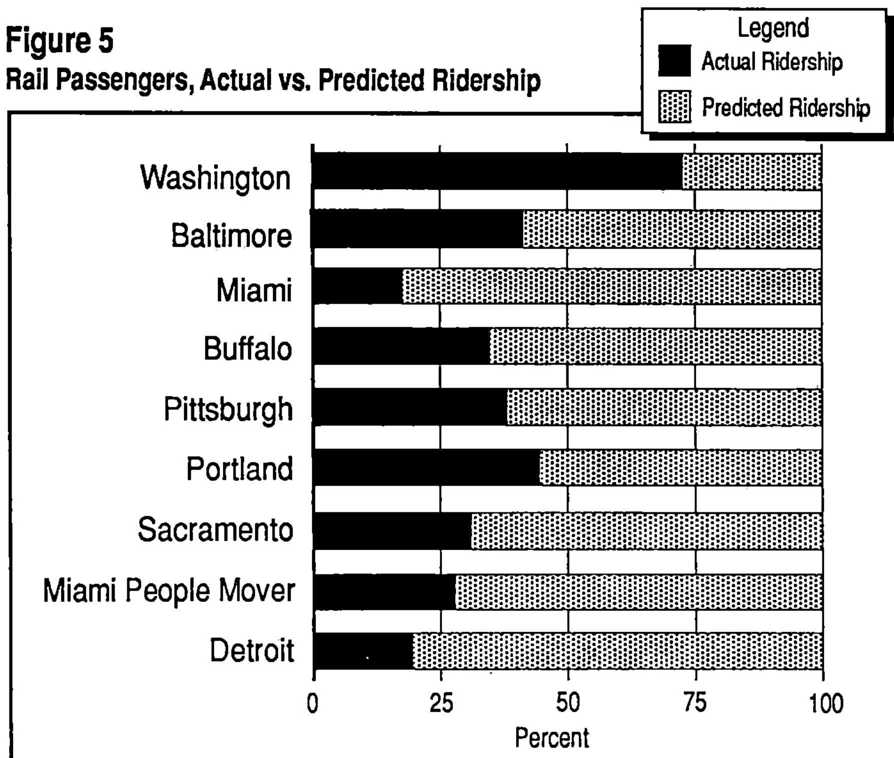
* Miami's Metrorail, which was built in the 1980s with massive federal assistance and carried a final price tag in excess of $1 billion, is ridden by only 1 percent of Dade County residents.[25]

Most cities that have constructed expensive new rail systems during the past 15 years have dramatically overestimated ridership. Figure 5 shows projected versus actual ridership in nine cities with rail systems built with federal dollars. Ridership fell below projections in every one of the cities, and only one achieved even half the predicted ridership levels.

Myth no. 3: Public Transit Can Meet the Transportation Needs of Urban Commuters in the 1990s

Transit use in the United States has been declining for at least the past five decades as a result of changing lifestyles and economic conditions, including low-density land

Figure 5
Rail Passengers, Actual vs. Predicted Ridership



Source: Don Pickrell, *The Causes of Rising Transit Operating Deficits* (Washington: U.S. Department of Transportation, 1983).

use patterns inside and outside of cities, suburbanization, the increase in female employment outside the home, the 40-hour work week, the steadily growing affluence of workers, and most important, the emergence of the automobile. Some argue, however, that public transit will experience a revival in the 1990s as public investment in buses and rail systems rises.

The evidence suggests that many of the changing commuter travel patterns that began to emerge in the 1970s and 1980s will continue in the 1990s, thus accelerating the exodus from subways and buses to automobiles and other forms of non-fixed-route transportation services such as minivans. Even if increasing government transit dollars are able to purchase increases in the level of transit service, those programs will become increasingly incidental to America's travel patterns.

As has been well established, the dominant commuting pattern is no longer from the suburbs to downtown but from low-density suburb to low-density suburb. Today the number

of suburb-to-suburb commuter trips is roughly double the number of commuter trips from suburb to center city.[26] Yet public transit's conventional forms--buses and trains--can be effective only in high-density corridors where a large number of riders begin or end their trips in a concentrated area such as a densely developed central business district. While many large downtown areas have grown, their relative importance in metropolitan areas has diminished--most commercial and office development has occurred in the suburbs. And the emerging suburban employment and retail centers do not have densities sufficient to justify expanded transit service--particularly rail service. The cost in subsidies, vehicles, and transit personnel to duplicate the radial networks that serve downtown areas would be prohibitive.

The unavoidable truth for the transit industry is that today's metropolitan area is tailor made for cars, not for fixed-route public transit. Conventional transit cannot serve suburban areas with speeds and total travel times comparable to those of private transportation. Further investments in modes of transportation to accommodate travel patterns that predominated more than 40 years ago will not meet commuters' needs in the 1990s.

Myth 4: Public Transit Can Be Successful in the United States Because It Is Successful in Other Industrialized Countries

Advocates of higher taxes for transit constantly point to the far higher levels of transit ridership in Western Europe, Canada, Australia, New Zealand, and Japan to suggest that substantial increases in U.S. transit ridership would occur if only there were much higher levels of public support for public transit.

But there are inconsistencies in that line of reasoning. First, public transit subsidies already are higher in the United States than they are in other developed nations. The extremely high operating costs of public transit in the United States suggest that, with the possible exception of the former communist countries, U.S. public subsidies per passenger may be the highest in the world. Subsidies account for approximately two-thirds of operating costs in the United States, substantially more than they do in nations where ridership is higher. In Europe and Canada subsidies are less than 50 percent, and in Japan subsidies are less than 15 percent.[27]

The higher ridership in other developed nations is not the result of more generous subsidies. The average resident

of a Western European urban area takes nearly five times as many public transit trips annually as a U.S. urban resident, despite the fact that a lower level of service (vehicle miles) per rider is provided in Europe. There are at least two fundamental causes of Europeans' more intensive use of public transit--density and concentration of destinations. Western European urban areas have a far larger percentage of their commercial development and employment in their urban cores, and their population densities are much greater--more than three times those of their U.S. counterparts.

Even in an urban environment that favors use of bus and rail service, public transit's market share is stable or declining, and automobile usage is increasing in Western Europe, just as it is in the United States.[28] Europe did not create higher transit ridership by attracting passengers from the automobile, although many transit supporters insist that can happen in the United States. Indeed, in Europe today, as income levels rise, the automobile is diverting passengers from transit. Moreover, even though subsidies are generally lower than they are in the United States, concern about rising public transit costs has induced Western European governments to take various actions to limit the growth of subsidies even further, such as competitive contracting, reduced reliance on national government subsidies, and overall limitations on subsidies.[29]

Myth no. 5: Increased Public Investment in Transit Will Increase U.S. Productivity and Competitiveness

Economists agree that there is a correlation between a nation's capital infrastructure and its productivity and competitiveness. But productivity is improved by a new capital project only when its benefits equal or exceed its costs and when the rate of return at least equals that of alternative investments. Infrastructure may be productive or unproductive--money expended to build a bridge to nowhere or an underutilized rail facility erodes productivity. On the whole, public investment in new transit infrastructure has diminished, not increased, the nation's total productivity.[30]

Transportation planners routinely overstate the projected economic rate of return on new public transit investments by systematically overestimating ridership and underestimating construction costs. For example, a U.S. Department of Transportation study of 10 urban rail projects showed that only one project came in under the estimated cost; construction costs for the remainder ranged from 33 to 106 percent over initial estimates.[31]

Proper tallying of the total public investment in cities' transit systems and calculation of the per passenger subsidy makes it clear that the costs of those projects far exceed any possible benefits to national productivity or competitiveness. Total costs of capital and operation range from $5.58 to $16.44 per rail passenger ride, yet most riders pay a base fare of roughly $1.00.

Many of the expensive transit projects funded in the 1980s turned out to be white elephants. Detroit, for example, built a three-mile downtown people mover (that operates in only one direction) largely with federal funding. Construction costs were 50 percent over budget and ridership 80 percent below projection.[32] To pay for the construction deficit, funding was siphoned from needed bus improvements in a city whose low-income population represents a substantial market for bus service expansion. Detroit proposed reduction of its police force as it increased its expenditures for the higher-than-anticipated operating deficit[33]--and Detroit has one of the nation's highest crime rates. Similarly, in Miami per passenger expenses are so great that it would have been cheaper for taxpayers to provide limousine service for public transit users than to build and operate an extravagantly expensive rail system. Such rail systems are anything but an efficient investment in America's infrastructure.

Undaunted by the evidence, cities throughout the country are now duplicating those expensive mistakes. Dallas, Minneapolis, Salt Lake City, and Tucson are all planning expensive rail systems that would be suitable only for the high-density cities of Europe. Those systems are not expected to cover their operating expenses let alone recapture the multi-billion-dollar federal, state, and local investment of taxpayers' money.

Unquestionably, the major explanation of the inability of the public transit industry to contain costs has been the inflated salaries and benefits of public transit workers. Public transit employees are paid as much as twice the amount received by the average nonsupervisory worker in the United States and 65 percent more than the average U.S. worker. Although the education requirement for transit drivers is less than a high school diploma, they receive nearly 11 percent more in total compensation than do private-sector employees with four or more years of college education. The average compensation for all transit employees exceeds the average salary for U.S. employees with college degrees by more than 30 percent.[34] Public transit fringe benefits average 50 percent of employee pay--nearly double the fringe benefits of the average private-sector

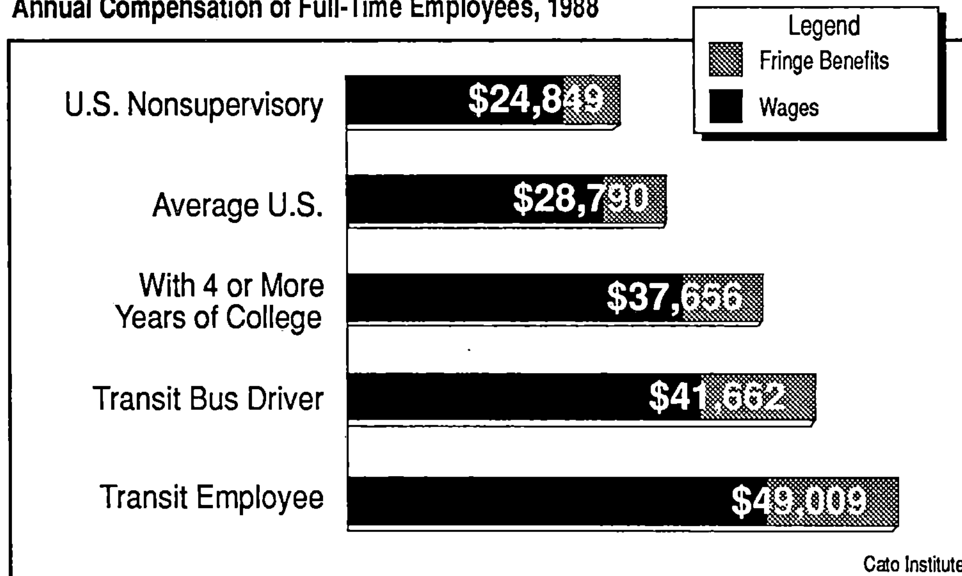
worker.[35] Hence, when fringe benefits are added to the equation, the average transit employee receives 70 percent more in compensation than the average U.S. employee (Figure 6).[36]

Worse yet, the pay premium enjoyed by transit workers appears to be widening. Philadelphia's fiscally troubled Southeastern Pennsylvania Transit Authority, for example, has developed a 1992 budget that includes a 5.5 percent wage increase (more than one-third more than the national average wage increase in 1991) for employees. Yet SEPTA is planning service cutbacks, demanding additional subsidies, and threatening to shut down the system if a new, dedicated tax is not provided for the deficit-plagued transit system.[37] San Francisco's Bay Area Raid Transit system reports that unionized employees have rejected an offer of a 4 percent wage increase for each of the next three years. The BART offer would bring drivers' salaries to $48,000, janitors' to $36,000, and mechanics' to $53,000 per year; benefits, which add to the total compensation, would remain at 51 percent of wages and salaries, so that drivers would be compensated at more than $70,000, janitors at more than $50,000, and mechanics at $80,000 annually.[38]

Public transit has suffered declining labor productivity over the past two decades. Productivity as measured by hours of bus service produced per constant dollar fell an average of 43 percent from 1964 to 1985; the productivity

Figure 6

Annual Compensation of Full-Time Employees, 1988



Derived from *Statistical Abstract of the United States* and UMTA section 15 report, 1988.

decline for large transit agencies was 55 percent. About one-third of the cost increases over inflation in urban transit since 1970 can be attributed directly to the decline in productivity.[39]

Let us put the dismal record of transit worker productivity and performance into perspective. The unsubsidized private taxi industry employs about the same number of workers as transit but provides three times as many vehicle miles of service.[40] Yet transit is heavily subsidized by government and taxis receive virtually no public assistance.

One explanation for transit's steep productivity decline is that transit employees are working less. Average annual service hours worked by each public transit employee (for buses) fell from 1,228 in 1964 to 1,028 in 1985. The decrease in productivity was worse for the largest transit agencies--from 1,205 hours in 1964 to 929 hours per employee in 1985.[41] Meanwhile, public transit driver absenteeism, which is epidemic in the industry, averaged 34 days a year in Miami, 32 days in Los Angeles, and 27 days in Pittsburgh, exclusive of vacations and holidays.[42]

Another cause of the anemic productivity levels in the transit industry is a provision of the Urban Mass Transportation Act of 1964, section 13(c),[43] which is administered by the U.S. Department of Labor. That provision has secured for transit workers a degree of bargaining power that is not shared by employees or labor unions in other U.S. industries.[44] It sounds innocent enough, requiring that adequate labor arrangements be made to ensure that employees are not harmed as a result of federal funding. In practice, however, section 13(c) has been interpreted to require negotiation of generous labor agreements between transit agencies and their unions. Failure of a transit agency to make concessions to labor can result in loss of federal funding, thus giving transit labor unions de facto veto power over the coveted capital (and operating) grants.[45]

Section 13(c) has impeded efforts to improve productivity and efficiency in the transit industry. It requires up to six years' pay for an employee whose job is eliminated as a result of economies or efficiencies. Assuming the 1988 annual compensation level of $41,000 for the average public transit bus driver, legally mandated severance pay could be as much as $250,000 per worker, compared with mandated severance pay (unemployment insurance benefits) of less than $5,000 for typical American workers.

Section 13(c) also has so skewed collective bargaining in favor of transit unions that they have negotiated not only higher-than-market compensation in the industry but absurd work rules that extract pay for not working. For

example, the use of part-time labor is severely restricted or prohibited outright, even though part-time labor is ideal for public transit, because a large percentage of public transit service is consumed during rush hour periods in the morning and evening. Under current operating practices, to cover both morning and evening rush hours, drivers are paid for time not worked during midday. Most public transit labor contracts also require the full-time employment of substitute drivers. Sometimes substitute drivers operate buses and are paid for driving; other times substitute drivers are paid to sit and wait. Substitute public transit drivers, who have skills that can be learned in a month or less, are paid whether or not they work; substitute public school teachers, who must have at least four years of college, are paid only when they work.

The net effect of those restrictive work rules is that public transit bus drivers work as few as 36 minutes of each hour for which they are paid on some services, and the average is less than 50 minutes of work for each hour's pay. Practices such as those would bankrupt a company in the competitive marketplace.

The combination of federal subsidies, excessive pay rates, routine cost overruns, and archaic work rules in the transit industry has prevented implementation of economical investment and operating procedures in public bus and rail service. That combination has been a major factor in transit's cost escalation. The annual excess of transit costs over inflation (from 1970) is now more than four times the total amount of federal operating subsidies. Pumping billions of additional federal tax dollars into such a system does not contribute to the development of America's infrastructure and ultimately makes the nation less, not more, competitive.

Myth no. 6: The Washington Metro Has Been a Stunning Public Transit Success That Can Be Duplicated in Many Other Cities

The most comprehensive federally supported rail system in the nation is Washington, D.C.'s Metro. It is typically regarded as a transit showcase that can be duplicated in other cities.

Although the Washington Metro carries more riders than any other new rail facility, it has fallen far short of reaching its ridership projections.[46] Part of the reason is that employment in the central business district has grown at a much lower rate than projected before the system was built, while suburban employment has grown at a greater

rate. Not only did public transit ridership per capita decline in the 1980s in the Washington area, but planners projected that public transit's work trip market share would decline another 9 percent from 1986 to 2000--despite a planned $3 billion, or 70 percent, expansion of the rail system.[47] Even the most recently opened Metro stations are drawing far fewer passengers than predicted. Two new suburban Maryland stations, which cost approximately $300 million to construct and opened in 1990, are attracting only 7,300 passengers a week--slightly more than half the 13,100 expected.[48]

The taxpayers of the Washington area could not have afforded to build the $8 billion Metrorail system. It has been built primarily by funding from taxpayers across the country. Indeed, the taxpayers of the Washington area can barely afford to pay for operating the system as local and state budgets strain to keep up with rising costs.[49] And the American taxpayers cannot afford the tens of billions of dollars it would cost to replicate the Washington system in other cities.

Myth no. 7: Public Transit Conserves Energy and Improves Air Quality

With its continually declining work trip market share, public transit does not and cannot reduce energy consumption or air pollution. Some transit vehicles are overcrowded during peak hours in high-demand corridors. Yet, most of the time, there is excess capacity. The average public transit vehicle in the United States operates with more than 80 percent of its seats empty.[50] Because of the low average number of passengers per bus, the energy consumption per passenger mile of public transit buses is now greater than that of private automobiles, and it far exceeds that of car and van pools.[51] And unlike automobiles, public buses are becoming less, not more, energy efficient. In 1985 public transit used nearly 55 percent more transit vehicles to provide approximately the same number of rides provided in 1965. Over the same period of time the number of vehicle miles increased by 22 percent even though ridership remained static.[52]

Rail, also because of its low ridership, has not contributed to energy conservation. Rail systems require large amounts of energy for the construction of roadbeds, tunnels, and rolling stock. For example, one study estimated that San Francisco's BART system, which is highly patronized, will never save enough energy to recoup its initial energy investment.[53] That is apparently the case for most urban

rail systems. A 1982 Congressional Budget Office study concluded that "under typical conditions rapid rail systems actually waste energy rather than save it."[54]

Boosters of rail and advocates of higher transit taxes contend that air quality will improve as transit subsidies increase. Portland's light rail line is often cited as an example of how transit has produced substantial improvements in air quality since 1972.[55] Other factors are responsible for the improvement in Portland's air quality. Since 1972 automobiles, which account for the overwhelming percentage of travel in Portland (and virtually all other U.S. metropolitan areas), have become 48 percent more energy efficient on average, and the average new car has become 100 percent more energy efficient.[56] Further, the average automobile produces less pollution per gallon of gasoline today than it did in 1972. In addition, the percentage of urban trips taken by public transit in Portland was lower in 1989 than in 1980.

Public buses have, on balance, had no favorable effect on air pollution in U.S. cities. Because of low average ridership, buses, on a per passenger basis, often contribute to air pollution because bus emissions are much greater than those of cars or taxis.

Even minute improvements in the fuel efficiency and emission standards of automobiles, which are expected in coming years, or an increase in the number of riders per car would have much more effect on the environment than would massive increases in expensive public transit service.[57] Increased energy efficiency and decreased air pollution could be more efficiently and effectively achieved by the use of high-occupancy-vehicle lanes, the automation of toll collection to speed traffic, and other such reforms.

Myth no. 8: Urban Transit Reduces Traffic Congestion

Automobile users are said to benefit from public transit because it reduces congestion on roads and highways. Indeed, that supposed external benefit to drivers is the justification for using 1 cent of the federal gasoline tax to pay for transit. (One proposal before the House of Representatives would increase the gas tax to fund transit. A portion of last year's federal gas tax is also to be appropriated for transit.) Yet the reduction in traffic congestion resulting from increased transit subsidies is trivial, even under a best-case scenario. For instance, if transit ridership were doubled and the ridership gain came entirely from drivers who left their cars to ride transit, the number

of vehicle miles traveled by car would decline by less than 3 percent.[58]

Again Portland serves as an example. The number of automobile commuters who switched to light rail in Portland was less than 0.5 percent of daily commuters in the metropolitan area,[59] a percentage quickly nullified by the rate of growth in employment. New light rail riders account for less than two months' natural growth in total travel in the metropolitan area.[60]

Winning over even small numbers of riders from the roads and highways to transit has proven to be prohibitively expensive. It cost $9.22 to attract each new passenger ride to Portland's light rail line and $28.23 per passenger ride on the Atlanta system. Translated into cost per commuter per year, the expense of diverting each commuter from an automobile was $4,702 for the Portland line and $14,397 for the Atlanta system.[61]

Myth no. 9: Transit Subsidies Are Essential to the Mobility of the Poor

Transit provides essential mobility to many of the poor, but transit accounted for less than 7 percent of trips made by low-income people in 1983.[62] The most pressing need of the inner-city poor is transportation from the city to suburban jobs for which they are qualified. Yet only 5 percent of the total "reverse commute" market is served by public transit. From 1970 to 1980 transit's reverse commute market share declined by 50 percent. [A federal program to encourage entrepreneurs to provide reverse commute services to the inner-city poor has encountered resistance and delay as a result of transit unions' using their power under section 13(c). Many proposals have been abandoned; new proposals have been discouraged; and the poor continue to go unserved.] The increasingly dispersed nature of inner-city-to-suburb trips renders conventional mass transit service (large buses) unsuitable for that market in terms of both travel time and financial feasibility.[63]

If public transit subsidies benefit anyone, they benefit affluent suburbanites, not the poor. A Los Angeles study determined that inner-city service, patronized largely by the poor, received less than 22 cents in total operating subsidy per passenger boarding, while express service, patronized largely by the affluent, received more than $1.18 per boarding.[64] A 1986 study showed that riders with incomes exceeding $50,000 per year received 50 percent more in federal operating subsidies per transit trip than did low-

income users of transit.[65] The difference would have been greater if capital figures had been included.

Some rail systems bypass areas with low-income residents. The Washington Metro, for example, does not go to many high-density poor areas of the city, but it does service the affluent surrounding suburbs. Most Metrorail riders--some 73 percent--earn $25,000 or more; 19 percent earn $75,000 or more.[66]

Improving Transit through Competition and Privatization

Clearly, inefficient, highly subsidized public transit systems cannot deliver the socioeconomic benefits that have been promised and hoped for. Federal subsidies have rewarded inefficiency and wasteful capital investment, while propping up transit monopolies that actually impede effective alternatives to public transit. The unique patterns of American urban and suburban development and our particular social problems do not lend themselves to old European solutions, which are being abandoned. To meet America's needs, the following reforms are needed.

Eliminate Federal Subsidies

Federal transit subsidies have resulted in higher costs than they have covered. Subsidies have resulted primarily in a transfer of wealth from the taxpayers and the productive private sector to well-paid transit employees. At a minimum, in the interest of equity and efficiency, section 13(c) should be eliminated; transit workers should not continue to receive extraordinary compensation.

Federal subsidies increase the cost of transit. Federal capital grants have generated a mad scramble among cities to secure federal transit dollars to pay for new buses and rail service. Often as little as 5 to 10 percent of the investment is local money,[67] yet mayors and local transit authorities have demonstrated repeatedly that to attract "free" federal dollars, they will undertake massive capital investments, even when ridership does not justify construction or purchase. The federal contribution to capital assistance can be as high as 80 percent; nationally, the federal government funds 62 percent of total capital costs.[68] That federal contribution has had an undue influence on the escalation of transit costs.

Many countries have recognized the cost distortion that results from national subsidies and are reducing or elimi-

nating them. Examples include Norway, New Zealand, the United Kingdom, and the Soviet Union.[69] Canada and Australia, with much higher per capita transit ridership, have neither federal operating nor federal capital subsidies. Costs are lower and investments are more effective when subsidies are eliminated altogether, or at least are drawn from a level of government closer to home.[70]

Eliminate Barriers to Unsubsidized Private Service

In most cities only the transit monopoly is permitted by law to provide public transit service. Where the private market can operate without subsidy, it should be allowed to do so. Turning to the private market does not require returning to private monopolies and franchises, which are only slightly better than public monopolies. It simply means allowing the free market to provide unsubsidized service where it can.

Private unsubsidized buses and vans currently are providing transit for people in New York and Miami.[71] A 1991 Wall Street Journal report found that private (sometimes outlawed) vans are increasing their market share rapidly.

> Transit officials estimate that more than 2,500 private transit vans now patrol New York City. They seem to be everywhere in the boroughs of Brooklyn and Queens, bearing names like "Knight-Rider," "Island Boy" and "Leo the People's Friend." The phenomenon seems to be spreading to other cities with large Caribbean immigrant populations. In Miami, transit officials count 300 private vans, some even offering video tapes of Spanish-language soap operas to entertain riders.[72]

Vans and minibuses, which many people prefer to large buses and which have been shown to expand ridership in some areas,[73] could provide unsubsidized services in many high-density areas, freeing subsidies to expand service in other areas. Yet such service is outlawed in many cities, and the public transit agencies jealously guard their monopoly status. Express service is also provided by the private sector in some areas, but generally it too is prohibited.

Public transit spokesmen argue that private vehicles "skim the cream" from profitable routes and increase the deficits of transit agencies. But public transit costs are so high that few if any routes cover their capital and operating costs. In other words, there is no cream to skim. Moreover, the private sector pays taxes, not paid by the

public sector, that can exceed the net revenue public transit can obtain from its best routes.

Opening the transit market to private vans and minibuses can provide an opportunity for the poor or near poor to become entrepreneurs as it has done in South Africa.[74] The cost of capital is relatively low. In time those private operators could expand to multiple vehicles, or the experience and profits earned could lead to other profitable ventures. Meanwhile, those entrepreneurs would be positive role models for the entire community, provide employment and a valuable service, and contribute to the tax base.

Adopt Competitive Contracting for Subsidized Transit

If political considerations mandate continued taxpayer subsidies, public transit service should at least be purchased through competitive contracting. Under that system the public authority awards service contracts to responsive and responsible operators who demonstrate an ability to provide the specified quality and quantity of service for the lowest price. The public authority retains policy control over the service, while the competitive market produces the service under public scrutiny.

Public transit services are being converted to competitive contracting in Sweden, Denmark, the United Kingdom, New Zealand, Norway, and Finland. Competitively contracted services in London carry as many passengers as the entire Philadelphia rail and bus transit system. Competitive contracting is used in the United States for most paratransit (dial-a-ride) service and almost 8 percent of bus service. Metropolitan areas such as Dallas, Los Angeles, Denver, St. Louis, Cincinnati, San Diego, San Francisco, Seattle, Minneapolis, and Atlanta have achieved large cost savings through competitive contracting of bus service. The extraordinarily high costs of public transit in the United States have made possible average cost savings of 30 percent.[75] There is little reason, except vested public transit interests, not to competitively contract for subsidized transit service.

Conclusion

The realities of public transit fall woefully short of the myths. Transit is needed, but we can no longer afford to imagine that conventional public transit can address the complex problems of the changing American city. And we can no longer support a monopoly system of public mass transit, which has proven to be ineffective, inequitable, and unaf-

fordable. Through incorporation of competition, America can have efficient transit systems in every city--systems that do improve the environment, lessen traffic congestion, reduce fuel consumption, and help the poor. And improved transit can be provided at much less cost to the American taxpayer.

Notes

1. Most larger public transit agencies pay for full-time lobbyists in Washington as well as in the state capital, and transit management also spends time lobbying. Most large transit agencies have fully developed public affairs departments. In addition, the American Public Transit Association, which is financially supported by most of the nation's transit agencies, is involved in lobbying activity. Federal law prohibits lobbying with federal moneys, so transit agencies use state and local moneys and fares to finance lobbyists.

2. Like private-sector businesses, many public transit agencies provide free parking for their employees. And large transit agencies keep large fleets of cars for nonemergency and nonsupervisory use by staff. Transit boards and executives also use single-occupancy vehicles. According to the New York Daily News (June 2, 1991), New York City's Metropolitan Transportation Authority board members spent $200,000 in the past 12 months for chauffeured limousines to travel to and from the MTA Madison Avenue offices. The newspaper quoted the MTA first vice chairman, who generated $22,000 in overtime in the previous 16 months for his personal driver: "public transportation can be slower and more inconvenient than a car." It should be noted that New York City is the nation's most densely populated large city and has by far the nation's most extensive transit system.

3. Alan E. Pisarski, Commuting in America: A National Report on Commuting Patterns and Trends (Westport, Conn.: Eno Foundation for Transportation, 1987).

4. National Urban Mass Transportation Statistics: Section 15 Annual Report (Washington: U.S. Department of Transportation, Urban Mass Transportation Administration, 1987).

5. Calculated from National Urban Mass Transportation Statistics: Section 15 Annual Report (Washington: U.S. Department of Transportation, Urban Mass Transportation Administration, 1986); and National Transportation Statistics, (Washington: U.S. Department of Transportation, Transportation Systems Center, 1988).

6. For an analysis of America's changing cities, see Joel Garreau, Edge City: Life on the New Frontier (New York: Doubleday, 1991).

7. Dieter Klinger and J. Richard Kuzmyak, Personal Travel in the U.S., vol. 1, 1983-1984: Nationwide Personal Transportation Study (Washington: U.S. Department of Transportation, Federal Highway Administration, 1986).

8. Data from National Urban Mass Transportation Statistics: Section 15 Annual Report, various years; and Transit Operating and Financial Statistics (Washington: American Public Transit Association, various years).

9. Urban Mass Transportation Act of 1964, 49 U.S.C. 1601 et seq. A prior act, the Housing Act of 1961, authorized $75 million in aid to urban transit over three years.

10. Paul N. Tramontozzi and Kenneth Chilton, "The Federal Free Ride: The Economics and Politics of U.S. Transit Policy," Center for the Study of American Business, Washington University, St. Louis, October 1987.

11. Randall Fitzgerald, When Government Goes Private (New York: Universe Books, 1988), p. 153.

12. "Transit Wins Big in House Bill," Congressional Quarterly, July 13, 1991, p. 1889.

13. For a discussion of the various interest groups lining up in favor of increased federal transit aid, see Kirk Victor, "Transit Turnaround," National Journal, August 31, 1991, pp. 17-20.

14. Calculated from Interstate Commerce Commission and American Bus Association data.

15. Calculated from Consumer Price Index Medical Care Component.

16. Data from National Urban Mass Transportation Statistics: Section 15 Annual Report, various years; and Transit Operating and Financial Statistics, various years.

17. Data from National Urban Mass Transportation Statistics: Section 15 Annual Report, various years.

18. Ralph L. Stanley, administrator, Urban Mass Transportation Administration, Statement before the Subcommittee on Appropriations, U.S. House of Representatives, April 9, 1986, pp. 3-4.

19. Data from National Urban Mass Transportation Statistics: Section 15 Annual Report, various years; and Transit Operating and Financial Statistics, various years.

20. Based on data from all public transit systems located within the 39 metropolitan areas that reported both in 1980 and 1989 and all new systems reporting in 1989 (102 public transit systems included in analysis).

21. Public transit figures are overstated--the figures include taxis, limousines, privately owned buses and vans, and other unsubsidized services.

22. Klinger and Kuzmyak.

23. The Renaissance of Rail Transit in America (New York: Regional Plan Association, 1991).

24. Data from National Urban Mass Transportation Statistics: Section 15 Annual Report, various years.

25. Stephen Moore, "Rx for Urban Mass Transit: A Dose of Competition," Heritage Foundation Backgrounder no. 542, October 1986.

26. Pisarski.

27. Analysis of data from Jane's Urban Transport Systems, ed. Chris Bushell (Coulsdon, Surrey, U.K.: Jane's Information Group, 1991). Sample included 139 foreign systems.

28. European Conference of Ministers of Transport, Promoting Regional Transport: Report of the Eighty-Second Round Table on Transport Economics (Paris: ECMT, 1990).

29. See Wendell Cox and Jean Love, "International Experience in Competitive Tendering," paper presented at Second International Conference on Privatization and Deregulation in Passenger Transport, Tampere, Finland, June 1991.

30. Perhaps the most successful investment in new transit rail infrastructure has been in San Diego. Fares cover more than 90 percent of the costs of operation for the first line of the "San Diego Trolley." Constructed without federal funding, that line was completed for a fraction of the costs of comparable rail lines built with federal funding. That performance far surpasses that of any other new rail investment.

31. Urban Rail in America: Forecast versus Actual Ridership and Costs (Cambridge, Mass.: U.S. Department of Transportation, Transportation Services Center, 1989).

32. Ibid.

33. "Police vs. the People Mover," Detroit News, April 15, 1988.

34. The Chicago Transit Authority provides a stark example of the excessive compensation paid public transit workers. The executive director of the CTA, who is not the most highly paid transit administrator in the nation (the executive directors of the Southeastern Pennsylvania Transit Authority in Philadelphia and the Washington Metropolitan Area Transit Authority that serves the nation's capital are paid roughly $50,000 more per year), receives more pay than elected officials such as the governor of Illinois, the mayor of Chicago, and U.S. senators and representatives or appointed officials such as the Chicago police superintendent and fire commissioner. The American Public Transit Association, Transit Fact Book (Washington: APTA, 1988); Kim Nauer, "Pay for City's Brass Matches Up with Peers," Chicago Tribune, October 15, 1990; Gary Washburn, "Gung-ho Chief Has CTA Jumping," Chicago Tribune, August 5, 1990; Statistical Abstract of the United States (Washington: U.S. Government Printing Office, 1990).

35. Data from National Urban Mass Transportation Statistics, Section 15 Annual Report (Washington: U.S. Department of Transportation, Urban Mass Transportation Administration, 1988); and Statistical Abstract of the United States (Washington: Government Printing Office, 1990).

36. Ibid.

37. Kimberly J. McLarin, "SEPTA Approves Budget," Philadelphia Inquirer, June 27, 1991.

38. Benny Evangelista, "BART Ad Incenses Unions," Oakland Tribune, July 18, 1991; and BART full-page ad: "Labor Negotiations Status Report No. 1," Oakland Tribune, July 18, 1991.

39. Don Pickrell, The Causes of Rising Transit Operating Deficits (Washington: U.S. Department of Transportation, Urban Mass Transportation Administration, 1983).

40. The Status of the Nation's Local Mass Transportation: Performance and Conditions, report to Congress (Washington:

U.S. Department of Transportation, Urban Mass Transportation Administration, 1988).

41. Calculated from data in Charles Lave, Measuring the Decline in Transit Productivity in the U.S. (Thredbo, NSW, Australia: International Conference on Competition and Ownership of Bus and Coach Services, 1989).

The transit industry dismisses declining public transit labor productivity as a necessary consequence of increases in rush hour service. See, for example, Elliott D. Sclar, K. H. Schaeffer, and Robert Brandwein, The Emperor's New Clothes: Transit Privatization and Public Policy (Washington: Economic Policy Institute, 1989). Lave, however, found that rush hour service has not increased; it has declined by 15 percent in recent decades. Lave also reports that public transit operating speeds have increased by 13 percent over the same period. The drop in rush hour service and the increase in operating speeds, of themselves, would have a positive effect on labor productivity. Lave's findings suggest that public transit productivity may have declined even more than is suggested by the raw numbers.

42. Subhash R. Mundle, "Impact of Work Rules on Transit Productivity and Costs," paper presented at the Urban Mass Transportation Administration's Fourth Annual Symposium: The Private Sector and Public Transit, March 1988.

43. Urban Mass Transportation Act of 1964, as amended, 49 U.S.C. 1601 et seq. Amendments include an extension of section 13(c) labor protection to cover federal operational funding in addition to original provisions covering federal capital funding.

44. Simon Rottenberg, "Protection of Employees in the Public Acquisition and Operation of Urban Mass Transit," in Government Protection of Employees Involved in Mergers and Acquisitions, ed. Herbert R. Northrup and Philip A. Miscimarra (Philadelphia: University of Pennsylvania, Wharton School, 1989) provides the most comprehensive examination of the effects of section 13(c).

45. Federal legislation created and enforces section 13(c). However, many transit agencies have signed a local version of 13(c) that is more stringent than the federal law. The model 13(c) agreement, developed jointly by the transit unions and the American Public Transit Association in 1975, specifies that disputes be settled by binding arbitration--something not federally required. Although individual agencies were not required to adopt that contract or its provisions, many did to avoid lengthy contract negotiations.

46. Urban Rail in America: Forecast versus Actual Ridership and Costs.

47. Federal City Council, Transit in the Nation's Capital: What Lies Ahead? (Washington: U.S. Department of Transportation, Urban Mass Transportation Administration, Technology Sharing Program, 1986), p. 2.

48. "2 New Md. Stations Draw Fewer Riders Than Metro Expected," Washington Post, September 16, 1991, p. C1.

49. Metrobus and rail operating costs exceeded $509 million in 1989; states and localities paid 90 percent of the total subsidies of $240 million. The Washington system currently is cutting service for lack of "adequate" subsidies.

50. National Urban Mass Transportation Statistics: Section 15 Annual Report, 1987.

51. Calculated from National Urban Mass Transportation Statistics: Section 15 Annual Report, 1986; and National Transportation Statistics, 1988.

52. Data from the National Urban Mass Transportation Statistics: Section 15 Annual Report, various years; and Transit Operating and Financial Statistics, various years.

53. Data from National Urban Mass Transportation Statistics: Section 15 Annual Report, various years.

54. Congressional Budget Office "Urban Transportation and Energy: The Potential Savings from Different Modes," 1982, p. 1.

55. The Renaissance of Rail Transit in America.

56. In 1972 the average automobile got 13.4 miles per gallon; by 1988 that figure had improved to 20.0 miles per gallon. The average new car achieved 14.4 miles per gallon in 1972 and 28.8 miles per gallon in 1988. Data from National Transportation Statistics Annual Report (Washington: U.S. Department of Transportation, Research and Special Programs Administration, Transportation Systems Center, 1990).

57. Lave.

58. Alan Altshuler, The Urban Transportation System (Cambridge, Mass.: MIT Press, 1979).

59. Ibid.

60. Calculations based on the 1980 to 1990 population growth rate and the national average of daily trips per person in metropolitan areas of similar size as of 1983 given by Klinger and Kuzmyak.

61. Calculated from data in Klinger and Kuzmyak.

62. Klinger and Kuzmyak.

63. The Status of the Nation's Local Mass Transportation: Performance and Conditions, p. 58.

64. Wendell Cox, "Distribution of Operating Subsidies in Los Angeles County," Transportation Research Record 877 (Washington: National Research Council, Transportation Research Board, 1983).

65. Charles River Associates, Allocation of Federal Transit Operating Subsidies to Riders by Income Group, cited in The Status of the Nation's Local Mass Transportation: Performance and Conditions.

66. Martin Tolchin, "Transit Aid Called No Help for Poor," New York Times, March 9, 1987.

67. States also provide capital funds, although at a lower rate than the federal government. The combined state and federal contribution often covers nearly all of the construction--or the proposed cost of construction--of rail and other capital projects and purchases. St. Louis provided an in-kind match so that the federal government is expected to provide the entire cost of planning and building a new light rail system.

68. Federal formula capital grants provide 80 percent of the total funding of a project up to the limit set by the formula; the remainder of the funding comes from state, city, or regional funds or from fares. Federal discretionary capital grants provide 75 percent. Federal grants no longer cover cost overruns; and because states and localities often provide capital assistance in excess of match requirements as well as fund cost overruns, the level of federal assistance for capital is sometimes less than the permissible statutory limits.

69. "Congress Bucks Privatization Trend," Transit Times (Washington: American Bus Association, September/October 1991).

70. William F. Shughart and Mwangi Kimenyi, Public Choice, Public Subsidies, and Public Transit (Washington: U.S. Depart-

ment of Transportation, Urban Mass Transportation Administration, Office of Private Sector Initiatives, February 1991).

71. E. S. Savas, Sigurd Grava, Jeffrey A. Parker, and Roy Sparrow, The Private Sector in Public Transportation in New York City (New York: City University of New York, Institute for Transportation Systems, 1991), prepared for the U.S. Department of Transportation, Urban Mass Transportation Administration; Daniel Machalaba, "Opportunistic Vans Are Running Circles around City Buses," Wall Street Journal, July 24, 1991; Dan Holly, "It's Metro vs Minis in the Battle of Buses," Miami Herald, May 4, 1991.

In Miami last year minibuses began to operate several transit routes for a lower fare when a change in the law created a loophole. The minibuses garnered 20,000 passengers a month according to the transit agency. The law has since been changed--as a result of pressure from the public transit agency--to prohibit the entry of new private companies and expansion of routes, but companies already operating were "grandfathered in." Metro, the public transit agency, recently has reduced its fares (incurring huge deficits) on one of its routes to drive the unsubsidized company from the market.

In New York private vans illegally divert nearly $30 million a year from the transit agency. Private vans operate their unsubsidized service for a lower fare than the transit agency.

72. Machalaba.

73. H. D. Blundred, "Barriers to Market Entry: Practical Experience of the UK Bus Market," paper presented at Second International Conference on Privatization and Deregulation in Passenger Transport, Tampere, Finland, June 1991.

74. "Congress Bucks Privatization Trend."

75. Roger F. Teal, "Transit Service Contracting: Experiences and Issues," paper presented at the Annual Meeting of the Transportation Research Broad, Washington, January 1985, p. 3. See also Cox and Love, "International Experience"; Private Sector Briefs: Private Sector Involvement in Public Transportation (Washington: U.S. Department of Transportation, Urban Mass Transportation Administration, Office of Private Sector Initiatives, July 30, 1988 and 1990); Wendell Cox and Jean Love, Designing Competitive Tendering Systems for the Public Good: A Review of the US Experience (Thredbo, NSW, Australia: International Conference on Competition and Ownership of Bus and Coach Services, May 1989).

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CATO INSTITUTE

Policy Analysis

No. 164 November 1, 1991

Routing

THE MYTH OF FAIR TRADE

by James Bovard

Americans' freedom and prosperity are being sacrificed on the altar of fair trade. Each year protectionists discover new moral pretexts for further restricting how American citizens may spend their paychecks. Fair trade is a moral delusion that could be leading to an economic catastrophe.

Unfortunately, the louder politicians have demanded fair trade, the more U.S. trade policies have become a travesty of fairness. The U.S. government has created a trade lynch law that can convict foreign companies almost regardless of how they operate. Between 1980 and 1989, the U.S. Commerce Department found only 5 percent of the foreign companies it investigated not guilty of dumping.[1] Two thousand foreign companies have been penalized since 1980 for selling their products to Americans at prices lower than those approved by the U.S. government.

When politicians call for fair trade with foreigners, they routinely use a concept of fairness that is diametrically opposed to the word's normal meaning. In exchanges between individuals--in contract law--the traditional test of fairness is the voluntary consent of each party to the bargain: "the free will which constitutes fair exchanges," as Sen. John Taylor wrote in 1822.[2] When modern politicians speak of unfair trade, they do not mean that buyers and sellers did not voluntarily agree but that federal officials disapprove of the bargains American citizens chose to make. Fair trade, as the term is now used, usually means government intervention to direct, control, or restrict trade. Fair trade means government officials decide what Americans should be allowed to buy and what prices they should be forced to pay. Fair trade is paternalism in international commerce.

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Fair trade often means that some politician or bureaucrat picks a number out of thin air and imposes it on foreign businesses and American consumers. Fair trade means that Jamaica is allowed to sell the United States only 970 gallons of ice cream a year, that Mexico is allowed to sell Americans only 35,292 bras a year, that Poland is allowed to ship us only 350 tons of alloy tool steel, that Haiti is allowed to sell the United States only 8,030 tons of sugar.[3] Fair trade means permitting each American citizen to consume the equivalent of only one teaspoon of foreign ice cream, two foreign peanuts, and one pound of imported cheese per year. Fair trade means the U.S. government imposes import quotas on tampons, typing ribbons, tents, twine, table linen, tapestries, and ties. Fair trade means that the U.S. Congress can impose more than 8,000 different taxes on imports, with tariffs as high as 458 percent.[4]

In practice, fair trade means protectionism. Yet every trade barrier undermines the productivity of capital and labor throughout the economy. A 1979 Treasury Department study estimated that trade barriers routinely cost American consumers 8 to 10 times as much as they benefit American producers.[5] A 1984 Federal Trade Commission study estimated that tariffs cost the American economy $81 for every $1 of adjustment cost saved.[6] Restrictions on clothing and textile imports cost consumers $1 for each 1 cent of increased earnings of American textile and clothing workers.[7] According to the Institute for International Economics, trade barriers are costing American consumers $80 billion a year--or more than $1,200 per family.[8]

We will examine the U.S. anti-dumping law, U.S. countervailing duty law, U.S. retaliations against alleged foreign unfair trade barriers, and the moral essence of fair trade.

The "Dumping" Myth

Economic xenophobia is the core of the U.S. anti-dumping law. The Commerce Department acts as if every sale of a foreign product at a low price is a Trojan Horse--an insidious attempt to undermine the American economy. While American politicians lecture the world on fair trade, our anti-dumping laws are an inquisitorial nightmare for foreign companies, a mockery of due process and justice.[9]

Dumping occurs when a company charges a lower price for a product in an export market than in its home market. Differential pricing according to demand and market conditions is a normal business practice, yet the U.S. government con-

siders it highly pernicious when done by foreign companies exporting to the United States.

Dumping has long been portrayed as a serious threat to the American economy. A 1921 House of Representatives report warned against "a now common species of commercial warfare of dumping goods on our markets at less than cost or home value if necessary until our industries are destroyed."[10] The Senate Judiciary Committee warned in 1986 that "the unlawful dumping of foreign goods . . . has become a serious threat to American industries."[11] In 1989 a federal judge characterized dumping as inherently "predatory" and declared that dumping involves an element of "wrongdoing."[12]

U.S. anti-dumping practices routinely expel foreign corporations from the U.S. market as punishment for normal business practices. The anti-dumping law forces foreign companies to run a nearly endless gauntlet of American bureaucrats. A more perceptive federal judge concluded that the anti-dumping law allowed American companies to conduct "economic war" against their foreign competitors.[13]

While many people consider dumping an arcane subject, penalties for dumping have forced Americans to pay more for photo albums, pears, mirrors, ethanol, cement, shock absorbers, roofing shingles, codfish, televisions, paint brushes, cookware, motorcycle batteries, bicycles, martial art uniforms, computers and computer disks, telephone systems, forklifts, radios, flowers, aspirin, staplers and staples, paving equipment, fireplace mesh panels, dry cleaning, and many other things. Anti-dumping laws increasingly prevent American businesses from obtaining vital foreign supplies and machinery. Commerce Department officials now effectively have direct veto power over the pricing policies of thousands of foreign companies. Anti-dumping law constitutes potential political price controls over almost $500 billion in imports a year.

Anti-dumping law exists to prevent foreign companies from selling goods in the United States at "less than fair value." What is less than fair value? The Commerce Department's creative definitions would challenge even a medieval scholastic. Technically, "less than fair value" means selling a good in the United States for less than its price in the foreign home market or for less than its cost of production plus a large profit. Commerce Department regulations state, "Fair value . . . is an estimate of foreign market value."[14]

The "crime" of dumping results solely from applying different tests of fairness to U.S. and foreign prices. The Treasury Department, in a 1957 report on dumping, defined "fair value" for foreign prices: "the word 'fair' as used here simply means what one ordinarily conceives of as the 'fair market' value--what a willing buyer will pay a willing seller."[15] But U.S. anti-dumping law rejects voluntary agreement as the measure of fairness of U.S. prices for imported products. The U.S. price of an imported product is "fair," not according to whether a foreign seller and American buyer voluntarily agree, but according to whether the foreign company can pass dozens of arbitrary tests imposed by the U.S. government.

Commerce convicted a Brazilian company for selling its frozen concentrated orange juice for 1.96 percent less than fair price.[16] The United States has a 40 percent tariff on orange juice, so Commerce subtracted 40 percent from the Brazilian company's U.S. sale price before comparing it with the Brazilian price. The Brazilian government imposes a 3.5 percent export tax on orange juice, and shipping and insurance costs probably added at least another 2 or 3 percent. Thus, Brazil was selling orange juice for at least 45 percent more in the United States than in Brazil. But the Commerce Department still considered the U.S. price unfairly low.

Anti-dumping laws are a relic of the days of fixed exchange rates. Commerce will convict a foreign company for a price difference as small 0.5 percent between its U.S. and foreign prices. Yet the dollar routinely fluctuates 10 or 15 percent or more in value annually.[17] Naturally, the number of dumping convictions has soared as exchange rates have become more volatile.

Commerce officials have used the capricious rules on exchange rates to encourage American companies to file anti-dumping cases against foreign competitors. In early 1988 the newsletter Inside U.S. Trade reported: "The Commerce Department is trying to cajole industries into filing dumping cases against Japanese imports for products that it feels are being sold at prices that do not sufficiently reflect the recent appreciation of the Japanese yen, according to many sources including Commerce officials. Commerce has been unofficially compiling a list of products suspected of being dumped by Japanese companies."[18] One Commerce official declared that the agency was "trying to force Japanese concessions on contentious trade issues--such as restrictive bidding on construction projects and agricultural quotas--by 'creating an anti-Japanese climate.'"[19]

Commerce sometimes penalizes foreign companies for selling different products for different prices. In 1984 an Italian company was convicted of having a less-than-fair-value margin of 1.16 percent on its sales of pads for woodwind instruments. Commerce compared the price of a smaller woodwind pad sold in the United States with that of a larger woodwind pad sold in Italy. Since the smaller pad sold for less than the larger pad, the Italian company was dumping.[20] In a brief defending its action to the Court of International Trade, the U.S. government admitted that it had not compared the sales price of identically sized pads--and then claimed that Commerce has unlimited discretion to accept or deny comparisons of that sort.[21]

In a Japanese TV case, one company had its dumping margins increased because it donated unsold television sets to charity. Commerce assessed the firm as if the television sets had been "sold" for $0 in the U.S. market--the ultimate act of unfair trade.[22] Companies have also received higher dumping margins for selling TVs to employees at a large discount and for selling damaged or defective televisions at a markdown.[23]

In the case of stainless steel products from the Swedish company Avesta, Commerce compared sale prices of small quantities of steel sold in Sweden with the prices of large quantities of steel sold in the United States. As Avesta's brief noted, "Over two-thirds of the sales in Sweden were for quantities less than 500 kilograms, and the average price of these sales is over 22 percent greater than the average price for sales with total order quantities between 501 and 5,000 kilograms, and over 60 percent greater than the average price of sales with total order quantities over 5,000 kilograms."[24] Because Avesta sold 5,000-kilogram quantities for lower prices than 500-kilogram quantities, it was acting unfairly.[25]

U.S. anti-dumping law also imposes a cost-of-production test on foreign companies. If a foreign company is not making an 8 percent profit on its exports, the Commerce Department automatically penalizes the company for selling at a loss. The 8 percent assumption is totally arbitrary and extremely biased against foreign companies. The International Trade Commission reported that average "profits before income taxes for all U.S. corporations in 1986 were 6 percent of sales."[26] Thirteen of the 15 largest companies in the Fortune 500 failed the 8 percent profit test in 1989.[27]

Cost-of-production analyses tend to be sinkholes of quibbles and capricious judgments. Commerce usually con-

siders only the cost of production during the six-month period in which it is examining the foreign company's U.S. sales. A major issue in a case involving Canadian raspberries was how to amortize the cost of a raspberry plant--whether 10, 15, or 25 years was the proper time frame.[28] In one cost-of-production analysis, Commerce included the expenses Suzuki incurred in defending itself before the U.S. Consumer Product Safety Commission on charges that its all-terrain vehicles were unsafe.[29] In a 1990 sweater investigation, Commerce penalized two Korean firms for making donations to local charities, claiming that the unrelated donations were part of the cost of making sweaters and should have been reflected in higher sweater prices.[30]

Commerce effectively wrecked the exports of hundreds of Taiwanese sweater companies because a few small Taiwanese companies could not quickly respond to Commerce's massive information requests. Commerce sent the Taiwanese firms a 100-page single-spaced questionnaire in English; the average Taiwanese firm was commanded to quickly provide over 200,000 bits of information. Commerce conceded in its Federal Register notice that "none of the investigated [Taiwanese] companies refused to provide the information requested, refused verification, or otherwise significantly impeded the Department's investigation."[31] The management of one Taiwanese sweater company consisted of the owner and his wife. Commerce imposed punitive duties on the company, declaring that "lack of manpower" to answer the questionnaire was no excuse. Commerce imposed punitive duties on another Taiwanese company largely because the company's factory had burned down and it had lost many of its records. Since the United States also imposes a 34 percent tariff on the sweaters, hundreds of Taiwanese sweater companies are effectively locked out of the U.S. market.

Every dumping duty is an attempt to create an artificial scarcity, to deter foreign companies from exporting, and to decrease the supply of goods on the American market in order to allow American companies to charge higher prices. Politicians measure the success of the anti-dumping law by the number of foreign companies that are banned from the U.S. market or are forced to sharply raise their prices here. Sen. Arlen Specter (R-Pa.) declared at a 1986 Senate Finance Committee hearing on the administration of the anti-dumping laws: "I am not looking for more people to collect damages from, frankly, I am trying to stop the [foreign] goods from coming in."[32]

The anti-dumping law turns foreign companies into economic lepers. Perpetual jeopardy is the natural condition of companies under anti-dumping orders. Although a company

may be complacent with a 1.93 percent margin established in an initial dumping investigation, Commerce can raise the dumping margin to 92 percent with only a short notice in the Federal Register.[33] An anti-dumping order can easily torpedo a foreign company's exports to the United States.

Federal officials have bragged about the chilling effect of anti-dumping laws. Deputy Assistant Secretary of Commerce Gilbert Kaplan told the Senate Finance Committee in 1986: "The minute a case is filed, an importer or a customer faces an undetermined liability, an undetermined price basically, for items, for an indeterminate period of time, into the future. . . . If you are a purchaser, you have to think very long and hard before buying from an exporter given that undetermined liability that you are going to face for quite a number of years."[34] Secretary of Commerce Malcolm Baldrige declared in 1986: "The [dumping] penalty is actually applied to the U.S. importer, but it means that if he's got to pay that penalty, he just ain't going to import any more. That's the stick that you're looking for."[35] The anti-dumping law provides a way for Commerce to beat up on American companies that import foreign products.

Commerce officials are sometimes quite candid about their biases. In a 1991 speech, Marjorie Chorlins, deputy assistant secretary of Commerce for import administration, thanked the American Wire Producers Association for their frequent use of the anti-dumping law against wire imports and declared, "The partnership which the AWPA and Import Administration have enjoyed over the past ten years has been active and rewarding."[36] In 1989 Secretary of Commerce Robert Mosbacher described himself as "the advocate for U.S. business in the [Bush] Administration."[37] Mosbacher is the highest "judge" in the Commerce Department in dumping cases. Since the judge has proudly declared his bias in favor of U.S. businesses, it is not surprising that anti-dumping proceedings are often a kangaroo court.

The basic premise of anti-dumping law--that it is a crime for a company to sell the same product for two different prices in two different markets 15,000 miles apart--is an economic absurdity. Price differentials usually prove nothing except that prices are different. If a businessman sells ice cream to Eskimos and to people on a tropical island--and the people on the tropical island willingly pay more--does that mean the businessman is unfairly dumping ice cream on the Eskimos because he is selling it to them at a lower price? Are the Eskimos harmed by the price differential between the arctic and the tropics?

Although fear of predatory pricing was the fount of the U.S. anti-dumping law, the list of products that have been hit with dumping duties makes a mockery of the predatory argument. Did Washington bureaucrats really believe in 1972 that Canadian companies were conspiring to dump ice cream sandwich wafers in the United States to destroy their American competition?[38] And what good would it have done to corner the ice cream sandwich wafer market anyhow? If the Canadians had obliterated their U.S. competition and tripled the price of ice cream sandwich wafers, Americans would simply have bought more ice cream cones and fewer ice cream sandwiches.

The Specter of Foreign Subsidies

U.S. trade policy appears to assume that every handout given to a foreign business is automatically a stab in the back of a competing American corporation. Foreign subsidies have long been a prime hobgoblin of American protectionists. Rep. Thomas Hartnett (R-S.C.) warned in 1986 that "foreign governments, through the introduction of subsidies, rebates, and other economic incentives have made fair competition an impossibility."[39]

The United States imposes countervailing duties on imported products that allegedly received foreign government subsidies. The CVD is supposed to insulate the United States from the effect of a foreign subsidy, thereby preventing foreigners from cornering the American market. The U.S. government does not hesitate to penalize foreign companies even when it is providing larger subsidies to competing American firms.

U.S. CVD policy presumes that regardless of how large a benefit foreign subsidies provide to American consumers, the subsidies must be penalized. CVDs have boosted prices Americans pay for wool, steel, ham, castor oil, cotton yarn, orange juice, scissors, carnations, sugar, pistachios, roses, auto glass, cement, leather apparel, cookware, lamb meat, shop towels, agricultural tools, footwear, ball bearings, rice, and aspirin. Disputes over foreign subsidies have greatly antagonized our trading partners.

American CVD law effectively hangs a sign at the U.S. border warning foreign companies: "Nonvirgins need not apply." But the U.S. government is constantly amending its definition of "virginity." While governments disagree about whether subsidies are good or evil, no other government in the world has such an expansive definition of subsidies as does the U.S. government. Over time, the administration of

U.S. CVD laws has become increasingly protectionist, arbitrary, and divorced from economic rationality.

In April 1986 Commerce imposed a 0.82 percent surtax on Thai rice imports. Commerce, after an exhaustive investigation, concluded that a Thai government price support program provided a subsidy equal to 0.004 percent of the value of Thai rice exports to the United States, a government cooperative assistance program provided a 0.09 percent subsidy, a mortgage program provided a 0.02 percent subsidy, discounts to rice millers provided a 0.01 percent subsidy, and so on.[40] While the Thai government was providing a trickle of aid to Thai farmers, it was also imposing export taxes on rice. The U.S. Department of Agriculture, in an unrelated study, concluded that, after subtracting the amounts spent on credit, fertilizer, and marketing assistance from the export taxes, Thai government policies imposed a net 5 percent tax on rice production in 1985.[41]

At the same time the U.S. Department of Commerce was nickel-and-diming Thai rice growers, the U.S. Department of Agriculture was bankrupting them. The U.S. government spent $2 billion in 1986 to flood international markets with American rice, driving down the world rice price by 50 percent. The Thai rice program spent less than $100 for each Thai rice grower, while the U.S. program spent the equivalent of over $1 million for each full-time American rice grower between 1985 and 1990.[42] Thailand's average per capita income is $860, while the average American full-time rice grower was a millionaire even before receiving lavish subsidies in the mid and late 1980s.[43]

In 1983 the United States imposed a CVD on Argentine wool.[44] Commerce justified the penalty on the grounds that the Argentine government, through a regional development program, paid a bonus of 6 percent for products exported from Argentina's southern ports. (The United States has a similar program: the Appalachian Regional Commission, which has given billions of dollars in grants and loans to businesses in that region.) While Argentine sheep producers were allegedly receiving a 6 percent subsidy, the Argentine government was also imposing a 17 percent tax on wool exports. Commerce disregarded the export tax because "the export taxes and duties and the [export subsidy] programs were enacted under separate laws."[45] In the same year that Commerce began penalizing Argentine wool growers for receiving a 6 percent subsidy, the U.S. Department of Agriculture's wool program gave American wool growers direct payments equal to 150 percent of the value of their wool.[46]

In 1990 Commerce imposed a 14.17 percent surtax on Argentine leather imports because the Argentine government had banned the export of cattle hides in 1985.[47] (The United States imposed a similar ban on the export of hides in 1966.) Commerce alleged that the export ban on Argentine cattle hides was equivalent to a direct subsidy to the Argentine leather-tanning industry. Commerce created a simple test of the fairness of Argentine prices: "the best measure we have of what [Argentine] prices would have been in the absence of the current embargo is a benchmark based on U.S. hide prices."[48] The fact that U.S. hide prices were higher than Argentine prices in the years 1985-89 proved that the Argentine leather producers were subsidized. But in the late 1980s Argentina suffered from hyperinflation, massive currency devaluations, a deterioration in the quality of cattle hides, and government policies that severely disrupted the economy and exchange rates. Commerce disregarded all those factors in judging Argentine prices by U.S. prices.

In some cases foreign companies and governments must spend more defending themselves than the total amount of the alleged subsidy. In January 1990 Commerce issued a preliminary determination alleging that a Singapore government research contract provided a subsidy to a Singapore software manufacturer.[49] Commerce claimed a subsidy existed because Commerce's contrived estimate of the Singapore government's future revenues from the research results was $42,891.57 less than the amount the Singapore government paid the private firm to do the research. In the final determination, Commerce conceded that no subsidies existed. Commerce's investigation cost the Singapore government and the software company over $170,000--almost four times the amount of the alleged subsidy.[50] Commerce's lengthy investigation of a Singapore software firm for allegedly receiving a $42,891 subsidy showed true chutzpah, as the U.S. government, a few months before Commerce's investigation began, committed $100 million to SEMATECH, a U.S. public-private semiconductor research consortium.[51]

A major goal of CVDs is to force foreign governments to end their subsidies and play fair. But even when foreign governments reduce or abolish their subsidies, Commerce still routinely refuses to abolish the CVDs. Commerce also refuses to repeal CVDs levied on companies that can prove that they do not receive government subsidies. Leonard Shambon, the chief of the Compliance Division, which oversees CVD orders, observed in 1987, "In the area of countervailing duties, the actual prospects for receiving a revocation because of the elimination of subsidies are dim, if not

nonexistent."[52] There were no revocations of CVD penalties between April 1981 and June 1987.[53]

Protectionists often justify CVDs by warning that foreign governments must be penalized or they will monopolize the American market. If we look at the list of nations currently hit with CVDs, we see that the vast majority are Third World nations--countries that are unable to pay their own bills, much less take over the world. Of the 76 current CVD orders, 8 are against Argentina, 7 are against Brazil, 10 are against Mexico, 5 are against Peru, 2 are against Venezuela, 1 is against Zimbabwe, 1 is against Ecuador, and 2 are against Iran.[54] Almost half of all CVD actions have been against nations that have effectively defaulted on their foreign debt--not exactly a sign of imminent economic hegemony. Despite the widespread perception that Japan heavily subsidizes its industry, there are no CVD orders against Japanese products.

The effect of foreign subsidies on exports is usually far less than the effect of gyrations of currency exchange rates. Though business subsidies, as are every other type of misguided government intervention, are pervasive in Latin America, they are dwarfed by changes in the exchange rate. The average CVD on Argentine exports was 5 percent, and the Argentine exchange rate fluctuated 244 percent between 1980 and 1987. The average Brazilian CVD was 12 percent, and the Brazilian exchange rate fluctuated 135 percent. For Chile, the average CVD was 12 percent, and exchange values fluctuated 223 percent; for Colombia, the values fluctuated 7 and 189 percent; for Costa Rica, 17 and 152 percent; for Mexico, 10 and 204 percent; and for Peru, 25 and 131 percent.[55]

Countervailing duty laws are premised on the idea that even minimal subsidies from a government are "magic beans" that enable a company to grow into the sky and conquer the world--that government aid is a steroid that vastly increases the strength of a foreign company. But the history of government subsidies is one of burning money almost as fast as tax collectors can scoop it up. Export subsidies are usually artillery shells that explode in the face of the nation that fires them.

International disputes over subsidies resemble a couple of drunks lying in a gutter, each accusing the other of overimbibing. While the U.S. government calculates foreign subsidies out to the millionth of a percentage point, it pours tens of billions into the coffers of American business. During the 1980s, when the Commerce Department launched over 300 CVD investigations of foreign firms, U.S.

government policy provided $260 billion in benefits to American farmers, over $5 billion to the merchant marine, over $30 billion to small businesses, and over $30 billion in subsidized credit to exporters.[56] Total U.S. government subsidies and liabilities for aid to business since 1980 exceed $500 billion. That amount is probably 20 times greater than the total foreign subsidies paid on products exported to the United States.

The clearest proof that foreign subsidies do not pose a grave threat to the United States is that few foreign countries have been troubled by the effect of subsidized imports. Switzerland, Austria, Sweden, and Norway have never imposed a single CVD; yet neither U.S., nor European, nor Asian subsidies have allowed foreign companies to corner those markets. Hong Kong imposes no CVDs, no dumping duties, and almost no tariffs. With that "bare-the-throat" policy, Hong Kong has had the highest economic growth rate in the world since 1960; Hong Kong's per capita income increased from $180 in 1948 to over $9,000 in 1989. Hong Kong's per capita income now exceeds that of Israel, Ireland, and Saudi Arabia.[57]

We have no national interest in obsessing over misguided foreign tax and economic policies. Does the U.S. government need to "countervail" every foolish act by every other government in the world? Most CVDs amount to economic shadowboxing--American bureaucrats and politicians thrashing the air to pummel imaginary enemies. Or, more accurately, U.S. countervailing policies resemble the scene from Don Quixote in which Quixote beats Sancho Panza and insists that he is actually beating a horde of evil demons. CVDs have had far more effect on American consumers than on foreign governments.

The U.S. subsidies policy is based on a doctrine of immaculate competition--any foreign company with the slightest taint must be sent to bureaucratic purgatory. Commerce essentially tries to apply the "Caesar's wife" standard to international commerce, demanding that foreign companies be free of even the suspicion of receiving aid from their governments. That is profoundly unrealistic and hypocritical.

The 301 Solution

When U.S. Trade Representative Carla Hills took office in February 1989, President Bush presented her with a crowbar to symbolize her task of prying open foreign markets.[58] Section 301 of the Trade Act of 1974--the main U.S. crowbar--authorizes the U.S. government to investigate and re-

taliate against foreign trade barriers that are judged to be unfair. Under section 301, U.S. producers may petition the Office of the U.S. Trade Representative to take action against a foreign practice or barrier, or the USTR can initiate an investigation. Once the USTR officially decides a foreign barrier is unfair, the United States gives the foreign government a deadline by which it must reform its policy or face American retaliation. As the Wall Street Journal noted, "American [trade] retaliation is supposed to be the nuclear deterrent that forces the rest of the world into submission."[59]

It is surprising how often the United States itself engages in the same practices that section 301 penalizes. The first section 301 case targeted Guatemala for requiring that cargo being shipped to Guatemala be carried by Guatemalan ships. The United States itself has extensive cargo preference laws, which the General Accounting Office estimated in 1985 added over $100 million to the cost of providing food donations to foreign countries.[60]

In 1976 the United States brought suit against Taiwan because of "confiscatory tariff levels on imports of major home appliances."[61] (The Taiwanese tariff on refrigerators and air conditioners was 60 percent.)[62] But the United States has confiscatory tariff levels on many items, including a 151 percent tariff on low-priced watch parts exported from Taiwan.[63]

Many section 301 complaints have involved agricultural export subsidies, including European Community export subsidies for poultry, wheat, and wheat flour and Taiwan rice subsidies. In recent years the U.S. government has also provided export subsidies for all of those items; it has paid export subsidies of 111 percent for poultry, 78 percent for wheat flour, 94 percent for wheat, and over 100 percent for rice.[64] The United States denounces Japanese rice import quotas, though unlimited U.S. export subsidies have done far more to distort the world rice market than has Japan's ban on rice imports. The United States brought a case against Korea for its beef import quotas, even though the United States also has beef import quotas. Five section 301 cases involved allegations that foreign governments subsidized their steel industries--as does the United States.[65] The Footwear Institute of America persuaded the USTR to launch seven section 301 cases against foreign trade barriers on footwear--even though the United States itself maintains tariffs of up to 67 percent on footwear.

In May 1988 the United States launched an investigation of Japanese citrus quotas. In the press release announcing

the case, U.S. Trade Representative Clayton Yeutter noted, "The Florida citrus industry . . . believes that removal of Japan's unfair barriers could cut the price of oranges for Japanese consumers by one-third."[66] By amazing coincidence, that is roughly the amount that the price of orange juice in the United States could fall if the 40 percent tariff on Brazilian orange juice imports were abolished.

In August 1988 the USTR settled a second unfair agricultural trade case with Japan. Under heavy U.S. pressure, the Japanese agreed to end their quotas on ice cream, cheese, and sugar; of course, American trade policymakers believed that the United States had a right to continue its own import quotas on the same items.[67]

In December 1988 the European Community banned the import of American beef produced with growth hormones. That action outraged the United States, as U.S. policymakers believed there was no scientific evidence that the beef hormones had adverse effects on humans. The EC ban was unjustified, but the United States has an equally unjustified ban on imports of German ham. German ham has an international reputation as a luxury product, yet the United States insists that it is not safe enough for Americans.

The United States retaliated against the EC beef ban by imposing 100 percent tariff surcharges on European hams and pork shoulders, cranberry juice, instant coffee, alcoholic beverages containing less than 7 percent alcohol, and pet food packaged for retail sale. The U.S. retaliation devastated some American businesses. As the Journal of Commerce noted: "A Chicago food importer's mid-size business will lose almost $3 million in revenue this year as a result of the trade sanctions. . . . National Food Trading Corp. saw 10 percent of its export business evaporate when the peeled tomatoes it imports from Spain were hit with the 100 percent tariff."[68] The importer of Riunite wine dodged the super tariff by raising the alcohol content of the wine by 25 percent. (Some Americans who drink low-priced sweet wine and were not aware of the U.S.-EC trade war may have been awarded drunk driving tickets as a result.) Christina McCown, a spokesperson for the USTR, justified the 100 percent tariff: "The amount of retaliation equals the amount lost in U.S. exports. We were not trying to cause any U.S. businesses a hardship."[69] The beef war sought to placate American cattlemen by padding the pockets of American pet food makers.

Other U.S. trade retaliations have also harmed U.S. companies. As Jim Powell noted: "In 1978, American broadcasters filed a complaint because Canada had abolished tax

deductions for advertising on stations in the United States. The United States retaliated by removing tax deductions for advertising on Canadian-owned stations. The consequence, of course, was that American advertisers had a harder time reaching the Canadian market. Twelve years later, these retaliatory measures are still in place--and Canada has not changed its original policy."[70]

Section 301 victories often skewer American consumers. In the 1985 settlement of a dispute over Japanese leather quotas, Yeutter declared: "The agreement is a significant victory for the principle of free and fair trade. . . . This is far preferable to protectionist measures that would restrict imports without increasing U.S. exports."[71] Yet as part of its "victory for free trade," the United States raised tariffs on Japanese leather imports from 12 to 40 percent--with the explicit goal of sharply reducing Japanese exports to the United States.

In 1988 the United States decided to punish Brazil for its denial of patent protection to American chemical and pharmaceutical companies operating in Brazil. The USTR imposed a retaliatory 100 percent duty on Brazilian penicillin and tetracycline, among other products. Apparently, some higher justice was served by punishing Americans with pneumonia (forcing them to pay higher prices for their drugs) in order to placate wealthy American multinational corporations.[72] Six months later Brazil announced cessation of interest payments on the $22 billion it owed U.S. banks.

American trade negotiators are often blinded by moral arrogance. Carla Hills told the House Ways and Means Committee in 1989, "I hasten to tell other nations that we are the freest and most open market in the world and that even in those areas that are most restricted, we do import per capita far more than our largest trading partners."[73] As Hills must know, Hong Kong has far fewer trade barriers than the United States, as do the United Arab Emirates and Singapore. Sweden and Austria also may be more open than the United States. And, in making her claim that "even in those areas that are most restricted, we do import per capita far more than our largest trading partners," Hills forgot that Canada, the largest trading partner of the United States, imports far more sugar, peanuts, and cotton per capita than does the United States. The assertion that the United States has the world's most open markets has long been a cardinal tenet of American trade theology and is often made as a prelude to demanding new trade barriers, somewhat like people loudly announcing that they are good Christians before slamming the door in their neighbor's face.

The U.S. government has done more to reduce exports than has any other government in the world. The amount of increased exports gained due to all the section 301 cases in the last decade is less than the annual estimated amount of U.S. exports lost thanks to the Export Control Administration. As George Gilder notes, "By constantly imposing special export controls for nonsensical national security concerns and changing policy from month to month in response to utterly spurious emergencies, the U.S. government has become the chief obstacle to U.S. competitiveness in electronics."[74] The National Academy of Sciences estimated in 1987 that unnecessary Commerce Department export controls on U.S. technology and products that pose no threat to national security reduced American exports by $9 billion.[75] U.S. agricultural exports would be far higher if the government abolished federal farm programs. A study by Andrew Feltenstein of Kansas State University estimated that unilaterally abolishing farm programs would have reduced the U.S. trade deficit by $42 billion in 1986.[76] A 1988 study by Purdue professors Thomas W. Hertel, former USDA chief economist Robert L. Thompson, and Marinos E. Tsigas concluded that the misallocation of resources and capital to agriculture depressed the productivity of other sectors of the U.S. economy and reduced American manufacturing exports by $7.5 billion and service exports by $3.4 billion.[77] An American Enterprise Institute study concluded that U.S. tobacco exports would double if the government abolished its tobacco quota and price support system.[78] The USDA imposes severe limitations or quotas, or both, on the export of lemons, almonds, raisins, peanuts, and peanut butter.[79]

The Morality of Fair Trade

Every restriction on imports is an attempt by the U.S. government to compel some Americans to pay higher prices to other Americans than they otherwise would have paid. Consumers do not offer to voluntarily pay higher prices; they pay higher prices only because 17,000 U.S. Customs Service officials leave them no choice.

Trade is not simply a matter of exchanging widgets for gadgets; it affects the way people live their daily lives. Since practically no one can make all the things he wears, eats, and uses, a person's standard of living and opportunity in life depend largely on his opportunities for trading the product of his labor with others. Pervasive trade barriers effectively force people to use inferior building blocks for their lives. Trade barriers are an attempt by politicians to control the market. And politicians cannot

control the market without commanding everyone who must rely on that market.

Trade barriers raise prices, and price hikes have the same effect as a federal decree that some Americans shall no longer be allowed to buy the restricted product. As John Stuart Mill noted in "On Liberty," "Every increase of price is a prohibition to those whose means do not come up to the augmented price."[80] The Joint Economic Committee observed in 1956, "For a government official to make a moral judgment on how we ought to spend our money is an invasion of liberty and privacy which is acceptable only where obvious public harm follows."[81] Government cannot drive up prices without knocking some people out of the market--without taking a notch out of someone's living standard, changing the types of clothes some people wear, the cars some people drive, the food some people eat, the medical care some people receive. The 1986 Softwood Lumber Agreement added $1,000 to the cost of constructing a new house in the United States,[82] thereby knocking as many as 300,000 people out of the home-buying market[83] and effectively decreeing that many families would be forced to live in trailer homes instead of real houses. If the federal government intervened to cause old people's bones to automatically break when they fell, that intervention would be denounced as the height of idiotic tyranny. But apparently federal intervention in the form of a quota that imposes the equivalent of a 170 percent tariff on dairy imports,[84] thereby ensuring that many Americans will have calcium deficiencies and weak bones, is okay. What is the moral difference between putting a 50 percent surcharge on imported clothing[85] and commanding millions of poor people to wear tattered garments?

Every trade restraint is a moral issue, forcibly sacrificing some Americans for the benefit of others. Treasury Secretary Robert Walker observed in 1845, "If the marshall were sent by the federal government to collect a direct tax from the whole people, to be paid over to the manufacturing capitalists to enable them to sustain their business, or realize a larger profit, it would be the same in effect as the protective duty."[86] If a businessman pulls a gun on a customer and demands 20 percent more for a product, that is robbery. If a politician intervenes to the same effect, it is fair trade. As the Supreme Court said in 1875, "To lay with one hand the power of the government on the property of the citizen, and with the other to bestow it upon favored individuals to aid private enterprises and build up private fortunes, is none the less a robbery because it is done under the forms of law and is called a taxation."[87]

Protectionism rests on a moral glorification of an economy's least competitive producers. Sen. Ernest F. Hollings (D-S.C.) announced in 1988: "The market will take care of consumers. The Government must take care of producers. No government was ever organized to get everybody something for a cheap price. The market does that."[88] (Hollings made that observation in a speech calling for further government suppression of the market.) Protectionism is a Dred Scott policy for consumers--the federal government promises not to let American buyers escape from American businesses that want to charge consumers higher prices.

Fair trade is based on the doctrine that producers have rights and consumers have duties. Fair trade assumes that the consumer's freedom of choice is an injustice to the producer. The soul of protectionism is that government should force customers to carry a company that cannot stand on its own two feet. Protectionism is an economic no-fault insurance policy: no matter how often an American company crashes in the marketplace, the consumer must pay the bill.

Federal officials have long talked and acted as if they had a droit du seigneur over American consumers. U.S. Deputy Trade Representative Linn Williams declared on December 4, 1989, "I should also note that the U.S. has 'contributed' a substantial part of its domestic market to imported steel."[89] It is outrageous for a high-ranking government official to speak of the U.S. government allowing some Americans to buy imported steel as a contribution--as if government officials own the consumers' dollar and can decide to "contribute" it to whom they choose. That statement epitomizes the notion that government officials own the market they seek to control. Rep. Joseph M. Gaydos (D-Pa.), executive chairman of the House Steel Caucus, declared in 1988, "We're not going to allow domestic companies, if we can help it, to buy [steel] overseas."[90] Federal officials talk as if they have the right to dispose of the dollars of any American company or citizen that needs to buy steel, or sugar, or cheese, or an auto. In 1990 Sen. Jesse Helms (R-N.C.) denounced U.S. textile policy "that gives our market to foreigners."[91] Helms apparently believes that the U.S. Congress should have the right and power to give the market to whom it chooses. To talk of giving the market is, in reality, to talk of giving away the dollars of anyone who must depend on that market. For politicians to allocate market share is to treat consumers like serfs who can be freely traded by their lords.

Medieval theologian Duns Scotus declared that a price was just when "the owners of things . . . preserve equality of value in the things exchanged, according to right reason

judging of the nature of the thing exchanged in relation to its human use."[92] U.S. trade law assumes that goods have an objective value in themselves that can be determined in a bureaucratic vacuum thousands of miles from the market where the product is exchanged. The soul of American trade law is that bureaucrats and politicians, not buyers and sellers, are the proper judges of fair value. All the absurdities, biases, and scholastic methods follow from that principle. Fair trade essentially substitutes the moral and political values of federal policymakers for the economic values of private citizens.

Conclusion

Fair trade is an income redistribution system based on the capture of political power. In the end, the morality of fair trade is pure realpolitik--the deification of power as an end in itself. Should the capture of political machinery give some Americans a right to put their hands in other Americans' pockets? Should politicians have the right to reduce one man's standard of living in order to buy another man's vote?

There is no way that restricting Americans' opportunity to buy and sell can make America a richer land. Protectionism is the ultimate "less is more" policy--a policy based on the idea that the United States will become richer if the government forces Americans to pay higher prices for fewer goods. Every trade barrier imposes an opportunity cost on the American economy.

Every unnecessary burden the U.S. government places on American industry and agriculture means lost exports and reduced income for American citizens. The fewer crutches the government provides, the faster American industry will run. Should we hold U.S. productivity hostage to the stubbornness or stupidity of other nations' trade policymakers? Should the United States wait until it receives a foreign bribe before it looks to its own interests? Are dairy import quotas--and the brittle bones of the American elderly--an asset that we should demand to be compensated for giving up? Are the tattered clothes of many poor Americans something the nation should be proud of? Is a federal sugar policy that drives American food manufacturers overseas a national asset?

The rising phobia of imports and trade balances misses the purpose of trade. Trade allows consumers everywhere a chance to benefit from increases in productivity anywhere. As Emerson observed, "If a talent is anywhere born into the

world, the community of nations is enriched."[93] Trade binds humanity together in laboring for mutual benefits. The expansion of trade between the end of World War II and the 1980s produced the greatest era of prosperity in world history.

The fundamental issue is not whether foreign governments treat American companies fairly but whether American citizens receive fair treatment from their government. Even if trade barriers exist abroad, U.S. politicians should not perpetuate them here. We should cease punishing American consumers for the alleged sins of foreign governments.

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16. Federal Register, March 17, 1987, p. 8326.

17. Washington lawyer David Palmeter observes: "In the U.S., exchange rates in anti-dumping proceedings are determined by applying an outdated regulation, a relic of an era that ended in the early 1970s when the fixed exchange rate system established at Bretton Woods was abandoned. . . . The rate established by the Federal Reserve is a quarterly one, set in advance, and based on transactions at the end of the previous quarter. . . . This average rate is used throughout the quarter unless, on any particular day, it varies from the average by more than five percent, in which case the daily rate is used." N. David Palmeter, "Exchange Rates and Anti-dumping Determinations," Journal of World Trade 22, no. 2 (1988): 73.

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